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LEGAL ASPECTS OF CORPORATE GOVERNANCE IN THE REPUBLIC OF SOUTH AFRICA: TOWARDS A POSSIBLE MODEL FOR IMPROVED STAKEHOLDER RELATIONS WITHIN THE CORPORATION

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A thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy in Law

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ABSTRACT

Traditionally, company law assumes that the directors' role is to run the company for the benefit of its shareholders alone and to maximise profits for them.

It can be argued, however, that this view is too narrow and outdated; that is, company directors should have regard to the rights and interests of a broader range of corporate stakeholders. Hence, the question is whether we should change our perception of the company or corporation from one run by directors dedicated exclusively to serving the interests of shareholders to that of a corporation whose main purpose is to bring benefit not only to its owners and creditors, but also to its employees, the community and the environment.

Given that reforms of directors' duties in light of the above considerations have found their way into legislation across the globe, this thesis examines how and to what extent legal rules and policies should develop in South Africa to place directors under a positive duty to take account of the interests of bodies other than shareholders. Current South African company law does not contain clear rules regarding corporate governance issues and the duties and liabilities of directors. These matters have been left to the common law and Codes of Corporate Practice. Thus, there is no extensive statutory scheme in South Africa, which covers the duties, obligations and accountability of directors.

The focus in this thesis is on the rights and interests of employees and the premise that is defended is that it is valuable to corporations to provide employees with an institutionalised voice at board level. It is argued that there is global evidence that where employees participate in the decision-making processes of the company, performance is generally enhanced. This, in turn, directly impacts upon and improves economic productivity, generating a 'win-win' situation.

The question of the duties of company directors and managers is attracting much attention in South Africa. With rapidly developing and changing labour legislation in South Africa, it is essential to consider the extent to which the country should

reassess its traditional principles of company law and corporate governance policies in order to encourage participatory roles for employees in the workplace.

It is argued that if South Africa is to improve corporate productivity levels with its re-entry into international markets, management and labour must find improved ways of dealing with one another. The main purpose of this thesis, therefore, is to propose and formulate a workable corporate governance model for South Africa – one that would be advantageous to all stakeholders, especially the employees. This is achieved by comparing and contrasting international models of corporate governance and by applying the best features of each to the unique South African corporate system of values, structures and traditions.

It is suggested that the current unitary board structure operating in South Africa has become outdated and does not provide employees with rights enabling them to engage in the decision-making processes of the corporation with their employees at an *adequate* level. In its place, a two-tier board system of corporate governance is proposed.

The economic success of a company will bring about social benefits to many stakeholder constituencies. This will not happen if the company is a financial failure. The issue of obliging directors to act primarily for the benefit of shareholders alone is questioned. Corporate governance reforms were undertaken in many parts of the world in the late 1980's and early 1990's. This reform process questioned whether the interests of the company should be managed for the shareholders alone or for the other corporate stakeholders as well. There are many views that strongly support the idea that corporate governance should be seen as a system by which corporations are to be governed for the benefits of all stakeholders, including shareholders, employees, creditors, suppliers and the community. In this way, companies should be run as communities in partnerships with all their stakeholders. Thus, this thesis proposes that the success of a company is inextricably intertwined with a consideration of the rights and interests of its employees and other stakeholders.

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In this thesis, the legal citation method adopted is the Melbourne University Law Review Association's Australian Guide to Legal Citation (AGLC), which provides Australia with a uniform system of legal citation (See http://mulr.law.unimelb.edu.au/aglc.asp)

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The University's rules encourage the publication of work done towards a higher degree. To this end, a number of Chapters and parts of this thesis have been published in journals or conference proceedings. Details of these publications and parts of the thesis to which they correspond are as follows:

(1) Spisto, M (2005), "Stakeholder interests in corporate governance: is a new model of governance a change for the better for South Africa? – Part 1", *Australian Journal of Corporate Law*, 18 (2): 129-147.

This publication covers, to varying degrees, much of the material included in the introduction section of the thesis, namely:

Introduction, Part I (Overview and objectives);
Introduction, Part II (Traditional characteristics and powers of corporations);
Introduction, Part III (What is cororate governance?);
Introduction, Part IV (The nature of employee participation for South Africa);

Introduction, Part V (A model of corporate governance for South Africa - a question of discipline);
Introduction, Part VI (The British and US systems of corporate governance);
Introduction, Part VII.I (The German system of corporate governance);
Introduction, Part VII.II (The Japanese system of corporate governance); and
Introduction, Part VIII (A new model of corporate governance for South Africa).

(2) Spisto, M (2005), "The significance of the King Reports and the Department of Trade and Industry's policy statements on South Africa's corporate law and worker participation reform programmes – Part 2", *Australian Journal of Corporate Law*, 18 (3): 304-341.

This publication covers much of the material included in chapter 6 and in the appendix of the thesis, namely:

Chapter 6, part 6.3 (The King I Report);
Chapter 6, part 6.5 (The King II Report);
Appendix, part A.1 (The Department of Trade and Industry (DTI) South Africa);
Appendix, part A.2 (Major reform proposals of the Department of Trade and Industry); and
Appendix, part A.3 (Conclusion).

(3) Spisto, M (2005), "A unitary or two-tier board structure – which one is right for the new South Africa?" *International Review of Business Research Papers*, 1 (2): 84-99, available: <http://www.bizresearchpapers.com/> (accessed 03 March 2006).

This publication covers much of the material included in the introduction section and also, to varying degrees, parts of chapters 8 and 9 and the appendix of the thesis, namely:

Introduction, Part II (Traditional characteristics and powers of corporations);
Introduction, Part III (What is corporate governance?);
Introduction, Part IV (The nature of employee participation for South Africa);
Introduction, Part VI (The British and US systems of corporate governance);
Introduction, Part VIII (A new model of corporate governance for South Africa);
Chapter 8, part 8.2.1 (Germany);
Chapter 9, part 9.3.3 (The building blocks that form the third step (c));

Chapter 9, part 9.3.4 (The building blocks that form the third step (d));
Appendix, part A.1 (The Department of Trade and Industry (DTI) South Africa);
Appendix, part A.2 (Major reform proposals of the Department of Trade and Industry); and
Appendix, part A.3 (Conclusion).

(4) Spisto, M (2004), "A new model of corporate governance for South Africa: stakeholder interests and board structures". In the proceedings of the *International Business Research Conference.* Melbourne, Australia, 15-16 November 2004.

This publication covers much of the material included in the introduction section and also, to varying degrees, parts of chapters 8, 9 and the appendix of the thesis, namely:

Introduction, Part II (Traditional characteristics and powers of corporations);
Introduction, Part III (What is corporate governance?);
Introduction, Part IV (The nature of employee participation for South Africa);
Introduction, Part VI (The British and US systems of corporate governance);
Introduction, Part VIII (A new model of corporate governance for South Africa);
Chapter 8, part 8.2.1 (Germany);
Chapter 9, part 9.3.3 (The building blocks that form the third step (c));
Chapter 9, part 9.3.4 (The building blocks that form the third step (d));
Appendix, part A.1 (The Department of Trade and Industry (DTI) South Africa);
Appendix, part A.2 (Major reform proposals of the Department of Trade and Industry); and
Appendix, part A.3 (Conclusion).

(5) Spisto, M (2005), "The South African King II Report – Can employees now participate in the governance of corporations?" In the proceedings of the *3rd International Conference on Law and Commerce 2005*: "Simplification and modernisation of law for responsible commerce". Kuala Lumpur, Malaysia, 28-29 September 2005.

This publication covers much of the material included in the King II Report of Chapter 6 of the thesis, namely:

Chapter 6, part 6.5 (The King II Report).

INTRODUCTION

I. Overview and objectives

This study is premised on three key research theses:

Research thesis 1: Corporate governance systems in South Africa have become anachronistic with regard to corporate stakeholders, especially in regard to employee participation (see introduction and chapters 1 to 4 inclusive).

Research thesis 2: In order to achieve higher levels of corporate performance and to become more competitive on the global market, South Africa needs, amongst other things, to update its corporate governance systems, structures and legislation (see introduction and chapters 5, 6 and 7).

Research thesis 3: Corporate governance models based on those systems, which have proven successful elsewhere and can be adapted to South Africa's specific needs and cultural dimensions, will provide a strategic platform to facilitate substantial improvements in corporate performance and productivity (see introduction and chapter 8).

In short, this thesis is concerned with recognising the rights and interests of all corporate stakeholders. However, the principal focus of the study and of the reforms suggested is on employee participation. This is because South Africa is emerging from a protracted period of relative isolation from participation in international markets. Many of South Africa's competitors have evolved corporate governance systems that reflect sound practices with regard to employee participation, while South Africa has not. It is therefore important that South Africa's economic performance is maximised by a change in its approach to corporate governance by including employee participation. This would result in an improvement in the productivity and efficiency levels attained by its corporations.

Consequently, the traditional company law concept, which enshrines the doctrine of profit maximisation for shareholders and which ignores other stakeholder rights, including those of employees, as stated in *Hutton v West Cork Railway Company* per Bowen LJ, will be examined in detail. Bowen LJ noted that

> … there should be 'no cakes and ale except such as are required for the benefit of the company … (and) … charity has no business to sit at the board of directors qua charity'.[1]

Even early writers referred to this decision and argued that the conventional role (and the prevailing view of the late nineteenth century) of the company in the Ango-American context maximising its profits to shareholders should be questioned. [2]

Thus, this thesis considers the traditional theories of company law and the interests and rights of the various stakeholders in so far as aspects of corporate governance practices are concerned. It also considers in detail South African and international legislation, reports, cases and materials pertaining to the legal and social aspects of corporate governance.

The focus of the improvements that I propose is on the rights and interests of the employees. I will also consider the rights and interests of the other non-shareholder constituents, including those of the creditors, bondholders and the community and environment. I examine the models in Germany (see parts VII and 8.2.1), Japan (see parts VIII and 8.2.2) and France (see heading 8.2.3) and propose a new model of corporate governance for South Africa (see chapters 9 and 10). This model will, I argue, be of immense benefit to industry in South Africa while also facilitating the successful re-entry of the nation as a fully-fledged trading partner in the modern world.

To this end, four 'building blocks' as *steps* in the process of designing and promoting a new and highly improved corporate governance model for South Africa are suggested to achieve an improved system of corporate governance in South Africa. Such a system has the potential to become a very significant and decisive factor in bringing about a wealthier and economically brighter South Africa.

The suggested steps in creating an improved corporate governance model are:

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1 *Hutton v West Cork Railway Company*, (1883) 23 Ch.D 654.

2 DF Vagts, "Reforming the 'modern' corporation: Perspectives from the German", (1966) 80 *Harvard Law Review*, 36.

1. The introduction and maintenance of a system of organisational development within corporations (chapter 5);
2. The introduction of new legislation, which promotes an improved and more meaningful system of worker participation (chapter 6);
3. The introduction of changed patterns of corporate thinking and an accelerated rejection of antiquated principles of company law (chapter 7); and
4. The introduction in South Africa of some of the favourable features of successful international corporate governance models (chapter 8).

To set the scene for a discussion of corporate governance in South Africa in so far as it pertains to the interests and rights of the non-shareholder constituencies, especially those of the employees, I have included in this introduction a brief discussion of the features and powers of corporations, corporate governance and employee participation and a consideration of the British, American, German and Japanese models of corporate governance. A brief discussion in the introduction of this information will provide a focused and immediate appreciation of the need for South Africa to restructure and redevelop its present model of corporate governance in so far as the rights and interests of corporate stakeholders are concerned. That is, corporate governance models currently employed in South Africa generally limit the participation on the board or at management level of any other group or body, other than the directors themselves, the shareholders or the officers. It can be argued that these models are becoming increasingly unworkable in corporate governance settings where all stakeholders, whether small or large, have a role to play in achieving effective corporate governance practices. Some countries have recently adopted procedures and rules, which provide non-shareholder interests with mechanisms for improved participation in corporate governance practices. This has compelled South Africa to re-evaluate its position with regard to its corporate governance practices. These principles will be fully developed in the 10 chapters of the thesis that follow.

II. Traditional characteristics and powers of corporations

The strengths and virtues of the corporation over other types of business entities have been succinctly stated as follows:

> A corporate body is not a natural person but has legal personality attributed to it by the law. A corporate body, therefore, acts through a living person who has a mind, which can have knowledge or

> intention or who can be negligent. The human who acts does so as the corporate body, and his mind directing his actions is the mind of the corporate body. [3]

Corporations are the most common business structure in the Western world and have been so ever since the nineteenth century. This is mainly because corporate structure has given businesses independence from their investors and limited their liability. Corporations are thus able to acquire funds from a large number of investors without having to acquiesce to vested interests. Consequently, a number of large companies have come into existence. [4] Some Chinese intellectuals are of the opinion that corporations greatly contributed to the prosperity of countries and, in so doing, improved the well-being of society. [5] It is also thought, however, that

> (t)wo centuries ago, in his Wealth of Nations, Adam Smith wrote of the 'benign hand'. … He … contemplated that business entities, all acting collectively in free and open competition in the pursuit of their own respective interests, would allocate resources optimally and, as a consequence, maximise the satisfaction of the population and the wealth of nations. Over the centuries there have been some serious misgivings regarding the 'hand' that guides the destinies of mankind. Most certainly the presumption implicit in Adam Smith's thesis, that of free and open competition with full access to all information, has not yet been made operative. Nonetheless, this philosophy is presently alive and kicking in the financial marketplace. [6]

However, notwithstanding the comments of Adam Smith, the corporate entity does have several advantages. It is the most effective structure for capital accumulation. Additionally, it has a legal *persona* separate from that of its investors. The corporation also has the potential to demonstrate an effective management system because it allows a separation of ownership from management. [7]

Traditionally, however, the cornerstone of company procedure is based upon a provision found in the articles of almost all companies to the effect that the directors (who can also be the managers) should manage the business of the company. Consequently, the *standard* operating procedures at present can be described as pyramidal in form . [8] At the base are the shareholders whose vote is required to elect

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3 D Bailes, "Watch your corporation", (1995) *Journal of Business Law*, 3(1), 24.

4 Y Wei (2003), *Comparative Corporate Governance: A Chinese perspective*, Global Trade and Finance Series, Vol. 3, Kluwer Law International, 2.

5 Ibid 8.

6 AJ Briloff, "The corporate governance and accountability malaise: an accountant's perspective", (1984) *Journal of Corporation Law*, 9, 473.

7 P Jiang & LF Fang (eds) (1998), *New Corporate Law Textbook*, 9th edn, Legal Publishing House, Beijing, 48-50. See also Y Wei, above n 4, 49.

8 RI Tricker (1984), *Corporate Governance: Practices, procedures and powers in British companies and their boards of directors*, The Corporate Policy Group, Oxford, 236.

the board of directors and to decide upon their major corporate actions. The directors, who constitute the policy-making body of the company and who select its officers, represent the next level. At the top of the pyramid are the officers and managers who have some discretion but, in general, must execute the policies formulated by the board. Thus,

> [managers] occupied … a position analogous to that of the captain and officers of a ship at sea; in navigation their authority might be supreme; but the direction of the voyage, the alteration of the vessel, the character of the cargo, and the distribution of the profits and losses were settled ahead of time and altered only by the persons having the underlying property interest. [9]

Additionally, it is interesting to note that the 500 largest corporations in the world control 25 percent of the global economic output. Therefore, the powers of management may affect others significantly:

> … managers now have more power than most sovereign governments to determine where people will live; what they will do, if any; what they will eat, drink, and wear; what sorts of knowledge they will encourage; and what kinds of society their children will inherit. [10]

Employees, however, generally have limited powers but may, upon the authorisation of directors, either expressly or impliedly, bind the company as the articles of association may permit. However, authority to perform the act in question, which in terms of the articles must be performed by the directors, cannot be delegated to the employees. Thus, directors may delegate executive functions to employees but cannot delegate the exercise of their discretion. [11] Accordingly, in *Barlows Manufacturing Co Ltd v R N Barrie (Pty) Ltd* Conradie J noted that a director owes a fiduciary duty to his company, which he cannot, as director, divest himself of. [12] A director may delegate some or even all of his powers of controlling the company but he may not delegate his fiduciary duty and “power to control the controller”. Thus,

> (h)e may delegate but he may not abdicate. The board must retain ultimate control. [13]

Hence, this ‘pyramidal’ form of a company reflects a distribution of powers that is being increasingly criticised throughout the world, including South Africa. This is

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9 AD Boyer, “Articles: Activist shareholders, corporate directors, and institutional investment: some lessons from the robber barons”, (1993) *Washington and Lee Law Review*, 50, 1041, 998.

10 P Goldenberg, “IALS Company law lecture – shareholders v stakeholders: the bogus argument”, (1998) *The Company Lawyer*, 19(2), 34.

11 JTR Gibson (1997), *South African Mercantile and Company Law*, 7th edn, Juta & Co Ltd, 338.

12 1990 (4) SA 608 (CPD) at 610–11, paragraphs I-A.

13 Ibid at 611, paragraph A.

because it excludes the participation on the board or at management level of any other group or body, other than the directors themselves, the shareholders or the officers. Thus, in terms of this ‘pyramidal’ type of model, employees, customers, suppliers and creditors are effectively excluded from such participation. Consequently, as a result of traditional and conservative company law models, typically, the distribution of powers may be formulated by distinguishing between the following three types of powers:

1. Constitutional powers (including internal management powers, such as the powers to appoint directors);

2. Business management powers; and

3. Powers, which are part constitutional and part management.

Constitutional powers are those for altering the company's constitution. On the other hand, a prime example of a management power is a general provision, usually contained in the articles conferring on directors the powers to manage the business of the company. Examples of the part constitutional and part management powers are the powers to issue shares, to sell all or part of the company and to authorise borrowing. Generally, constitutional powers are given to the members/shareholders, while the management powers are given to the directors. Powers that partake of both elements are given to the directors subject to the consent of the members. Therefore, the other stakeholders in the company, including the employees, would hold neither constitutional nor management powers nor a part combination of either in terms of the traditional models of company law. It can be argued that these models are becoming increasingly unworkable in corporate governance settings where all stakeholders, whether small or large, have a role to play in achieving effective corporate governance practices.

Furthermore, there has been much controversy about the proper role of the corporation in the larger community and the extent to which directors should consider the interests of those other than shareholders. This debate continues and consensus has not yet been reached. Therefore, a discussion of corporate social responsibility considers whether companies should have a wider responsibility to other ‘stakeholders’, including customers, consumers, employees, the environment,

charities and local communities. [14] Furthermore, in terms of traditional company law models, once one turns from general policy to a consideration of the *actual* distribution of power, it becomes evident that, while the distribution of the company's powers between the members in general meeting and the board of directors is in some instances explicit, in other cases, it reflects areas of corporate theory, which have been only partially resolved. Therefore, the distribution of powers is, in the first place, determined by the *Companies Act*, secondly, by the articles of association of the company and, thirdly, by the common law, within which members have certain powers.

For the purposes of the *Companies Act* 61 of 1973, in terms of section 1(1), the term 'officer' includes (unless the context otherwise indicates) any managing director, manager or secretary, but excludes a secretary, which is a body corporate. Hence, the very *exclusion* of the other bodies or stakeholders from partaking in or being invested with the various powers of the company, by virtue of both this 'pyramidal' form and company legislation, highlights the need for a review of the principles of corporate governance.

This thesis will explore in detail an alternative corporate governance model (see chapter 9) – one, which does not conform to the traditional pyramidal approach discussed above.

III. What is corporate governance?

'Corporate governance' is a concept that has been used for at least twenty years and is derived from American corporate law.

According to Farrar,

> … (i)n its narrower, and most usual, sense it refers to control of corporations and to systems of accountability by those in control. … In a wide sense, corporate governance includes 'the entire network of formal and informal relations involving the corporate sector and their consequences for society in general'. [15]

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[14] CM Slaughter, "Corporate social responsibility: a new perspective", (1997) *The Company Lawyer*, 18(10), 313.

[15] J Farrar (2005), *Corporate Governance Theories, Principles, and Practice*, 2nd edn, Oxford University Press, 3-6.

The term ‘corporate governance’ has become a widely used term in modern corporate practice. Although, it has been the focus of attention in developed countries since the 1980s, the meaning, however, is not always clear. [16]

> A beginning, a muddle, and an end. Ubiquitous though it may be in late 1990s legal discourse, ‘corporate governance’ is hardly a clear concept. At one level, ambiguity exists as to the scope of corporate governance – whether it encompasses only the relationship between shareholders and managers, or whether it is more expansive, involving the relationship between a broader range of stakeholders and the board. [17]

It has been noted, however, that the term corporate governance is used globally and encompasses all the issues facing a board in directing and controlling a company’s operations. These issues include its interaction with management and with other stakeholders including the shareholders, employees, financiers, suppliers, purchasers, auditors, corporate regulators, the community at large and the Government. [18]

In popular use, however, corporate governance refers mainly to the functions of directors and managers in especially larger corporations, including the structure of management. Therefore, how directors carry out their fiduciary duties, and what the law prescribes that they ought to do, are issues, which affect all of us. This draws attention to the struggle between two basic principles that form the pillars of authority in our society - corporate activity and freedom of enterprise on the one hand, and legal procedure and accountability on the other.

Consequently, “(a)lthough corporate governance can be defined in a variety of ways”, it generally refers to the “mechanisms” by which a company “is directed and controlled”. These mechanisms include a determination of the accountability for corporate conduct and performance by managers and directors. [19]

There is also a view that a shift towards governance through a consideration of market principles has been justified by those who believe that ‘market’-based

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16 Wei, above n 4, 3.

17 J Hill, “Deconstructing Sunbeam – Contemporary issues in corporate governance”, (1999) *Company and Securities Law Journal*, 17, 288.

18 T Shaw (1999), *Corporate Governance a Director’s Handbook*, CCH New Zealand Limited, Auckland, New Zealand, 5.

19 Weil, Gotshal & Manges LLP (2002), *Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States*, <http://www.odce.ie/_fileupload/services/EU%20Comparison.pdf>, 1.

transactions provide a more rational and efficient basis for economic organisation. [20] Consequently, some believe that market forces should be the main, if not the only, regulator of corporations and their managers. [21]

There is, however, an alternative view. The idea of corporate restructuring, which was once only considered possible by a few academics, has, within the last decade, progressed to such a stage that, even people with conservative instincts, are willing to consider this issue. [22]

Jacoby writes that in the last decade, corporate governance has become a controversial issue because the rules for governing public corporations are being challenged by many critics, ranging from investors to social activists. Consequently, some critics hope to give greater power in corporate decision-making to shareholders, whilst others hope to provide this to other stakeholders, such as employees and customers. However, Jacoby emphasises an important point, which is that no two countries deal with corporate governance issues in precisely the same way. [23]

Furthermore, it is important to remember that the main task of corporate governance in any modern company is to reduce its costs so that it may increase productivity and managerial efficiency. Consequently, corporations should divide and balance corporate powers amongst the shareholders' meetings, the board of directors and the managers. Thus, corporate governance must address the balancing of powers and interests amongst the corporate stakeholders. [24] In effect, the main objective of corporate governance is to improve corporate efficiency. Thus, questions regarding the nature of the corporation, the reasons for incorporation, for whose benefits the corporation is governed and how the corporation should be governed should be addressed. These answers would provide the direction and basis for judging corporate efficiency. [25] Thus,

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20 M Ezzamel & H Willmott, "Corporate governance and financial accountability: recent reforms in the UK public sector", (1993) *Accounting, Auditing & Accountability Journal*, 6(3), 109.

21 DM Branson, "The American Law Institute principles of corporate governance and the derivative action: a view from the other side", (1987) *Corporate Practice Commentator*, 28(4), 475.

22 DF Vagts (1981), "The governance of the corporation: reality and law", *Commentaries on Corporate Structure and Governance, The ALI-ABA Symposiums 1977-1978*, 159.

23 SM Jacoby, "Corporate governance in comparative perspective: prospects for convergence", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 5.

24 Wei, above n 4, 2.

25 Ibid 37.

> (t)wo competing policies must be balanced by whatever solution to this problem is chosen. On the one hand, management must be free to make corporate decisions, including litigation decisions; the board of directors must be able to avoid strike suits. On the other hand, the board must be held accountable to its shareholders and society generally for its actions; corporate accountability must be maintained.[26]

There are, however, powerful economic and technological forces at work, which are forcing corporations towards greater efficiency. These forces include the re-aggregation of shareholders in institutional investors and the emergence of the global economy. [27]Thus, the fact that current law assumes that the directors' role is to run their company for the benefit of its shareholders *alone* and to maximise profits for them is acknowledged by Fiflis, who suggests that corporate governance should enforce adequate procedures to ensure that the corporation is operated solely for the benefit of shareholders. Corporate managers would then adequately discharge their duty to them. [28]

This view, however, is too narrow and outdated. That is, directors should, especially in the larger type of corporations, have regard to a wider range of interests. More specifically, directors should have a concern not only for its shareholders, but also, for example, for employees, customers, suppliers and creditors. This idea, by extending its application, would refer to and also include the environment and community at large. Consequently, in different countries, the development of corporate governance would be shaped by the ideology, economic circumstances, political preferences and social ethos of the time. [29]

Thus, the question arises as to whether we should change our perception of the corporation as being run by directors dedicated exclusively to the benefit of shareholders to that of a body whose main purpose is for the creation of wealth, not only for its owners and creditors, but also for its employees, the community at large and the environment. This latter situation might, for example, mean creating and preserving jobs while taking better care of its community and environment. Some countries have recently taken into account and have adopted procedures and rules, internally and through the enforcement of legislation, which provide non-shareholder interests with mechanisms for improved participation in corporate governance

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[26] PN Edwards, "Compelled termination and corporate governance: The big picture", (1985) *Journal of Corporation Law*, 10, 373.

[27] TW Allen, "Contracts and communities in corporation law", (1993) *Washington & Lee Law Review*, 50, 1406.

[28] TJ Fiflis, Commentary: "Thoughts evoked by 'accounting and the new law'", (1993) *Washington & Lee Law Review*, 50, 964.

[29] Wei, above n 4, 3.

practices. It is this trend, together with domestic pressures from within, that has compelled South Africa to re-evaluate its position with regard to its corporate governance practices.

Hence, the real issue to be considered is how and to what extent legal rules should develop, which place directors under a positive duty to take account of the interests of bodies other than shareholders. The issue of the extent to which the rights and interests of non-shareholder corporate constituencies (the employees, creditors, suppliers, customers, and communities) should be considered by management is one of the most complex issues in modern corporate scholarship. [30]

In South Africa, the duties of company directors and managers are an issue that is attracting much attention at present. With rapidly developing and constantly changing labour laws, it is now timely to examine this situation in detail and to consider reassessing the law to bring it into line with other countries that have adopted more modern corporate governance practices. Consequently, the question of how fiduciary duties should be allocated within the corporation must be considered. This is because corporate law doctrines have for decades provided that directors' fiduciary duties relate to shareholders alone. While protection for other corporate stakeholders has existed only in terms of contract, this principle has been subjected to debate as a result of recent legislative action in Canada, which authorised directors to consider the interests of other non-shareholder constituencies. [31] Furthermore, in New Zealand, [32] the powers of directors are not only limited "to make provision for the benefit of employees of the company in connection with the company ceasing to carry on the whole or part of its business". The definition of a company also includes its subsidiaries. [33]

This thesis proposes a model of corporate governance for South Africa that takes into account the extent to which other non-shareholder interests and rights, especially those of the employees, should be considered. The extent to which employees should be permitted to participate in the actual running of the corporation, alongside the directors and shareholders, will, therefore, be considered in great detail. The corporate world is in a stage of rapid change and development.

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30 R Daniels, "Stakeholders and takeovers: can contractarianism be compassionate?", (1993) *University of Toronto Law Journal*, 43, 315.

31 JR Macey and GP Miller, "Corporate stakeholders: A contractual perspective", (1993) *University of Toronto Law Journal*, 43, 401-402.

32 Section 132, *Companies Act 1993*.

33 CCH (2001), *New Zealand Companies and Securities Legislation*, Volume A, 18th edn, CCH New Zealand Limited, 313,004.

The creation and rise of new economic powers and the increased domination of corporate groups and multinationals have created new complexities for corporate governance. We need to use a new approach to define the roles of corporations. [34]

In short, this study maintains that poor corporate governance can lead to business failure. Thus, South Africa's existing corporate governance programmes need to be reformed and modernised to enable it to face new challenges that may affect its businesses. [35] Thus, public policy requires a corporate governance model that "is both legally justifiable and acceptable in our developing economic community". [36] In short, James Wolfensohn, president of the World Bank in 1999, noted very appropriately that

> (t)he proper governance of companies will become as crucial to the world economy as the proper governing of countries. [37]

Thus, the main objective of corporate governance must be ultimately to improve corporate efficiency. To achieve this, issues regarding the nature of the corporation, the reasons for incorporation, for whose benefits the corporation is governed and how the corporation should be governed should be addressed.

IV. The nature of employee participation in corporate governance

There are various ways in which employees can participate in corporate governance decisions. For example, they might engage in individual and collective bargaining about the terms and conditions of employment, participate in workplace committees or consider matters such as occupational health and safety or employment equity. Moreover, there is no reason why employees could not become members of a company's board of directors. [38]

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34 Wei, above n 4, 7.

35 M Ross (1999), *Corporate Reconstructions Strategies for Directors*, CCH New Zealand Limited, Auckland, New Zealand, 2–3.

36 M Havenga, "Directors' fiduciary duties under our future company-law regime", Inaugural lecture (UNISA), (1997) 9 *South African Mercantile Law Journal*, 313.

37 RAG Monks & N Minow (2005), *Corporate Governance*, 3rd edn, Blackwell Publishing, US, 295.

38 K Swinton, "Comment: On labour participation in workplace governance", (1993) *University of Toronto Law Journal*, 43, 793.

Consequently, an important question that needs to be considered in this regard is the extent to which employee participation in decision-making processes would *actually* improve productivity standards and product quality. Jacoby notes,

> (i)n theory, giving employees a voice in governance – either at the workplace or corporate levels – should enhance their willingness to invest in firm-specific skills and to share productivity-enhancing ideas with the employer. … Voice should also reduce … turnover-related costs. [39]

It is also argued that where workplace-based institutions for worker representation are absent, labour/management relations are likely to be exceedingly poor, ultimately affecting the efficiency, performance and profitability of the corporation. Furthermore, it is important to remember that corporate governance systems are riddled with a complex set of costs and benefits. Thus, a reluctance to change to a more costly system of governance might arise. [40]

If South Africa has any hope of achieving improvement in productivity levels with its re-entry into international markets, then management and labour *must* find improved ways of dealing with each other. To this end a model needs to be formulated, which would be mutually advantageous to all sectors and bodies constituting the work place. This model needs to take into account the interests and rights of non-shareholder constituents of the corporation. Furthermore, it needs to be remembered that the best laws can be justified by usual practice. [41] Thus, if a model is too far away from reality and makes it too difficult to apply to current legislation, its influence will be reduced. [42] Furthermore, it must be noted that although some corporate systems have developed some of the strongest economics in human history, it is difficult to determine which country's corporate governance system is the best one. [43]

It is evident from the research discussed above that some of the most influential corporate governance systems in the world have emanated from Germany, France and Japan. These systems have either created powerful corporate economies in the world, or carried out drastic corporate reforms and brought new insights into corporate development. Consequently, in discussing and analysing different models,

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39 Jacoby, above n 23, 24.

40 Ibid 21.

41 DC North (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, New York, US, 37-69. See also Y Wei, above n 4 at 3.

42 Ibid 3.

43 Ibid 12.

the distinguishing features, which shape the system of corporate governance, can be identified. This entails examining the successful systems of corporate governance and identifying the conditions that have resulted in this success. The German and Japanese models operate in the strongest corporate economies in the world. The economies, political preferences and cultural and legal traditions are important features, which shape a country's corporate system. Therefore, the development of a corporate system in a specific country should be studied and applied in the country's own historical context. [44] It is also important to make the proposed governance model as scientific as possible. However, it must be remembered that the ultimate design cannot be entirely free from arbitrariness. [45] That is, even after a model is formulated and put into practice, ongoing work is still required to develop this model because there are always gaps between theories and practice. These gaps must be filled by informal rules, tradition, culture and customs. Legislation does not always reflect the reality completely or predict all foreseeable events. Thus, a model of corporate governance must take into account the conditions of a particular system in a particular country, which include its economic, political, cultural, historical and legal factors.

V. A model of corporate governance for South Africa – a question of discipline

In developing a corporate governance model for South Africa, the corporate governance models of Germany, Japan and France have been considered in this thesis. The reasons why these models have been chosen as the building blocks of the new South African corporate governance model are fully discussed elsewhere in this thesis (see introduction and chapters 8, 9 and 10). However, briefly stated, the German, Japanese and French systems of corporate governance have unique features, which could, I argue, improve South Africa's current model of corporate governance, which is based upon a single tier board structure. Germany operates a mandatory two-tier board structure, which is designed to be advantageous to all stakeholders in the corporation. Japan relies, to a large extent, upon customary practices rather than on an institutionalised legal system of governance. Japanese corporations also emphasise the significance of lifetime employment. The French

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44 Ibid 12-14.

45 Ibid 14.

system provides a unique selection of corporate governance systems. Companies may either select to adopt a unitary or two-tier board structure of governance. Furthermore, companies may choose to alternate freely between these governance systems as they wish. The British and American systems of governance, I argue, are unlikely to take South Africa's current system of corporate governance much further at present. This is because the UK and US models of governance are based upon the unitary board system, which does not provide adequate levels of participation to employees and the other corporate stakeholders in the governance of corporations.

Overall, corporate governance must be concerned with directing corporations to achieve its maximum efficiency. Hence, corporate governance must ensure the organisation of various relationships amongst its corporate participants for an optimal economic outcome. [46]

There is also the view that financial hardship in a corporation can create the opportunity to reallocate the economic resources through the use of corporate governance mechanisms. Thus, the extent to which corporate governance may play a role in generating improved economic returns is a question that needs to be considered. Parker *et al* believe that the evidence shows that effective corporate governance mechanisms are very important in increasing the likelihood of survival of distressed firms. [47] Consequently, the very survival of corporations depends upon discipline introduced through managers. This discipline, affected through good governance mechanisms, may arise through the market place or it can come from within the firm itself through the corporate governance structures. [48] Thus, Parker *et al* note,

> … (i)n the process, more and more people are recognising that corporate governance is indispensable to effective market discipline. … I have come to view strong corporate governance as indispensable to resilient and vibrant capital markets. [49]

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46 Ibid 51.

47 S Parker, GF Peters and HF Turetsky (2003), "Corporate Governance and Corporate Failure: a Survival Analysis" in *Corporate Governance* 2.2, 5; also found, <http://www.emeraldinsight.com/1472-0701.htm>.

48 Ibid 10.

49 A Levitt (1999), "An essential step in the evolution of corporate governance", Speech given at the Audit Committee Symposium, US Securities and Exchange Commission, New York, NY, US. See also S Parker et al, above n 47, 10.

VI. The British and US systems of corporate governance

As mentioned previously, both the UK and US adopt a unitary board structure of governance. This has also been referred to as the shareholder system of corporate governance in terms of which the employees and other corporate stakeholders have very limited or no influence on corporate governance matters. The UK and US are reluctant to adopt a two-tier board structure because this would facilitate a worker participation system of governance.

VI.I BRITAIN

The British model of corporate governance has not been considered in detail in this thesis, as it is unlikely to take the present system of corporate governance in South Africa much further than it is at the moment. This is because the UK system adopts a one-tier board structure. Furthermore, it has always been held that in this type of board structure the interests of employees and the interests of shareholders conflict. [50] The problem with one-tier board systems is that they are required to fulfill two incompatible corporate functions. That is, it is both the supreme executive body and the supervisory organ. This raises the possibility of abuse of executive power by management and doubts about the accountability of directors are high. [51] Moreover, one-tier board systems emphasise the role of non-executive directors on the basis that the non-executive directors' independent judgment and monitoring of corporate governance strategies can raise the standards of good corporate governance. [52] Employees, appointed as directors, are usually known as the executive directors. [53]

Furthermore, the unitary board has been attacked on further fronts. Firstly, it is argued that even where the unitary board applied, a *de facto* distinction existed between active members managing the business of the company and passive members who confined themselves to supervision. Secondly, it is argued that the unitary system did not answer the "needs of modern management undertakings". Thirdly, the unitary system does not provide "equivalent safeguards to shareholders

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50 Wei, above n 4, 15.

51 Wei, above n 4, 126.

52 Wei, above n 4, 47.

53 HS Cilliers, ML Benade, JJ Henning, JJ du Plessis, PA Delport, L de Koker and JT Pretorius (2000), *Corporate Law*, 3rd edn, Butterworths, 166. See also HS Cilliers, ML Benade, JJ Henning, JJ du Plessis and PA Delport (1992), *Corporate Law*, 2nd edn, Butterworths, 161.

and third parties". Thus, "all member states (should) abandon a system of a single board and … replace it (with) a two-tier system in … public companies". [54]

Hence, the proposed model of corporate governance for South Africa is based upon a two-tier board structure. The two-tier board system constantly attempts to enhance the independence and strength of the supervisory board. Independent auditors are introduced into many jurisdictions and, therefore, major creditors, financial institutions and related companies can effectively influence the board. [55] Regarding the single board structure operating in the UK, Dore notes,

> … what seems to me the obvious "social justice" case for subordinate-employee power … is most obvious here in Britain where, last year, executive compensation (not including stock options) rose by 15% while average salaries rose by 5%. [56]

Thus, in British companies, directors have a fiduciary relationship towards the company and, consequently, must act in the interests of the company. The interests of the other groups, namely the employees, creditors, investors, customers, the community and the state "are ill-defined in … company law". Traditionally, management was only accountable to the shareholders. Thus, the German system with its work councils, system of co-determination and supervisory board structure is "at the ultra-red end of the comparative spectrum on industrial democracy", whilst the British system falls within the "ultra-violet band". [57] Hence, the *contractual model* best describes UK company law in which the company is regarded as the property of its owners. Thus, the wishes of the shareholders are the most significant consideration for management acting in the best interests of the corporation. In this way, creditors and employees are considered as "outsiders", whilst the interests of the shareholders are equated with the interests of the company. [58]However, ownership and control may be in different hands and thus "the identification of the shareholders with the company no longer represented reality". [59]

The *constituency model*, on the other hand, has two variants. The first variant describes the company as being run in the interests of shareholders who must take

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54 JJ du Plessis & J Dine, "The fate of the Draft Fifth Directive on company law: accommodation instead of harmonization", (1997) *The Journal of Business Law* 30.

55 Wei, above n 4, 47.

56 R Dore, "Comment: papers on employees and corporate governance", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance* Vol. 22, No. 1, 159.

57 Ibid 25-26.

58 Ibid 26.

59 Ibid 28.

account of the other interest groups. [60] The second variant accepts that the interests of the other group must be taken into account because this would benefit the company directly. In this case, it is clearly the company, rather than the shareholders, that has this corporate governance role.

The *enterprise model* differs from the constituency model because directors must take into account the interests of all stakeholders *and* regard them as part of the company. Each stakeholder then has its own corporate governance role in the decision-making process. This model is the classic model developed in Germany. [61]

Thus, in describing models of corporate governance, Jacoby identifies two distinctive *governance systems* in industrial countries. There is the 'shareholder' or Anglo-American system, also referred to as the 'market-outsider system' or 'stock-market capitalism'. This model is used in Britain, the US and in South Africa. There is also the 'stakeholder' system, which is also referred to as the 'relational-insider' system, the 'dedicated-capital' system or 'welfare capitalism'. This model is used in Germany and Japan. Thus, the shareholder model is an "exit" model, in terms of which shareholders sell their shares to express dissatisfaction with management. The stakeholder model is a "voice" model, in terms of which the other stakeholders within the corporation, including the employees and shareholders, express concerns by communicating directly with management. These systems provide employees with very different roles in corporate governance. Employees have little or no influence on corporate matters under the shareholder system. Under the stakeholder model, employees have a moderate role, through custom, in Japan, and an important role, through statute, in Germany. In Germany, this occurs through a legal system of work councils and co-determination. In Japan, most large companies have unions and joint committees with access to senior management. Thus, employees are important stakeholders and management mediates between the shareholders, employees and other stakeholders. [62]

Moreover, the British have recently realised that their hesitation to take a significant step forward to reform their existing corporate system have made the UK corporate system and company law outdated. Since the mid-nineteenth century, the development of UK company law has been a process of constant addition of new rules to the existing legal framework. Thus, although the law became voluminous

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60 Ibid.

61 Ibid 29.

62 Jacoby, above n 23, 6-7.

and complex, no attempts were made to reassess its traditional principles and policies. [63]

The British have been reluctant to adopt a two-tier board system, as they believe that it would facilitate a worker participation system. This would contradict traditional mainstream corporate theory, which is that corporations should be run only for the interests of shareholders. Consequently, the interests of employees and shareholders remain in conflict. It will, however, be interesting to see, with the development of corporate laws within the European Union, whether the UK's corporate governance system will move towards a two-tier board system, which would incorporate employee participation. [64]

Worker participation is no longer a question of *whether* they will participate or not; the question is rather *how* they will participate in the decision-making processes of the corporation. Thus, "employee participation in the broadest sense of the term "is a desirable development in a democratic society". [65] The fact that workers' participation has developed even in "lean years" is indicative of the fact that that this is "a lasting and deeply rooted movement". [66]

Vitols *et al* argue, however,

> (t)here is no 'one best' system of corporate governance. Rather, the two systems have different comparative advantages. The British corporate governance system better supports companies in sectors where there is a need to move quickly into and out of new markets and in which there is need for greater flexibility in the use of employees. The German system, by contrast, better supports companies in sectors that require long-term commitments and investments by employees, suppliers and other 'stakeholders'. [67]

Because the UK model of corporate governance places managerial decision-making in the hands of the board and chief executive, it is likely to be able to take and implement decisions faster than the German model. This entails greater risks as top management may then make "strategic mistakes". However,

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63 Wei, above n 4, 15.

64 Wei, above n 4, 130-133.

65 E Cordova, "Workers' participation in decisions within enterprises: recent trends and problems" (1982) 121 *International Labour Review*, 125.

66 Ibid 126.

67 S Vitols et al (1997), *Corporate Governance in large British and German companies*, 35. See also P Davies (2000), "Employee representation and corporate law reform: a comment from the United Kingdom", *Comparative Labour Law & Policy Journal: Employees and Corporate Governance* Vol. 22, No. 1, 136.

> the two systems are unlikely to converge: 'change can better be characterized as incremental adaptation rather than the wholesale adoption or replacement of corporate governance systems'. [68]

VI.II THE UNITED STATES OF AMERICA

Corporate governance in the USA involves a unitary board structure with shareholders being the owners of the corporation. In America, it is believed that shareholders alone should direct management decision-making. This can be achieved either through proxies, through the fiduciary duties of managers and corporate boards, or through legal and economic means, which align management decisions with shareholder interests. In other countries, however, there is a greater willingness through the law and through the managers and shareholders to allow employees to participate in corporate governance. [69]

According to Jacoby, the implications of this for corporate governance are clear. He notes that corporations favour shareholders in the United States in order that capital for diversification and acquisitions may be obtained. In contradistinction, corporations favour managers and employees in Germany and Japan in order that internal organisational structures may be created. [70] Jacoby quotes an American union official, who said,

> it is amazing to me that in Europe … the corporations feel that they have [an ethical] obligation to their employees. … Th[is] comes naturally from the European culture. [71]

O'Connor also suggests that the American system of corporate disclosure does not provide sufficient information about their employees. He believes that employees show up as payroll expenses rather than being considered as a potential source of value to the corporation. [72] The important point is that in order for corporate law to be able to protect employees while holding directors accountable, it must recognise that directors have enforceable fiduciary duties towards its employees. [73]

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68 Davies, above n 67, 137. See also Vitols, above n 67, 35-36.

69 MW Finkin and SM Jacoby, "Introduction", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 1-2.

70 Jacoby, above n 23, 11.

71 Ibid 13.

72 M O'Connor, "Labor's role in American corporate governance structure", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 127.

73 Ibid 103-104.

Referring to another jurisdiction reinforces this point further. From an Australian context with regard to the question of having enforceable fiduciary duties to protect employees of the corporation, Hocking wrote a political biography on Lionel Murphy, whose professional life in Australia covered many fields, from labour lawyer to Senator to Attorney-General to High Court judge. He died in 1986. Regarding the question of company law, she notes that Murphy pointed out that under Australian company law, management owed no duty at all to employees. English judges continued to rule that company law provided no authority with which to support the contention that company directors had any obligation or duty to their employees, Murphy noted that whilst,

> such is not the law in Australia either … the question may fairly be asked, I think, whether it should be. Was it possible … to take the law in the direction … to introduce 'a new concept of social responsibility' into the law? [74]

Moreover, Gulati points out that all corporations involve and affect many other groups other than the shareholders themselves and the members of the upper management team. These other stakeholders are the employees, the lower and middle management teams, the creditors, the suppliers, the customers and even the government and local communities. All of these groups play important parts in the decision-making processes of the corporation. Thus,

> (t)he puzzle, therefore, is why U.S. corporate law ignores them. … The thrust of O'Connor's article is … that labour has an important part to play in the governance of corporations and that this role needs to be recognised within corporate law. [75]

Gulati notes that in Germany and Japan, employees are given a much greater role in running the corporation than in the United States. Gulati refers to O'Connor's proposals for the incorporation of employees as a more integral part of the governance structure. Consequently, the law should recognise a fiduciary duty to the employees. [76] Such disclosures would greatly assist investors in deciding where they should allocate their funds. Gulati believes that

> … the primary asset of many companies is their human capital. … How a company hires employees, its promotion and wage practices, its training programs, its absentee and retention rates, etc., are all

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74 J Hocking (2000), *Lionel Murphy: A Political Biography*, Cambridge University Press, 220.

75 M Gulati, "Incorporating Labor", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No 1, 171.

76 Ibid 172.

> likely to be crucial determinants of future economic prospects for many companies. This seems to be a good thing from a labour point of view. Further, from a social optimality point of view, everyone gains because both labour and financial capital will be better allocated". [77] Furthermore, it is important that employees are owed fiduciary duties. "The rationale is that the presence of these duties will provide a protection against opportunistic conduct by management. [78]

It is also noteworthy that the Anglo-American share of the world's outward foreign investment 'pie' has fallen from 66% in 1980 to about 50% in 1997. By contrast, French, German and Japanese investment rose sharply during this period. [79] This suggests that the US style of corporate governance, which emphasises the "shareholder" system, has waned considerably in popularity. Thus, the economic case for the superiority of Anglo-American governance and of the Anglo-American version of "free markets" is weak. [80]

Furthermore, Jacoby believes that the question of costs and benefits will force American workers in the position of being among the least influential group of employees in the advanced industrial world. Thus,

> … (n)ot a few journalists and even some respected academics are asserting that U.S.-style corporate governance promotes "rent extraction" – greed, in plain English – and is not, as was alleged back in the 1990s, a system of "optimal contracting. [81]

Thus, employees in the US have been restricted to workplace discussions concerning wages and working conditions. This allowed managers the opportunity to maintain control over strategic decisions. Thus, when the German economy began to perform better than that of the US, corporate law scholars reexamined the employees' role in the German system of co-determination. This means that, under German law, employee representatives of the supervisory board may fully participate in the decision-making processes of the corporation. [82]

A few mainstream corporate scholars agreed that labour board representation might be a good way to facilitate the tradeoff between worker commitment and firm

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77 Ibid 176.

78 Ibid 173.

79 Jacoby, above n 23, 29.

80 Ibid 30.

81 Ibid 31-32.

82 H-C Hirt, "The German corporate governance code: co-determination and corporate governance reforms" (2002) 23 *The Company Lawyer*, 352.

adaptability in a world of rapid technological change. However, unions in the United States have not supported any reform proposals for the German-style co-determination, as labour is reluctant to challenge the "system" that established the managers as "thinkers" and the workers as "doers". [83]

Davies believes that commentators and institutions in the 1980s began to take an interest in both the German and Japanese systems of corporate governance especially when the economies of these countries "out-performed" that of the US economy. [84] Sullivan also notes that in the 1980s and 1990s, there was a great deal of interest in the German and Japanese "insider systems of corporate governance", as compared with the American shareholder model of corporate governance. This was due to the fact that the German and Japanese systems produced excellent returns economically and was hugely successful in achieving "social cohesion". [85] However, O'Sullivan believes that each country is different and, therefore, no one system of corporate governance can be applicable to all. Furthermore, there is inadequate attention to the question of what it is that makes each country different from another. [86]

However, in terms of corporate governance, the US unitary board structure is composed of committees, such as auditor committees, executive committees, compensation committees and nomination committees. Most companies have the first three types of committees attached to their unitary board structure. Thus, although executive committees and auditor committees are composed of internal appointments and are involved in the daily management and financial control operations of the corporation, compensation committees and nomination committees, which are composed of outside directors, supervise the executive directors and managers. This step towards a two-tier structure has improved the effectiveness and accountability of the US one-tier board. [87]

This thesis considers the possibility of attaching various types of committees to the present unitary board structure in South African to improve the governance of the

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83 O'Connor, above n 72, 102.

84 Davies, above n 67, 136.

85 M O'Sullivan, "Variety and change in the role of employees in corporate governance", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance* Vol. 22, No. 1, 180.

86 Ibid 182.

87 Wei, above n 4, 137-138. See also Charkham (1995), *Keeping Good Company: A study of corporate governance in five countries*, Oxford University Press, New York, 191.

corporations. However, Wei notes that some have suggested that the USA may be better off if it adopts instead the German corporate model. [88]

Araki points out that ever since the 1970s, American employers tried to introduce the notion of employee participation schemes so as to enhance productivity and quality of work life. However, American law, as interpreted by the National labour Relations Board and Federal Courts, prohibits most such employee involvement. These bodies believe that such involvement amounts to illegal intervention into "labor organisation" through employers. In such situations, therefore, it would not be possible for labour and management to develop a corporate governance structure that respects employee participation. Thus, American law only allows adversarial labour relations through the involvement of representatives under collective bargaining systems, which have been certified under the *National Labour Relations Act*. [89] O'Connor believes that the Americans have taken this approach because some view employee representation on the German board as that which weakens the board's monitoring function. Thus, O'Connor notes that the Americans believe that large blocks of shareholders are needed in Germany to counterbalance worker power on the board. Furthermore, stock markets depend on shareholder-focused boards and, accordingly, co-determination prevents this by including employee objectives in strategic decision-making. Moreover, some commentators suggest that employees have limited wealth and have differing interests in corporate decision making because they have different educational levels, race, class and sex. Capital hires labour in order to diversify their financial risks better and therefore maximise their wealth. [90]

These views, it is suggested, are not progressive. They do not address concerns about the system of corporate governance adopted in the US. They also do not encourage or direct the directors towards a consideration of the other stakeholders in the corporation other than the shareholders. Given this, the system appears outdated and fails to conform to modern global trends on corporate governance. O'Connor submits that

> (i)n analyzing the advantages and disadvantages that result from providing employees with a role in corporate governance, we cannot rely solely on empirical research. In the end, we must engage in an

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88 Wei, above n 4, 140.

89 T Araki, "A comparative analysis: corporate governance and labour and employment relations", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 89.

90 O'Connor, above n 72, 101.

> honest discussion of the political issues involved – issues that do not lend themselves to precise mathematical testing. These political issues involve questions such as, "What kind of society do we want to live in?" In defining a "socially optimal" corporate governance system, we should talk about the quality of life, rather than just about gross national product and shareholder value. [91]

Furthermore, O'Connor provides a succinct overview in noting that Germany provides for co-determination, Japan permits directors to balance the competing interests of employers with shareholders and the United States does not provide for the participation of employees. The United States has a model, which is based upon shareholder primacy. This model defines the interests of workers through contract and governmental regulation. Thus,

> … (t)he absence of employee voice in corporate governance demonstrates a great deal about American corporate culture. … The free market position states that employees do not play a role in corporate governance because they are protected by contractual mechanisms, such as collective bargaining. … (However), corporate governance rights for workers are necessary because private contracts are inadequate; practical and legal hurdles prevent employees from negotiating against corporate opportunism. [92]

All of this suggests a real need to redesign American corporate governance structures in order to reallocate decision making to encourage investments in human capital. This approach is not widely accepted. However, its concerns are beginning to receive attention amongst influential people, which is a victory for those scholars who believe that employees deserve greater protection of their rights and interests through corporate law. The aim would be to provide employees with a voice in the new world of global corporate governance. [93]

VII. The preferred models of corporate governance

The German, Japanese and French models have unique features, which, I argue, can be very advantageous in the formulation of an improved and workable model of corporate governance in South Africa for all stakeholders.

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91 Ibid 133.

92 Ibid 97.

93 Ibid 98-99.

VII.I THE GERMAN SYSTEM OF CORPORATE GOVERNANCE

Germany has developed a system of corporate governance, which is quite different from the Anglo-American model. Because Germany has one of the most successful corporate economies in the world, it is possible that other countries can derive significant insights and advantages from the institutional structures of this type of governance system. Thus, it has been noted,

> (b)y virtually any standard, Germany has developed one of the world's largest and most successful economies. Many of its companies are known internationally, particularly in the automative, manufacturing, and chemical sectors. Germany is renowned for its system of industrial and labour relations, high labour productivity, its cradle-to-grave social welfare system, and a modern infrastructure that is the envy of many nations. At least some of the success of Germany's post-war "economic miracle" has been attributed to a system of corporate law governance that has historically differed markedly in many important respects from the Anglo-Saxon model. [94]

The Germans operate an institutionalised stakeholder model, which is designed to be advantageous to all stakeholders in the corporation, not just shareholders and directors. [95] The German corporation is "to be managed in a very narrowly profit-minded way". [96]

Germany has an economy consisting of practices and work councils. These features form the basis of German law and practice. [97] Thus, the "ground was laid" to shift away from the traditional theory of maximising profits for shareholders. [98]

There has been little, if any, movement towards the establishment of a unitary board structure in Germany. [99] Thus, there is almost no likelihood that Germany would ever abandon its two-tier board structure and replace it with the Anglo-Saxon unitary structure. [100]

Hence, according to German law, a mandatory two-tier board structure must be established in corporations, consisting of a supervisory board (*Aufsichtsrat*) and a

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94 TJ Andre, "Some reflections on German corporate governance: A glimpse at German supervisory boards", (1996) 70 *Tulane Law Review*, 1820.

95 Araki, above n 89, 89.

96 Vagts, above n 2, 38.

97 Jacoby, above n 23, 16.

98 Vagts, above n 2, 40.

99 Andre, above n 94, 1821.

100 Ibid 1822.

management or executive board (*Vorstand*). It was made compulsory in 1870. [101] The term "two-tier" board system does not connote that one board "is superior to the other board". It means rather that the two boards "function side-by-side, with different and very specific duties". [102]

Stock companies founded after 10 August 1994 and, which employ fewer than 500 people, are exempt from the co-determination system. This does not apply to stock companies founded before this date (other than family businesses) where one-third of the seats on the supervisory board must consist of the employee representatives.[103] Du Plessis notes that the supervisory board was only included into German Law "at a relatively late stage" through the General German Commercial Code in 1861. [104]

The supervisory board is selected by and composed of shareholders and employees. It supervises the management of the corporation, whilst the management board manages the company. Consequently, this "division of responsibilities" provided the shareholders with a system, which could actively "check, supervise and correct" management. [105]

In terms of the co-determination system a certain proportion of the supervisory board members must be elected by and composed of the employees of the corporation. Thus, du Plessis notes that the appointment and removal of members of the supervisory board is inextricably linked with the belief that employees should participate in the decision-making processes at board level. [106]The Germans believe that companies have a human and personal component to it and will "produce a general benefit for the community as a whole". [107] Thus, the interests of employees must be taken into account. This creates a climate of stability. Thus,

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101 Vagts, above n 2, 50.

102 N Kendall & A Kendall (1998), *Real-world Corporate Governance: A programme for profit-enhancing stewardship*, Pitman Publishing, London, Great Britain, 53.

103 D Sadowski, J Junkes and S Lindenthal (2000), "The German model of corporate and labour governance", *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 34.

104 JJ du Plessis (1996) "Corporate governance: reflections on the German two-tier system" *Journal of South African Law*, 22.

105 Vagts, above n 2, 50.

106 Du Plessis (1996), above n 104, 22.

107 J Charkham (1995), above n 87, 8-11. See also Y Wei, above n 4, 143.

> (t)he underlying ideology is that worker participation in the decision-making will promote trust, co-operation and harmony. [108]

It has been suggested that Germany's two-tier board system appears to be a more efficient system than the one-tier board system. [109] This point will be fully examined in this thesis.

It has also been stated that the German government has played an important part in shaping German corporate patterns. Consequently, industrialisation in Germany has been a more organised process as compared to that of the UK. Thus, the German corporate system can be described as not only 'cooperative', but also as 'organised'. [110] The government has promoted German industry as a matter of national pride and German entrepreneurs relied heavily on the government for guidance. [111] Banks also play a very influential role. Furthermore, German legislation can be described as having a "broad social and economic" base. [112]

Independence of the supervisory board is maintained through the legislation, which provides the two boards with totally separate functions. [113] Thus, the system of co-determination, operating through the structure and mechanisms of the supervisory board, ensures that a certain proportion of supervisory board members must be employees. It is thought that, through co-determination, participation of the employees in decision-making will promote sound working relationships. [114]

Araki further points out that there are two-types of co-determination processes, namely co-determination at the level of the supervisory board (*Aufsichtsrat*) and co-determination between employer and works council (*Betriebsrat*) at establishment level, which is required by German legislation. [115] Thus, to take action relating to a co-determination matter in terms of the 1972 *Works Constitution Act*, employers must first obtain the consent required to do so from the works council. Any unilateral action on the part of the employer is thereby rendered void and unenforceable.

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108 Lutter M, "The German system of worker participation in practice", (1982) *Journal of Business Law*, 154-155. See also Y Wei, above n 4, 145.

109 Wei, above n 4, 144.

110 Charkham (1995), above n 87, 7-8.

111 Wei, above n 4, 15.

112 Ibid.

113 KJ Hopt (1997), "The German two-tier board (Aufsichtsrat), a German view on corporate governance" in KJ Hopt & E Wymeersch (eds), *Comparative Corporate Governance, Essays and Materials*, 6. See also Y Wei, above n 4, 17.

114 Charkham, above n 87, 13.

115 Araki, above n 89, 88.

When the employer and the works council cannot come to an agreement on a co-determination matter, the matter is then referred to an arbitration committee (*Einigungsstelle*). Any decision made by the arbitration committee is binding on both sides. [116]

Furthermore, Sadowski *et al* point out that the composition of the supervisory board depends upon the size and the type of corporation. Briefly, in terms of the German *Co-Determination Act* of 1976, the supervisory board may consist of either 12, 16 or 20 members depending upon the number of employees employed within the corporation. [117]

Sadowski *et al* further state that a positive effect of co-determination is that dissatisfied employees may elect to communicate their dissatisfaction ("voice"), rather than choosing the option of leaving the company ("exit"). [118]

Furthermore, works councils, as a voice institution, provide employees with an even greater negotiating power and consequently with a disproportionately large part of an enlarged pie. [119] Thus, O'Sullivan notes that the *Works Constitution Act* of June 2001 increased the formal power of work councils by strengthening their rights in training, employment security, work organisation, environmental matters and racism issues in the workplace. Consequently, a major aim of the new works council reform is to keep co-determination from deteriorating. [120]

Finally, another aspect that can enhance cooperation between shareholders and employees, are employee share ownership schemes, which have become common in Europe in the 1990s. Although the growth in employee shareholdings has been steady, it has not been spectacular and, as with stock options, penetration of employee shares in Germany is much lower than that of the United States and Britain. Consequently, what the future might hold for the relationship between employee shareholding and corporate governance depends to a large extent upon the employees and whether they decide to use their financial influence to shape corporate decision making. [121]

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116 Ibid 88-89.

117 Sadowski et al, above n 103, 36-38.

118 Ibid 39-41.

119 Ibid 63-64.

120 O'Sullivan, above n 85, 189-190.

121 Ibid 193-194.

VII.II THE JAPANESE SYSTEM OF CORPORATE GOVERNANCE

Unlike the Anglo-Saxon model of corporate governance, Japanese society believes that the corporate profits should not only go to the shareholders, but also to customers, the local and national community and to employees, who are termed the *shain* ("members of the firm"). [122] Araki notes,

> companies in Japan are administered for employees' interests. … (P)riority of access to the companies' assets is given in the following order: 1) creditors; 2) regular workers; 3) management; 4) shareholders; and, lastly, non-regular workers. … (W)orkers have priority over shareholders and even over management. … (This is because) the contributions and risk exposure of the core employees are greater than those of shareholders, and … employees invest a hidden contribution via the seniority based wage and retirement allowance system. [123]

The stakeholder model in Japan therefore relies more on customary practices than on an institutionalised legal system such as that found in Germany. [124] Importantly, it has been noted by Perry that sophisticated technology is not the primary source of competitive advantage for Japan. Japanese manufacturing instead emphasises aspects, such as devotion to the company and lifetime employment. A main feature of Japan's approach to mass production is to manufacture only as and when needed. This approach contrasts with Western mass production, which generally keeps employees and machines in continuous production. By the 1980s, Western industrialists were eager to learn from Japan, as they believed that this was now imperative for their survival. Thus, Japanese work practices have been so important because Japanese businesses have been very successful. [125]

Moreover, Jacoby identifies six main features of Japanese-style corporate governance. These are

> stable shareholders, an emphasis on steady payment of dividends, heavy reliance on banks for debt financing, internal labour markets for managers, managerial pay cuts to protect employee jobs and a stakeholder ethos that includes employees as a key bloc. … While Japan never went as far as Germany in giving employees a voice inside firms, nearly all large Japanese companies today continue to have

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122 Dore, above n 56, 165-166.

123 Araki, above n 89, 67.

124 Ibid.

125 M Perry, C Davidson and R Hill (1995), *Reform at Work: Workplace change and the new industrial order*, Longman Paul Limited, Auckland, New Zealand, 3.

> enterprise unions that are involved to varying extent in strategic issues such as restructuring and technological change. [126]

Araki believes that both German and US law has influenced Japanese corporate law and, as a result, displays unique features of each. He notes that the Japanese Commercial Code of 1899 adopted a monitoring structure based upon German law, which consists of both managing directors and auditors. In this way, the general shareholders' meeting appoints the auditors and the board of directors, both of which supervise and monitor the directors that the board appoints. [127] The board and the representative directors have "real power" of governance. Furthermore, 75.6% of board members are promoted from within a company and not hired from the outside. The remuneration gap between employees and board members is narrow. Thus, the averaged annual remuneration paid to board members is only about nine times greater than those salaries paid to entrants who have graduated from universities. [128]

As Araki points out, however, there are major differences between the German supervisory board and the Japanese auditor system. The German supervisory board, depending upon the size of the company, consists of employee and shareholder representatives. However, the Japanese auditor component of the corporate governance system does not include employees. Secondly, although the German supervisory board may perform both auditing functions as well as being permitted to monitor its business administration, Japanese auditors may only carry out their auditing duties. [129]

Furthermore, according to Wei,

> the Japanese corporate economy has become an economic miracle within a short time. … The Japanese corporate system has developed by importing organisational models, managerial methods and production and distribution technologies from the West, with necessary adjustments and adaptations, into a fundamentally different social and economic environment. Considering the success of this process, the Japanese corporate system provides another significant model that is admired by other systems. [130]

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126 Jacoby, above n 23, 17.

127 Araki, above n 89, 74.

128 Ibid 74-75.

129 Ibid 77-78.

130 Wei, above n 4, 148.

Almost every Japanese corporation has a 'main bank' relationship, which is not only its largest lender, but also one of its largest shareholders. [131] Consequently, banks play a central role in Japanese corporate governance. [132]

Jacoby believes that in Japan and Germany, enterprise unions and co-determination fit well with the stakeholder system of corporate governance. This is because this system does not elevate its shareholders to a privileged status. The long-term relations that the corporation has with banks, customers and suppliers encourage the establishment of permanent employees by, for example, promoting training programmes. In the United States, however, employer training investments are much less than in Germany or Japan. Thus, there is little involvement of employees in corporate governance other than in unionised firms. [133]

Araki refers to the Top Management Survey [134] to point out that only 8.5% of respondents support the notion that the corporation belongs to its shareholders whilst 85,8% believe that the shareholders are not the only stakeholders in the corporation. Araki suggests that in Japan this factor encourages cooperative labour and improved management relations. [135]

Additionally, in Japan corporations exist to advance the interests of the whole nation.[136] Thus, Japanese companies maintain employment stability with lifetime employment. This encourages employees to be loyal. Through a policy of lifetime employment, the personal improvement and social status of employees are inextricably intertwined with the prosperity of their companies. [137] Therefore, the Japanese system has two characteristics. Firstly, nearly all the members of the board are insiders and the directors are appointed from the management ranks. Secondly, shareholders are passive owners. Thus, most of the shares of a company are held by banks and related companies with strong business ties to the company. [138]

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131 Ibid 151.

132 Ibid 19.

133 Jacoby, above n 23, 19-20.

134 Interim Report, 127 Rengo Soken Report Dio 19 (1999).

135 Araki, above n 89, 66-67.

136 Wei, above n 4 at 19.

137 Ibid.

138 RAG Monks & N Minow (1995), *Corporate Governance*, Blackwell Business, Massachusetts, 272. See also Y Wei, above n 4, 19-20.

Thus, in Japan, shareholders tend to be more friendly and passive than their contemporaries in the West. This means that, in Japan, control exists not through hostile bids and the replacement of ineffective managers, but through career employment and a managerial promotion system. The best managers become the company directors with a seat on the board. They are the directors that are trusted by the other stakeholders of the corporation, including the banks, customers, suppliers and the employees. [139]

Jacoby, however, believes that Japan's approach to corporate governance resembles the stakeholder system of governance, which characterises continental Europe. There is a preference for "voice over exit". There are also expectations (and not regulations) that a company should be responsible to employees and suppliers, as well as its shareholders. Thus, these practices are not legally enforceable, but are regularly and widely applied. [140]

Araki endorses these sentiments, noting that job security is an important priority in Japanese corporate governance. Thus,

> (e)mployees in Japanese companies are not merely seen as a factor of production that can be adjusted in accordance with fluctuating economic needs. Instead, corporations treat employees as important constituents. … (Firstly) employment security is provided for not by legislation, but rather by case law. … (Secondly) … Japanese case law sets stringent restrictions on economic dismissals. … (Therefore) major companies refrained from resorting to employment adjustment through dismissals.[141]

Furthermore, it can be said that the economic situation of a particular system can determine the basic appearance of its corporate governance system. [142]Additionally, national culture is another factor that significantly influences the development of a corporate governance system. [143] Corporations comprise people of different cultures with different behavioural norms and values. For example, the group and cooperative approach of management existing in Japanese firms, have deep roots in Japanese culture. [144] Thus, there is a distinctive corporate group system in Japan and most Japanese companies survive collectively. [145]

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139 Jacoby, above n 23, 20.

140 Ibid 13.

141 Araki, above n 89, 79-81.

142 Wei, above n 4, 21.

143 OE Williamson, "Transaction cost economics: the governance of transactional relations", (1979) *Journal of Law and Economics*, Vol. 22, 239-242. See also Y Wei, above n 4, 21.

144 Ibid 21.

145 Ibid 149.

As noted previously, the Japanese board is a type of hybrid and is mainly composed of insiders. It has a statutory auditor (*kansayaku*), which has some of the functions of the supervisory boards of German companies. A listed company has from one to three statutory auditors who supervise the board and its management of the corporation.

It can be suggested that the Japanese corporate system stands somewhere between a one-tier and a two-tier board system. Although it has one board and a "supervisory organ", its "supervisory organ" is not the same as the supervisory board found in the German corporate system. [146]

Most members of the board of directors have come through to the board after holding lower ranks in the corporation. Other people joining the management board of directors are ex-employees of banks or ex-employees from affiliated companies or governmental ministries. Thus,

> (i)n Japan, there is a common understanding that companies, as social institutions, are actually owned by employees and run in their best interests. Employees join firms after school … and are supposed to stay with the companies until retirement. Their living, professional achievements and life accomplishments are all connected with the success of the companies. [147]

In Japan, rewards for employees tend to be calculated in accordance with their ages and their length of service. [148] Therefore, Araki believes that almost half of the board members are currently "directors-with-employee-function". This means that Japanese companies have established a channel to allow employees an opportunity to voice their opinions to corporate management. [149]

Wei notes that Japanese corporate governance is characterized by having features of 'groupism', 'familism', lifetime employment and national service rather than profit maximisation. [150] In this way, joint labour-management consultation has become

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146 Ibid 150.

147 Ibid 151.

148 Ibid 154.

149 Araki, above n 89, 87-89.

150 Wei, above n 4, 179.

> an established practice in Japanese industrial relations. … Japanese labour and management learned from their bitter confrontations that adversarial relations benefited neither party and found that by establishing cooperative relations and enhancing productivity, they could change a zero-sum game into a win-win game. [151]

Finally, Araki refers to the fact that from April 2003 it was possible in Japan for companies whose capital was more than five hundred million yen or whose debt was greater than 20 billion yen to adopt an American-style of corporate governance in place of the traditional Japanese corporate governance model. However, according to the survey of about 1100 companies conducted in April 2003, only four of them had sought to adopt this option. Therefore, most companies intend to keep the traditional corporate model firmly in place. [152]

VII.III THE FRENCH SYSTEM OF CORPORATE GOVERNANCE

France has unique features of corporate governance in terms of which the French government is linked to French business. There are various types of French companies in operation. The two main types are the *Societés anonymes* (SAs), which are public companies similar to the AG's in Germany. Any French company with shareholders that exceed fifty in number must be incorporated as an SA company. These companies must have a capital base of at least FF 250,000. The other type of main company, which operates in France, is the *Societés a responsibilité limitée* (SARLs). There companies are limited liability companies similar to the GmbH in Germany. These companies must have shareholders, which do not exceed fifty in number and must have a capital base of at least FF 50,000.

As mentioned previously, very uniquely in France there is a choice between two types of corporate governance systems. These systems comprise the unitary board or two-tier board structures. The unitary board structure, which characterises the traditional French system of corporate governance, consists of two main components: the *président directeur-général* (PDG) and the board (*Conseil d'Administration*). The PDG is elected by the board, which, in turn, is elected by the shareholders. The PDG has the only right to represent the company, a right, which cannot be delegated. The PDG has *greater* power than the CEO in the USA or in the UK.

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151 Araki, above n 89, 85-86.

152 Ibid 91.

The other type of governance system for companies is to have a system of corporate governance based upon the two-tier approach, which incorporates the additional supervisory board structure. This system, introduced by the French government in 1966, is similar to the two-tier approach found in Germany comprising the *Vorstand* and *Aufsichtsrat*. However, it is arguable that German supervisory boards take a more proactive role than the French supervisory boards to ensure that the management board performs competently. Consequently, it seems that the supervisory boards of French Companies have less authority and power than the supervisory boards of German companies.

A corporation may, at any time, *change* from the unitary board structure to the dual board structure and visa versa, provided that it calls an extraordinary general meeting and, at such meeting, acquires a two-thirds majority of votes in favour of the change called for.

The main reason why another model of corporate governance was introduced into France was *primarily* due to the differing personalities of people. It was thought that the personalities that could not fit within the traditional, older structure would fit within the newer, more modern version. In this way, it is logical to offer alternatives to fit people rather than force people to fit a single type of structure. Thus, those problems that are associated with having problematic personalities in control with executive powers could be easily solved.

VIII. A new model of corporate governance for South Africa

As we saw in part VIII above, there are sound features of stakeholder participation that characterise the German, Japanese and French systems of corporate governance. These features are fully discussed in chapters 8, 9 and 10 in so far as a new model of corporate governance for South Africa is proposed.

"While Anglo-American systems are moving to adopt a wider conception of stakeholder interests," [153] a corporate governance model for South Africa is

[153] Wei, above n 4, 19.

proposed, which takes into account the rights and interests of the other stakeholders of the corporation. More specifically, in this model, a structure will be created, which will bring the employee into the decision-making processes of the corporation at board level. Thus,

> (c)orporate development has come to the stage where human capital or employees play an important role in creating and increasing corporate value. Employees physically own companies, the outcome of corporate performance directly concerns their interests. [154]

This provides additional recognition that South Africa needs to have a corporate system in place where employees are able to play a dynamic role in corporate governance. Jacoby endorses these sentiments. He notes,

> ... many types of employee voice are associated with better firm performance, which is hardly surprising given that employees possess inside information about inefficient processes and ineffectual managers, and are at least as motivated as shareholders to see that the firm is run effectively. ... Voice and civic values are associated with equity in the distribution of economic rewards and equity, in turn, is associated with higher long-term growth rates. ... So, perhaps, this is one of those rare moments of modern global capitalism where the odds have shifted a bit to favour employees. [155]

However, it is to be noted,

> (e)ven after a sound model is adopted work is still needed, because there are always gaps between theories and practice. These gaps have to be filled by informal rules and norms shaped by tradition, culture and customs. In fact, peoples' social relationships and behaviour are more greatly influenced by such informal rules and norms. Any law cannot completely reflect reality, cannot predict all foreseeable events and cannot extinguish language obscurity. Moreover, a law usually lags behind social development. [156]

Wei notes that two elements are required to determine the effectiveness of any model of corporate governance. Firstly, an institutional framework of economic efficiency is required. Secondly, institutional changes must take into account particular conditions, which include economic, political, cultural, historical and legal factors. Both elements must be balanced to have an effective model of corporate governance. It is also essential that the proposed model is efficient and effective. Different systems of corporate governance have developed distinctive characteristics based on different styles of capitalism and cultural and legal traditions. It is, therefore, important to identify and examine those economic, political and cultural

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154 Ibid 25.

155 Jacoby, above n 23, 30-32.

156 Wei, above n 4, 4.

determinants that would play a significant part in shaping a corporate governance system. A sound system of corporate governance can only help to produce a sound outcome of economic performance. A desirable corporate governance system only works in a competitive economy. To adopt a model, which provides insufficient consideration to the special social conditions of a particular society would be undesirable (not to mention disastrous). Thus, the most desirable option is a model, which represents the best economic efficiency after balancing the economic benefits and the cost of introducing the new model. It is also highly recommended that the workers' involvement in corporate governance be increased to a significant level. [157]

Thus, the most significant advantages of comparative corporate governance research are a consideration of the "best characteristics of alternative corporate governance systems". These characteristics are then added to one's own corporate governance system "taking into consideration tradition, history, culture and the local corporate law". [158]

It is along these lines that a new model of corporate governance for South Africa has been developed. The study concludes with an appendix discussing the recommendations and proposals of the Department of Trade and Industry. These proposals highlight the fact that corporate reform will commence in 2006 with the introduction of a *new* South African *Companies Act*. [159]

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157 Ibid 175-207.

158 JJ du Plessis, "Reflections on some recent corporate governance reforms in Germany: A transformation of the German *Aktienrecht*?" (2003) 8 *Deakin Law Review*, 384.

159 Department of Trade and Industry (DTI) South Africa policy document, "South African Company Law for the 21st Century: Guidelines for Corporate Law Reform", May 2004, <http://www.dyi.gov.za>.

CHAPTER 1:

(1.0) THE COMPANY – A DISTINCT LEGAL PERSONA: TRADITIONAL THEORIES AND PRACTICES; PROBLEMS AND NEW STRATEGIES

Debate about how South Africa should proceed to develop its corporate governance mechanisms to improve employee/employer and other stakeholder relations is increasing. However, very little has been translated into actual practice. This thesis sets out to develop a workable solution to South Africa's corporate governance problems, especially in relation to employer/employee relations. Sources of useful information and examples of more progressive situations are drawn from various writers and international models of corporate governance. There will be *inter alia* politico-social and legal ramifications. Any destabilisation caused by these factors, however, is likely to be far outweighed by the benefits that would be achieved. The essential elements and functions of corporate governance, theories of corporate law, sources of power, various perspectives and conceptual frameworks distinguishing the different types of companies will assist directors in determining the basis of governance within any type of corporation.

In this chapter I will examine the traditional conception and governance of the company in South African company law contrasting it with conceptions in other jurisdictions. It is seen that the South African model of corporate governance is anachronistic and needs to be reformed. As mentioned in the introduction, particular

attention should be paid to the advantageous features of the corporate governance systems of Germany, Japan and France in the design and formulation of a new model of governance for South Africa. In this way, South African company law would be able to leave behind its traditional concepts that plague it and which enshrine the primary goal of the corporation as one that maximises shareholder profits. In light of the above, this chapter discusses the problems associated with traditional company law doctrines, its classification of companies and sources of corporate power and its conceptual frameworks as applied to matters of corporate governance.

Furthermore, with regards to the current problems of classification of company types in South Africa, it has long been argued that private companies should be abolished due to the introduction of the close corporation. It is therefore a concern that South Africa still retains the distinction between private and public companies even though close corporations now exist for small business entrepreneurs. Thus, the necessity to adhere to traditional statutory distinctions between private and public companies should be questioned.

(1.1) Introduction

> Since the mid-1980's … corporate governance has been seen as a key element relating to the performance and economic efficiency of the enterprise system. [160]

Tricker in a personal interview captures a remark of Lord Caldecote, which establishes one of the most essential points of this thesis. He notes,

> (t)he trouble with British companies is that the directors mark their own examination papers. [161]

Directors, in many jurisdictions, still dictate the extent to which they run their corporations. They also dictate the extent to which the members or shareholders of the corporation, as well as the other stakeholders of the company, actively participate in corporate governance processes.

Fleming emphasises the promotion of a sound corporate governance relationship between the various stakeholders of the corporation. Moreover, he states that relationships exist within the corporation between the management and other employees, depending upon the corporation's organisational complexity. In addition, there are relationships that exist with other stakeholders, including the suppliers, customers and the community. Therefore, the corporation has a relationship with the community, which encompasses responsibilities in terms of it being a 'good' corporate citizen. [162]

Generally, regarding the methods used to run companies, there have been numerous proposals for change outlined in recent literature, which have been discussed in this thesis (see *inter alia* parts VII and VIII of the introduction section and 2.5, 4.3, 6.3, 6.5, chapters 7, 8 and the appendix). This has led to significant re-evaluations with respect to corporate governance practices and therefore a rethinking of the traditional, conservative conceptual frameworks established by the Companies Act found in many countries, including South Africa.

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160 DC North (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, New York, 69. See also Y Wei, above n 4, 212.

161 Tricker, above n 8, 1.

162 G Fleming, "Corporate governance in Australia", (2003) *Agenda. A Journal of Policy Analysis and Refor*m, Vol. 10, No. 3, 196-7.

As mentioned previously, corporate governance mechanisms exert significant direction and control over corporations. Wei suggests that the main aim of corporate governance is to improve the economic efficiency of the corporation. Different views exist on how this may be attained. In accordance with the Anglo-American system the corporation should exist only to maximise shareholder profits. However, other systems take relevant social interests into account, including the welfare of employees. Consequently, the approach of regarding the primary goal of the corporation as maximizing shareholders' profits is subject to increasing scrutiny. Thus, the corporation must also give consideration to other goals such as gaining bigger market shares, long-term survival, satisfactory and secure profits, technological leadership and attaining a good image. Consequently, in addition, corporations must give attention to stakeholder groups such as employees, creditors, banks and consumers. Shareholder profits should not be obtained at the expense of social interests and should not allow an overall loss of wealth to exist for the community. This is because a corporation must be beneficial to the public as a whole. Therefore, the employees, the board of directors, management, consumers, creditors, suppliers, unions and the government are all to be regarded as stakeholders along with the shareholders. Consequently, the corporation should be seen as a "multipurpose organisation", which balances the interests of the various stakeholders. Hence, the corporation cannot be in existence merely to maximise investors' profits. It is important that the economic efficiency of the corporation is measured on a basis, which would ensure the long-term prosperity of the corporation and improved social wealth and welfare. [163]

Cannon, who notes that business, government, academia and the wider society shape corporate responsibility, further elaborates upon this concept. Consequently, in summary, the affairs of the corporation should focus upon five broad areas, which are:

1. Its social, economic, ethical and moral responsibilities;
2. Its compliance with the legal and voluntary provisions and practices for business;
3. Its effects upon the environment;
4. The challenges created for it by providing for the economically and socially disadvantaged groups; and

[163] Wei, above n 4, 44-45.

5. The management of its corporate responsibility activities towards other businesses. [164]

(1.2) Theories of corporate law

Corporate law can be described in terms of four different theories: the organic, fiction, contract and economic theories.

Succinctly stated, the *organic theory* describes a corporation as a "real being in society". The theory is concerned with the question of how a corporation can be "real" and even attempts to define "the soul and the brain of the corporation". On the other hand, the *fiction theory* describes a corporation as that which has been created by law and is therefore of an artificial and fictional design. It therefore possesses only those properties and rights, which have been conferred upon it by law or are incidental to its existence. Some people also described this theory as being evasive, as it does not provide any definition of a legal person. However, both theories are influential in Western systems, although neither has provided a definitive answer of what a corporation is. [165] Therefore, the two theories share a common theme, which both focus upon the corporation itself instead of on the shareholders. The *contract theory*, however, regards a corporation as a 'nexus of contracts'. [166] Thus, the theory supports the view that the State should interfere with corporate activities in a minimal way. The law should only intervene when people act irrationally. [167]

This theory does not, however, provide a definition of what a corporation is. It is argued that a corporation cannot merely be a "collection of contracts". [168] Thus, describing the corporation as a "nexus of a set of contracting relationships among individuals" is "seriously misleading" because "the firm is not an individual". Furthermore, it has been noted that the "nexus of contracts" approach, which

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164 T Cannon (1994), *Corporate Responsibility: A textbook on business ethics, governance, environment: roles and responsibilities*, Longman Group UK Limited, Great Britain, 4.

165 M Wolff, "On the nature of legal persons", (1938) *Law Quarterly Review*, Vol. 54, 509. See also Y Wei, above n 4, 5.

166 MC Jensen & WH Meckling, "The theory of the firm: managerial behaviour, agency costs and ownership structure", (1976) *Journal of Financial Economics*, Vol. 3, 311.

167 Wei, above n 4, 5.

168 Ibid.

suggests that the corporation is engaged "in a series of unrelated bilateral arrangements with various parties" having "no relationship with each other", is inaccurate for two reasons. Firstly, this approach excludes the interests of involuntary and passive stakeholders who may not have a contractual relationship with the corporation. Secondly, this approach does not recognise that all stakeholders are in fact linked indirectly with one another. [169]

On the other hand, however, Strikwerda believes that the corporation, as a legal entity, should be changed into one, which comprises a nexus of contracts. [170]

O'Connor points out, however, that in the "nexus of contract" approach, corporate law seeks to maximise shareholder profits. [171] O'Connor notes that this model is dependent upon various relationships, such as those between the shareholders, employees, suppliers, customers and the community. In this way, the focus is on the relationship between shareholders and managers. Therefore, management's main duty would be to maximise the wealth of the shareholders that are the owners of the corporation. Thus,

> employees are assumed to lack the business acumen to participate in board decision making and are best left to provide information, if at all, on the shop floor within their teams. Thus, this model does not examine the possible efficiency benefits of worker participation under different corporate governance systems. [172]

Davies, however, believes that the nexus of contract theory is "more favourable" than a shareholder ownership theory where employees are given rights of control. He notes,

> control rights for employees constitute a challenge to the sanctity of property rights. Under the nexus of contracts theory, the company stands as a sort of central counter-party, through which each of the groups whose long-term commitment to the business is essential for its successful contract with each other. … The position of the shareholders is no longer automatically privileged as it is under the shareholder ownership approach. [173]

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169 JE Post, LE Preston and S Sachs (2002), *Redefining the Corporation: Stakeholder management and organisational wealth*, Stanford University Press, Stanford, California, US, 23.

170 J Strikwerda (2003), "An entrepreneurial model of corporate governance: devolving powers to subsidiary boards", *Corporate Governance*, Vol. 3, No. 2, 50.

171 O'Connor, above n 72, 100.

172 Ibid.

173 Davies, above n 67, 138.

Wei suggests, however, that the organic theory, which is widely accepted in continental Europe, treats a corporation as a social being with a life, in a similar manner to a human being with a body. This theory attempts to link particular "organs" of the corporation with certain physical organs of a human being. The main problem with the organic theory is its "unscientific approach". Therefore, this theory does not deal with the issue pertaining to the nature of the corporation. However, in terms of the fiction theory, a corporation has the legal capacity as if it were a natural person. Thus, a corporation is analogous to a human being in some respects, but non-human in others. Thus, the common law only gives the rights of a real person to a corporation, as it deems necessary. Another approach is to treat a corporation as a contractual arrangement. In this way, the theory describes the corporation as a "private arrangement of individuals contracting with each other". [174]

Additionally, according to the *economics theory*,

> … the firm exists because economic transactions use the price system and there are costs of using it and it provides a means of internalizing market transactions, which reduce transaction costs. [175]

In other words, companies with limited liability can raise funds from the public through share subscription. Such economic transactions make the separation of ownership and control possible. Consequently, to judge economic efficiency, it is important to decide in whose interests a corporation should be governed. Thus, in Anglo-American systems, such as the US and UK, it is believed that corporations should maximise shareholder profitability. In Germany and Japan, however, corporations are viewed more as entities, which have "social welfare" and the "public good" among their central aims. [176] Therefore, as noted by Wei,

> (i)f we see the corporation as a social or state creation, it should exist for the good of society. … If we see the corporation as a nexus of contracts, it is logical that attention should be given to the overall relationship among contractors including shareholders, managers, creditors, debtors, employees, suppliers and consumers. … From an economic point of view, efficiency should be aimed at an overall increase in the wealth of the community. The key is whether the increase in the owner's wealth represents the overall gain of society. … [177]

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174 Wei, above n 4, 40-41.

175 Ibid 5.

176 J Kay & A Silberston (1997), "Corporate Governance" in FM Patfield (ed), *Perspectives on Company Law*, Kluwer Law International, Vol. 2, 58. See also Y Wei, above n 4, 6.

177 Wei, above n 4, 6.

This suggests that the economics theory is arguably the most comprehensive and useful basis to describe the nature of the corporation. This is because it uses economic rationality to do this, which places "the theory on solid ground". [178]

(1.3) Corporate governance applied to modern companies

A joint-stock company is defined as

> (a)n unincorporated association of individuals possessing common capital, the capital being contributed by the members and divided into shares, of which each member possesses a number of shares proportionate to the member's investment. (It is also) (a) partnership in which the capital is divided into shares that are transferable without the express consent of the partners. [179]

The joint-stock company or association had an early development in English company law. The term was used to distinguish companies operating "on a joint stock account and with a 'joint-stock' (in trade) of their members" from those companies where each member traded in a "separate account (and) with one's own stock in trade". In America, the joint stock association is generally an unincorporated business entity "with ownership interests represented by shares of stock". [180]

Historically, the joint-stock company, with its limited liability for its shareholders, was a simple, yet highly successful concept that arose during the mid-nineteenth century. It facilitated the provision of capital, encouraged business growth, secured employment and created wealth. [181] Ownership was the basis of power and was exercised through meetings of the shareholders of the company. Incorporation of joint-stock companies was a special state privilege and only a few businesses would attain this status. Joint-stock companies, in effect, became an extension of the domestic guild to overseas trade. As such, their main purpose was to acquire a monopoly in a particular trade. Therefore, incorporation was not commonplace during this period. Nonetheless, important concepts in corporate law evolved,

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178 Ibid 42.

179 *Black's Law Dictionary*, 8th edn, 2004, BA Garner (ed), Thomson West Publishing Co, US, 298.

180 Ibid 298-9.

181 Tricker, above n 8, 2.

including features of modern day corporations such as perpetual succession, separation of its acts from those of its members and the transferability of shares. [182]

Companies today, however, no longer incorporate joint-stock companies. Many companies are too small and are controlled by the owner who is often the manager. Others are vast, highly complex and operate internationally by having hundreds of subsidiaries and associate companies in their group. This suggests that, on the whole, the practices and structures of modern business can no longer reflect the underlying concepts that were characteristic of the joint-stock, limited liability company. Furthermore, it has been suggested that economic efficiency is a principle factor for measuring corporate performance. This is because a main objective of corporate governance is to improve the corporation's economic efficiency. [183] Hence, joint stock companies are outdated because they are no longer economically efficient.

Fleming observes that with regard to corporate governance in Australia over the last forty years, the question of the

> (s)eparation between ownership and control has been a relatively recent characteristic of firms in Australia. … Australian companies in the first half of the twentieth century were best described as 'family capitalism' with important director and managerial positions held by a close-knit group. … The nature of the separation of ownership from control changed in the second half of the twentieth century. [184]

This has precipitated a need to rethink the basic conceptual framework upon which companies in modern society are based. In the past there was little challenge to management's power to run the company. [185] There was virtually no demand for independent supervision or disclosure, no intervention in matters of accountability, no questioning of corporate power and legitimacy and little interest in the involvement of or the participation by other stakeholders in management decisions. Today, however, there is widespread concern in matters of corporate governance from all stakeholders from both within and outside the enterprise, especially with regard to corporate accountability, regulation and public policy.

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182 Wei, above n 4, 38.

183 Ibid 5.

184 Fleming, above n 162, 198.

185 Tricker, above n 8, 5.

According to Fleming, during the last forty years in Australia, there have been three noticeable changes in corporate governance mechanisms. These are the amount of share ownership by directors and managers, the structure, size and composition of the board of directors and the number of shareholders having more than five percent of the shares. [186]

These issues are taken into account in developing a model of corporate governance for South Africa, which allows and establishes effective participation in matters of concern by all of its stakeholders. Thus,

> … in a corporation there are other stakeholders who are also rational beings, and their interests may not coincide with those of investors. The fact that corporations cannot prosper if economic inequities imposed on certain interested groups persist suggests an unfavourable response (to the idea) that corporations exist only for shareholders' interests. In reality, most corporations in developed countries pursue multiple goals. [187]

In this regard, because a corporation is comprised of individuals with different interests, [188] a model of corporate governance, which attempts to provide for the active participation of all the stakeholders within the corporation, especially the employees, in the enterprise's decision-making processes, is needed.

Tricker believes that issues of governance that might arise are considered to be *external* to managing businesses. [189] He submits that the management role has been primarily perceived as running the business operations efficiently and effectively. The governance role, however, is not concerned with running the businesses of the company but with controlling the executive actions of management and regulating interests beyond the corporate boundaries by focusing on corporate accountability. Therefore, as noted by Tricker, if management exists to run the business, governance should exist to ensure that the business is run properly. That is, *all* companies require governing as well as managing. [190]

In this regard, however, Tricker's argument is not entirely convincing. Policies of corporate governance in today's world are *also* concerned with management processes. This means that it is *also* concerned with the actual running of the

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186 Fleming, above n 162, 201.

187 Wei, above n 4, 6.

188 Ibid.

189 Tricker, above n 8, 6.

190 Ibid 7.

business itself, not only ensuring that the business is run properly. Corporate governance policies generally seek to ensure (or should seek to ensure) that adequate operating mechanisms in the corporation exist by which directors and the other participating stakeholders may effectively and profitably run the affairs of the enterprise. It is therefore difficult, if not impossible, to completely *separate* issues of management and governance, as propounded by Tricker. The two issues are inextricably linked and work in tandem. Thus, as emphasised by Wei,

> … attention must be given to corporate direction and management. This is a game of balancing power. Corporate direction and management play the key role in continuing the game. In this game, we need to identify the players, the rules of the game and the incentives for each player to continue the game. Strictly, corporate governance, as a system of directing and controlling the corporation, involves shareholders, the board of directors (or supervisory board) and managers. Generally, corporate governance should involve all stakeholders including shareholders, directors, managers, employees, creditors and consumers. … The rise of the German and Japanese corporate economies has shown the importance of employee participation in corporate governance. [191]

(1.4) Processes of corporate governance

According to Tricker, the processes of corporate governance entail four principal functions:

1. *Direction*: Corporate governance policies must formulate the strategic direction for the future of the enterprise;
2. *Executive Action*: Corporate governance policies must refer to any issues involving crucial executive decisions;
3. *Supervision*: Corporate governance policies must monitor and oversee the performance of management; and
4. *Accountability*: Corporate governance policies must recognise the responsibilities to those stakeholders who demand accountability. [192]

In line with the focus of this thesis, a fifth criterion could be added:

5. *Management:* Corporate governance policies must seek to ensure that adequate operating mechanisms in the corporation exist (preferably at the

[191] Wei, above n 4, 6-7.

[192] Tricker, above n 8, 7.

> commencement of the business) by which directors and the other participating stakeholders may effectively and profitably run or manage the affairs of the enterprise.

Corporate governance involves the use and limitation of powers and identifies rights and responsibilities, legitimises actions and determines accountability. Hence, corporate governance policies should not only be concerned with the direction and management of power, but also with the supervision, control and accountability of executive actions. As such, it needs to take into account the effect of the business on other parties, the acceptance of a duty to be accountable and the regulation of the corporation, which ensures that it complies with legislation and its internal corporate governance policies. [193]

Although scant attention had been paid to governance prior to the 1980s, the expectations and demands of modern corporations necessitated changes in traditional company law concepts. In effect, corporate governance has become a 'buzzword' and is as important to companies as personal computers are to households.

Furthermore, Tricker notes that there are two main reasons for adopting corporate governance policies:

1. To regulate companies in society. In this way, corporate governance policies prevent abuses of corporate power without necessarily inhibiting flexibility. It allows innovation and entrepreneurial risk-taking; and
2. It also improves the quality of board activities and for making the boards more effective. [194]

In the model of corporate governance developed in this thesis and presented in chapter 9, the manner in which the boards ought to be composed will be discussed.

(1.5) The underlying concepts

[193] Ibid 8.

[194] Ibid.

It is a known precept of company law that the company has a separate legal persona, may sue and be sued and may also, in its own capacity, contract and own property. Consequently, Tricker believes that the corporation would

> (bear) … as much resemblance to the reality of the modern corporation as a hang-glider does to a Concorde. [195]

This view is very accurate. Thus, all business entities today, despite their size or composition, should have corporate governance processes in place, which seek to allow the participation of the various stakeholders in the running of the enterprise to varying degrees. Otherwise, business entities would be applying anachronistic governance policies, which would more than likely be ill-suited to real-world situations. In this regard, the extent to which employees should be permitted to participate in the corporate affairs by having seats on the board is significant. Thus, Fleming notes that the size and composition of the board is a significant factor of the governance process and that the corporation's ability to perform effectively is dependent upon this factor. [196]

(1.6) Corporate governance applied to different companies

(1.6.1) PUBLIC COMPANIES

Tricker notes that with modern public companies, traditional legal models do not adequately reflect corporate governance processes. This is because shareholders may be geographically dispersed and have vastly differing shareholdings. Some shareholders may also influence matters directly without involving others. Furthermore, much power vests in the board and particularly its chairman, which means that boards become inadequately accountable. Hence, many of the stakeholders, including the member shareholders, suppliers, creditors, customers and even employees, are excluded from participating in the processes of governance of the company. [197]

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195 Ibid 13.

196 Fleming, above n 162, 201-202.

197 Tricker, above n 8, 15.

Thus, a suitable model of corporate governance for South Africa would allow shareholders to be viewed as part of the general group of stakeholders, rather than as the traditionally isolated separate class. In other words, the shareholders would then be seen as only one of the stakeholders that directors take into account when initiating and implementing corporate governance programmes. As well as shareholders, employees of the corporation would be able to participate in the decision-making processes of the organisation. All stakeholders in the corporation need to be able to co-operate for common and individual interests. A good system of corporate governance would be one that pursues the goal of increasing total wealth for all its stakeholders and avoids the emergence of any economic losers amongst the corporate participants. Moreover,

> (a)ny theory of corporate governance must have respect for the historical precedents and the economic, political and legal realities, as well as the social (that is the effects of the corporate entity on and in society) and the individual (that is the effects for and on people) implications. Otherwise it will be irrelevant. [198]

(1.6.2) SUBSIDIARY COMPANIES

A subsidiary company in Australia is defined as

> (a) company under the control of another company. For the purposes of the (Australian) *Corporations Act 2001*, a body corporate is a subsidiary of another body corporate if the body corporate controls the composition of the board of directors of the subsidiary, or is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the subsidiary, or holds more than one-half of the issued share capital of the subsidiary (excluding any part of the issued share capital that carries no right to participate beyond a specified amount in distribution of profit or capital) … A body corporate is also deemed a subsidiary of another body corporate if it is a subsidiary of a subsidiary of the body corporate. … The control of the board must be actual, rather than de facto, control. … The controlling company is known as the 'holding company'. It may form a subsidiary by acquiring a controlling interest in an existing company, or by setting up a new company retaining a controlling interest. [199]

Tricker notes that the rise of the large and complex groups of companies is an issue, which was not considered by the traditional company law theorists. Consequently, entities, capable of acquiring shares in other enterprises, were created. In the early days of corporate mergers, companies, which aggregated together to form a larger

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198 Ibid 238.

199 *The Encyclopedic Australian Legal Dictionary*, http://w2.vu.edu.au/library/einet/lexisnexisau.html, accessed 8 November 2005. See also the Australian *Corporations Act 2001*, section 46.

corporation, largely disappeared as separate entities. These days, however, groups of companies can be vast and interconnected. There may be hierarchical levels of companies with many subsidiaries, or the company may comprise of interconnected holdings. Some may be wholly owned subsidiaries, while others may have minority outside shareholder interests. [200]

In Australia, a wholly-owned subsidiary is defined as

> (a) subsidiary of a holding company, none of whose members is a person other than the holding company, a nominee of the holding company, or a nominee of such a subsidiary. [201] (Furthermore), (f)or income tax purposes, (a wholly-owned group company is) a company where one of the companies is a subsidiary of the other company and all the shares in the subsidiary are held by the holding company or other 100 percent subsidiaries, or both companies are 100 per cent subsidiary companies of the same company. A wholly-owned group company may transfer a tax loss, a foreign tax credit, a net capital loss, or an asset to another group company. [202]

Similarly, the British (UK) *Companies Act* of 1985 also defines these terms as follows:

> A company is a "subsidiary" of another company, its "holding company", if that company –
> (a) holds a majority of the voting rights in it, or
> (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
> (c) is a member of it and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in it,
>
> or if it is a subsidiary of a company which is itself a subsidiary of that other company. [203]
>
> A company is a "wholly-owned subsidiary" of another company if it has no members except that other and that other's wholly-owned subsidiaries or persons acting on behalf of that other or its wholly-owned subsidiaries. [204]
>
> In this section "company" includes any body corporate. [205]

The English *Companies Act* of 1989 inserted the aforementioned provisions into the 1985 Act as a new section 736. The original section 736 of the 1985 Act was

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200 Tricker, above n 8, 15.

201 *Australian Legal Dictionary*, above n 199, accessed 8 November 2005. See also the Australian *Corporations Act 2001*, section 9.

202 Ibid. See also the Australian *Income Tax Assessment Act 1997*, section 975-500.

203 *British Companies Legislation* (2001), Sweet and Maxwell, London, England, section 736(1), 516. See also C Ryan (2002), *Company Law* 4th edn, Butterworths LexisNexis, UK, 309.

204 *British Companies Legislation*, above n 203, section 736(2), 516. See also Ryan, above n 203, 309.

205 *British Companies Legislation*, above n 203, section 736(3), 516. See also Ryan, above n 203, 309.

different. This definition of the holding/subsidiary relationship gave rise to two main problems. Firstly, it ignored "the fact that control is exercised through voting rights", which did not require any relationship to the number of shares held. Secondly, the old section 736 was also different with respect "to the control of the board of directors". Under the old section, a company was able to control the composition of the board by appointing or removing the majority of directors. Furthermore, even if a company was able to "appoint less than a majority of directors", but were able to appoint those with "extra voting rights", these directors could nevertheless "outvote the other directors". Thus, the real intention of the legislation, which was to regard a group of companies as a single business, for example, for accounting purposes, was avoided. Hence, a new section 736 was inserted into the Act to avoid the previous shortcomings of its predecessor. [206]

A holding company in Australia is defined as

> (a) body corporate that controls the composition of another body corporate's board of directors, is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of another body corporate, or holds more than one-half of the issued share capital of another body corporate (excluding any part of that issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital). Through this control, the holding company may manage the activities of its subsidiaries. Holding companies are required to prepare accounts for all the companies in the group. [207]

In terms of the South African *Companies Act*, the terms "subsidiary", "holding company" and "wholly-owned subsidiary" are similarly defined as follows:

> (3) (a) For the purposes of this Act, a company shall be deemed to be a subsidiary of another company if –
>
> (i) that other company is a member of it and –
>
> (aa) holds a majority of the voting rights in it; or
>
> (bb) has the right to appoint or remove directors holding a majority of the voting rights at meetings of the board; or
>
> (cc) has the sole control of a majority of the voting rights in it, whether pursuant to an agreement with other members or otherwise; or
>
> (ii) it is a subsidiary of any company, which is a subsidiary of that other company;
>
> (iii) subsidiaries of that other company or that other company and its subdiaries together hold the rights referred to in subparagraph (i) (aa), (bb) or (cc).
>
> (b) …

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206 J Dine (2001), *Company Law*, 4th edn, Palgrave, London, Great Britain, 14.

207 *Australian Legal Dictionary*, above n 199, accessed 8 November 2005. See also the Australian *Corporations Act 2001*, sections 9 and 46 and Ch 2M.3 Div 1.

(c) A body corporate or other undertaking, which would have been a subsidiary of a company had the body corporate or other undertaking been a company shall be deemed to be a subsidiary of that company. [208]

(4) For the purposes of this Act, a company shall be deemed to be a holding company of another company if that other company is its subsidiary. [209]

(5) For the purposes of this Act, a subsidiary shall be deemed to be a wholly-owned subsidiary of another company if it has no members except that other company and a wholly owned subsidiary of that other company and its or their nominees. [210]

Therefore, in South African company law, a company will be deemed to be a subsidiary of the holding company if the holding company is a member of the subsidiary company "and holds or controls a majority of the voting rights in it" or if it can appoint or remove directors who hold a majority of the voting rights at the meetings of the board. This "holding-subsidiary" relationship is significant, as it regulates any abuse of control that might arise and also ensures that a proper disclosure of the group's financial position is made. [211] In this way, there is some control over the holding company using its controlling position to compel its subsidiary "to act to its own detriment". According to the common law, however, directors of the holding company do not owe any fiduciary duties to the subsidiary company. Consequently, the shareholders, creditors and other stakeholders of the corporation would not have been able to hold directors of the holding company liable at common law for a breach of a fiduciary duty towards the subsidiary company. Only the directors of the subsidiary company have a fiduciary duty towards the subsidiary at common law. The current *Companies Act* has now amended the common law position to regulate the possible "abuse of control" of directors of the holding company. [212] Consequently, the main purpose of the group annual financial statements is to provide the members of the holding company with a fair representation of the state of affairs of the subsidiary companies at the end of the financial year. Thus, for the purposes of the group annual financial statements, the holding and subsidiary companies are not viewed as separate but rather as one corporate entity. [213] See also heading 2.1.

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208 *Companies Act* 61 of 1973, section 3.

209 *Companies Act* 61 of 1973, section 4.

210 *Companies Act* 61 of 1973, section 5.

211 JT Pretorius, PA Delport, M Havenga and M Vermaas (1999), *Hahlo's South African Company Law through the cases – A source book*, 6th edn, Juta & Co, Ltd, South Africa, 421.

212 Ibid 434-5.

213 HS Cilliers, ML Benade, JJ Henning, JJ du Plessis, PA Delport, L de Koker and JT Pretorius (2000), *Corporate Law*, 3rd edn, Butterworths, 12.

Chapter 13 of the South African *Companies Act* also discusses "external companies". These are companies, which, although incorporated outside of South Africa, establish a business within South Africa. In terms of section 322, an external company must register its memorandum with the Registrar. It can then own immovable property in South Africa. [214] If it is a public company, it may also offer shares and debentures to the public. [215]

In South African company law, a subsidiary company is a wholly-owned subsidiary of another company if it has no other members except those from that other company. In this way, a wholly-owned subsidiary company is treated differently in various respects from a subsidiary company, which is not wholly-owned. For example, in terms of section 117(4) of the *Companies Act*, a wholly-owned subsidiary may mortgage any of its property as collateral security for the issue of debentures of its holding company, whilst a subsidiary company, which is not wholly-owned, can not do this. Furthermore, in terms of section 288(1) of the Act, whereas a non-wholly-owned subsidiary is obliged to disclose its group accounts before the annual general meeting, a subsidiary company, which is wholly-owned, does not do this. [216]

Tricker also points out that in a wholly owned subsidiary, the holding company has *both* an ownership and a managerial function. Hence, the executive directors of the subsidiary, far from being independent, may be obliged to rely on the management structure *throughout* the group when making decisions. Consequently, a wholly owned subsidiary does not automatically enjoy the autonomy enshrined in the classical corporate theory except in those aspects relating to the limitation of liability on the part of the owners. [217]

However, Strikwerda notes,

> … that each corporation is a separate juridical person, even when owned and controlled by another corporation with which it conducts a common business enterprise. … Under this interpretation subsidiaries are legally independent firms and the formal relationship between the parent board and

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214 Section 324. See also EML Strydom (2005), *Company Legislation Handbook 2005 including the Close Corporations Act*, 18th edn, Butterworths, Durban, South Africa and Strydom (1998), *Company Legislation Handbook 1998 including the Close Corporations Act*, 11th edn, Butterworths, Durban, South Africa, 140. See also Pretorius et al, above n 211, 39.

215 Section 142. See also Strydom (2005), above n 214 and Strydom (1998), above n 214, 62. See also Pretorius et al, above n 211, 39.

216 Pretorius et al, above n 211, 422. See also Strydom (2005), above n 214 and Strydom (1998), above n 214, 53, 125.

217 Tricker, above n 8, 17.

the subsidiary is that of shareholder. This statutory approach enables parent boards to co-ordinate the activities of subsidiary firms as if the parent is the direct owner of the assets contained in the subsidiaries. [218]

(1.6.3) PRIVATE COMPANIES

Many private companies are small and have minimal separation between their owners and managers. In owner-managed companies, the owners, themselves take part in the corporate governance programmes in regard to the management of the corporation. Hence, management are able to treat the corporation as its own. However, in other private companies, significant separation may exist between its owners and managers. In these situations, matters of governance would have to be determined especially where a major individual investor wishes to exercise some supervision over an investment. [219]

In South Africa a legal distinction is still drawn between private and public companies. Whether to retain this distinction or not has recently invited much discussion and debate in South African academic circles. In New Zealand, the distinction between these two types of companies has now been abolished. As a result, a new company Act was introduced, which treated these previous company types as one type only. However, *prior* to the 1990s, the situation was quite different. New Zealand corporate law was entirely based upon and followed closely English company law. Although it was suggested that the English acts should no longer be followed in New Zealand, this idea was initially dismissed on the grounds that uniformity within the British Commonwealth should be maintained. Thus, the decisions of English Courts would, at that time, still be applicable in New Zealand in the same manner as they were applied in England. [220]

New Zealand, however, could not maintain this position indefinitely, especially as the populace wanted New Zealand to comprehensively reform its corporate law and to break away from the traditional mould of English corporate law. This resulted in the enactment of the New Zealand *Companies Act 1993*. Under this new Act the traditional distinction between public and private companies was abolished. The aim was to provide a much simpler and cheaper method of incorporation and company organisation, which was flexible enough to meet the needs of many different groups.

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218 Strikwerda, above n 170, 48-49.

219 Tricker, above n 8, 20.

220 Wei, above n 4, 167.

The Act also needed to clearly identify the duties and powers of the various stakeholders within the corporate structure in such a manner that its use was comprehensible "by directors and shareholders and not just lawyers and accountants". [221]

Later in this chapter, the question relating to the extent to which developments in South African company law have created a need to abolish the distinction between private and public companies and to thus reform the current voluminous company act, as has been done in New Zealand, will be examined in greater detail.

In Australia the *Corporations Act 2001* is one of the most complex and detailed in the world. It introduced small proprietary companies into its legislation and has allowed proprietary companies to raise funds from the public under certain conditions. [222] Its *Corporations Act* is voluminous and therefore very burdensome for the small entrepreneur to follow or apply. Therefore, it is not suggested that South Africa embarks upon the course of corporate reform that Australia currently follows.

(1.7) Rethinking the traditional precepts of company law

Some companies' legislation, together with the demands of stock exchanges, has increased the demand on companies for the disclosure of information and the regulation of corporate behaviour. Designed to protect the interests of the stakeholders of the corporation including the creditors, potential investors, employees and others, this protective mechanism has led to the incorporation of a vast number of small companies and also of large international companies. The latter tend to operate through groups of companies with a significant number of subsidiaries at various levels. Hence, as discussed previously, the original, simple and successful traditional concept of wealth maximisation for shareholders no longer mirrors the reality of the modern day corporate world. [223]

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221 Ibid 168.

222 Ibid, 170-171.

223 Tricker, above n 8, 71.

Thus, an alternative corporate framework has to be developed so that corporate governance programmes and policies can be *properly* implemented within all types of business entities.

(1.8) Sources of corporate power

Tricker states that four primary sources of corporate power may be identified. These are:

1. Ownership power within the corporation;
2. The balance of power between the shareholder members and the board of directors;
3. Managerial power; and
4. Institutional shareholders' power. [224]

(1.8.1) OWNERSHIP POWER WITHIN THE CORPORATION

As companies grow and increase their share capital, with more shareholders investing in shares, so the proportion of voting stock, held by the largest shareholders, decreases. Hence, the power of the shareholders to control large corporations effectively diminished. As a result, the interests of ownership and control have diverged and the balance of power has shifted from members to managers. [225] Additionally, the annual general meeting, in many cases, proved to be both inadequate and ineffective for exercising governance where there was a diversity of shareholders, most of whom generally did not attend. Other stakeholders of the corporation were not invited to attend the annual general meeting. Any concerns that they had were generally not heard, as there were no corporate governance policies or programmes in place to allow for this.

Furthermore, disgruntled shareholders (other than the institutional shareholders themselves) seeking to change board policies, tend to be rare, particularly in countries such as South Africa. Even in the United States of America, where

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[224] Ibid.

[225] Ibid 74.

members are generally more active at meetings of public companies, boards may still fail to respond to the wishes of shareholder members. [226] Consequently,

> (m)eetings should zero in on those primary issues of governance, not on issues of executive management. The distinction between governance and management domains is the most misunderstood facet of board conduct. [227]

[226] Ibid 75.

[227] RK Mueller (1992), "Smarter board meetings: For effective nonprofit governance", *National Center for Nonprofit Boards Governance Series Booklet*, 1.

(1.8.2) TESTING THE BALANCE OF POWER BETWEEN THE SHAREHOLDER MEMBERS AND THE BOARD OF DIRECTORS

In both corporate and non-profit organisations, Chait believes that boards, which have sound and workable governance practices in place, generate successful organisations. [228] Thus, to achieve good governance practices, Tricker believes that the *balance of power* between the members of a public company and the board of directors needs to be correct. This factor is tested through a consideration of *seven basic principles*: [229]

(1.8.2.1) Board Membership

Nominations to fill places on corporate boards of management typically originate from the incumbent chairman and are supported by the board. Because shareholder attendance at meetings is often poor, the appointment of new directors is determined by the existing board rather than by the owners (shareholders) themselves. Thus,

> (b)oard meetings are the critical event in which trustees … determine what impact an organisation will have on society. Robert Frost voiced perhaps the best perspective on board members. 'The world is full of willing people,' said the American poet, 'a few willing to work, the rest willing to let them'. [230]

Fleming notes that the board size and composition have always been regarded as important components of the governance process. [231] He states that the board should be composed of both executive and non-executive directors. Executive directors usually hold both a board and a senior management or executive position within the company and are able to bring their wide knowledge of the corporation to board meetings. However, their independence from management may be impaired, as they may be subject to greater influence by the company's CEO than are outside

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228 RP Chait (1994), "How to help your board govern more and manage less", National Center for Nonprofit Boards, above n 227, 14.

229 Tricker, above n 8, 76-79.

230 Mueller, above n 227, 19.

231 Fleming, above n 162, 201.

directors. Additionally, non-executive directors are usually appointed for their industry expertise and their decision-making abilities. [232]

Fleming also notes that during the last forty years in Australia, both board size and board composition have increased by about 30 to 40 percent while the number of share block-holders quadrupled. Additionally, most corporations maintained a majority of non-executive directors, due to the professionalisation of governance practices in large organisations. Fleming further suggests that the appointment of non-executive directors has contributed to an improvement in decision-making and governance practices generally. [233]

With regard to board size and composition, in August 2002, the Australian Stock Exchange Corporate Governance Council was formed to develop a framework for corporate governance, which would 'provide a practical guide for listed companies, their investors, the wider market and the Australian community'. The council comprised representatives from 21 stakeholder groups including major investors, firms and professions and delivered a set of principles and best practice recommendations in March 2003. [234] These principles were 'not prescriptions' but designed to 'produce an efficiency, quality or integrity outcome'. However, all companies listed on the stock exchange were encouraged to use the principles for 're-examining their corporate governance practices'. These recommendations were not designed to be peremptory and companies may opt out of implementing them simply by indicating why they needed to do so. [235]

The Australian Stock Exchange (ASX) corporate governance council has indicated that board composition should in terms of its principle number 2 be structured as follows: [236]

1. A majority of the board should be independent directors;
2. The chairperson should be an independent director;

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232 Ibid 202.

233 Ibid 203–204.

234 Ibid 205. See also ASX Principles of good corporate governance and best practice recommendations (2003), <http://www.shareholder.com/shared/dynamicdoc/ASX/364/ASXRecommendations.pdf>.

235 Ibid 207. See also ASX Principles, above n 234.

236 Fleming, above n 162, 206. See also ASX Principles, above n 234, principle 2, recommendation 2.1-2.4, 19-21.

3. The same person should not hold the roles of chairperson and chief executive officer; and
4. The board should establish a nomination committee.

The council, however, does not specify whether the boards could be composed of other stakeholders within the corporation, such as the employees. However, the ASX does provide a note on how independence should be assessed. Consequently,

> (a)n independent director is a non-executive director and … is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the company. [237]

Since these ASX principles of corporate governance and its recommendations are not mandatory, a company could, in terms of the "comply or explain" principle, attempt to make such an appointment and then explain it. The ASX does, however, in terms of principle number 10, recognise the rights and interests of all stakeholders by suggesting that corporations establish and disclose a code of conduct in order to facilitate 'compliance with legal and other obligations to legitimate stakeholders'. [238]

Furthermore, Tricker's comments suggest a possible way forward to improve shareholder attendance at board meetings. Principle number 6 of the ASX corporate governance council makes sound suggestions that the corporation should respect the rights of shareholders by designing and disclosing

> … a communications strategy to promote effective communication with shareholders and encourage effective participation at general meeting. … (Also the board should) request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's Reports. [239]

(1.8.2.2) Remuneration of Directors

It is usually the board rather than the shareholders that determines the remuneration for the directors.

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[237] ASX Principles, above n 234, principle number 2, box 2.1, 20.

[238] Fleming, above n 162, 207. See also ASX Principles, above n 234, principle 10, recommendation 10.1, 59.

[239] Fleming, above n 162, 206. See also ASX Principles, above n 234, principle 6, recommendations 6.1 and 6.2, 42-43.

Principle number 9 of the ASX corporate governance council suggests that the corporation should remunerate fairly and responsibly and [240]

1. Provide disclosure of the company's remuneration policies to enable investors to understand the costs and benefits of the policies and the link between remuneration paid to directors and key executives and corporate performance.

2. Establish a remuneration committee.

3. Distinguish the structure of non-executive directors' remuneration from the other executive directors.

4. Ensure that equity-based executive remuneration is made in accordance with shareholder-approved plans.

Additionally, Principle number 8 of the ASX corporate governance council makes the suggestion that the corporation should encourage enhanced performance by disclosing the process for board performance evaluation, its committees, individual directors and key executives. [241]

(1.8.2.3) Raising of Capital

Members in a general meeting do have to approve significant changes in the structure of capital or in any other significant matter. Such actions, which are required by the Companies Acts, seek to protect investors rather than supervising the management of the board. Hence, directors may not change fundamentally the nature of the corporation's business. However, because objects clauses are written very widely for many modern companies, effectively, this frequently fails to act as a major constraint.

(1.8.2.4) Allocation of Resources

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[240] Fleming, above n 162, 207. See also ASX Principles, above n 234, principle 9, recommendations 9.1-9.4, 54-59.

[241] Fleming, above n 162, 207. See also ASX Principles, above n 234, principle 8, recommendation 8.1, 47.

The directors of public companies are able to allocate resources between subsidiary companies as they deem fit. Approval of its members is only sought when required by the Articles of Association or when the change would result in fundamentally restructuring the company.

(1.8.2.5) Acquisition of Other Companies

Directors have discretion to undertake the acquisitions of other companies provided any constraints indicated in the articles of association are complied with. At the same time no fundamental change in the financing or basic nature of the company must take place.

(1.8.2.6) Appointment and Remuneration of Top Executives

Many directors believe that a primary duty of the main board is to ensure that the management of its subsidiary companies is effective. In this way, appropriate subsidiary company management policies are formulated for the appointment and remuneration of top executives.

(1.8.2.7) Oversight and Control of Management Performance

Board members accept the responsibility for executive management performance. In large public companies, members' knowledge of the corporation is often limited to an awareness of some of the corporation's products and services. Therefore, the annual general meeting is not regarded as an appropriate method for the supervision of the executive management team.

Consequently, although members retain certain powers, significant power in public companies is placed in the hands of the board and its executive. In terms of the proposed model of corporate governance, power should be divested from the board and the executives and placed into the hands of other stakeholders, especially those of the employees.

(1.8.3) MANAGERIAL POWER

In a large public company with many subsidiaries operating in various businesses in different parts of the world, power is exercised in a range of roles and at various

levels. Corporate governance is not simply determining whether the board or the members exercise power. [242] It *also* involves an analysis of the functions and responsibilities of directors of subsidiary and holding companies, managers of businesses and its members, employees, creditors and other interested stakeholders. It is upon this understanding that a new and arguably workable model of corporate governance for South Africa has been designed.

Furthermore, directors generally formulate corporate objectives. They ensure that sound strategies are formulated for their product development and for other business activities. They are not usually compelled to make such strategies explicit, as this might reveal valuable competitive information. [243] Thus, in many cases, the members themselves are unable to supervise the board's activities.

(1.8.4) INSTITUTIONAL SHAREHOLDERS' POWER

Tricker believes that it is usually only in extreme situations, for example when the company appears to be on the verge of collapse, that the votes of shareholders begin to count. On a day-to-day basis, however, members are more passive investors than active participants in the governance process. [244] This applies to institutional shareholders where financial institutions would rather incur small losses than allow members to become involved in the processes of corporate governance. Therefore, the actions taken by such institutions are not necessarily in the interests of *all* shareholders. By circumventing the corporate governance processes, the institutions may well be disenfranchising the legitimate rights of the other members. Hence, questions of accountability have become important issues in this regard.

The model of corporate governance proposed in this thesis makes any such circumvention of corporate governance processes very difficult. This is because it gives the other stakeholders of the corporation, especially the employees, a very real joint decision-making role in very significant corporate affairs. Thus, the proposed model removes many powers from the board and places them in the hands of other interested stakeholders.

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242 Tricker, above n 8, 80.

243 Ibid 81.

244 Ibid 82.

(1.9) Alternative methods for categorising companies – would these be of any value for advancing corporate governance programmes?

Tricker believes that an alternative method for categorising companies may be permitted because the underlying sources of power to govern and the ability to exercise power over executive actions would differ in each type of business entity. Thus, an alternative basis for categorising companies for the purposes of corporate governance is listed as follows: [245]

1. Firstly, in the modern public company, investors may be private individuals, corporate bodies or financial institutions. Hence, the sources of power to govern can be derived from ownership exercised in meetings of the shareholders and through the board members themselves. Hence, the processes of governance *must* recognise the diversity of the source from which power can be derived. Furthermore, no other company should be allowed to dominate its affairs. Although many of these public companies are very large, some would be small with only a few investors. Tricker, however, does not specifically mention the extent to which the other non-shareholder interests and rights of the modern public company would be recognised. Therefore, it is arguable that this type of structure does not improve the current classification of modern public company law already in existence in South African law.

2. Secondly, in the proprietary company (a definition not known to many company law systems, including South Africa, but resembling the close corporation structure that we have in South Africa) investors, directors and top management would all be synonymous. This is an owner-managed corporation. This means that ownership, governance and top management are effectively in the same hands. Membership could be limited so as to allow effective governance. Most importantly, no corporate body may be a member. Hence, the shares must be in the hands of individuals who must exercise governance. [246]

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[245] Ibid 86-91.

[246] Ibid 87.

Legislation, however, may require a formal distinction to be maintained between members and directors. This would be problematic if the member and director was the same person. Furthermore, members and directors are required to then hold meetings in each capacity. This, of course, would be again rather problematic when they happen to be the same person. In addition, resolutions should be formally passed, minuted and registered. These measures are designed to protect the interests of the members against dominating executive directors. This might mean that the owner would be protected from him- or herself. [247]

Questions of corporate governance relating to the rights and interests of all stakeholders would be less important in this type of corporate structure. The shareholders, managers and employees could very well be the same person in which case the extent to which each participant would be empowered in the decision-making processes of this business entity would not be an issue. Therefore, it is arguable that Tricker's mention of the proprietary company would not advance corporate governance programmes under existing company law.

3. Thirdly, in the subordinate company structure, one company would exercise the direction and control of another (see subheading 1.12.4). This domination may occur where the one company holds a major part of the undertaking of the subscribed capital of the other company. It may also occur where a company controls a majority of the voting rights attaching to the shares. Domination may also exist where the dominant company could appoint at least half of the members of the administrative, management or supervisory body where these members have the majority of the voting rights. [248] Therefore, the basis of power is a managerial one either based on the whole ownership of a subsidiary company or on the partial ownership with outside minority shareholders thereby allowing the company to determine the processes of governance. Consequently, although a subordinate company could have considerable autonomy through delegated authority, it may still be dominated over by a public, proprietary or private company.

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247 Ibid 88.

248 Ibid.

Furthermore, a contemporary issue is to determine how to devolve powers to subsidiaries as they develop in response to new technologies and changing markets. Directors must meet the needs of the new economy, while at the same time, parent boards must create proper conditions for their subsidiaries to expand and grow. Directors need to encourage subsidiaries to co-operate and to compete as if they were independent firms. The decision-making powers of subsidiaries must be adjusted continuously as business requirements change. [249]

Another factor is that companies must respond quickly to changes in technologies. Thus, international businesses are delegating discretion to subsidiaries. The need to delegate powers to subsidiary boards is necessary for three reasons. The first reason is to enable the corporation to quickly respond to local opportunities in the market. A second reason for decentralizing decision powers is based on ethics. A third reason is to develop managers. Individuals need opportunities to develop into managers and directors. Thus,

> little of what is needed to be a successful manager or director can be learned through books. [250]

The corporate governance model proposed in this thesis would be able to determine the rights and interests of the stakeholders in the subordinate company in such a manner that they would enjoy some participation in the decision-making processes of the corporation. Furthermore, the employees would be invested with joint decision-making powers.

4. Fourthly, the next proposed category could consist of the private company, which exists in South Africa. These companies obviously cannot invite public subscription for shares and are not dominated over by other companies. Individuals and/or corporate bodies own these companies. Generally, some separation of ownership from management and direction exists. The basis of power in a private company would be one of ownership. [251]

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249 Strikwerda, above n 170, 55.

250 Ibid 38-39.

251 Tricker, above n 8, 80.

> The proposed corporate governance model could be applied to private companies in ensuring that the rights and interests of the owners, managers and especially of the employees are adequately recognised and protected.

The existing conceptual framework for the corporation is rooted in nineteenth-century theories and practices and treats ownership as the basis of power. In modern company law, however, it is vitally important that power is derived from the *various sources* that comprise the various types of corporate structures. These sources of power arise through the shareholders, the members of the board, the management in the group of companies or financial institutions and also from the other stakeholders, especially the employees.

Hence, an alternative conceptual framework for the corporation is proposed, which is derived from the *reality* of the power-base existing in each case. It is arguable that these fundamental differences in ownership patterns and sources of power in the different corporate structures may well enable proper governance and thereby allow all stakeholders the opportunity of being involved in the processes of corporate governance in some meaningful and significant way.

(1.10) Implementing the processes of corporate governance

Having considered another approach for categorising companies, it will be necessary to establish how this may impact on the processes of corporate governance.

Nader and Green note,

> (w)e must redesign the law to keep up with the economic and political evolution of giant corporations, which are tantamount to private governments. ... (Giant corporations) can spend decisive amounts in elections to determine which towns thrive and which gather cobwebs ... (which) develop technology that take lives or saves lives. ... The economic government (giant corporation) is largely unaccountable to its constituencies - shareholders, workers, consumers, local communities, taxpayers, small businesses, future generations. [252]

[252] Ibid 95.

In this regard Tricker proposes that one must 'redesign the law' to develop a framework for considering the checks and balances on corporate power by considering the following perspectives, which are: [253]

1. Legal;
2. Normative and Descriptive;
3. Rational and Economic;
4. Organisational; and
5. Socio/Political.

(1.10.1) THE LEGAL PERSPECTIVE

It has been seen that the traditional classical theories and practices of a company are based on the notions of capitalism of the nineteenth-century rather than on modern business reality. Hadden is probably correct when noting that traditional company law ideology has ceased to reflect the realities of the commercial and industrial world. [254] These classical ideas do not reflect the complex ideology of modern companies and ignores many of the issues that face directors. Thus, traditionally, the company has a dual purpose: it is a corporation registered in terms of company law *and* it is a business in terms of which production and markets are organised. The main focus is the regulation of the relationships between the company and its member shareholders. Consequently, the main purpose of a company in terms of company law is the profitable growth of the corporation for the benefit of its shareholders. [255] Hence, in this way, the interests of other groups, such as the employees, creditors and customers are only relevant where they coincide with those of the shareholders. [256]

However, it is important for directors to conceptualize the objectives of the company in order to take into account the long-term interests of all of the principal groups who are associated with it. The model of corporate governance, which is proposed, takes into account the interests and rights of the other stakeholders of the corporation by recommending *inter alia* significant legislative changes.

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253 Ibid 96.

254 T Hadden (1977) *Company Law and Capitalism*, 2nd edn, Weidenfeld & Nicholson. See also Tricker, above n 8, 97.

255 Tricker, above n 8, 98.

256 The Bullock Committee, *Report on the Committee of Inquiry on Industrial Democracy* (Bullock Report) (January 1977), Cmnd 6706, HMSO. See also Tricker, above n 8, 98.

(1.10.2) THE NORMATIVE AND DESCRIPTIVE PERSPECTIVE

Contrasting with the legal perspective, this view establishes the task of directors by considering their *practical* experience. This is useful in establishing changing strategies and styles of direction for the modern corporation. However, although such experience may well lack the objectivity of independence, it may be useful in the sense that it could give rise to new trends in the corporate governance processes, which take into account the rights and interests of *all* stakeholders.

In this thesis, the effects and significance of a normative view are considered. To this end, practical examples are discussed as to how some companies have achieved good or improved corporate governance programmes in the workplace. The introduction and maintenance of a system of organisational development within the corporation is a vital first step for any organisation. This would allow positive changes to be achieved in the workplace and, consequently, good models of corporate governance to be maintained.

(1.10.3) THE RATIONAL AND ECONOMIC PERSPECTIVE

This perspective takes into account the fact that only in the long run can a profitable company obtain funds from the capital market and provide a reliable source for the supply of goods and services for its customers, stable employment for its employees and a profitable business for its suppliers. [257] However, this would only be rational and economic if the decision of top management considers the needs of all the stakeholders. In addition, this perspective "makes strong assumptions about human behaviour without performing the hard task of observing people". [258]

However, the reality of business decision-making involves uncertainty in taking decisions and in recognising various constraints, which may not be of equal benefit to all stakeholders. Consequently, happier employees yield better productivity, which, in turn, yields improved profitability for the corporation. The suppliers and creditors are happier and so is the community, as the corporation would most likely have more funds to contribute to the environment. It is therefore important for all stakeholders to be involved in the decision-making processes of the corporation so

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[257] Confederation of British Industry: Company Affairs Committee Report (1973), *The Responsibilities of the British Public Company*, Lord Watkinson (chairman). See also Tricker, above n 8, 101.

[258] HA Simon (1965), *The New Science of Management Decision*, Prentice Hall. See also Tricker, above n 8, 101.

that informed and better decisions can be made. The traditional aim of company law, which is to maximise the profits for the shareholders, consequently becomes less important in modern day company law. It is therefore important to consider the rights and interests of the non-shareholder constituents. This, in turn, is likely to result in greater profitability for the company. The traditional methods of *first* maximising shareholder profits by excluding a consideration of all other stakeholder interests and rights is generally no longer workable in modern day company law. This is because the non-shareholder constituents now expect to be considered and to have a part in the joint decision-making processes of the corporation.

(1.10.4) THE ORGANISATIONAL PERSPECTIVE

Some writers believe that board attention should be focused rather on the running and the supervising of the internal structure of the corporation than on its involvement with longer-term strategies, opportunities or problems. Hence, "bureaucrats will care more for the routine than for results". [259] Other writers believe, however, that directors should rather play an active role in determining the future direction of their companies. [260]

In modern companies these complex organisational structure and management styles are reinforced by the various corporate systems and procedures. This may well result in a lack of forward thinking and impinge upon the rights and interests of all stakeholders and thereby undermine the corporate governance process.

Management and governance issues are, however, tightly interlinked in modern day company law. Indeed, the directors and the other stakeholders need to all play some role in promoting, directing and advancing the interests of the company on a day-to-day basis. At the same time, they also need to bear the future in mind so that the company can actively progress as the future unfolds. Therefore, both forward thinking and an observance of daily affairs are necessary for the success and advancement of all stakeholders in the corporation.

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[259] W Bagehot (1963), *The English Constitution* (first published 1867), Fontana. See also Tricker, above n 8, 101.

[260] KR Andrews, "Directors' responsibility for corporate strategy", (1980) *Harvard Business Review*, Nov/Dec. See also Tricker, above n 8, 102.

(1.10.5) THE SOCIO / POLITICAL PERSPECTIVE

Tricker convincingly states that interest groups, with power to influence corporate direction, exist both inside the company and in its external environment. Hence, the boundaries of the corporation are no longer simple - the strategic direction of the corporation can no longer be solely in the hands of the directors. Therefore, Tricker notes that there have been many calls for corporations to accept a wider responsibility to stakeholders beyond its members and thereby allow the participation of employees, minority interest groups, consumers, creditors and others in the managerial decision-making of the company. [261] However, Tricker believes that to ascribe beliefs and expectations about corporate behaviour to *society in general*, may be questionable. These interest groups, he notes, may not necessarily provide *objective* criteria for determining what is important for the responsibility of corporations. [262] Tricker's argument, however, is not convincing when he notes that governance processes must involve some sort of *negotiated agreement* with all those who can exercise power both internally and externally. [263] Society may provide some insight as to how the corporation may advance in the future, but it may have a passive rather than an active participatory role in the affairs of the corporation. Its input, however, would still be of value. This point will be highlighted later in this thesis.

(1.11) Checks and balances in corporate power

People with ambitions and needs create businesses. Companies are simply the *vehicles* used to attain these. [264] Therefore, *checks and balances* are vital as they respond to human greed and error. They render the stakeholders accountable for their actions. Checks and balances have been considered and differentiated for the four proposed types of companies that were discussed earlier. These are the proprietary, the private, the public and the subordinate company. In all of the cases, there are external factors, which impose the checks and balances upon the particular

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261 Tricker, above n 8, 103.

262 Ibid 104.

263 Ibid.

264 Ibid 105.

type of company. These are the *societal factors, the market factors and the self-regulatory factors*. [265]

(1.11.1) THE PROPRIETARY COMPANY – CONTROLLING POWER

In this type of company the owner-manager is at the head of the corporation who makes the over-riding decisions. Additionally, an approved auditor must be appointed and must file accounts on which he or she has reported. These are the self-regulatory factors. [266] Tricker notes that market factors and the reality of business provide the requisite checks and balances - the business must buy goods and services and sell them at a profit. Hence, the terms demanded by suppliers, the choices available to customers and the resultant competition in products and pricing, place onerous, yet challenging, checks upon the company. Societal factors in the form of local regulations (bye-laws, planning, health and environment), commercial and industrial law and policy, labour law and policy, tax law and company law all play an important role together in placing checks and balances on this type of corporation. [267] It has also been correctly said, though, that

> (i)n the United States, labour law and corporate law have long been radically separated both in practice and in scholarship. Today, however, there is growing consensus that, whatever may have been true in the past, this split is no longer desirable. [268]

Furthermore, even without considering the effect of legislation, there are many 'natural' external factors that determine and control the actions of stakeholders in the proprietary company. These stakeholders are the 'corporate driving force' within the corporation. [269] Since the owner, manager and employee are generally the same person in this type of corporate setting, it is easier to control this type of power. The question of the extent to which each stakeholder should possess power and therefore be involved in the joint decision-making processes of the company become largely reduced and irrelevant.

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265 Ibid.

266 Ibid 106.

267 Ibid 107.

268 H Hansmann, "Worker participation and corporate governance", (1993) *University of Toronto Law Journal*, 43, 589.

269 Tricker, above n 8, 105.

(1.11.2) THE PRIVATE COMPANY – CONTROLLING POWER

Private companies may not invite public subscription. The dominance of the owner-manager over matters of corporate governance has been reduced. [270] The shift from the dominance of the owner-manager to a board of directors (some of whom may have minimal or no shareholding at all) is important here. The power of the shareholders is exercised through an annual general meeting and through the other processes of law, which give rights to its members. These are self-regulatory factors, which include the appointment of auditors and accountants. In addition to the societal factors noted with regard to the proprietary company, checks on the powers of the private company may also come from monopoly and competition legislation both domestic and foreign from which its revenue is generated. The company could also be constrained by national and local lobbying forces (pressures beyond those directly available from the law) such as environmental pollution, ecology, product safety and others. Additional business and market factors would also evolve while the roles of employees and their union representatives may emerge. Management may also disclose information to its employees and thereby encourage commitment and participation with the company. Formal channels of representation may be created. The collective bargaining process with the unions may also assist with the governance processes. [271]

In the proposed model of corporate governance, the question of co-determination is considered by recommending that employees take an active part in the decision-making processes of the corporation. This aspect is discussed in great detail later in this thesis.

(1.11.3) THE PUBLIC COMPANY – CONTROLLING POWER

The greatest burden of checks and balances with regard to the exercise of corporate power is experienced by public companies. The checks and balances discussed with regard to the proprietary and private companies apply to public companies as well. However, stock market regulation and the protection of investor interests, provide further self-regulatory checks and balances with the securities market and stock exchange exerting control over the regulation of issuing, buying and selling shares in

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270 Ibid.

271 Ibid 109.

companies. [272] Additionally, the ability of external shareholders to influence corporate governance is unpredictable. In the small public company, the external shareholding may be a minority group. This would encourage founder directors to retain the voting power of veto. In larger companies one or few shareholders may hold many shares and thereby exercise power over governance should they wish to do this. [273] Another self-regulatory factor would be the threat of a hostile bid by potential predators. [274] As with the private company, technological and competitive factors are important checks and balances.

Furthermore, a trend evident in recent years has been to encourage employee shareholdings and to provide incentives to them when they use company services. This has increased the number of smallholdings in such companies. [275] The implications of this trend is significant with regard to governance processes, as it allows board actions to be influenced, thereby reducing the power of the members at meetings.

It is sound practice to encourage employee shareholdings. It encourages loyalty and interest and contributes to the overall well being of the corporation. It is, however, only one method of inviting employee participation in the corporation. The model, which is proposed in this thesis, gives employees a considerable and very active role in the decision-making processes of the corporation.

(1.11.4) THE SUBORDINATE COMPANY – CONTROLLING POWER

The British *Companies Act* of 1989 states

> (1) The expressions “parent undertaking” and “subsidiary undertaking” in this Part shall be construed as follows; and a "parent company" means a parent undertaking which is a company.
> (2) An undertaking is a parent undertaking in relation to another undertaking, a subsidiary undertaking, if—
> (a) it holds a majority of the voting rights in the undertaking, or
> (b) it is a member of the undertaking and has the right to appoint or remove a majority of its board of directors, or
> (c) it has the right to exercise a dominant influence over the undertaking—
> (i) by virtue of provisions contained in the undertaking's memorandum or articles, or
> (ii) by virtue of a control contract, or

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272 Ibid.

273 Ibid 111.

274 Ibid 112.

275 Ibid 107.

(d) it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.

(3) For the purposes of subsection (2) an undertaking shall be treated as a member of another undertaking—

(a) if any of its subsidiary undertakings is a member of that undertaking, or

(b) if any shares in that other undertaking are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings.

(4) An undertaking is also a parent undertaking in relation to another undertaking, a subsidiary undertaking, if it has a participating interest in the undertaking and—

(a) it actually exercises a dominant influence over it, or

(b) it and the subsidiary undertaking are managed on a unified basis.

(5) A parent undertaking shall be treated as the parent undertaking of undertakings in relation to which any of its subsidiary undertakings are, or are to be treated as, parent undertakings; and references to its subsidiary undertakings shall be construed accordingly.

(6) Schedule 10A contains provisions explaining expressions used in this section and otherwise supplementing this section. [276]

Thus, a subordinate company has another company dominating its processes of governance. The holding company may be a public, proprietary or private company. The board in the subordinate company is subject to the decisions of the management of the holding company. Hence, where various companies jointly own the subordinate company, the board of the subordinate company has to find a compromise solution to governance that satisfies the various stakeholders. The checks and balances, which are likely to be found here, are the societal factors (including the legal and national regulations and the laws of the states in which the company operates), the business and market factors (including the technological and competitive factors in the business and markets of the company), and the self-regulating factors (including the managerial power (controlled by the dominating company) and shareholder power (including minority interests)). [277]

Strikwerda lists the types of decisions, which are delegated to the boards of subsidiaries. [278] These include the following:

1. Product innovation and product policy.
2. Pricing and market positioning.
3. Sales, distribution and marketing.
4. Product development and process development.
5. Manufacturing and procurement.

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[276] United Kingdom Legislation (1989), *Companies Act 1989*, section 21, available: <http://www.bailii.org/uk/legis/num_act/ca1989107.txt>, accessed 9 November 2005, 23-24.

[277] Tricker, above n8, 114.

[278] Strikwerda, above n 170, 45.

6. Hiring staff but not first level management of the subsidiary.
7. Investments in equipment and some other assets (but not real estate).

Additionally, the following powers are usually reserved for the board of the parent company:

1. Setting the business scope of subsidiaries, product divisions, etc.
2. Accounting standards, rules for consolidation.
3. Financing operations, changes in share capital and international cash management.
4. Corporate resources: patents and trademarks.
5. Ownership of real estate.
6. Official Reporting, annual Reports, fiscal Reports, government relations, relations with shareholders and capital markets.
7. Changes in the legal system.
8. Guarantees to third parties, pledges on assets.
9. Cash management.
10. Acquisitions and divestments, mergers and alliances.
11. Management development policies.
12. Appointing the top management of subsidiaries.
13. Major restructuring and large volume lay-offs.

These lists are based on observations of Strikwerda in his work as management consultant and on the research conducted for clients. They represent guidelines only and will differ from company to company, depending upon its size, nature of the business, the local legal system, the history of the corporation, the risk profile and the experience and the personality of the directors. In large and multinational companies, corporate governance, in most cases, is well established. It is in the smaller firms that directors and managers must develop a balanced system of delegated and non-delegated powers.

(1.12) The corporate tomorrow

As companies have changed in size and in complexity, they have also become remote from the communities in which they are established. This has led to demands for large companies to be more responsible to the needs of society in general and to

their employees. [279] Hence, for long-term profitability, directors must recognise their responsibilities to employees, creditors, customers, the local community and society in general as well as to the shareholders. [280]

Self-regulation is generally more desirable in overseeing and controlling corporate activities than state intervention and involvement. In order to preserve the nature of a free enterprise system, which does work well, care must be taken in affording the state opportunities to interfere with the way in which the company is operating. Giving the state the freedom to interfere with the free enterprise system, would lead to an information-providing bureaucracy where management's power to take business risks would become seriously eroded. [281] However, because the company is a means to providing and using vast sums of capital, necessary controls must be imposed on it by society in the forms of environmental law, health and safety law, labour law, competition and securities regulations, consumer protection and many others. Hence, corporate accountability must exist where there is an accountability relationship between at least two parties, which involves certain rights and duties. It must not be confused with disclosure requirements established by the *Companies Act* or with socially responsible behaviour, which involves discretion by management. [282] Hence, it can be argued that a notion of public accountability owed by a company to a wide range of stakeholders, including the general public, is a viable concept. Furthermore, Tricker points out that the 'stakeholder theories' of accountability argue that the company owes responsibility to customers, consumers, suppliers, creditors, local and other interests and the public generally. [283]

Hence, there is a need to provide a new conceptual framework to describe companies in modern societies. This should be based on the reality of corporate governance. By virtue of their constitution as independent legal entities, the nature of ownership, and the reality of the power of the board, companies need to be governed *as well as* managed. This would apply to both the simple corporation and to the vast complex groups of subsidiaries and holding companies. Hence, as discussed previously, the key elements of corporate governance would be the supervision of executive activity, accountability to legitimate interests, the establishment of corporate direction and management and the involvement in the

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279 Bullock Report, above n 256. See also Tricker, above n 8, 117.

280 Confederation of British Industry, above n 257. See also Tricker, above n 8, 119.

281 Tricker, above n 8, 120.

282 Ibid 123.

283 Ibid 128.

executive action. How these processes of corporate governance are carried out in a particular company, and how effective they are, vary considerably depending on the type and the nature of the enterprise. The governance processes reflect corporate reality. It is therefore not dependent on the nineteenth-century ideas of authority and ownership expressed through the owners acting together. Because fundamental differences exist in the way power is exercised in the various types of companies, the form of governance must reflect this. As discussed, any theory of corporate governance must take into account the economic, organisational, practical, political and legal realities as well as any social and individual implications that may exist. Otherwise it would be irrelevant and meaningless. [284]

The model of corporate governance, which is proposed for South Africa, can be applied to all types of companies where the stakeholders are able to be heard and take part in the running of the business. Fleming does, however, make a very sound practical point when he notes,

> … that structural change in itself will not lead to better outcomes for shareholders … or other stakeholders of the firm. Behavioural change is a longer-term process. … (Therefore), rules on the behaviour of senior executives and the board will encourage oscillation to a particular structural and behavioural equilibrium. Firms should not be penalised, however, if they find alternative solutions to solving coordination and governance problems associated with the separation of ownership and control. [285]

(1.12.1) THE FUTURE GOVERNANCE OF PUBLIC COMPANIES

Neither members themselves, nor the board with a majority of executive directors, can exercise adequate governance over a public company. Tricker argues that what is required is a body capable of exercising professional supervision over executive actions and thereby demonstrating the legitimacy of corporate activities to outside interests. He proposes that all public companies should have a *governing body*. However, this concept is not a new one.

In the nineteenth-century, the Crown appointed governors to oversee the work of the trading corporations, and, even today, independent governors are found in various institutions. Hence, in this way, members would elect a group of governors who would be totally independent of the company's business and would neither have any financial nor any other interests at stake in the company. They would not be

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[284] Ibid 238.

[285] Fleming, above n 162, 210.

employees, or past employees of the company. A governor cannot be a director of a company. He notes that governors should be paid reasonable fees but not an amount that is so great so as to prejudice the exercise of an independent judgment. [286]

Furthermore, *a chairperson of the governing body* could be created - the chairperson could not also be the chief executive. His or her primary duty would be to ensure that the corporation exercised its duties of accountability. This task would be *much* wider than that of the chairperson of the board at present. In some existing public companies, where the roles of chairman and chief executive are separated, little change is required. However, in companies where these roles are combined, a change would be desirable to protect external investors. [287]

Tricker's argument is convincing when he notes that an *independent body* is necessary to supervise the board of directors (including its chairperson) and the chief executive of the corporation in order to legitimise corporate decisions to both internal and outside interests. In this thesis, a model of corporate governance for South Africa has been proposed, which includes a supervisory board. This is based upon the German co-determination system and other approaches to corporate governance.

Additionally, Tricker mentions the various *dimensions* that the proposed governing system would bring into play. [288] These dimensions can be listed as follows:

(1.12.1.1) Direction

Directors would be responsible for formulating strategies and for bringing fundamental proposals for shifts in policy to the governing body. The governing body would consider these strategic formulations and, when satisfied, approve them. If changes need to be made, the governing body would then simply make them. This involves formulating the strategic direction for the future of the corporation in the long term.

(1.12.1.2) Executive Action

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[286] Tricker, above n 8, 243.

[287] Ibid 244.

[288] Ibid 245.

The board would be entirely responsible for executive action. Hence, the responsibility for running the business lies with the board. Delegation to various individuals or bodies is a matter of choice in management style and structure.

In the proposed model of corporate governance, a two-tier board system is recommended for South Africa. One board would be the supervisory board consisting of the employees of the company, while the other would consist of the directors.

(1.12.1.3) Supervision

The responsibility for supervising the performance of the executive lies with the governors. The governors would set the objectives, review and approve plans and monitor aspects of corporate performance. Thus, the board would be continuously accountable to a separate and independent governing body that would ensure that the business is being run properly. This responsibility, therefore, involves monitoring and overseeing the performance of management.

In the proposed two-tier board model of corporate governance, a supervisory board would supervise the board of directors. Therefore, the employees would have an important role in determining how the board of directors should be composed using their powers within the corporation. Thus, the German two-tier board system

> … provides a governance structure that delivers a strong monitoring function over managerial performance. By clearly dividing powers among corporate organs, this structure is somewhat superior to a one-tier board structure. Theoretically, a separate supervisory board, responsible for monitoring the executives and the financial affairs of the company, is … more effective … to ensure that supervision is exercised independently and effectively. … After the appointment, the supervisory board elects the members of the board to directors, which has a duty to submit its work Reports to the supervisory board. Hence … the supervisory board is not only a supervisory organ, but also a decision-making organ of the corporation with authority over the board of directors. [289]

(1.12.1.4) Accountability

The governing body would be responsible for demonstrating accountability to the members and thereby providing them with an independent assessment of corporate performance. The governors would have direct contact with the auditors. In this way, the firm would recognise the responsibilities of the corporation to those making legitimate demands for accountability.

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[289] Wei, above n 4, 116-17.

This idea would be easily applied to the corporate governance model, which has been devised for corporate/labour relations within the South African enterprise. The supervisory board would be responsible for providing an independent assessment of corporate performance to the members and to the other stakeholders who have rights and interests within the corporation.

Furthermore, Strikwerda notes that

> Tricker's model immediately raises the question: How is … the strategy formulated by the board to be implemented? … First, the (directors) need to define the mission of the company, what it stands for in society, its contribution and its values. … This is the formative role of the board. A second role is the performance role, which is about developing strategies through which the mission will be accomplished. … This role also includes the creation … (of) … the "social capital" … of the corporation, i.e. its key relationships with customers, employees, suppliers, and the community. A third role is the conformance role. In this role the board performs its duties towards shareholders, … seeing to it that the integrity of the corporation is maintained. … These three roles, the formative role, the performance role, and the conformance role … (allows) a board … to determine whether it does a good job or not. [290]

(1.12.2) THE FUTURE GOVERNANCE OF PRIVATE COMPANIES

Tricker argues that with regard to private companies, some separation of ownership from management must exist in the form of external investors otherwise the company would be owner-managed (as in the case of the proprietary company). Such external shareholders could be dormant investors, non-executive members, a financial institution or others. [291]

The proposal for governance noted by Tricker is similar to existing arrangements in private companies, which consists of a board of directors, an independent auditor and meetings of shareholders from time to time. However, in addition to this, Tricker recommends that the boards should also consist of non-executive directors and an audit committee, and that the chairman and chief executive roles be separated. [292]

As with the public company, the various dimensions that the proposed governing system would bring into play are listed as follows: [293]

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[290] Strikwerda, above n 170, 41-42.

[291] Tricker, above n 8, 249.

[292] Ibid 250.

[293] Ibid.

(1.12.2.1) Direction

The board as a whole would be responsible for establishing the direction of the company. The board would consist of the chairperson, the chief executive officer and the executive and non-executive directors. Non-executive external directors would be appointed.

(1.12.2.2) Executive Action

The executive members of the board together with top management run the business.

(1.12.2.3) Supervision

The board exercises supervision over executive actions. In addition, what is required, are non-executive directors and an audit committee of non-executives otherwise the executive directors will have to 'wear two hats', which would not be in the best interests of the corporation.

The ASX Corporate Governance Council mentions this point as a suggestion for publicly listed companies in terms of its principle number 4. This proposes that the board should establish an audit committee, which consists of only non-executive directors, a majority of independent directors and an independent chairperson, who is not the chairperson of the board. It should have at least three members and have a formal charter assigned to it. [294]

(1.12.2.4) Accountability

The shareholders, who have a closer interest in this type of corporation, need to question the board structure and processes at members' meetings.

In the model of corporate governance proposed for South Africa, the two-tier board structure would insist upon extensive supervision and very close observations of the

[294] Fleming, above n 162, 206.

actions of the chief executive, the chairperson of the board and the executive directors. This will be discussed in detail later in the thesis.

(1.12.3) THE FUTURE GOVERNANCE OF PROPRIETARY COMPANIES

Tricker proposes that the proprietary company is entirely owner directed and managed. All the investors are insiders and involved in the business and there are no corporate members. Thus, anyone dealing with such an enterprise would know that the management was in the hands of those that both owned and ran the business. An audit would not be required. Since the members would also be the directors, formal meetings of members would not be required. [295]

Therefore, the question regarding the extent to which each stakeholder in the corporation would be involved in the joint decision-making processes would be become reduced or non-existent.

(1.12.4) THE FUTURE GOVERNANCE OF SUBORDINATE COMPANIES

A parent or holding company (also referred to as the controlling company) controls another company, for example, through the ownership of more than half of the voting stock. [296] *A subordinate or controlled company can include either a wholly owned subsidiary, a subsidiary with other minority shareholders or an associate company* over which the dominant (or holding) company can exercise managerial functions. [297]

For general purposes, this control would be established when the holding company has a majority of the voting rights attached to its shares (either because of its ownership of those shares or because of an agreement with the other shareholders) or because it has the right to appoint or remove a majority of its board of directors. Thus, if company A controls company B, which itself controls company C, then company C would be the subsidiary of both company B and company A. For the purposes of group accounts, even a wider definition applies. Thus, the subsidiary need not be incorporated and control can also be established in other ways, for

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295 Tricker, above n 8, 252.

296 *Australian Legal Dictionary*, above n 199, accessed 8 November 2005.

297 Tricker, above n 8, 252.

example, when the holding company has the right, under the subsidiary's articles or memorandum of association, to exercise a *dominant* influence over it (see heading 1.9). [298]

An associate company is defined as

> (a) body corporate linked with another body corporate in terms of control of operations. Whether a person or company is an associate of another is relevant in determining entitlements to shares for the purposes of (the Australian) (CTH) *Corporations Act 2001* Ch 6 … Wide definitions of 'associates' are provided in (CTH) *Corporations Act 2001*. For example, one company may be associated with another if certain types of agreements exist between the two bodies or if the companies are acting in concert. More generally companies may be considered to be associated when one company has an interest in another. [299]

Since the directors of a dominant or holding company company can take decisions that could adversely affect the interests of minority shareholders and creditors in the subordinate company, such stakeholders should have the right to pursue their interests with the directors of the dominant company. To facilitate this proposal, Tricker submits that the ownership and organisational structure of groups of companies should be disclosed as a statutory requirement. This would supplement existing requirements to list subsidiaries. [300]

Governance of the subordinate company could also be affected by means of a management board consisting mainly of executive directors of the subordinate company, non-executive directors of the dominant company and external/outside directors of neither. In this way, corporate direction would exist through a management board subject to the approval of the dominant company. Supervision would be in the hands of the dominant company. If the dominant company wanted to give considerable autonomy to the subordinate company, non-executive directors could be appointed to the board of the subordinate company. [301] Accounts would be audited, published and filed by all subordinate companies. [302]

Interestingly, Strikwerda remarks that

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[298] *A Dictionary of Law* 2002, EA Martin (ed), Oxford University Press; *Oxford Reference Online*. Oxford University Press, <http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t49.e3579>, accessed 8 November 2005.

[299] *Australian Legal Dictionary*, above n 199, accessed 8 November 2005. See also the Australian *Corporations Act 2001*, sections 10 to 17.

[300] Tricker, above n 8, 253.

[301] Ibid 254.

[302] Ibid 255.

> (l)egally, when a parent company delegates … the delegation is normally restricted to the use of assets (ius utendi), the right is not delegated to the income from those assets (ius fruendi) nor the power to sell the assets (ius abutendi). … In many corporations the board of a corporation does not devolve powers to subsidiary boards. On the contrary, this main board must decide which powers to take from subsidiary boards in order to create a corporation with a clear centre for co-ordination and to exploit synergies between subsidiaries. [303]

It might be preferable, however, to consider the advantages of having a two-tier board structure in place rather than a unitary structure.

(1.13) The issue of close corporations and whether private companies should be abolished in South Africa

Problems with corporate governance in South Africa are also linked to the problems associated with the current classification of South African companies. Despite the introduction of close corporations for small businesses, private companies still exist even though it is currently in a form, which is almost indistinguishable from that type of corporate body created in the United Kingdom in the early 1900's. Consequently, private companies have arguably become unnecessary and even perhaps redundant as a form of incorporation.

(1.13.1) THE DEFINING CHARACTERISTICS OF CLOSE CORPORATIONS

The *Close Corporations Act* No.69 of 1984 became operative on 01 January 1985. It catered for the small businessperson that ought not to have been subjected to the complex and extremely burdensome and voluminous *Companies Act* of 1973. Therefore, the *Close Corporations Act* was designed to legislate for small enterprises in such a way that easy compliance with the provisions could be achieved. In this way, the Close Corporations Act consists of only eighty-three sections, whilst the Companies Act contains four hundred and forty-three sections, five schedules and a number of additional regulations. Consequently, the *Close Corporations Act* has considerably simplified the rules of company law pertaining to small business close

[303] Strikwerda, above n 170, 44.

corporations in South Africa. In close corporations, unlike in private and public companies, there is no separation between ownership and control. Therefore, every member is entitled to have a say in the decision-making processes in managing the close corporation. In terms of section 59 of the *Close Corporations Act*, a close corporation must appoint an accounting officer who must report on the annual financial statements. [304] Consequently, a formal audit, as in the case of private and public companies, is not required.

Only natural persons can become members of close corporations. Close corporations may consist of only one member, which is currently the situation with about seventy-five percent of all close corporations. [305] Furthermore, because close corporations do not have shares or share capital, the interests of members in the corporation are expressed as agreed percentages. There are also provisions in the *Close Corporations Act* to allow the conversion of companies into close corporations and close corporations into companies. This is generally a simple procedure.

Henning notes that small businesses play an extremely significant role especially in those countries where there are high rates of unemployment. This creates

> … new job opportunities, … stability, eliminat(es) poverty, improv(es) competitiveness, promot(es) the development of labour skills, and ensur(es) economic growth. … (I)n 1996 more than ninety percent of South Africa's formal business entities could be classified as small to medium businesses, (which) provided employment to approximately seven million South Africans and … comprised almost forty-five percent of the South African Gross Domestic Product. … The recognition … that the small business sector forms the very backbone of a market-orientated economy gave added impetus to the introduction of the *Close Corporations Act* 69 of 1984. [306]

In England, however, close corporations, as a type of business enterprise, have not been created. Sugarman writes that since the mid-nineteenth to the mid-twentieth century, English company law was usually characterised as relatively flexible. Since 1945, however, English company law has become very "complex, obscure and elephantine". [307]

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304 Strydom (2005), above n 214. See also Strydom (1998), above n 214, 439.

305 JJ Henning, "Symposium: Unincorporated business entities: close corporation law, reform in Southern Africa", University of Iowa, (2001) *The Journal of Corporation Law*, Vol 26, 925.

306 JJ Henning, "Reforming business entity law to stimulate economic growth among the marginalised: the modern South African experience", (2002/03) 91 *Kentucky Law Journal*, 774.

307 D Sugarman, "Reconceptualising company law: reflections on the Law Commission's Consultation Paper on Shareholder Remedies: Part 1", (1997) *Company Lawyer*, 18(8), 230.

The term "close corporation" has been derived from the expression "closely held corporation", which refers to the close relationship of its members and to its limited numbers. [308] Henning notes that in 1984 South Africa became the first country with a British company law system to effectively provide for the legal needs of the small businessman. The *Close Corporations Act* is arguably one of the most remarkable and significant innovations in South African company law. The Act introduced a simple, inexpensive and flexible form of incorporation for the enterprise, which may consist of a single entrepreneur up to ten members inclusive. [309] The close corporation is designed to meet the needs of the member or members without being burdensome.[310]

Section 63(c), which enforced the rule that a close corporation can consist of up to ten members with limited liability,[311] has now been repealed. [312] Presumably, a close corporation can now enjoy unlimited membership with limited liability. It is important to note, however, that members of close corporations who fail "to observe the relatively few basic rules of the system" would incur "personal and concurrent liability with the close corporation" for its debts [313] in terms of section 63. [314]

The close corporation has a separate legal existence and can sue and be sued. It also has perpetual succession and limited liability and has the legal standing of a natural person of full capacity. There is no restriction on the size of a close corporation's business or undertaking, the number of employees or creditors it may have, the size of the contributions of the members (which can be money, property or services), its turnover, value of assets or the types of business in which it may be engaged. [315]

The *Close Corporations Act* also contains important differences, as compared to the Companies Act. The more important of these features is the traditional capital maintenance rule in company law, which has been replaced with the solvency and

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308 Henning (2002/3), above n 306, 782.

309 Section 28 of the *Close Corporations Act* 69 of 1984. See also Cilliers et al (2000), above n 213, 596 and HS Cilliers, ML Benade, JJ Henning, JJ du Plessis and PA Delport (1992), Corporate Law, 2nd edn, Butterworths, 588.

310 Henning (2001), above n 305, 918.

311 Strydom (2005), above n 214; Strydom (1998), above n 214, 442.

312 JJ Henning and S du Toit, "Corporate law reform and the empowerment of the victims of economic crime", (1999) *Company Lawyer*, 20 (8), 284.

313 Strydom (2005), above n 214; Strydom (1998), above n 214, 441.

314 Henning and du Toit, above n 312, 289.

315 Henning (2001), above n 305, 919.

liquidity test in close corporations. Since 1994 this test has been adopted and used in New Zealand Company law. The New Zealand *Companies Act 1993* came into effect from 01 July 1994. In New Zealand, there was a transition period and companies were given three years in which to register under the new act. [316] The new Act applies to all companies in New Zealand irrespective of their size or type. In this way, the traditional capital maintenance rule was abolished. Thus, in New Zealand, the basis for making a distribution is whether the 'solvency test' is met. The content of the test is set out in s 4(1) of the Act. There are two limbs to the test and a company must satisfy both. Firstly, the company must be able to pay its debts as they fall due in the normal course of business. This test is referred to as 'trading solvency'. Secondly, the value of the company assets must be greater than the value of its liabilities including its contingent liabilities. In other words, the company must demonstrate 'balance sheet solvency'. [317] Thus, in New Zealand, the legal concept of 'capital' has disappeared under the 1993 Act. A share now represents not a fraction of the capital, but an entitlement to benefits including the dividends and voting rights. [318]

In South African close corporations, the solvency and liquidity test is used as a basis for regulating payments to members, the purchase by the close corporation of its members' interests and financial assistance by the close corporation in the acquisition of its members' interests. Furthermore, there is also a complete break with traditional company law in regard to shares and share capital, which do not exist in close corporations. [319]

(1.13.2) SHOULD PRIVATE COMPANIES BE ABOLISHED?

The idea was advanced that since the close corporation has been introduced, this should result in the phasing out of the private company. [320] It is to be noted that the small private company is also subject to the voluminous sections of the *Companies Act* of 1973 in the same way it is applicable to large public companies. Thus,

> (t)he alternative of building further exemptions for small companies into the *Companies Act* was considered unacceptable. It would only have increased the overall complexity of the *Companies Act*

316 A Beck and A Borrowdale (1998), *Guidebook to New Zealand Companies and Securities Law*, CCH New Zealand Limited, 1.

317 Ibid 119.

318 Ibid 104.

319 Henning (2001), above n 305, 922.

320 Ibid 918.

> and would have aggravated the problem. The *Companies Act* had in effect become inappropriate for the needs of the bona fide small entrepreneur. … At the root of the new development is the conviction that a single Act can no longer present a satisfactory legal form for the giant as well as the small *man*.[321]

Henning also notes that even though the introduction of the close corporation in South African has been very successful, the distinction between private and public companies has still been maintained. He writes,

> … it is … paradoxical that in the interim the (private company) is simply allowed to soldier on in South Africa in a form almost indistinguishable from that in which it was originally introduced in the United Kingdom in 1907. [322]

Sugarman notes that, in England, more defined distinctions between private and public companies are essential. Thus, the contracts governing the internal relations within the company may result in the boundaries between public and private companies becoming increasingly blurred. [323] Furthermore, in South Africa,

> (t)here is a massive failure of compliance with company law. Every person who works with company law knows this. … It is extremely complicated, but it falls flat on its face as far as actual application is concerned. … Indeed, the recommendations by one eminent authority on consumer protection was widely quoted in the press: "Scrap the *Companies Act*!" In essence what was said was that the *Companies Act* is out of touch with the needs of the country and should be repealed and replaced by legislation only in areas where it is considered to be absolutely necessary. The Act is too complicated and should be more easily and effectively enforceable. [324]

These sentiments echo beliefs about the former New Zealand Act, which has now been repealed. It was then said that,

> (in) New Zealand, the *Companies Act 1955* was based substantially on the United Kingdom Companies Act 1948. … The imperial model was influential and it was inevitable, given the domination by the United Kingdom of New Zealand trade, that New Zealand should follow that trade. … (T)hat model, which has become increasingly inappropriate to modern conditions in the United Kingdom, is even less appropriate to conditions in New Zealand. [325]

However, the introduction of the close corporation did not automatically result in the phasing out of the private company (or any other business entity for that matter).

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321 Ibid 920.

322 Ibid 922.

323 Sugarman, above n 307, 229.

324 Henning and du Toit, above n 312, 287.

325 J Farrar (1987), Introduction, *Contemporary Issues in Company Law*, Commerce Clearing House, New Zealand, ix.

[326] Henning indicates that the whole process of considering a new form of business enterprise for the small entrepreneur commenced in 1981 when a proposal for the introduction of a new legal form was submitted to the Standing Advisory Committee on Company Law (SAC). [327] Cilliers *et al* note that the SAC issued a statement in 1985 with the purpose of informing the commercial world of its objectives for company law reform. The overriding aims were to simplify the *Companies Act* of 1973 and to ensure that South Africa keeps "abreast of developments in the European Community and in Anglo-American law". At this time, the abolition of the distinction between public and private companies was ranked as the second priority in category A of the reform proposals. There were twenty reform proposals contained in categories A, B and C. The first priority in category A was the introduction of a takeover panel. [328]

The SAC also appoints the Standing Sub-committee on Close Corporations (SSCC). Its task is to advise the SAC on matters concerning the "operation and development of the *Close Corporations Act*". It shapes "suggestions for reform" as well. [329]

In 1989 the SAC, which is also responsible for making recommendations for the amendment of the *Close Corporations Act*, considered again the issue pertaining to the abolition of the distinction between public and private companies. This time the phasing out of the distinction between public and private companies in South African law appeared third from the top in importance in a list of nineteen reform proposals.[330]

In 1991 the SAC issued a statement on the review of distinctions between public and private companies. Henning writes that the SAC published proposals, which involved the removal of most of the distinctions between private and public companies. This related to the filing and disclosure of annual financial statements, maximum and minimum membership, minimum number of directors, quorum requirements for general meeting, special conditions in the memorandum providing for the personal liability of directors regarding the section 53(b) company, the number of proxies who

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326 Henning (2002/03), above n 306, 780.

327 Ibid 778.

328 Cilliers et al (1992), above n 309, 21. See also Cilliers et al (2000), above n 213, 25.

329 Henning and du Toit, above n 312, 282.

330 Cilliers et al (1992), above n 309, 22. See also Cilliers et al (2000), above n 213, 26 n 57.

can be appointed by members at general meetings and the performance by an auditor of the duties of a secretary or accountant of the company. [331]

Furthermore, some privileges would need to be retained for private companies. For example, a private company would be allowed to load its voting rights. It need not restrict its rights to transfer its shares, although it could opt to do so if it so wished. A public company, on the other hand, is prohibited from limiting its rights to transfer its shares. However, the most significant traditional privilege of a private company to withhold its financial statements would have been abolished, whilst the obligation of public companies in this respect would have been relaxed. Under the SAC proposals, these two forms of companies would be treated more equally, which would have resulted in a substantial simplification of the *Companies Act*. [332]

Despite all this, the SAC decided in 1992, as a result of extensive submissions received by it and through its own research findings, *not* to recommend the abolition of the distinction between private and public companies. Therefore,

> (t)he wider issue of the place of private companies in company legislation is under consideration by the committee and a recommendation as to private companies will be made in that regard and after appropriate consultation. [333]

Since the democratic elections of 1994, it is interesting to note that certain issues received greater priority than before. These issues

> include worker participation in the managing organs of corporations (for instance, the board of directors); (and) facilitating the introduction of ESOPs (employee share-ownership plans). [334]

In 1997, after a meeting between the Minister of Trade and Industry and the SAC, the SAC issued a further press release with regards to the development of business law in South Africa. This called for a "strategic framework" of five principal statutes, which included a redrafted *Companies Act*, a new *Securities Act*, a new *Bankruptcy Act*, a new *Business Enterprises Act* and the *Close Corporations Act* (as amended in 1997). [335] The new *Companies Act* would *not* abolish the distinction between private and public companies. The amendments to the *Close Corporations Act* were mainly

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331 Henning (2001), above n 305, 923. See also Cilliers et al (1992), above n 309, 23 and Cilliers et al (2000), above n 213, 26-27.

332 Ibid.

333 Ibid.

334 Henning and du Toit, above n 312, 279.

335 Henning (2002/03), above n 306, 793-794.

technical in nature with no substantial changes made. Thus, SAC considered that the *Close Corporations Act* was more than adequate for the purposes for which it was designed. Thus, it was not envisaged that significant changes would be made to it. [336] The SAC further emphasised that until the new legislation had been drafted, existing statutes would have to be amended from time to time as the need arises. [337]

As Henning notes,

> … a three tier system presently exists or is provided for: Public and private companies formed under the *Companies Act* and a specialised new legal form of business enterprise, close corporation or private business corporation, formed under a separate enabling Act. … It may very well be that the private company will not survive such a reform in its present guise and with all the distinctions between private and public companies intact. The necessity for the continued rigid adherence to traditional statutory distinctions between private and public companies, such as presently exists in South African … company law, can be seriously questioned. … [338]

Henning writes that the *Close Corporations Act* is to be retained in its present form as one of five principal statutes. [339] Therefore, it is expected that the issue whether to abolish the distinction between public and private South African companies will receive further attention when drafting the newly proposed, leaner and simplified *Companies Act*. [340] Consequently, it is believed that it is time for corporate law reform in South Africa.[341]

Finally, it is important to emphasise the developments in New Zealand. Although the New Zealand *Companies Act 1955* recognised the concept of a “private company”, with a restricted number of members and certain privileges, this type of company no longer exists under the New Zealand *Companies Act 1993*. Thus, regardless of the number of shareholders, or the size of the company’s operation, all companies are treated by the 1993 Act in the same way. [342]

It will be advisable for South Africa to study the New Zealand corporate system. Although South Africa has the close corporation, which New Zealand does not have, the distinction between private and public companies in New Zealand was abolished.

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336 Henning and du Toit, above n 312, 280.

337 Ibid.

338 Henning (2002/03), above n 306, 807.

339 Henning (2001), above n 305, 931.

340 Ibid 923.

341 Henning and du Toit, above n 312, 278.

342 Beck et al, above n 316, 13.

More than a decade has now passed and the abolition of these company types remains in New Zealand. It is therefore a concern that South Africa still retains the distinction between private and public companies even though legislation has brought into existence the close corporation.

(1.14) Conclusion

The identification of the *five essential elements* of corporate governance - direction, management, executive action, supervision and accountability - assists with the assessment of board level competence, whether a unitary or two-tier board structure is ultimately adopted in South Africa in the future. At the same time, the *proposed conceptual framework* distinguishing the different types of companies assists a director in understanding the basis of the governance processes to be developed within any type of corporation. Such a typology could form the basis for any future legislation designed to regulate companies in society. Company law needs to reflect this role and facilitate the processes of corporate governance. In addition, Fleming sums up the position in Australia, which can be equally applied to future and present corporate governance mechanisms in South Africa. He writes,

> … an examination of some of the basic features of the governance mechanisms of large Australian firms over the last forty years shows that corporate governance has changed in nature but not necessarily improved. Data on ownership concentration, share ownership by directors, and the size and composition of the board of directors certainly suggest that by the 1990s Australian managers faced greater scrutiny by a market-based corporate governance system. However, structural changes by themselves do not imply improved governance. … [343]

It does, however, influence the context of the decision-making process. [344]

Corporate governance policies today expect all stakeholder interests and rights in any type of corporation to be fully taken into account when decisions are made. Additionally, there is a growing need and expectation that all of the stakeholders will have some role in the activities of the corporation. In many cases, there is a desire to be involved in the actual decision-making processes of the corporation. Thus,

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[343] Fleming, above n 162, 205.

[344] Ibid 208.

> (t)his … is particularly evident in the question of which groups have a legitimate stake in corporate governance, of whether employees are one of those groups, and, if so, what should be the employees' role. Every nation has struggled with these questions and developed answers based on its particular legal and political traditions and its historical trajectory of labour relations. … The employee role in corporate governance has become an important yet controversial issue in recent years. [345]

Owen Young, leader of General Electric from 1922, rejected the idea that managers were 'the paid attorneys of capital' and that their task was to squeeze from labour 'its last ounce of effort and last penny of compensation'. [346]

Davies, however, questions whether there are any sound reasons for privileging employees over the other stakeholders in the company in respect to corporate governance, such as the suppliers, customers and creditors. Thus,

> … (i)t may be possible to distinguish workers from other stakeholders … on the basis that other stakeholders can effectively rely on other bodies of law, insolvency law or commercial law, for example, to protect them. However, … (the question is) … whether insolvency and commercial law contain effective governance mechanisms, which labour law lacks. … At first sight, the proposition carries … the argument … traditionally used to exclude employees from corporate governance, namely, that they are effectively protected by labour law. [347]

In this thesis, the extent to which the current labour and other legislation in South Africa effectively protects the employees and permits them to participate in the decision-making processes of the corporation will be considered in detail.

Furthermore, the proposals for reconsidering the processes of corporate governance contain a vision for the future where companies could promote business and enhance societal needs. Corporate effectiveness cannot be achieved through legislation. The role of the law is only to facilitate and regulate. It is for the people themselves to act and produce success. DeMott believes that current times are interesting because so much that was once absolute is now open to change, including the nature of employment. Furthermore, the division between those who do work and those who provide capital are less categorical. Thus, corporate governance should reflect these changes. [348]

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345 Finkin and Jacoby, above n 69, 1-2.

346 O'Sullivan, above n 85, 185.

347 Davies, above n 67, 138-9.

348 DA DeMott, "Fluid relationships in transitional times: a comment on employees and corporate governance", (2000) *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 157.

Finally, O'Sullivan cites the aspiration of Young on the future of corporations. Young inspiringly states that

> I hope the day may come when these great business organisations will truly belong to the men who are giving their lives and their efforts to them, I care not in what capacity. Then … they will all be interested in working it to the highest economic advantage. Then an idle machine will mean to every man in the plant who sees it an unproductive charge against himself. Then we shall have zest in labour, provided the leadership is competent and the division fair. … Then, in a word, men will be as free in cooperative undertakings and subject only to the same limitations and chances as men in individual businesses. Then we shall have no hired men. … [349]

[349] O'Sullivan above n 85, 185.

CHAPTER 2:

(2.0) THE INTERESTS OF THE CORPORATION VERSUS THE INTERESTS OF ITS EMPLOYEES

In chapter 1, the difficulties associated with traditional company law conceptions, traditions, doctrines and classification were examined. In this chapter, we go one step further and discuss the difficulties created by company law, which have affected the relationship between the employer and the employee. This is necessary in order to determine the conflicts that arise between the said groups as a result of the influences of company law on labour law, and, as such, attempt to reduce such conflicting situations through various means. At the same time, we have seen in chapter 1 that there is no guidance provided by South African company law to directors for recognising the needs of company employees. Company law requires the directors to exercise their fiduciary duties and, up to now, this has generally meant acting *only* in the interests of the company. Thus, in this chapter, the issues are taken further by comparing and contrasting a company, which operates with the sole aim of maximising its profits, with a company, that is required to keep pace with developments in the employment relationship and to consider the welfare and interests of its employees. In this regard, this chapter will examine the traditional doctrines of piercing the veil as applied to modern circumstances, the interests of the company as compared to those of its employees and the participation of employees in corporate decision-making. In order to justify piercing, it is arguable that the facts must indicate either a misuse of the separate corporate existence principle or a need

to limit this in the interests of justice and equity. Such a test is far easier to apply than determining whether fraud has been committed or whether improper conduct exists. This approach is based on policies of justice and equity and the application of these fundamental principles of law, would promote the industrial rights of employees through the principles of fairness and equity.

This chapter will also discuss the extent to which collective bargaining mechanisms have allowed employees to participate in the running and governance of South African companies. Reference will also be made to the English Cadbury, Hampel and Higgs Reports, which highlight the extent to which employee participation in UK corporate governance has been developed. In this regard, the corporate governance codes relevant to the European Union and its member states and the Organisation for Economic Co-operation and Development (OECD) will also be considered. A brief consideration of the South African 1994 King Report and section 309 of the UK Companies Act will also highlight the problems associated with recognising the participatory roles of employees in the corporation. The 2005 White Paper on English company law reform will also be considered in this regard.

(2.1) Introduction

According to the classical approach to management, the relationship, which existed between shareholder and employee, was not, in any way, considered to be a joint venture between the company and the employee. In fact, the employee's relationship to the company was simply that of servant and master and was dominated entirely by the necessity of producing a profit for the shareholders.

Some examples of this approach follow.

In *Hutton v West Cork Railway Company*, Bowen LJ stated that directors may only have regard to the interests of the company's employees in so far as those interests may consequentially affect the interests of their company. [350]

Similarly, in *Dodge v Ford Motor Company*, Ostrander J noted,

> (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 directors is to be exercised in the choice of means to attain that end itself, to the reduction of profits or to the non-distribution of profits among stockholders in order to devote them to other purposes. [351]

In *Re Lee, Behrens and Co., Ltd*, Eve J noted that it could not be said that the interests of a widow were for the benefit of, or to promote the prosperity of the company, or that the assumption of liability in this regard was reasonably incidental to the carrying on of the company's business. [352] Furthermore, in *Parke v Daily News Ltd.,* Plowman J noted that it is not the duty of the board of directors to take into consideration the interests of its employees. [353] He suggested that, however laudable it might be to take into account the interests of employees from an industrial relations point of view, the law does not recognise the same.

In *Re W. & M. Roith, Ltd.,* Plowman J noted that the law was content to recognise that a company is an entity comprising simply of shareholders who have joined

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350 *Hutton v West Cork Railway Company*, (1883) 23 Ch.D 654, 675.

351 *Dodge v Ford Motor Company*, 170 N.W. 668 (1919).

352 *Re Lee, Behrens and Co., Ltd* (1932) 2 Ch.46.

353 *Parke v Daily News, Ltd.* (1962) 1 Ch. D 927.

together to make a profit. [354] He also noted that this is the main goal of companies and directors should constantly bear this in mind since employees have no rights in company law and, consequently, the law does not permit directors to take into account their interests other than in circumstances where there is evidence to suggest that the course adopted had been taken for the benefit of, or to promote the prosperity of the company, or that the assumption of liability is reasonably incidental to the carrying on of a company's business.

R v Smit noted that a company's obligations towards its employees extend no further than its contractual obligations derived from the traditional employment contract. [355] Thus, one of the main principles in South African company law, was enunciated in the Appellate Division case of *Dadoo v Krugersdorp Municipal Council*, where it was noted per Innes CJ that

> (a) registered company is a legal persona distinct from the members who compose it. ... This conception of the existence of the company as a separate entity distinct from its shareholders is no merely artificial and technical thing. It is a matter of substance; property vested in the company is not, and cannot be, regarded as vested in all or any of its members. [356]

Thus, its members could not sue to enforce its rights, nor could they be sued in respect of its liabilities. This veil of corporate 'personality' conceals the internal workings of a company. However, in South Africa, and elsewhere, the legislature has been compelled to "forge a sledgehammer capable of cracking open the corporate shell". [357] Company law has accomplished this by the insertion of various sections into the South African *Companies Act* 61 of 1973. Sections to which reference can be made in this regard include section 344(h), which deals with the "just and equitable rule" with regard to the winding up of a company (see also heading 3.3), section 252, which deals with a member's remedy in cases of oppressive or unfairly prejudicial, unjust or inequitable conduct in managing the affairs of the company and section 424 (see parts 4.4, 4.4.1, 4.4.2 and 4.5.2), which gives a creditor or a member the right to apply to court for a declaration that any person, including a director, who was knowingly a party to the carrying on of the company's affairs in a reckless or fraudulent manner, may be held responsible for the liabilities of the said company.

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354 *Re W. & M. Roith, Ltd.* (1967) 1 All ER 427.

355 *R v Smit*, 1955 (1) SA 239 (C), 241H-242A.

356 *Dadoo v Krugersdorp Municipal Council*, 1920 AD 530.

357 LCB Gower (1979), *Gower's Principles of Modern Company Law*, 4th edn, Stevens and Sons, London, Great Britain, Ch. 5, 1, n6 112. See also WM Venter, Research Dissertation: "Company Law and the Interests of Company Employees", Cape Town, October 1991, Ch. 1 at 2.

(2.2) Piercing the veil

It is arguable that to justify piercing, the facts must indicate either a misuse of the separate corporate existence principle or a need to limit this in the interests of justice and equity. This approach, based on policies of justice and equity and the application of these fundamental principles of law, would promote the industrial rights of employees through the principles of fairness and equity. However, South Africa has preferred to embark upon a categorisation approach: if the situation complained of fits within the defined categories, the courts will pierce the veil; if not, the courts have been generally reluctant to do so even if this results in hardship to the employees or other stakeholders in the corporation. In this regard, several leading cases will now be considered.

Several interesting South African case decisions have discussed the question of piercing the veil. In the case of *Botha v van Niekerk* it was noted per Flemming R that it is important to recognise the separate legal existence of a juristic person, including the rights to sue and be sued. [358] However, in some cases, where "special grounds" exist, this special charactistic can be ignored and the veil can be pierced or lifted and therefore shareholders and/or directors may be held personally liable on company contracts for the debts of a company. [359] These special grounds include showing that the defendant's actions amounted to "unconscionable injustice and clearly improper conduct". [360] The court did not find this to be so in this case and the company veil was not pierced. Accordingly, personal liability could not be attributed to Mr G (the first respondent). [361] The application was dismissed. [362]

In *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and others* the court per Smallberger JA disagreed with the test of "unconscionable injustice" put forward by the decision of the court *a quo*. [363] The court thought that the test was "too rigid".[364] The court indicated that the law had not settled the circumstances exactly

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358 1983 (3) SA 513 (W).

359 At 514G.

360 At 515G.

361 At 515H.

362 At 516H.

363 1995 (4) SA 790 (A).

364 At 805F.

when the corporate veil could be pierced. [365] Each case is to be decided by considering its own unique set of facts. In so doing, it is important to consider the fundamental doctrine that the law regards the substance rather than the form of things. [366] Thus, a court does not simply have a general discretion to disregard the company's separate legal personality whenever it regards it fair to do so. [367] Fraud, dishonesty and improper conduct would provide grounds to pierce the veil. [368]

Thus, a court should not lightly disregard the separate existence of a company. In this way, the need to preserve a company's separate legal existence should be balanced against policy considerations in favour of piercing the veil. [369] The court decided that, based on fraudulent and improper dealings, policy considerations suggested that the veil of corporate personality should be pierced. [370] Accordingly, in this case, the appeal was allowed. [371]

Furthermore, in the decision of *Hulse-Reutter and Others v Godde* the court reiterated the sentiments of the *Cape Pacific* decision [372]. Thus, the court does not have a general discretion to disregard the separate legal existence of a company whenever it considers it fair or convenient to do so. [373] Furthermore, it remains unsettled in which circumstances exactly the court would be prepared to pierce the corporate veil. [374] The unique circumstances of each case, judicial judgment and policy considerations will be considered. [375] However, it is clear as a matter of principle that there must be a misuse or abuse of the corporate entity by those who control it. On the facts in this case, the court per Scott JA found that there was no such abuse. [376] There was no suggestion that the respondent was unfairly prejudiced by the distinction, which exists between the company and those who control it. [377] Thus, the appeal in this case was successful. [378]

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365 At 802H.

366 At 803J.

367 At 803A.

368 At 803D.

369 At 803H-I.

370 At 804I.

371 At 807H.

372 2001 (4) SA 1336 (SCA).

373 At 1346A.

374 At 1346B.

375 At 1346B.

376 At 1346C.

377 At 1346D-E.

378 At 1346C.

In South Africa, the legislature and the courts have disregarded the separate existence of the corporate entity in specifically defined and categorised cases. With regard to the legislature, it has disregarded the principles of separate corporate personality where:

1. a director, officer or agent of a company signs a bill of exchange, a promissory note, a cheque or an order for money or for goods for the company, but does not mention the registered name of the company correctly, this person becomes personally liable for that debt; [379]

2. a public company's membership remains less than seven for a period of more than six months, members become liable for the company's debts; [380]

3. it appears "just and equitable" to wind up the company; [381]

4. it appears that any business of the company was or is carried on recklessly or with intent to defraud, the court may order any person to be liable for the debts of the company who knowingly carried out such business in that manner; [382] See also parts 4.4, 4.4.1, 4.4.2 and 4.5.2.

5. a crime has been committed by its directors or servants in the performance of their duties or while furthering the interests of the company. The intention of the person is deemed to be the intention of the company and; [383]

6. an abuse of control arises between the holding and subsidiary companies. Thus, the "holding-subsidiary" relationship is significant, as it regulates any abuse of control that might arise and also ensures that a proper disclosure of the group's financial position is made. [384] See also part 1.6.

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379 Section 50(3) of *Companies Act* 61 of 1973. See also Cilliers et al (2000), above n 213, 12 and Cilliers et al (1992), above n 309, 9.

380 Section 66 of *Companies Act* 61 of 1973. See also Cilliers et al (2000), above n 213, 12 and Cilliers et al (1992), above n 309, 10.

381 Section 344(h) of *Companies Act* 61 of 1973. See also Cilliers et al (2000), above n 213, 12 and Cilliers et al (1992), above n 309, 10.

382 Section 424 of *Companies Act* 61 of 1973. See also Cilliers et al (2000), above n 213, 12 and Cilliers et al (1992), above n 309, 10.

383 Section 332 of the *Criminal Procedure Act* 51 of 1977. See also Cilliers et al (2000), above n 213, 13 and Cilliers et al (1992), above n 309, 10.

384 Cilliers et al (2000), above n 213, 12. See also Cilliers et al (1992), above n 309, 10.

The courts have also disregarded the separate legal existence of the corporation and have held directors, officers and agents liable for the debts of the corporation where the company was an enemy alien, the subsidiary company was used as a "device" to evade a director's fiduciary duties to the holding company, fraud was used resulting in improper conduct, company tax is evaded or concealed or an underlying partnership intention existed even though the parties had formed a company. Additionally, in the UK, instead of having a separate legal existence, holding and subsidiary companies in a group have also been treated in some instances as one "economic entity". [385]

In France, Germany, Japan, the UK and the US, the courts pierce the corporate veil only "in extreme circumstances" in order to hold controlling shareholders, managers or directors personally liable for the debts of the company. Consequently, courts do not easily or readily pierce the corporate veil in these jurisdictions. However, the most successful cases of piercing the veil relate to "blatant misrepresentation or *ex post* opportunism by shareholders". Additionally, the corporate veil is pierced when "controlling shareholders disregard the integrity of their companies by failing to observe formalities" or mix up their personal assets with those of the company. Courts will also pierce the veil when these shareholders fail to "capitalise the company adequately". In all cases, there must exist "an element of fraud or 'injustice'". [386]

However, it is important to consider the approach used in the American case of *Glazer v Commission on Ethics for public Employees.* [387] The 'balancing test' for piercing the corporate veil was noted in this judgment. Thus, the test formulated in this regard is one, which balances the various policies in favour of recognising separate corporate existence against policies justifying piercing. In order to justify piercing, the facts must indicate either a misuse of the separate corporate existence principle or a need to limit the same in the interests of justice and equity. Such a test is far easier to apply than determining whether fraud has been committed or whether improper conduct exists. The approach in *Glazer* is based on policies of justice and equity and the application of these fundamental principles of law would go a long way in promoting the industrial rights of employees through the principles

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385 Cilliers et al (2000), above n 213, 13-14. See also Cilliers et al (1992), above n 309, 11-12.

386 RR Kraakman, P Davies, H Hansmann, G Hertig, KJ Hopt, H Kanda and EB Rock (2004), *The Anatomy of Corporate Law: A comparative and functional approach*, Oxford University Press, Oxford, Great Britain, 93-94.

387 *Glazer v Commission on Ethics for Public Employees*, 431 So 2d 752 (La 1983).

of fairness and equity. Furthermore, Lord Wilberforce in *Ebrahimi v Westbourne* Galleries notes,

> ... a limited company is more than a mere judicial entity, with a personality in law of its own ... there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure. [388]

Domanski discusses the issue of piercing the corporate veil in South Africa and refers to the *Glazer* case. [389] He notes that the categorisation approach, which South African courts have used to pierce the corporate veil, is unsatisfactory. This approach has brought about "inconsistency and uncertainty" in South African law. He believes that the *Glazer* case has brought into existence

> a broad, unifying principle, which could well serve as a basis for deciding 'piercing' cases in a more logical and juridically satisfactory manner. [390]

> … So here at last come the winds of change: no categories for the judges of Louisiana! Instead, the court lays down a broad principle that requires an evaluation of competing policy considerations in order to determine whether or not the veil of incorporation should be pierced. This 'balancing test' represents a radical break with the past. … [391]

Domanski also submits that *Botha's* case for piercing the veil is clearly *obiter.* He submits that the court's refusal to pierce the veil is "unconvincing". On the basis of the test formulated by Flemming J, the court, submits Domanski, would have been justified in piercing the veil. [392]

The balancing test laid down by the *Glazer* decision could perhaps be adopted in South Africa. In this way, policies behind recognising the separate corporate existence must be balanced against those policies, which would justify piercing the corporate veil. [393] Domanski submits that the *Glazer* principle may not resolve all the problems relating to the question of piercing the veil. However, it does "provide … a coherent principle", which may be "applicable to any 'piercing' situation". [394]

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388 *Ebrahimi v Westbourne Galleries*, 1973 AC 360 (HL) p.2 n.11, 379B. See also WM Venter, above n 357, at 8.

389 A Domanski, "Piercing the corporate veil – a new direction?" (1986) *South African Law Journal* 224.

390 Ibid.

391 Ibid 232.

392 Ibid 227.

393 Ibid 233.

394 Ibid 235.

Thus, Domanski concludes,

> the application of this principle in … *Botha v van Niekerk* … might well have produced a different and more equitable result. … (I)t may prove capable of bringing order and clarity into an untidy area of law. [395]

Thus, in recognising the rights and interests of employees and of the other corporate stakeholders, the courts should pay regard to the non-categorisation approach adopted in the *Glazer* case. In this way, policies of justice and equity would promote the industrial rights of employees through the principles of fairness and equity. This would allow company directors to keep pace with developments in the employment and stakeholder relationships and promote an improved model of corporate governance in South Africa. This would encourage and allow a greater representation and participation of these parties in matters pertaining to governance.

(2.3) What are the interests of the company and those of its employees?

Some writers argue that management should pursue not only profit maximisation but also other "noneconomic goals" that "enhance the welfare of employees or some segment of the public". [396] Furthermore, corporate managers often do no not take into account the fact "that a company is only as good as its people". Very often, employees "have a much greater stake in the company than most of the shareholders", as "they depend on it for their careers, their livelihood and, eventually, their pensions". [397]

Venter notes that a company should be viewed as a separate entity wherein many conflicting interests need to be reconciled, such as those of its shareholders, creditors, employees, consumers and environmentalists. [398] Thus, one needs to examine the need for the modern day company to change its nature by moving away from its historical norm where its sole purpose is to attain as much profit as possible

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395 Ibid.

396 Vagts, above n 2, 38.

397 Kendall & Kendall, above n 102, 39-40.

398 Venter, above n 357, 9.

to a system, which recognises the rights of other bodies other than only the rights of its shareholders.

It needs to be recognised that, with regard to corporate law, ownership involves responsibilities as well as rights. This means that directors of companies need to discharge their social responsibilities to society and they therefore have a social obligation towards all with whom they deal including the employees of companies. These sentiments had already been expressed in *The White Paper on Company Law Reform*, published by the English Conservative Government, as far back as in 1973.[399] Subsequently in 1977, *The English Committee of Inquiry on Industrial Democracy (Bullock Report)* indicated that modern corporations needed to take into account the interests of its employees as well. [400] The view set out in the *Bullock Report* is that a corporation must balance all of its main goals, such as profit, growth, size and employment opportunities, so that each one of these goals does not, in any way, impinge upon the growth of the other.

Since a company in law is an entity with its own legal personality and, as such, affects all of those persons who participate in it, it is worthwhile to consider some of the interesting statements taken from various systems in order to appreciate the views of courts and of academic writers.

In *Unocal v Mesa Petroleum Co*, the Supreme Court of Delaware viewed a corporation as an enterprise, which consists not only of its shareholders, but also of its employees, creditors, customers and the community. [401] This means, therefore, that the court recognises that a corporation has more obligations than merely being a profit-making entity. Hence, the corporation has economic and sociological functions other than merely a business one.

Furthermore, in *Peso Silver Mines Ltd (N.P.L) v Cropper* the court stated,

> (a) classical theory that once was unchallenged must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting bona fide in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the

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399 The White Paper on Company Law Reform, published by the English Conservative Government, 1973 (Cmnd.5391, 5).

400 Bullock Report, above n 256.

401 *Unocal v Mesa Petroleum Co.*, 493 A 2d 946 (1985), 955.

> company intended to pursue, and were deflected in the commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of shareholders. [402]

A concern started to be expressed by the courts as to how a company could possibly expect to prosper if its employees and other interested stakeholders were dissatisfied with the running of the corporation. Lord Wedderburn has noted, however, that in his opinion, the English courts in their application of equity, have generally remained very conservative in their approach by assuming that the only goal of corporate responsibility is that of profit-making. [403]

Furthermore, Schmitthoff notes,

> ... a fundamental change has taken place in the concept of the company. The company is no longer regarded as an instrument of profit maximisation for the sole benefits of its shareholders. It is generally recognised that the company as an economic unit consists of a combination of several interests, namely those of the shareholders as providers of capital, of the employees as providers of labour, of the creditors and of the public as such. The concept of the company as an instrument of economic capitalism has thus developed into one of the enterprise as an instrument of a new social order. The modern concept of enterprise is founded on the theory of social responsibility. [404]

Consequently, in continental Europe, the company is not simply regarded "as a piece of financial real estate". Its main aims are rather to ensure that employees are given the "scope and space to develop and to live useful, fulfilling and rewarding lives". [405]

In South Africa, Venter notes that it is important that corporations begin to acknowledge and discharge social as well as business responsibilities. [406] Thus, within modern South Africa, the social responsibility dimensions of a company must start taking firm root in order to assist in meeting the aspirations of the masses. Furthermore, Venter refers to Sullivan's 1977 demand that certain companies direct considerable amounts of money towards social upliftment programmes in South Africa. [407] Sullivan stated that

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402 *Peso Silver Mines Ltd (N.P.L) v Cropper*, 56 D.L.R. (2d) 117, 154-5.

403 Venter, above n 357, 15, See also Lord Wedderburn, "The legal development of corporate responsibility", in Hopt & Teubner (1985) *Corporate Governance and Directors' Liabilities*, Walter de Gruyter, Berlin, New York, 3.

404 Ibid. See also CM Schmitthoff (1981), *Commercial Law in a Changing Economic Climate*, 2nd edn, Sweet & Maxwell, London, Great Britain, 9, n.42.

405 Kendall & Kendall, above n 102, 40.

406 Venter, above n 357, 17.

407 Ibid. See also LH Sullivan, "Foreign investment: statements of principles for U.S. firms in S.A.", *The Independent Trade Union Guide '89*, 187.

> (these principles) provide the most comprehensive standards for enlightened corporate behaviour in South Africa. Furthermore the implementing programme of reporting and task groups of companies has proven to be the most effective corporate change agent in South Africa.

By obliging companies to direct monies towards social rather than business needs, Sullivan created a transition in the companies affected to the extent that those companies could never revert to the traditional perceptions for which they were designed to further only profit-making goals for the shareholders.

Venter is of the view that the interests of the majority of large companies in South Africa have already changed from being those of solely profit-making enterprises to ones in terms of which there is recognition of their obligations towards the interests of employees and other interested stakeholders in the company and, as a result thereof, a new social order is being created. [408] In this regard, Innes CJ in *O'Callaghan N.O. v Chaplin* notes,

> (i)t is the duty of a court- especially of an appellate tribunal- so to administer a living system of law as to ensure- without the sacrifice of fundamental principles- that it shall adapt itself to the changing conditions of the time. And it may be necessary sometimes to modify, or even to discard, doctrines, which have become outworn. [409]

(2.4) The participation of employees in corporate decision-making

In South African law, the powers of shareholders to make decisions for the company are entrenched through the mechanism of general meetings. [410] The shareholders then, in a general meeting, appoint a board of directors who act as fiduciaries of the company and must consequently exercise their powers in the best interests of the corporation. Generally, these interests are considered to be the interests of only the shareholders, both present and future.

The question of whether “the interests of the company” can be interpreted to mean stakeholders other than shareholders has been an issue, which has been increasingly discussed by both academics and labour lawyers during the last decade. Thus, in

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408 Ibid 20.

409 *O'Callaghan N.O. v Chaplin*, 1927 AD 310, 327.

410 *Companies Act* 61, 1973, sections 179 and 180.

practice as noted *supra*, many large companies do acknowledge the fact that they have some responsibility to society other than being totally engaged in a scheme of profit-making for the shareholders.

O'Regan notes that businesspeople should regard corporate social responsibility as "enlightened self interest ". [411] Consequently,

> (t)his means that business perceives appropriate social responsibility action to be an integral part of, and not in any way separate from its primary function of profitably producing and distributing goods or services. [412]

Consequently, corporations should have a concern for all of its corporate stakeholders. This includes its employees, customers, suppliers and even creditors. Social responsibility means that corporations today should also take into consideration the impact of its functions and services on the environment and community.

O'Regan notes further that, although traditionally the company's power base consists of a three-levelled pyramid (authority originates from the general meeting of shareholders, is then passed on to the board of directors whom in turn passes this authority on to the officers of the company, such as the managing directors), in reality, power is rarely exercised in this way. [413] She cites Prentice's critique of the Bullock Report. Prentice notes that,

> ... in the large public company, the shareholders, except perhaps in a crisis situation, do not exercise any meaningful ownership powers. ... The underlying reasons for this shareholder apathy are … not difficult to unearth: (1) holdings are widely dispersed … (2) shareholders are relatively ignorant and on the whole lack the necessary skills ... (3) management enjoys liberal access to corporate proxy machinery ... (4) shareholders who are discontented with corporate management will vote with their feet and sell their shares (5) lastly, a lack of active shareholder involvement in corporate affairs may possibly be explained on the ground that on the whole, directors manage companies in the economic interests of shareholders. [414]

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411 Catherine O'Regan, "Possibilities for worker participation in corporate decision-making" (1990) *Labour Law*, Juta, 120.

412 O'Regan, above n 411, 120.

413 Ibid 121.

414 DD Prentice, "Employee participation in corporate government: a critique of the Bullock Report" (1978) 56 *Canadian Bar Review* 227-8.

As has been noted in chapter 1 of this thesis, where *inter alia* the distinction between ownership and actual control was discussed, shareholders may in fact *not* wield substantial control at all, which is contrary to the formal structures of power defined by the three-levelled pyramid approach of the legal system. Moreover, employees are traditionally given no direct control with regard to decision-making by the legal structures of authority within the enterprise. It is, however, important to evaluate the extent to which recent worker participation in each of the *three levels* (the shareholders or owners, the board of directors, and the management) has increased.

(2.4.1) SHAREHOLDING / OWNERSHIP LEVEL

O'Regan refers to Employee Share Ownership Plans (ESOPs) as the most widely used institution for changing the structure of corporate ownership in South Africa. [415] These plans provide employees with an option to purchase shares and obtain dividends in the corporation. However, there has been much disagreement between management and unionists as to the value of such plans. Management has maintained that ESOPs have not only improved the economic growth and productivity of the corporation and of the country, but have also increased the employees' share in the economy and thereby lowered the rate of unemployment. Unionists, however, maintain that ESOPs have done nothing more than increase *slightly* employee participation in a capitalist economy and have done very little, or anything, to change the patterns of control within the corporation.

O'Regan is of the view that ESOPs do *not* in fact give employees any decision-making role at all. She notes that

> (w)here ESOPs give shares to individual workers, as they mostly do in South Africa, there is no prospect that workers will gain any control in decision-making. [416]

O'Regan also refers to other ESOPs systems elsewhere, which seem to be working better. [417] She notes that in Sweden a wage-earner's fund (the Meidner Plan) was established, the purpose of which was to buy equity in Swedish companies. The Act governing this fund, the *Employee Investment Funds Act* of 1983, provided that a maximum amount of two billion Swedish Kronor be collected annually from

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415 O'Regan, above n 411, 122.

416 Ibid 124.

417 Ibid.

companies, which must contribute 20 percent of its net profit over a certain amount and also be collected by increasing employers' contributions to the state pension fund by 0,2 percent. In addition, the boards controlling the funds are composed of the unionists themselves, which gives them some real control with regard to the decision-making processes of the corporation because ownership of the shares is vested in an institution (the wage-earner fund) rather than in individual employees.

O'Regan also refers to the establishment of ESOPs in the United States and in the United Kingdom where they have become extremely widespread. [418] This is mainly because legislation in these countries has encouraged the formation of ESOPs by giving employers tax benefit incentives for doing so. In South Africa, however, there is a lack of tax or other incentives for establishing ESOPs.

O'Regan also refers to the process of nationalisation as a possible means to affect employee participation. She notes, however, that

> ... nationalisation merely makes the State the sole shareholder of an enterprise, and has no necessary implications for worker participation … Of course, should the State feel that as part of the process of nationalisation it must be responsive to the interests of workers within the enterprise, the possibility of worker participation will be greater. [419]

(2.4.2) BOARDS OF DIRECTORS LEVEL

O'Regan refers to the most well-known system of employee representation at board level: the German model of co-determination (*Mitbestimmung)*, which has been discussed and referred to throughout this thesis. [420] In this system, only a two-levelled pyramid exists: a board of directors consisting of a supervisory board *(Aufsichtsrat)* and an executive board *(Vorstand).* In terms of the German Co-determination Law of 1976, section 1 specifies that all companies employing more than two thousand workers must have worker directors. In terms of section 29 of this law, the board must consist of an equal number of worker and shareholder directors, although the chairman, who has the casting vote, must be a shareholder representative. O'Regan notes that the supervisory board must not only appoint the executive board, but must also supervise the general management of the enterprise,

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418 Ibid 123.

419 Ibid 125.

420 Ibid.

inspect the books of account and receive performance reports and plans of the corporation. [421] However, O'Regan points out that

> ...trade unions have been committed to establishing a vigorous union presence on supervisory boards, and this has led to many disputes and considerable litigation in the last 10 years.

This model will be discussed in greater detail in chapter 8 in this thesis, which will deal with a consideration of various legal systems with regard to the question of constructing a new model of corporate governance for South Africa.

The question of having 'worker directors' at board level in South African companies, has, however, met with some criticism.

Thus,

> (t)wo places on the board of directors at best give workers access to information they can use during bargaining – if they are not barred by secrecy clauses. Decisions to retrench or implement rationalisation programmes stay firmly in the hands of management. [422]

Therefore, if workers are to be given greater access to information and increased participation in the decision-making processes of the corporation, O'Regan argues that any major restructuring of the board of directors will require major changes to company (and labour law) with regard to the appointment of directors and the exercise of their powers. [423] Thus, she notes further that

> (t)he company's interest will have to be redefined so as to incorporate the interests of workers effectively within that notion, and the rights of shareholders will have to be redrawn to accommodate worker rights.

However, even if major changes are made, the question will still remain regarding the extent to which, if any, workers would *in reality* be able to represent their interests *effectively* on the board. Simits notes,

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421 Ibid 126.

422 Ibid 127.

423 Ibid 128.

> ...the German commission on co-determination could trace no really important case where workers' representatives seriously opposed issues defended by the management notwithstanding differences of opinions on details. ... [424]

(2.4.3) MANAGEMENT LEVEL

Another level at which industrial democracy may operate is at management level itself. An example of worker-participation at this level is the German works council (*Betriebsrat).* As O'Regan notes, the work council consists of employees who are elected by their peers but who are totally independent of trade unions (although many of these elected members may also be members of the trade unions). [425] These works councils are involved in functions such as the regulation of social matters (including the conditions of work) and the health and safety of employees. Management must obtain the approval of the works council first, failing which the matter will be referred to arbitration where the worker representatives may veto any decisions held in this regard by management.

These work councils are also involved in personnel matters where, procedurally, they must be informed of all dismissals, although management is not obliged to accept their view in this regard. However, a management's failure to comply with these procedural obligations would invalidate the dismissal. In addition, the works council must be advised of any changes to the corporation, which could cause prejudice to the employees and has the power to demand some compensation to be paid to its employees as a result thereof. Otherwise, the matter may be referred to a conciliation committee and then to arbitration. Thus, the works council has much control with regard to the decision-making functions of the corporation. Works council members are, however, not permitted to initiate any strike activity, although they may participate in the same if the strike is called by the trade union itself.

As O'Regan points out, *plant-level worker participation* in South Africa, has been achieved thus far mainly through union shop stewards who have been given certain rights by collective agreements. [426] These rights generally include the right to represent workers in disciplinary matters, to raise grievances and to represent workers in any bargaining matters. In this thesis, it is argued that such worker participation is insufficient in representing the rights and interests of employees.

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424 S Simits, "Workers' participation in the enterprise: transcending company law?" (1975) 38 *MLR* 1, 10.

425 O'Regan, above n 411, 130.

426 Ibid.

O'Regan also cites *Volkswagen South Africa* as an example of a system that is similar to the German system and where various forms of worker participation has been adopted. For example, in addition to the ordinary collective bargaining structures, Volkswagen has established other joint union-management structures. The joint union-management executive committee consists of the managing director, the directors, the key production managers and the union shop stewards. In this case, the union is said to be able to influence company policy by their very participation. The company also discloses full details of its financial position. This example may be significant in so far as it may exemplify a company, which has been noticeably concerned about the shortcomings of the collective bargaining procedures employed in South Africa and has, as a result, taken measures to improve worker/management relations.

However, there has to date been little worker participation in decision-making outside of collective bargaining in South Africa.

(2.5) Collective bargaining in South Africa

O'Regan points out that collective bargaining has been a process in terms of which trade unions and management have negotiated the terms and conditions of employment and of the workplace itself. [427]

The previous South African *Labour Relations Act* recognised three types of collective bargaining fora: industrial councils, conciliation boards and works councils. Industrial councils consisted of an equal number of employer and trade union representatives who negotiated the terms and conditions of employment. [428] When an agreement had been reached, the industrial council would usually send this agreement to the Minister of Manpower who might, in his discretion, bind all parties thereto. Section 24 of the Act determined those matters that might be included within an industrial council agreement and notes that this is

> ... generally any matter affecting or connected with the remuneration or other terms and conditions of all employees ... or ... any matter whatsoever of mutual interest to employers and employees.

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[427] Ibid 114.

[428] South African *Labour Relations Act* 28 of 1956.

However, few industrial council agreements embraced regulated conditions for employees within the workplace or imposed procedures for disciplinary, grievance or retrenchment matters. Thus, the scope of the duty to bargain had been very limited, as the courts were reluctant to expand the same. As a result of this, the *Labour Relations Amendment Act* of 1988 was enacted, in terms of which credibility was given to the establishment of the *social contact* where parties sought to regulate their own employment relationships thereby excluding the provisions of the *Labour Relations Act* and the Industrial Court. Disputes in cases were settled by agreement. However, despite these developments, most agreements still recognised that management would enjoy the upper hand in so far as investment and production issues of the corporation were concerned. Thus, although trade unions participated in collective bargaining to further their members' interests, the relationship between employer and employee remained uneven.

O'Regan notes,

> (collective bargaining) embodies an enclave of due process within an overall context of managerial domination. [429]

Thus, the problems associated with collective bargaining in South Africa were two-fold: [430]

1. Shortcomings with the system, which could be remedied; and
2. Structural limitations in bargaining.

With regard to the first issue, the Industrial Court has been unwilling to expand the scope of topics for bargaining through its unfair labour practice definition. These topics would include matters such as production processes, long-term planning and investment. Additionally, unions often had little or no access to confidential information, which curtailed their ability to bargain. Thus, where a dispute existed, management was generally able to give effect to its interpretation of a collective agreement. Where a union wished to oppose the same, it had to either declare a dispute and initiate an industrial action or launch proceedings in the Industrial Court or commence arbitration proceedings. In the USA, this is generally referred to as the *work-now-grieve later rule.*

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[429] O'Regan, above n 411, 117. See also Karl Klare, "The labor-management co-operation debate: a workplace democracy perspective" (1988) 23 *Harvard Civil Rights Civil Liberties Law Review* 39 at 71.

[430] O'Regan, above n 411, 117.

With regard to the second issue, O'Regan notes that, although the unions' main weapons in collective bargaining issues were strike actions, the same were only effective in certain circumstances. [431] In a depressed economy where unemployment is rife, strike action is not a very attractive alternative to the workforce whose jobs may be replaced by 'scab' labour. In addition, collective bargaining is only as effective as worker organisation. In regions where there is not a powerful union organisation, collective bargaining would not go very far in establishing workers' interests. Importantly, collective bargaining does *not* challenge the rights of management to manage and therefore accepts that management is the decision-maker.

Thus,

> (collective bargaining) does not challenge the basic division of the enterprise into the managers and the managed. Indeed, it might be seen as supporting that division. ... In this sense the rights of management receive no major challenge from the process of collective bargaining. ... Checks in the way managerial authority is exercised do not affect the principle; rather they underwrite it. [432]

O'Regan also notes that collective bargaining institutionalised an adversarial approach to labour relations, which was not necessarily advantageous. [433] Therefore, co-operation within the corporation should not be excluded by collective bargaining.

From the above arguments, it is evident that collective bargaining itself *cannot* fully recognise the interests of workers or lead to maximum economic growth. What is needed in South Africa is a system that increases worker participation in corporate decision-making in a meaningful way. It is therefore important to consider the *Labour Relations Act*, [434] which was brought into force and makes the industrial council (now referred to as the bargaining council) the main focus in the Act. Chapter V of the Act makes provision for the establishment of workplace forums for its employees by a representative union. Disputes must now be referred either to the Commission for Conciliation Mediation and Arbitration (CCMA) in the unorganised sector, [435] or to the bargaining council. [436] In 1997 the new *Basic Conditions of*

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431 Ibid 118.

432 Ibid 119.

433 Ibid.

434 *Labour Relations Act* (LRA) 66 (1995).

435 LRA, Chapter VII, Part A.

436 LRA, section 65(1)(b) and (c).

Employment Act (BCEA) also came into being, which attempts to entrench basic worker rights. [437]

In this thesis, sections of these Acts will be examined, which have made some inroads into allowing employees roles in participating in the affairs of the organisation (see parts 6.2 and 6.9-6.11). Arguably, these Acts have gone further than collective bargaining processes in recognising the rights and interests of employees and of the other corporate stakeholders in matters of corporate governance.

In the next section, I will examine the extent to which British committees on corporate governance have addressed and recognised the rights and interests of workers who were previously denied the opportunity of participating in the governance of corporations. A consideration of these reports is both useful and significant, as they provide further guidance on the restructuring and reformulation of a new and improved corporate governance model for South Africa.

(2.6) Corporate governance and the Cadbury, Hampel and Higgs Reports

Du Plessis notes that various commissions set up the Cadbury Committee, including the accountancy profession in 1991, to address various corporate issues including the financial aspects of corporate governance. [438] He refers to the Draft Report, which states ,

> (t)he country's economy depends on the drive and efficiency of its companies. Thus the effectiveness with which their boards discharge their responsibilities determines Britain's competitive position. They must be free to drive their companies forward, but exercise that freedom within a framework of effective acceptability. This is the essence of any system of good corporate governance. [439]

These objectives should not be regarded as being unique to the United Kingdom because recent political developments in South Africa have opened up various international markets to corporations.

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[437] *Basic Conditions of Employment Act* (BCEA) 75 of 1997.

[438] JJ du Plessis, "Corporate governance and the Cadbury Report", (1994) *South African Mercantile Law Journal*, vol. 6, 81.

[439] Ibid 82, referring to the Draft Report, paragraph 1.1, 5.

Du Plessis further refers to the Draft Report, which states ,

> (c)orporate Governance (is) the system by which companies are directed and controlled. [440]

Hence, the Code of Best Practice was formulated by the Cadbury Report, which set out to achieve a high standard of corporate governance between all the stakeholders of the corporation - the board of directors, the shareholders in general meeting, the managing directors, the non-executive directors, the managers, the audit committees and the other committees of the board of directors. Du Plessis notes *supra* that in this context, corporate governance is now relevant in South Africa because various groups were denied the opportunity of participating "in internal company law" because of the political system of the past.

The Code of Best Practice was based on principles of openness, integrity and accountability. [441] Its basic purpose was to create a system of checks and balances within the corporate structure, particularly with regard to general aspects concerning the board of directors, the non-executive directors, the executive directors, and financial reporting. As Farrar *et al* note,

> (u)nderlying any discussion of company law and any rational debate about reform is the question of interests. The limited liability company does not simply represent one interest. It represents an arena in which there is a potential clash of many interests. We may identify the interests underlying it as: (1) investors share capital/loan capital; (2) outside creditors commercial finance/trade creditors; (3) employees; (4) consumers; (5) the public. [442]

Thus, the Code requires a division of responsibilities to ensure a balance of power and authority. This is to ensure that no single individual has unfettered powers. It notes further that the role of the non-executive directors should be to bring an independent judgment and, in so doing, maintain the relevant standards of good conduct of the corporation. With regard to the issue of *employee representation on the board*, however, the commissions of the Cadbury Report did *not* specifically address this aspect. This is most likely due to the very controversial nature of the various parameters surrounding this issue from a United Kingdom context.

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440 Ibid, referring to Draft Report, paragraph 2.5, 15.

441 Ibid, referring to Draft Report, paragraph 3.2, 16.

442 Ibid 83. See also John H Farrar, Nigel E Furey, Brenda M Mannigan & Philip Wylie (1991), *Farrar's Company Law*, 3rd edn, 13.

The Hampel Report [443] followed the recommendations of the Cadbury Committee to review their findings on corporate governance in the UK. [444] The Cadbury Committee recommended that the "institutional investors should encourage regular, systematic contact at senior executive level to exchange views on strategy, performance, board membership and quality of management". In this way, investors should develop their communication channels with management. [445]

The purpose of the Hampel Committee was to review the roles of directors, shareholders and auditors in corporate governance. [446] The remit of the Hampel Committee was as follows:

> The committee will seek to promote high standards of corporate governance in the interests of investor protection and in order to preserve and enhance the standing of companies listed on the Stock Exchange. The committee's remit will extend to listed companies only. [447]

The Committee noted that corporate governance mechanisms do differ from country to country depending upon local economic and social factors. [448] It further believed that high standards of corporate governance are just important for smaller listed companies as they are for the larger companies. [449] Thus, corporate governance is not just about applying "hard and fast rules"; "broad principles" need to be considered as well. Thus, rules should be applied "flexibly and with common sense" in accordance with the needs of individual companies. This follows the intended recommendations of the previous Cadbury Committee. [450] The Hampel Committee endorses the recommendation that companies need to develop relationships "relevant to its success". This includes relationships with "employees, customers, suppliers, credit providers, local communities and governments". [451]

The Hampel Committee on corporate governance has recommended the retention of the unitary board structure. They believe that the "unitary board offers considerable flexibility", as it may delegate matters to various board committees, such as audit,

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443 Committee on Corporate Governance (1998), *Final Report* (Hampel Report), Alresford Press Ltd, Great Britain.

444 Hampel Report, above n 443, 5, paragraph 1.

445 Ibid, 43, paragraph 5.10.

446 Ibid, 8, paragraph 1.6.

447 Ibid 66.

448 Ibid, 17, paragraph 1.4.

449 Ibid, 19, paragraph 1.10.

450 Ibid, 10, paragraph 1.11.

451 Ibid, 12, paragraph 1.16.

remuneration and nomination committees. However, the Committee does acknowledge the fact some "operational decisions" are remitted to an "executive committee" and therefore "adopt some of the features of the two tier board". [452] One commentator did, however, acknowledge the fact that the previous Cadbury Committee, in its suggestions on the strengthening of the role of the non-executive members of the board, noted that this was

> … a step towards a more independent control of the executive directors and starts to approach the thinking behind the separate German supervisory-board system. [453]

Regarding the question of board composition, the Committee notes that large companies have boards, which are composed of "equal numbers of executive and non-executive directors". The Committee further acknowledges that non-executive directors have an important role in corporate governance. [454] Additionally, non-executive directors come from technical backgrounds or have overseas or political connections, which are very significant to the company. Thus, the Committee believes "that there are people from other fields who can make a real contribution to the board". [455] The Committee proposes that for boards to be effective, they need to be composed of at least one-third of non-executive directors. [456] These directors must also come "from a wide range of backgrounds". [457]

The Hampel Committee acknowledged the criticisms of the previous Cadbury Report with respect to its "box ticking" approach to governance. Although many companies were observed to be "in good condition" through this approach, it was well known that this was not in fact the case. The Hampel Committee sought to move away from this box-ticking approach by requiring companies to state in their annual reports *how* they applied the 18 "Principles" formulated by the Committee and *whether* they complied with the 42 "Provisions", which underpinned the Principles. Any non-compliance with the Provisions must be explained. Hence, the approach adopted was to "comply or explain". The combination of the Provisions and Principles are referred to as "The Combined Code". [458]

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452 Ibid, 26-7, paragraph 3.12.

453 J Shearman, "Controlling directors the German way," (1997) 18 *The Company Lawyer*, 124.

454 Hampel Report, above n 443, 27, paragraph 3.14.

455 Ibid, 27-8, paragraph 3.15.

456 Ibid 58, paragraph 12.

457 Ibid 58, paragraph 13.

458 R Smerdon (2004), *A Practical Guide to Corporate Governance*, 2nd edn, Sweet & Maxwell Limited, London, Great Britain, 3.

The UK Higgs Report on non-executive directors was released in 2003. [459] It suggested an "extensive enlargement of the Combined Code". The revised Combined Code is comprised of 17 main principles, 26 supporting principles and 47 provisions.[460] The Higgs Report recommended that the "comply or explain" approach of the Listing Rules be adopted, which the previous committees (Cadbury and Hampel) had endorsed. [461]

The most important recommendation was that the board should be composed of at least 50% independent non-executive directors (excluding the chairman). [462] In the ideal world, boards of directors would consist of a "diverse group of experienced and talented individuals". Thus, the aim of the Higgs Review with respect to the role and effectiveness of non-executive directors was "to provide benchmarks and guidance so as to enable boards to achieve as near to the ideal as is practicable in the real world". [463]

Prior to appointment, "new non-executive directors should carry out due diligence on the board and on the company" in order to ascertain that they do have the necessary "knowledge, skills, experience and time to make a positive contribution to the board". [464] The Report provides a definition of an "independent non-executive director". Thus,

> (a) non-executive director is considered independent when the board determines that the director is independent in character and judgment, and there are no relationships or circumstances which could affect, or appear to affect, the director's judgment.

These relationships would include the situations where the director has been, within the previous five years, an employee of the company, or, within the previous three years, has had a material business relationship with the company either directly or indirectly, or has received or receives additional remuneration from the company in any form (other than a director's fee), or has close family ties with any of the company's senior employees, or holds cross-directorships or has significant links with

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459 Higgs Report, <http://www.dti.gov.uk/cld/non_exec_review>.

460 Smerdon, above n 458, 19.

461 PL Davies (2003), *Gower and Davies' principles of modern company law,* 7th edn, Sweet & Maxwell, London, Great Britain, 324.

462 Higgs Report, above n 459, 1.

463 Smerdon, above n 458, 29.

464 Higgs Report, above n 459, 2.

other directors in other companies, or is a significant shareholder or has served on the board for more than 10 years. [465]

The Committee also recommends the establishment of a nomination committee of the board (to conduct board appointments) and audit and remuneration committees (to set the remuneration for the executive directors, the chairman and senior executives). [466] Non-executive directors should not sit on all of the three board committees simultaneously. [467] This recommendation does not apply to smaller listed companies. Other than this exception, the Committee recommends that there should be "no differentiation" in the corporate governance provisions between larger and smaller companies. [468]

It has been suggested that the Review's "concept of independence is difficult to reconcile with" the need for non-executive directors to have the requisite knowledge and to be qualified. [469] Furthermore, even in a two-tier board structure, it would be very difficult to ensure that non-executive directors are really independent in the true sense. [470] Thus, there are problems with the Review's definition of independence. However, nothwithstanding the above, the Review

> will make a welcome contribution to the improvement of the corporate governance of listed companies in the United Kingdom. … (T)he effectiveness of board and non-executive directors depends above all on the experience, skill, integrity and judgment of individual directors. Therefore, an open, fair and rigorous appointment process is the key to a significantly improved corporate governance. [471]

In summary, the Higgs Report recommended significant developments: [472]

1. Half of the board (instead of only one-third) should be composed of non-executive directors, all of whom should be independent;

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465 Higgs Report, above n 459, 3.

466 Ibid.

467 Ibid 6.

468 Ibid 7.

469 H-C Hirt, "The review and the role and effectiveness of non-executive directors: A critical assessment with particular reference to the German two-tier board system (part 1)" 14 (2003) *International Company and Commercial Law Review* 246.

470 Hirt, "The review and the role and effectiveness of non-executive directors: A critical assessment with particular reference to the German two-tier board system (part 2)" (2003) 14 *International Company and Commercial Law Review* 271.

471 Ibid 272.

472 Davies (2003), above n 461, 325.

2. “A more explicit definition of independence should be provided”. This would exclude anyone who had been an employee of the company during the previous five years or someone who had a “material business relationship” with the company during the previous three years;

3. Non-executive directors need to “meet regularly as a group without the executive directors (being) present”. They should also meet “at least once a year without the chair of (the) board (being) present”;

4. The chair and chief executive should not be the same person. A retiring CEO should not become the chair of the board;

5. The functions of the appointments committee and of the independent executives should be “strengthened”. Non-executive directorships should be extended to a wider range of people; and

6. A “senior independent director” should be “available for shareholders to contact” if “contact through the CEO or chair … would be inappropriate”. Senior directors should attend meetings, which are held between the management and the shareholders.

(2.7) Corporate governance codes relevant to the European Union and its Member States

The 2002 European Commission Report on corporate governance was undertaken to determine the “commonalities and differences in corporate governance practices among the European Union (EU) (fifteen) Member States”. The member states are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden and the United Kingdom. [473] In this regard, corporate governance codes, which are non-binding sets of “principles, standards or best practices” were studied and compared. [474] Thirty-five codes were studied and every Member State had at least one code except for Austria and Luxembourg. [475]

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[473] Weil et al, above n 19, 97-8.

[474] Ibid 1.

[475] Ibid 2.

The Commission found that

> (t)he greatest distinctions in corporate governance practices among EU Member States appear to result from differences in law rather than from differences in recommendations that emanate from the types of codes analysed in this Study. … (T)he trend towards convergence in corporate governance practices in EU Member States appear to be both more numerous and more powerful than any trends towards differentiation. … (T)he Codes … appear to serve as a converging force, by focusing attention … on governance issues, articulating best practice recommendations and encouraging companies to adopt them. [476]

However, the greatest difference in corporate governance practice amongst the EU Member States relates to the role of the employees. In Austria, Denmark, Germany, Luxembourg and Sweden, employees could elect some of its members to the supervisory board. In Finland and France, however, only the company articles may provide employees with this right of election. Furthermore, in France and in the Netherlands, although employee representatives may have the right to attend the board meetings, they may not vote. In all the other EU Member States, only the shareholders may elect the members of the supervisory board. Thus, the strength of "shareholder influence" differs fundamentally in the EU Member States. [477]

Whilst some of the EU Member States "emphasise broad stakeholder interests", others "emphasise ownership rights of shareholders". However, most of the Codes of the EU Member States recognised "that corporate success, shareholder profit, employee security and well being, and the interests of other stakeholders" are inextricably intertwined and dependent upon each other. [478]

Another important legal difference in corporate governance amongst the EU member States relates to the structure of the board. Although the one-tier board structure could arguably offer a closer relation and better information flow between the supervisory and management functions of the board, the two-tier system allows for a "clearer, formal separation between the supervisory body and those being "supervised". [479]

It is important to emphasise that the Codes are "flexible and non-binding" even where a "comply or explain" structure exists. Thus, a company may not follow the

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476 Ibid 3.

477 Ibid.

478 Ibid 4.

479 Ibid 4-5.

Code provided it explains why it is not doing so. Another important point is that companies are free to choose whatever Code in any of the EU Member States they wish to follow provided that the Code does not conflict with the company law of the country governing the incorporation of the companies concerned. [480]

Thus, the Commission notes that the "code movement is a positive development". Codes are beneficial because they [481]

1. Stimulate discussion of corporate governance issues;
2. Encourage companies to adopt widely-accepted governance standards;
3. Explain both governance-related legal requirements and common corporate governance practices to investors;
4. Benchmark supervisory and management bodies;
5. Prepare … for changes in securities regulation and company law.

Thus, the Commission believes that variation within the Code does not impose any "impediment to the formation of a single European equity market". The Codes, if anything, have supported "a convergence of governance practices" between the EU Member States. [482]

(2.8) Corporate governance principles of the Organisation for Economic Co-operation and Development (OECD)

The member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, the United States, Japan, Finland, Australia, New Zealand, Mexico, the Czech Republic, Hungary, Poland, Korea and the Slovak Republic. The OECD came into existence on 30 September 1961. Its main functions are to. [483]

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480 Ibid 6.

481 Ibid.

482 Ibid.

483 OECD Principles of Corporate Governance (April 2004) <http://www.oecd.org/dataoecd/47/50/4347646.pdf>, 2.

1. Achieve the highest sustainable growth and employment and an improved living standard in member countries whilst maintaining financial stability;
2. Contribute to economic expansion in member and non-member countries; and
3. Contribute to world trade expansion on a multilateral, non-discriminatory basis.

The OECD notes that today, the principles of corporate governance go "beyond that of shareholders in the performance of individual companies". [484] The Principles of the OECD offer non-binding standards and good practices of corporate governance as well as guidance on the implementation thereof. [485] The OECD Principles of Corporate Governance were agreed upon in 1999 and "formed the basis for corporate governance initiatives in both OECD and non-OECD countries".[486] Subsequently, these 1999 Principles were revised "to take into account new developments and concerns". [487]

> The Principles are intended to assist OECD and non-OECD governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance. [488]

These principles are mainly directed at publicly traded companies. However, they might also be of some use for improving corporate governance processes in privately held and state-owned companies. Furthermore, the OECD Principles acknowledge that corporate governance "involves a set of relationships between a company's management, its board, its shareholders and other stakeholders". [489] Thus, corporate governance "is affected by the relationships among participants in the governance system". Employees and other stakeholders contribute "to the long-term success and performance of the corporation". [490]

Regarding the role of the stakeholders in corporate governance, the OECD Principles state:

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484 Ibid 3.

485 Ibid 4.

486 Ibid 9.

487 Ibid 10.

488 Ibid 11.

489 Ibid.

490 Ibid 12.

> The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. … Performance-enhancing mechanisms for employee participation should be permitted to develop. … Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis. [491]

A corporate governance framework should consist of "legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices", which are unique to each country. [492] Furthermore, various branches of law often influence corporate governance processes. These include company law, securities regulations, accounting and auditing principles, insolvency, contract, labour and tax law. It is important for companies to be aware of the fact that, from time to time, some of these branches of law may overlap or even conflict. This may "frustrate the ability" to carry out significant corporate governance objectives. Thus, measures should be taken to minimise this risk. [493]

The contributions of stakeholders in the corporation are directly related to "building competitive and profitable companies". It is therefore important for corporations "to foster wealth-creating co-operation among stakeholders". Consequently, it is in the interests of corporations to recognise "the interests of (its) stakeholders and their contribution to the long-term success of the corporation". [494]

In all OECD countries, the rights of the different stakeholders are either created through legislation, contract or other commitments. Mechanisms for employee participation include representation on the boards and in governance processes such as on work councils. [495] Consequently, according to the OECD, whether a country has adopted a two-tier or unitary board system, the Principles will apply where boards must "take due regard of, and deal fairly with", the interests of employees, creditors, customers, suppliers, local communities and the environment. [496]

In some countries, the board must legally act in the interests of the company and thus consider the "interests of the shareholders, employees and the public good".

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491 Ibid 21.

492 Ibid 29.

493 Ibid 31.

494 Ibid 46.

495 Ibid 47.

496 Ibid 58.

This principle comprises the duty of care and the duty of loyalty. The duty of care entails "board members to act on a fully informed basis, in good faith, with due diligence and care". The duty of loyalty relates to the "equitable treatment of shareholders, monitoring of related part transactions and the establishment of remuneration policy for key executives and board members". [497]

The revised Principles "reinforce OECD's contribution and commitment … to strengthen the fabric of corporate governance around the world in the years ahead". This has contributed towards the development of a sound system of professional and ethical values upon which an efficient world market depends. [498]

(2.9) Corporate governance, the King Report (1994) and section 309 of the United Kingdom Companies Act

The effectiveness of the two King Reports (released in 1994 and in 2002) is discussed in detail elsewhere in this thesis (see parts 6.3-6.6) where it is concluded that, although these Reports will assist in the design and construction of a model of corporate governance for South Africa, they have have not gone far enough in ensuring that worker participation exists in the corporation. For example, the King Reports do not support the development and implementation of the two-tier board system. Although the Reports acknowledge the success of this type of system in Germany, it encourages the unitary board system to be retained in South Africa. This is one of the most unsatisfactory aspects of both of the King Reports. Also, no other alternatives to the unitary board system are even considered. Furthermore, the King Reports cannot be construed as enforceable legal documents, although they have arguably considerable persuasive value. They have to rely on other factors and "self-regulation" to encourage compliance therewith. [499] Thus, the rights of workplace forums under the South African *Labour Relations Act* to be involved in the joint decision-making processes of the corporation have not been increased or improved in any significant manner as a result of the recommendations of the latest King II Report.

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497 Ibid 59.

498 Ibid 4.

499 Blackman, MS, Jooste, RD and Everingham, GK (2002), *Commentary on the Companies Act*, Juta & Co, Ltd, South Africa, Volume 2, paragraph 208, 8–15 and 8–16-1.

In the same way, although section 309 of the UK Act notes that directors of the company are to have regard in the performance of their functions to the interests of the company's employees and its members, the *Companies Act* does not indicate *how* the interests of the shareholders and the employees are to be weighted. Consequently, the directors need to decide themselves how to balance these interests, which then generally makes this duty unenforceable in practice. Thus, having regard to the interests of employees becomes merely a procedural duty and one that has no substantive content.

I will now discuss briefly the effectiveness of the first King Report and of section 309 of the UK Companies Act.

Firstly, I will deal with the 1994 King Report briefly here in order to highlight the problems associated with recognising the participatory roles of employees in the corporation. It comprised a set of recommendations and also *The Code of Corporate Practices and Conduct.* The Code is essentially a set of principles recommended as being integral to corporate governance practices.

The Code was to apply to all companies listed on the main board of the JSE, large public entities as defined in the *Reporting by Public Entities Act* 93 of 1992, banks, financial and insurance institutions as defined in the various financial services Acts and large unlisted, dependent public companies with a total shareholders' equity greater than R50 million.

The King Committee was formed under the direction of the Institute of Directors in Southern Africa, with support from the South African Chamber of Business, the South African Institute of Chartered Accountants, the JSE, the South African Institute of Business Ethics and the Institute of Chartered Secretaries and Administrators in South Africa. Although the first King Report had its origin in the Cadbury Report of the United Kingdom, the King's Report had to have regard to circumstances unique to South African corporations.

Armstrong notes that the King Report places a burden on non-executive directors to maintain standards of good conduct. [500] Thus, emphasis is placed on non-executive directors functioning as partners in providing a guiding influence to the executive directors rather than 'watchdogs'. In addition, he notes that the King Report recommended that directors have a responsibility and duty to the wider society,

[500] P Armstrong, "The King Report on Corporate Governance", *JBL* vol. 3, part 2, 65, 66.

termed the 'dynamic participation' approach, rather than the traditional, conservative approach that the directors were only responsible and accountable to the shareholders who elected them to office. [501] Thus, with South Africa's new socio-political climate, the code expected greater accountability to be made from companies to its stakeholders with regard to its financial and non-financial affairs.

To this extent, matters that needed to be addressed included:

1. Negotiations with and involvement of employees;
2. Environmental issues;
3. Social responsibility activities and programmes;
4. Customer interest matters; and
5. Supplier interest matters.

Armstrong notes further that the Code required, as part of the corporate governance processes, [502]

1. A commitment by the organisation to standards of good conduct;
2. An infusion of the company's culture in *all* of its stakeholders;
3. A total commitment by the board and its chief executive officer; and
4. The formulation of a detailed set of guidelines for the benefit of its employees.

Pretorius, however, in his unpublished work on the nature of the first King Report and on its application to the various corporate stakeholders states,

> (s)hareholders own the company. If shareholders do well, the employees of the company do well, as does the community in which the company operates and, in turn the general economy. But the shareholders are at the top of the list. Otherwise the foundation of our economy weakens, the system falls apart, and the public interest is not served. [503]

Pretorius notes that, traditionally, shareholders' interests were regarded as being exclusive in the sense that the other stakeholders in the corporation may be

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501 Ibid 68.

502 Ibid 69.

503 JT Pretorius, The King Report and Corporate Governance (unpub.), 1, 1996.

benefited *only* to the extent that this would further the interests of its members [504]. Thus he notes,

> ... the interests of employees, customers, or the local community, for example, may be served only as a means of increasing shareholder wealth and may not be treated as ends in their own right.

However, Pretorius also observes that

> (a) different approach to company law may start by noticing that the way companies are run affects not only their members and creditors, but also their customers, suppliers, employees and neighbours, and also society in a more general sense. [505]

Thus, although company law has traditionally focused on the rules and principles, which safeguard the interests of shareholders, it is now being forced to adapt to modern circumstances and, in so doing, recognise the position of the employees within the corporation. The first King Report attempted to recognise this factor more comprehensively than had been done previously.

In addition, the United Kingdom *Companies Act* states that

> the matters to which the directors of the company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members. [506]

Pretorius argues that it is now the *duty* of the directors to operate the business so as to further the interests of the employees in addition to those of the members. He notes further that the traditional approach to company law is to be rejected for one that does not explain company law in terms of the rights of owners, but rather regards its members and employees as stakeholders, each with legitimate demands. Furthermore, he notes that “there is a substantial community of interest between the shareholders and employees” because any increase in the wealth of the company may lead to higher dividends or share values, which may result in increased wages and job security. However, there may also be a conflict of interests where each of the stakeholders has a competing interest in maximising its share of the surplus funds generated by the company's business activities. Thus, shareholders have an

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504 Ibid 3.

505 Ibid 4.

506 United Kingdom *Companies Act 1985*, section 309(1).

interest in maximising their profits, whilst the employees prefer lower profits if this would prevent "plant closures or the introduction of job-destroying technology". [507]

Additionally, there is a further concern that section 309 of the United Kingdom *Companies Act* does not indicate *how* the interests of the shareholders and the employees are to be weighted; rather it is left to the directors themselves to balance these interests. However, this duty is generally *unenforceable* in practice.

Pretorius argues that, although the directors are required to take employee interests into account, they can never subordinate the shareholders' interests to them. [508] Thus, 'having regard' to the interests of employees is merely a procedural duty and one which has no substantive content.

Pretorius notes that section 309(1) of the UK *Companies Act* is

> either one of the most incompetent or one of the most cynical pieces of drafting on record. A supposed legal duty, which is not matched by a remedy is a nonsense. [509]

To this end, Pretorius suggests that the King Report should be welcomed, as it must be seen as the start of a restructuring process of some of the main components comprising our company law. [510]

The King Report formulates nineteen guidelines for directors. Amongst these guidelines is the recommendation that directors

> must act with enterprise and always strive to increase shareholder' value while having regard for the interests of all stakeholders. [511]

Chapter 4 of the King Report, which is concerned with the issue of worker participation in the governance of corporations, recommends *inter alia* that

> corporations should evolve their own system of worker participation whether by way of workers' committees or at management, executive committee or board level. [512]

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507 Pretorius, above n 503, 6.

508 Ibid 7. See also AJ Boyle, (1986), *Gore-Brown on Companies*, 44th edn, paras. 27.4 and 27.4.1.

509 Ibid 8. See also LS Sealy, "Directors' 'wider' responsibilities – problems conceptual, practical, and procedural" (1987) 13 *Monash University LR* 164, 177.

510 Pretorius, above n 503, 9.

511 The King Report, ch. 5, paragraph 2, 8.

512 Ibid, ch. 4, paragraph 12, 7.

Furthermore, chapter 1 of the King Report notes that the stakeholders of a company include the

> shareholders, employees, bankers, suppliers, customers, environmentalists, the community or country in which it operates and the State. [513]

while chapter 12 of the King Report notes,

> ... a stakeholder is any person, entity or interest group that has some association with the company. There are three classes of stakeholders: shareholders, parties who contract with the company and parties who have a non-contractual nexus with the company. [514]

Pretorius, however, notes that, although the employees of the company are included as stakeholders by way of definition, it is possible that "the term 'having regard' to the interests of the stakeholders' (employees) will … suffer … the same fate as that of section 309 of the United Kingdom Act". However, in South Africa, the directors will be faced with "a considerably larger spectrum of potentially conflicting interests". Furthermore, the proposal in the King Report is not likely to have much affect on the way companies operate because the duty is "effectively unenforceable and … subjective". [515]

This is especially so if one considers the following aspects:

1. Various diverse groups would exist who might qualify as the 'stakeholders' of the corporation; and
2. The directors must act in accordance with what *they* believe to be the appropriate balancing of interests. Thus, the court *cannot* merely intervene on the basis that it disagrees with the way in which the directors have decided to have those interests weighed. Furthermore, the court would *not* be able to review the substantive merits of the directors' decision.

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513 Ibid, ch 1, paragraph 3.

514 Ibid, ch 12, paragraph 2.

515 Pretorius, above n 503, 10. See also Blackman et al, above n 499, paragraph 208, 8-15.

(2.10) English Company Law Reform: the 2005 White Paper

In 1998, the Government commissioned the Company Law Review (CLR), an independent group of experts, practitioners and business people, to conduct research into ascertaining how the UK *Companies Act* could be updated and modernised. Many of the CLR proposals for legislative change (together with the proposals contained in the government's subsequent White Paper of 2002) are contained in the 2005 Company Law Reform White Paper. [516] The CLR "is part of a wider programme" to "encourage investment, (and) promote long-term company performance". [517]

Consequently, the English Government published a White Paper, the "Company Law Reform" in March 2005. The White Paper sets out the Government's proposals for a comprehensive reform of the English Company Law so as to bring it into line with the needs of modern business. Public consultation closed on 10 June 2005 and the various responses are being considered. [518]

The White Paper sets out measures for the Company Law Reform Bill. The draft Company Law Reform Bill proposes four major changes: [519]

1. *Enhancing shareholder engagement and a long-term investment culture*. The view is that "shareholders are the lifeblood of a company, whatever its size". Thus, the Bill wishes to encourage and promote a "wide participation of shareholders". Decisions should be "based on the longer-term view and not just immediate return". Directors must promote the company for its shareholders. However, to do this, it must take "due account" of "wider factors such as employees, effects on the environment, suppliers and customers". [520] To allow companies to work best, the roles and responsibilities of directors "need to be clearly defined". These changes ensure that the directors and shareholders can work and function in such a manner that "promotes long-term company performance". [521]

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516 White Paper (2005), <http://www.dti.gov.uk/cld/review.htm>, accessed 6 November 2005, 5, 9.

517 Ibid 9.

518 Ibid.

519 Ibid 5.

520 Ibid.

521 Ibid 12.

2. *Ensuring better regulation and a "Think Small First" approach*. Most of the UK companies are small, with more than "90% of companies having five shareholders or fewer". [522] Traditionally, however, company law was written in reference to large companies. Consequently, this balance needs to be "reset" to "make the law easier for all to understand and use". In this regard, the decision-making processes for private companies will be simplified as well as the rules pertaining to their share capital. Furthermore, the requirement of private companies having a company secretary will be abolished. Better and more appropriate advice and guidance will also be available especially to smaller firms so that all may "understand the options available … and the requirements placed upon them". [523] The government wishes the new legislation "to recognise smaller private companies not as the exception, but as the rule". Consequently, unnecessary burdens on small firms will be removed and the law made more accessible to them. [524]

3. *Making it easier to set up and run a company.* The idea is to "remove unnecessary burdens to directors and to preserve Britain's reputation as a favoured country in which to incorporate". Consequently, the requirement for a company to have authorised share capital will be abolished. A single person may also be able to form a public company. [525] Thus, it is "relatively easy and cheap" to establish a company in the UK. [526]

4. *Providing flexibility for the future*. A "new reform power" must be introduced, which would allow the legislation to be updated and amended as required, subject to "full consultation and appropriate parliamentary scrutiny". "Some measure of flexibility" should be "built into the company law framework to ensure that it can be kept up-to-date in (the) future". [527]

The government is of the view that these four measures would allow company law to fit better with the business reality of today. Consequently, this "should create improved performance across the economy as (a) whole, as well as reducing direct

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522 Ibid 13.

523 Ibid 6.

524 Ibid 13.

525 Ibid 7.

526 Ibid 13.

527 Ibid.

compliance costs for business and producing cost savings which could amount to some 250 million pounds a year". [528] A "modern and effective" system of corporate governance "can promote enterprise, enhance competiteveness and stimulate investment". However, "an ineffective or outmoded" system "can inhibit productivity and growth and undermine investment confidence". Consequently, "a modern, enabling and robust framework for … companies", would allow the UK to maintain its position "as one of the most attractive places in the world to set up and run a business". [529] To achieve this aim, the government has "worked alongside businesses, professionals and investors". [530] For example, the new Combined Code on Corporate Governance was published in 2003. This Code (the Higgs Report) also contains some of the changes recommended in the 2005 White Paper with regard to the "independence and effectiveness of non-executive directors". [531] These developments have contributed towards the creation of "a modern, enabling framework, which facilitates enterprise and market confidence".

The Company Law Reform Bill will amend and restate provisions of significance for the day-to-day business operations of small companies. The "revised provisions" will be set out "in a new, more logical and easily accessible way". "The Bill will also include new provisions" to establish "the duties of directors". [532]

(2.11) Further comments regarding the range of a company's interests

As previously alluded to, it is clear that public policy no longer shares the view that directors should always be compelled to act in the interests of the company, which are capable of feathering the nests only of the shareholders.

Dodd notes,

> ... (t)here are three groups of people who have an interest in that institution. ... a group of ... people who have put their capital in the company, namely, its shareholders. Another is a group of ... people

[528] Ibid 7.

[529] Ibid 8.

[530] Ibid 10.

[531] Ibid 11.

[532] Ibid 14.

> who are putting their labour into the business of the company. The third group is of customers and the general public. Customers have a right to demand that a concern so large shall not only do its business honestly and properly, but, further, that it shall meet its public obligations and perform its public duties. … One no longer feels the obligation to take from labour for the benefit of capital, nor to take from the public for the benefit of both, but rather to administer wisely and fairly in the interests of all. [533]

These sentiments, as Beuthin points out, have been echoed by many leading businesspeople in different parts of the world. [534] Moreover, Beuthin notes that when the board of an Australian company was being attacked by shareholders, who thought that they, as *the shareholders*, had a right to a greater portion of the profits than that which the corporation intended to give them, the board responded by stating that

> (w)e have four sections of the community to whom we are responsible: shareholders, employees, customers, and the public in general. [535]

As Beuthin puts it, this "*growing sense of trusteeship"* has been reflected in South African corporations as well. [536] Sir Ernest Oppenheimer defined the aim of the corporation, in his fifty-first annual report in 1967, as being

> to make profits for its shareholders, but to do so in such a way as to make a real contribution to the welfare of the countries where it operates. [537]

Beuthin conducted a survey in South Africa in 1969 and concluded that approximately 57% of public and private companies had acknowledged that they needed to balance the group interests of shareholders, employees, consumers and the general public and, in addition, might have even, in appropriate circumstances, advanced the interests of certain groups at the expense of shareholders. [538] Furthermore, these companies were of the view that the general public would agree that this was in fact the directors' duty.

Beuthin refers to a commentary taken from *The Times,* which stated,

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533 RC Beuthin, "The range of a company's interests", (1969) *SALJ* Vol. LXXXVI, 164.

534 Ibid 165.

535 Ibid.

536 Ibid.

537 Ibid, referring to Sir Ernest Oppenheimer, 51st Annual Report (1967).

538 Beuthin, above n 533, 165.

> (w)e start from the fact that the company has duties to the community. At least we must not pollute the river or cause too much smoke. Then we go a step further and argue that we should promote developments of benefit to the community, which tends to be a geographical responsibility. ... Extending the logic again we hope to go further than to give money and liked to be involved in the way in which the money is spent. [539]

In addition, Beuthin refers to the views of Seymour, who seems to think that maintaining a service to the shareholders, to the employees and to the public, are three legs of a tripod supporting the existence and success of a business. [540] Each of them must be rigid if the business is to prosper. Hence, the object is to ensure a proper balance in the pursuit of all these purposes and to continually improve the method for their attainment. Thus, Beuthin maintains that *all* stakeholder interests must be recognised. Firstly, the shareholder has invested and risked his or her money in the company. Secondly, the existence and life of the employees is even more closely linked with the company that that of the shareholder. With each day that passes, employees invest more of themselves in the company. Thus, the relationship between employer and employee in modern companies can no longer be described as merely a master/servant relationship. Management must have the loyalty of the company's employees to be successful. Thirdly, directors owe duties to consumers not to extort excessive prices or to manufacture poor quality products. Thus, directors should not "ride roughshod" over interests of stakeholders, including that of the nation. Management is also finding it more difficult to avoid a consideration of the interests and rights of the non-shareholder constituents, as these groups have been placing "increasing pressure" on directors to consider them.

Beuthin points out, however, that no matter how desirable it may be that the board should consider the interests of all the groups when planning its overall policy, it may not be practical for it to do so rigidly on a day-to-day basis. [541] That is, it is arguable whether any board could be expected to weigh each competing interest against the others and then assess with satisfactory accuracy the extent to which some should, on that particular occasion, give way to the others.

He notes furthermore that

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539 Ibid 166, referring to *The Times*, 13 May 1968.

540 Ibid 169, referring to John Seymour, *Company Direction* (1954) at 22.

541 Ibid 172.

> (i)n a competitive market the lesson has always been that profit is the key criterion. In the process of making profits the directors will find that they have at the same time successfully protected the interests of all groups. ... By devoting their attention to profit the directors will ensure that the company is being served by well-paid employees who are contented in their jobs, and that quality goods or first-rate services are being made available to its customers at low prices. (However), directors will indeed find it impossible to maintain optimum profit for any length of time if they sacrifice the interests of any one of the groups. [542]

Many would agree that the directors should be entitled to take into consideration the interests of all groups; there are also some who would go much further and would wish to *compel* directors to take same into consideration. Thus, many believe that all the interest groups, and particularly the employees, should be given an opportunity of ensuring that their interests are in fact considered. This can only be achieved by employees being placed in a position where they may exercise some degree of control over directors and managers. Goyder succinctly notes,

> (o)ne can no longer expect the employee to be satisfied with mere 'hand-outs' from a benign board. It is not 'free ice cream' he wants, but the opportunity of participating in the creation, direction and expansion of industry. [543]

(2.12) Conclusion

Competition in a competitive labour and supply market will probably be the strongest factor in ensuring that corporations acknowledge the rights and interests of stakeholders other than merely those of the shareholders. Thus, the traditional concept of the corporation cannot be maintained in the changed social and economic conditions embracing South African corporate policy. The function of the corporation is no longer set merely to provide maximum profits for its shareholders.

Hence, companies cannot escape being influenced by political, economic and sociological factors. In response to these pressures, changes are taking place within companies and sometimes independently of any law. In any event, it is now timely for the legal system in South Africa to catch up with developments in the commercial and industrial world. In this regard, however, Gower's arguments are convincing and

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542 Ibid 173.

543 Ibid, referring to George Goyder, *The Future of Private Enterprise* (1951), 28-9.

arguably correct when he notes that he is against any legislation, which would envelop the law in a "*legislative strait-jacket*". [544] Gower therefore maintains that

> (o)n the whole it may be better to leave a penumbra of uncertainty from which intriguing questions can occasionally emerge, rather than to paint a clearly defined line to which all may step but which must not be crossed.

In addition, collective bargaining, although effective at some levels, did *not* challenge, but probably strengthened, traditional structures of authority within corporations. Systems of worker participation in decision-making in capitalist economies have been more successful where strong trade union movements have existed. However, final control over decision-making has *still* rested with management and/or shareholders. Nevertheless, trade unions regard participation on company boards and at management level to be beneficial to worker interests, *even* if it does not fundamentally alter any social or economic interests in industry. The reason for this support is that worker participation is able to address some of the shortcomings, which existed with collective bargaining. Therefore, Baskin has concluded that

> (there) are signs of a trend towards greater, structured, involvement by unions in a range of issues. The trend towards active engagement is also noticeable at industry level. Unions are engaged in … issues more complex and far-reaching than anything with which they have previously dealt. At plant-level, a significant number of companies are introducing worker participation schemes, in the hope of winning greater co-operation from their employees … hoping the carrot will work where the stick has failed. The shift by unions away from adversarialism and towards engagement with a broader range of issues has been widely noted. Some have spoken of a new "strategic unionism" emerging, others of a shift "from resistance to reconstruction". … But, for the first time, greater co-operation with both state and employer is now possible. Unions have the chance to influence the macro-environment, which fundamentally determines what happens to their members at home and at work. [545]

In addition, the first King Report seems to advance the rights and interests of other stakeholders in the corporation. For the purposes of this chapter, selected paragraphs were discussed, which arguably deal for the first time in South African corporate history, with the issue of worker participation in the governance processes of companies. The 'bottom line' is that the employees of the company should qualify as one of the 'stakeholders'. However, whether the King Reports will have a major effect on the way companies operate in practice is questionable, simply because the

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[544] LCB Gower, *Harvard Law Review* (1955) 68, 1193.

[545] Jeremy Baskin, "The trend towards bargained corporatism", (1993) *SA Labour Bulletin* Vol. 17 No. 3, May/June, 64.

duties envisaged are *effectively unenforceable*. Thus, although Codes of Conduct are used in many countries, the main challenge is to devise an effective method of *ensuring and enforcing compliance*. If a company fails to observe the terms of the Code and it is not backed by legal sanction or does not provide an available remedy to a particular individual or interest group, the effectiveness of the same is then to be doubted. In chapter 6, the King Report will be discussed in greater detail. The effectiveness of the King II Report in considering the issue of stakeholder interests in the corporation will also be discussed.

Additionally, Botha, frowns upon the King I Report and states that

> (t)he Report was commissioned and supported mainly by the South African corporate community. The composition of the King committee, the objectives of some of the task groups, and the terms of reference for the Report provide circumstantial affirmation for the submission that the motivation for the undertaking was primarily for institutional considerations. I submit that the main incentives were to protect vested interests of the corporate groups in the South African economy and to avoid direct governmental involvement in issues of corporate governance. It should also be noted that the Report was prepared at a time when the social fabric of South Africa was exposed to a process of significant and swift reforms arising from a combination of adjustments and changes in a number of issues relating to culture, customs, traditions, and politics. As far as corporate South Africa was concerned, these adjustments revealed, inter alia, the tensions between the liberal individualism of a refined form of efficient capitalism and the more socially directed concerns of 'social capitalism'. The Report has emerged from these submitted initiatives and an environment of these … conflicting influences. [546]

The King Report, however, should be viewed as a *continuing* initiative in a dynamic socio-political environment as South Africa enters a new era of democracy. Accordingly, it may be appropriate for corporations to monitor developments and define a course of conduct relevant to their particular business. In this way, guidance needs to be provided to corporations in the application and interpretation of the King Committee's recommendations. Berle & Means succinctly sum up this position in noting that

> the … shareholder in the modern corporate situation has surrendered a set of definite rights for a set of indefinite expectations. The whole effect of the growth of powers of directors and "control" has been steadily to diminish the number of things on which a shareholder can count; the number of demands, which he can make with any assurance that must be satisfied. The stockholder is therefore left as a matter of law with little more than the loose expectation that a group of men, under a nominal duty to run the enterprise for his benefit and that others like him, will actually observe this obligation. [547]

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[546] Derek Botha, "Confusion in the King Report", (1996) *SA Mercantile Law Journal* 8, 26.

[547] Pretorius, above n 503, 12. See also Adolf A Berle & Gardiner C Means (1991), *The Modern Corporation and Private Property*, 3rd edn, 244.

Thus, although the classical style of management has thus far been evidenced in various legal systems (including the South African *Companies Act*), there is growing support for the view that this practice is *not* the pattern followed in boardrooms today. Many officials, including directors, contend that any law that supports such a classical approach to management, has not kept pace with society, which generally seems to acknowledge that the modern corporation today, should function not simply as an economic entity designed to maximise profit-making, but rather as one which, in addition, owes social responsibilities to a wider circle of interests. Thus, it is arguable that it is the *duty* of directors to consider and satisfy not only the interests of shareholders, but also the interests of its employees, customers, trade partners, the local community and the nation.

In referring to the comments of Henry Ford, Beuthin notes,

> (m)y ambition is to employ still more men to spread the benefits of this industrial system to the greatest possible number, to help them build up their homes. To do this we are putting the greatest share of our profits back into the business. [548]

[548] Beuthin, above n 533, 157, referring to Henry Ford (1959), *Cases and Materials on Corporations*, 3rd edn, 1386.

CHAPTER 3:

(3.0) COMPANY CONTRACTS OF SHAREHOLDERS VERSUS EMPLOYMENT CONTRACTS OF EMPLOYEES: A COMPARISON OF THE STATUS OF THE SHAREHOLDERS AND THE EMPLOYEES WITHIN THE CORPORATION

In this chapter an analogy will be sought between the position of shareholders with respect to their company contracts and that of employees in terms of their employment contracts with the company. These contracts arise from very different sources of legal creation.

(3.1) Introduction

The South African *Companies Act* creates a legal relationship of a *contractual nature* between a corporation and its shareholders (members). The employment relationship is no longer *solely* based upon the Roman law master and servant principle. It is based nowadays upon various sources, which include the common law, legislation, customs and uses and international conventions. Thus, although company contracts between the company and its shareholders are created by legislation alone, the contract of employment, is nowadays developed by the courts to a significant degree. Consequently, in the development of a new corporate governance model for South Africa, it needs to be recognised that the employment contract is not completely governed by legislation, as is the case with shareholder contracts. Based upon the traditional Roman law concepts of employment, the rights and interests of employees could easily be ignored especially in so far as this might pertain to their participation in matters of corporate governance. There is arguably, however, some legislation, which could assist employees in safeguarding their rights and interests and thereby afford them with an opportunity of some means of participation in matters of corporate governance. In this chapter reference is made to two sections of the Companies Acts, which have, to date, generally not been utilised by employees. These sections include section 252, which encompasses the situation where any particular act or omission of a company is unfairly prejudicial, unjust or inequitable. The court could make an order bringing to an end the matter complained of on the basis of it being just and equitable to do so. Furthermore, in terms of section 344(h) of the South African *Companies Act* a court may order a company to be wound up if it appears to the Court to be just and equitable to do so. Thus, employees *ought* to have the right, as do creditors, to intervene by using these sections to assist them in their grievances.

(3.2) The contract between a corporation and its shareholders in South African company law

Section 65(2) of the South African *Companies Act* creates a legal relationship of a *contractual nature* between a corporation and its shareholders. It provides,

> (t)he memorandum and articles shall bind the company and the members thereof to the same extent as if they respectively had been signed by each member, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this Act. [549]

Furthermore, leading case decisions have expressed the same views.

Trollip JA in *Gohlke and Schneider v Westies Minerale (Edms) Bpk* notes,

> (t)he company and its members are bound only to the same extent as if the articles had been signed by each member, that is, as if they had contracted in terms of the articles. The articles, therefore, merely have the same force as a contract between the company and each and every member as such to observe their provisions. [550]

Furthermore, in *Clark v Workman*, Ross J notes,

> (it) is a contract of the most sacred character, and it is on the faith of it that each shareholder advances his money. [551]

This suggests that a contract is created which entitles the shareholders to receive dividends in the company.

(3.3) The employment contract

In respect to employment the South African *common law contract* is based upon the Roman law principle of *locatio conductio operarum.* This is a common law principle in terms whereof a person voluntarily provides his or her services for a certain time for a specific salary.

Venter notes, however, that the courts are

> shifting the contract of employment towards a more substantial and lasting relationship between employer and employee. [552]

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549 South African *Companies Act* 61 (1973), section 65(2).

550 Venter, above n 357, 22. See also Trollip JA in *Gohlke and Schneider v Westies Minerale (Edms) Bpk*, 1970 (2) SA 685(A) at 692F.

551 Ibid. See also *Clark v Workman* (1920) 1 I.R. 107 at 112.

552 Ibid 25.

Thus, in *Media Workers' Association of S.A. and Others v Perskor* John AM notes,

> (a)t common law a contract can be brought to an end by the employer's acceptance of the striker's repudiation of his contract, evidenced by his refusal, in concert with others, to fulfill his obligations to work. The question in labour law, however, is whether it is fair for the employer so to do. [553]

Venter notes, however, that although John AM refers to the common law, by having added principles of fairness and justice to it, the contact has been extended to such a degree, that its common law elements have become *"barely recognisable".* [554]

Hence, the various *types* of contracts governing the relationships between the company and the shareholder on the one hand, and the employer and employee on the other, are significantly different.

Venter notes that, although the company contract to which the shareholder becomes a party is created by legislation, more specifically section 65(2) of the Act referred to above, the contract of employment, as developed by the courts, has, as its basis, the common law contract. [555] He further notes, however, that

> the quid pro quo, whether it be in the form of a dividend or in the form of wages, is derived from " contract" and the ability of the company (employer) to pay either will depend on the financial well-being of the company. … The employee is, in accordance with his contract with his company, compelled to tender his services in exchange for his wages. … This relationship, inter alia, includes concepts of fidelity and obedience. The position of the shareholder is different. The courts have affirmatively held that shareholders owe no duty of care to the company or to other shareholders and have traditionally defended the free exercise of the individual's right to vote. Thus the respective duties of shareholder and employee remain far removed from one another. [556]

Because both the shareholder and the employee derive rights from and incur obligations against the company by contract, both parties *should* be afforded the protection required to safeguard their rights and interests. Thus, the rights and interests of the employee should not, in any way, be treated by legislation as inferior to those rights and interests of the shareholders. Xuereb notes that no particular

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553 Ibid. See also John AM in *Media Workers' Association of S.A. and Others v Perskor* (1989) 10 ILJ 1062 (IC) at 1071J et seq.

554 Ibid.

555 Ibid 26.

556 Ibid 27.

right or interest, whether that is of the employee or shareholder, is entitled to predominate always. [557] Furthermore, Gower notes,

> (n)ow, however, the time is past when our blood can be made to run cold at the thought of crossing the wires of company law and 'master and servant' law. [558]

Hence, industrial democracy is demanding that the traditional master and servant relationship of the Victorian era is terminated. Thus,

> ... it remains true that if the South African lawyer ignores the demands and aspirations of the workforce in the era of the new South Africa, he will find himself overtaken by events. [559]

(3.4) Various sections of the South African Companies Act to provide relief to employees

Various sections of the South African *Companies Act* 61 of 1973 may further assist employees in asserting their rights in the participation of corporate governance matters. [560] These include sections 252 and 344(h).

It is necessary to consider the possible extension of relief envisaged in section 252 to employees of the corporation.

For example, section 252 provides that

> (1) Any member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable to him or to some part of the members of the company, may, subject to the provisions of subsection (2), make an application to the Court for an order under this section.
>
> (2) ...

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557 Ibid 28. See also PG Xuereb, "The juridification of industrial relations through company law reform" (1988) 51 *MLR* 156 at 159.

558 LCB Gower (1979), *Gower's Principles of Modern Company Law*, 4th edn, Stevens and Sons, London, Great Britain, ch 5, 66. See also Venter, above n 357, 29.

559 Venter, above n 357, 29.

560 Ibid.

> (3) If on any such application it appears to the Court that the particular act or omission is unfairly prejudicial, unjust or inequitable, or that the company's affairs are being conducted as aforesaid and if the Court considers it just and equitable, the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the future conduct of the company's affairs or for the purchase of the shares of any members of the company by other members thereof or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise. In this way, section 252 permits the court to assist a member or members of the corporation who complain about the way the affairs of the company are being conducted where the same is unfairly prejudicial, unjust or inequitable.

In *Donaldson Investments (Pty) Ltd and Others v Anglo-Transvaal Colliers Ltd*, Preiss J notes,

> ... the applicant must establish a lack of probity or fair dealing, or a visible departure from the standards of fair dealing or a violation of the conditions of fair play on which every shareholder is entitled to rely. [561]

Venter submits that the *standards of fair dealing* referred to above, should apply to *employees* as well. Thus,

> ... that if sub-section 1 were to be amended to provide for the inclusion of similar rights to employees, this could have a profound effect on the employment relationship between companies and their employees because in accordance with sub-section 3, the court may make such order "as it thinks fit" in the circumstances. … (An amendment) will make a considerable contribution towards lessening the tensions between a company and its employees particularly if one anticipates a demand for some form of workers' democracy in the new South Africa. [562]

This indicates that the time is opportune for labour to erode *the foundations of company law* so that employees of the corporation do *in fact* have their interests protected in such a way that it does become *meaningful to them*. This idea will be more fully explored in this thesis where the birth of a new model of corporate governance will be proposed.

An aggrieved employee should be able to rely on the provisions of sub-section 3 in terms whereof the court could make an order bringing to an end *the matter complained of* on the basis of it being *just and equitable* to do so. Thus,

> …it is suggested that where the company is conducting its affairs as described in sub-section 1, an employee could obtain rights in addition to those to which he may be entitled under existing law. The employee could also protect his rights in cases of unfairness, which may be more extensive under the

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561 Ibid 31. See also *Donaldson Investments Pty Ltd and Others v Anglo-Transvaal Colliers Ltd* (1979) 3 SA 713 (W) at 722E.

562 Ibid 31-32.

> section than any rights he may enjoy in unfairness situations in labour law. Where the matter complained of is of a nature that will seriously impair the well being of a company's employees or their relationship with the company, the situation could be prevented by the intervention of an employee or employees in terms of the section. [563]

There are sound reasons to extend the provisions of section 252 to *include* the interests and of employees as well. This is primarily due to the fact that neither the employee nor the corporation could abuse the provisions of section 252 because the right to grant relief at all times vests in the court.

Furthermore, section 344(h) of the South African *Companies Act* pertains to one of the circumstances where a court may order a company to be wound up. See also heading 2.1 above. It provides that

> A company may be wound up by the court if:
> ...
> (h) it appears to the Court that it is just and equitable that the company should be wound up. [564]

In a discussion of section 111(g) of the now repealed *Companies Act* of 1926, which is very similar to the present 344(h), Trollip J in *Moosa N.O. v Maujee Bhawan (Pty) Ltd and Another* notes,

> ... just and equitable ... postulates not facts but only a broad conclusion of law, justice and equity, as a grounds for winding-up. ... In its terms and effect, therefore, sec. 111(g) confers upon the Court a very wide discretionary power, the only limitation arguably being that it had to be exercised judicially with due regards to the justice and equity of the competing interests of all concerned. [565]

Furthermore, Meskin *et al* note,

> ... an applicant must come to court with clean hands and a creditor may apply provided that if the creditor is not also a member, or entitled to be registered as a member, he must have a legitimate interest. [566]

With regard to *the competing interests of all concerned*, two important issues arise, which are:

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563 Ibid 32.

564 Ibid 34. See also the South African *Companies Act* section 344(h).

565 Ibid 35. See also the decision of *Moosa N.O. v Maujee Bhawan (Pty) Ltd and Another* (1967) 3 SA 131 (T) at 135G-H.

566 Ibid. See also Philip M Meskin et al (eds) (1985), *Henochsberg on the Compamies Act*, 4th edn, Butterworths, 587.

(a) Where conduct by the directors or the members is *fraudulent or otherwise wrongful, oppressive or unfair*, then the competing interests of all the stakeholders (including the employees) in the corporation ought to be considered. With regard to employees themselves, this is significant because of the fact that their existence depends on the company's affairs being managed properly; and

(b) Where a company is not properly managing its affairs, and as a consequence of which is forced into liquidation, employees *ought* to have the right, as do creditors, to intervene.

In *Sweet v Finbain*, it was noted that

... there are individuals with rights, expectations and obligations, inter se, which are not necessarily submerged in the company structure. One such individual must surely be an employee for if a creditor is able to rely on section 344(h) to protect his debt, there is no reason in law or in logic why an employee should not indulge in the same privilege so as to protect his vital interests. It seems that employees have been timid or reluctant in applying the provisions of this subsection towards protecting their interests but this is no doubt due to a lack of knowledge of the internal workings of the company. ... [567]

Finally, Simitis notes,

... The law must replace the unilateral decision of the employer by an increasingly objective decision-making process. ...The legislature must increasingly intervene ... with the aim of steering economic and social developments in a direction, which ... control social conflict. ... (J)uridification is an inescapable consequence of industrialisation ... to achieve ... a democratic society. A study of the process and effects of juridification cannot simply concentrate on 'labour law' in the narrow sense, but must see labour law as part of a wider 'social law' convening the whole employment relationship. [568]

It would appear, therefore, that there are sound reasons for the introduction of legislation, which would allow employees in companies the opportunity to have a more equal treatment in law with shareholders. Thus, this principle would enable directors to satisfy the interests of employees, but would be subordinated to those interests of its shareholders where this is *reasonably* required or necessary in long-term shareholder and employee interests, but not otherwise. [569]

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[567] Ibid 37. See also *Sweet v Finbain* (1984) 3 SA 441 (W) at 445B-C.

[568] Ibid 65. See also Spiros Simitis, "Verrechtlichung der Arbeitsbeziehugen" in (1987-8) *Comparative Labour Law Journal* Vol. 9, 93 (condensed translated version).

[569] Ibid 67.

(3.5) Conclusion

Section 65(2) of the South African *Companies Act* creates a legal relationship of a *contractual nature* between a corporation and its shareholders. However, the courts have shifted the contract of employment towards a more substantial and lasting relationship between employer and employee. The employment relationship is no longer solely based upon the Roman law *locatio conductio operarum* (master and servant) principle. It is composed of and based nowadays upon the common law, legislation, customs and uses and international conventions. This is due to the fact that the employee/employer relationship is no longer based solely upon the traditional master and servant relationship. The employment relationship is further shaped and developed by *inter alia* economics, sociology and political science. [570]

There are good reasons for extending the provisions of section 252 to include, in addition, a consideration of the rights and interests of the employees as stakeholders of the corporation. This is primarily because neither the employees nor the corporation would be able to abuse the provisions of section 252, as the right to grant relief would remain fixed in the hands of the courts.

Furthermore, regarding section 344(h), if a creditor is able to rely on this section to protect his or her debt, there is no reason in law or in logic why an employee should not be able to do the same in order to protect his or her rights and interests. Consequently, where the conduct of a director or member is fraudulent or otherwise wrongful, oppressive or unfair or where a company is not properly managing its affairs, then the competing interests of all the stakeholders (including the employees) in the corporation ought to be considered.

Further to this, Xuereb notes,

> (i)t is submitted that the answer lies in the law's demanding that directors act in continuing interests of the hypothetical shareholder and hypothetical employee, balancing short-term interests against long-term interests so that short-term demands of either group will be met … provided these are compatible with long-term interests (… a continuing reputation for taking employee interests into account). [571]

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[570] Ibid 64.

[571] Ibid 68. See also Xuereb, above n 557, 159.

By extending the practical application of these two provisions of the Companies Acts to employees, a movement in the right direction towards an improved model of corporate governance for South Africa can be achieved.

CHAPTER 4:

(4.0) THE IMPACT OF DIRECTORS' DUTIES ON THE INTERESTS OF THE CORPORATION'S STAKEHOLDERS

In this chapter a closer consideration will be undertaken in respect to the duties of directors and to whom these currently apply and should in the future apply. In this regard, various considerations and views will be noted and discussed. The directors' duties towards its shareholders, employees, creditors, bondholders/debenture holders and the community and environment will also be documented and compared in different legal jurisdictions. It is significant to determine the scope of the duties of directors and to whom they should or could apply in the formulation of a new corporate governance model for South Africa.

(4.1) Introduction

This is a period of major change for company law in South Africa. It was argued in chapter 1 of this thesis that the traditional rules and concepts enshrining the doctrine of profit maximisation for shareholders and which may have served their purpose well a century ago when companies brought their disputes, are now anachronistic and can no longer cope satisfactorily today even with the same problems. Procedures, remedies, concepts and fact-situations have been modified or altered completely, and thus we must expect the law to respond and adapt accordingly thereto as well.

Consequently, regarding the fiduciary duties of directors, the courts do not recognise the validity of articles, which release directors from their duties towards the company. However, although the articles confer powers upon directors, they do not themselves constitute a contract between the company and director. Thus, the articles cannot *alone* impose duties or confer rights on directors. However, a director and a company could enter into a contract to confer these rights and impose these duties. Usually, when a directorship is accepted without such an express contract having been created, an implied contract is deemed to exist to the extent that the director is entitled to such rights and subject to such duties as the articles purport to confer and impose upon its directors. However, the courts do recognise that the articles of a corporation allow a director to fulfil his or her duty of *disclosure* to the company through a disclosure to the *board* rather than to the general meeting. Furthermore, the articles permit a director to retain an "incidental profit" and to act in matters in which he or she may have a corporate interest. [572]

From the above, it is clear that directors' duties may not always be clearly defined in terms of the articles or an agreed contract. Thus, the question to be determined is *how* to best define the director's fiduciary duty and, more specifically, whether it should be cast narrowly to maximise shareholders' wealth or whether it should be extended to non-shareholder constituencies as well. Consequently, although directors in the performance of their duties stand in a fiduciary relationship to the company alone, it is unclear as to what precisely these fiduciary duties entail.[573] It is

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572 MS Blackman, "Exemption of directors from liability and section 247(1) of the *Companies Act* 1973", (1993) *THRHR*, 56, 557. See also Blackman et al, above n 499, paragraph 208, 8-8.

573 JG MacIntosh, "Designing an efficient fiduciary law", (1993) *University Of Toronto Law Journal*, 43, 425. See also Blackman et al, above n 499, paragraph 208, 8-11.

argued that directors should be *under a duty* to have regard to the interests of the other groups – for example, the employees, customers, suppliers, bondholders and the community and environment. Thus, many writers have challenged the traditional rules of company law regarding directors' duties applying only to the shareholders and to the company itself. It is only with creditors that sentiments have been expressed through the courts and writers that the fiduciary duties of directors need not necessarily be extended. Some writers argue that creditors' interests are sufficiently safeguarded by the law as it currently stands.

Whatever is decided by our courts in the future or whatever legislation on directors' duties is enacted, a director must act *reasonably* to the stakeholders at all times. Thus, in conducting the affairs of the company, a director must act reasonably in accordance with the uniqueness of that company. In other words, the kind of company it is and its nature of business are subjective elements against which the question of reasonableness has to be assessed. [574]

(4.2) Background

Much of the English company law adopted by South Africa reflects the Victorian perception of the company including the notion that the director acts as an agent or trustee for his or her constituents, the shareholders and the company itself.

Sealy notes,

> (i)t is (the shareholders) who have chosen him, warts and all; they who can remove him; they who can ratify his acts in excess of authority and forgive his sins; even, for many decades, they who could dictate to him and his co-directors how to run the business. His duties of care and skill can properly be assessed by subjective criteria, since he has been elected for whatever qualities he has. And in fixing his duties to the company it is right to take account of the particular terms of the members' social contract (i.e. the memorandum, including the objects clause, and the articles of association), since all concerned are party to it. [575]

Additionally, in the decision of *Re Smith v Fawcett Ltd* Lord Greene MR recites the traditional company law principle that directors owe their duties only to the company and they do so individually:

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[574] JS McLennan, "Duties of care and skill of company directors and their liability for negligence", (1996) *South African Mercantile Law Journal*, 8, 102.

[575] Sealy, above n 509, 165.

> (d)irectors must exercise their discretion bona fide ... in the interests of the company, and not for any collateral purpose. [576]

In addition, Ford notes,

> the members is the membership as a continuum: directors are to "balance a long term view against the short term interest of the present members".... (T)he members' "capacity as associated persons" requires their particular social contract to be taken into account: ... the position ... is that the company is the totality of members viewed in the light of their association and corporate objects. [577]

Sealy notes that, traditionally, directors owe *no* legal duties to any of the non-shareholder constituents, including the employees and creditors. [578] Hence, with regard to the traditional rules of company law, directors' duties were regarded as being owed to the company and to the company alone. Directors were not bound to consider the interests of other groups including the employees, creditors, customers and suppliers, or to have any concern for the community, the environment, welfare or charity unless, by doing so, this would have derivative benefits for their shareholders. Indeed, in Australia as well, although directors should be obliged to consider the interests of its employees, customers, contractors and the community "when making decisions for the company, there is no case law or corporations legislation in Australia that imposes that obligation". [579]

Sealy notes that there are widely-held views, however, that the law on directors' duties should be modified, extended, substituted or altered so as to recognise the role played in modern business by groups other than shareholders, and particularly by its employees. The view has also been expressed that directors should be *under a duty* to have regard to the interests of these other groups.

It is against this background that many practitioners and academics have challenged the traditional rules and concepts of company law regarding directors' duties. Indeed, the traditional rule that the directors of a company owe their duties to the company and to the hypothetical individual shareholder has been subject to such significant pressure for change

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576 Ibid 166. See also Lord Greene MR in *Re Smith v Fawcett Ltd* (1942) Ch. D 304 at 306. See also Blackman et al, above n 499, paragraph 208, 8-8.

577 Ibid. See also HAJ Ford (1986), Principles of Company Law, 4th edn, Sydney, Butterworths, paragraph 1507.

578 Sealy, above n 509, 166.

579 HAJ Ford, RP Austin and IM Ramsay (2005), *Ford's Principles of Corporations Law*, 12th edn, LexisNexis, Butterworths, Australia, 351, paragraph 8.120.

> over the last twenty five years that it is not surprising to see other "attempts" to wear away this hallowed rule of law. [580]

(4.3) The traditional concepts of the directors' duties under challenge

As noted previously, the law, having until now generally concentrated on the interests of shareholders to the detriment of other groups, is thought to be too narrow. It has been contended by many groups that the law ought to oblige directors to have regard to the interests of other stakeholders in the corporation as well.

Thus,

> those who manage our business corporations should concern themselves with the interests of employees, consumers, and the general public, as well as of the stockholders … . [Those acting for the corporation should] employ its funds … imbued, with a sense of social responsibility. [581]

There have even been demands for the recognition of interests of the corporations' employees, their customers, suppliers, creditors and even the local community and environment. This problem has been the subject of debate at different times in different contexts. This chapter focuses on some of the main debates in this regard and will be highlighting the problems associated therewith. Additionally, the view that there is lack of clarity as to the *role* of the board of directors, a question, which arguably *precedes* any discussion of duty, is explored. [582]

(4.3.1) VARIOUS CONSIDERATIONS AND VIEWS

A useful starting point in considering the views of others with regard to the ambit and extent of the duties of directors is Sealy's contention. He notes,

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[580] R Baxt, and A Robinson & Hedderwicks, "Directors' duties and corporate governance", (1999) *Company and Securities Law Journal*, 17, 462.

[581] HJ Goldschmid (1981), "The governance of the public corporation: internal relationships", *Commentaries on Corporate Structure and Governance – The American Law Institute–American Bar Association Symposiums 1977-78*, 168.

[582] JH Farrar, "The duties of care of company directors: one or many, delegation and business judgment", (1999) *New Zealand Business Law Quarterly*, 5, 204.

> ... what goes for employees would probably apply also to the case of any other interest group, such as local residents, customers, and so on. It should be stressed that the issue is not whether any of these "wider" interests merits recognition and protection, but whether this can be satisfactorily achieved within the framework of company law as we know it, through the conceptual and remedial vehicle of directors' duties. [583]

However, this view may be too narrow, as it would, most likely, not provide interested stakeholders, other than the shareholders themselves, with an opportunity of participating in the decision-making processes at board level, or, perhaps, in representing themselves in a manner that is meaningful to them and to the corporation. It may be necessary to break away from the confines of traditional company law.

Furthermore, Sealy's statement does not conform to the modern day view in allowing participatory or decision-making roles to all stakeholders in the corporation. He notes,

> (t)o extend directors' duties so as to embrace the interests of employees and similar groups ... is to deny any effective role for the law and the courts. The concept of "duty" ceases to be justiciable, and company law lacks proper enforcement procedures. At best, these enlarged "duties" can only provide directors with a defence against self-centred claims brought by shareholders. [584]

With regard to the traditional model of the corporation, directors' duties are perceived entirely in terms of the members, present and future. However, this simple model is inadequate when the interests of the other stakeholders, such as employees, are taken into account. If directors are to be required to have regard to the same, it is then no longer appropriate to regard the membership (shareholders) alone as *the* constituent body and to entrust it with an unfettered power to do as it pleases. Thus, it can be argued that, in this way, objective criteria ought to be used to measure the directors' standards of care and skill, since these "new" stakeholders have had no say whatsoever in appointing them to office.

It is also argued that the position of shareholders is not "inherently special" and therefore the company should not only be run to maximise shareholder profits. There are three classes of stakeholders: shareholders, parties who contract with the company and parties who have a non-contractual nexus with the company (see part

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583 Sealy, above n 509, 173.

584 Ibid 187.

2.8). All stakeholders (whether they have some contractual interests in the company or not) are, therefore, entitled to complain if the company has failed to deliver (see chapters 2,3 and 4). Stakeholders with contractual interests would include employees, customers, suppliers, business partners, subcontractors and creditors (see part 6.5.3). Stakeholders with usually no contractual interests would include neighbours, local authorities and communities and the government (see part 6.3.3). Furthermore, an independent, non-executive director, who is not a representative of a major share owner or nominated by such share owner and is not a professional advisor or significant supplier or customer to the company or its group, has no significant contractual relationship with the company or group and is free from any business or other relationship that could materially interfere with his or her capacity to act in an independent manner (see part 6.5.2).

Nowhere is there an explicit promise to maximise shareholder profits. Furthermore, this promise cannot be implied from shareholders property rights. All that can be said is that there is a promise to run the business in accordance with certain objectives, which were established at such time when the shareholders invested. The traditional models currently in use do not provide compelling justification for the adoption of a rule of shareholder primacy. Thus,

> it seems there is no such rule and nor should there be. [585]

Sealy does concede, however, that there is a sound argument by some that, for the future, it will be necessary

> for the law to conceptualise "the company" not as the corporate membership but as the corporate enterprise, … to formulat(e) new rules of director' duties … where interests other than purely membership interests are affected. … Such an approach would … more accurately reflect the modern director' own attitudes: … they are conscious that their company has shareholders, but they are … aware that it has customers, a workforce, goodwill, a product, a brand-name and logo, possibly even a company flag and anthem. [586]

Sealy, however, notes unconvincingly that this duty, which is formulated, raises a justiciable issue. That is, where duties are owed to stakeholders who have potentially opposed interests, the duty "bifurcates and fragments" and becomes only a vague obligation to be fair, which then becomes non-justiciable. Thus, argues Sealy, it is *impossible* to impose co-existing duties towards all of the stakeholders in any

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585 S Worthington, "Shares and shareholders: property, power and entitlement (Part 2)", (2001) *The Company Lawyer*, 22 (10), 311.

586 Sealy, above n 509, 174.

situation of conflict. If legislation does this, it would then abandon all control over the decision-maker. [587]

However, in *Ngurli Ltd v McCann* it was noted,

> the powers conferred on shareholders in general meeting on directors by the articles of association of companies can be exceeded although there is a literal compliance with their terms. ... Voting powers conferred on shareholders and powers conferred on directors ... must be used bona fide for the benefit of the company as a whole. [588]

Sealy refers to the meaning of "the company as a whole" and notes that the phrase has an elusive meaning. Some commentators believe that it should include *all stakeholders*, including the shareholders, employees and creditors. The better view, notes Sealy, is to say that it could "mean different things in different contexts", provided that the company is regarded as a commercial entity. [589]

Modern corporations must, however, acknowledge that it should and does have obligations of social responsibility. That is, times have changed and therefore the interests of employees and of other interested stakeholders *must* be furthered by amendments to company and labour legislation in terms of which the fiduciary duties of directors in respect of these groups are placed alongside (and with equal enforcement) to those duties shown to the shareholders. Hence, there is a demand for a shift in emphasis in order that company and labour legislation can address the day-to-day problems of employees in the employment relationship, including the interests of other stakeholders, rather than exclusively concerning itself with traditional legal concepts and institutions. Thus, although the corporate entity has been used more and more in most economies, company law has, to some degree, *remained* fixed in the nineteenth century. Thus, any "new" company and labour legislation that comes into existence must permit directors to act in such a manner that the corporation's interests are equally directed towards a consideration of its employee's interests and the interests of other stakeholders.

Furthermore, Venter notes that in England, prior to the enactment of section 309 of the English *Companies Act* of 1985, which was referred to in chapter 2 of this thesis, the interests of employees could *only* be taken into account by the directors of a

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587 Ibid 173.

588 Sealy, "'Bona fides' and 'proper purposes' in corporate decisions", (1989) *Monash University Law Review* Vol. 15 264, 267. See also *Ngurli Ltd v McCann* (1953) 90 CLR 438.

589 Ibid 269.

company insofar as a decision in this regard would contribute towards the profit-making goals of the company. [590] Thus, Bowen LJ in *Hutton v West Cork Railway Co* notes,

> (t)he 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. Charity has no business to sit at boards of directors qua charity. There is, however, a kind of charitable dealing, which is for the interest of those who practice it, and to that extent and in that garb (I admit a not very philanthropic garb) charity may sit at the board, but for no other purpose. [591]

However, Venter notes that in relation to the rights and interests of the employees, directors are under a duty to comply with the objects of the company, in a way that is not *ultra vires*. [592] Thus, directors, in reaching their decisions, should take into account the interests of employees without acting *ultra vires*. Therefore, a company can no longer be viewed as one that only maximises shareholder profits. It should be regarded rather as an entity in terms of which the shareholders are the "providers of capital" and the "employees the providers of labour". [593] Consequently, company law can no longer ignore the interests and rights of employees. If this view were adopted, South African company legislation would then become "legitimized" through the recognition of the rights and interests of employees. This is important in the transitional period, which South Africa is currently going through. Employees would then play a significant role in determining their futures, which would lessen any impacts in respect of the "social, political and economic future" of South Africa. Thus,

> (l)awyers cannot continue wearing blinkers in their application of laws, which have become unsuited and are unable to cope with the realities of current corporate life. ... If one assumes that a remedy ought to lie where there is a legitimate interest of the employee and, which is worthy of protection, then company law ought to recognise, not necessarily that directors owe a duty to employees, but that the employees have a legitimate interest in enforcing the duty owed by directors to the company to act in the interests of the company as a whole. [594]

Likewise, Botha argues for the need for corporations to take into account the rights and interests of the non-shareholder constituents and to develop and implement social responsibility concepts. [595] Thus, Botha notes that there is "a continuum",

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590 Venter, above n 357, 41.

591 Ibid 42. See also Bowen LJ in *Hutton v West Cork Railway Co.* (1883) 23 Ch. 654 at 673.

592 Ibid 44

593 Ibid 45.

594 Ibid 64.

595 D Botha, "The changing business in South Africa: some comments on developments in the scope and control of the social responsibility of business in South Africa", (1994) *South African Mercantile Law Journal* Vol. 6, 90.

which stretches from a broad to a strict interpretation. The groups at either end of this continuum are the "social reformers" and the "free-market proponents". Social reformers extend the responsibility of business to include social responsibility. [596] Thus, the company accepts social values, which places constraints on behaviour and thus guides directors towards "socially-responsible directions". Free-market proponents, however, focus solely upon the maximisation of profits for shareholders. Levitt, however, notes that welfare and society are not the company's business. Thus, its business was to "make money, not sweet music". [597]

Furthermore, Friedman notes that it is not for a business to

> rectify social ills, which burden a society. ... A doctrine of social responsibility subverts the ends of a free society: it is the objective of company officials to make as much money as possible for their shareholders - these officials have no authority to spend shareholders' money on projects, which the officials deem to satisfy socially-responsible needs. [598]

However, Botha notes that the South African corporate economy is shifting along the continuum fairly rapidly from a "mixed economy" at the free-market end to social reformation, as companies and stakeholders focus upon societal issues. [599]

Although the South African corporate-management strategy had once been determined essentially by the primary profit-making function of maximising shareholders' wealth, with the recent repeal of repressive laws, which formed the cornerstone of apartheid policy, the socio-political goals of corporations will surface and will result in a form of legal ideology characteristic of a social democracy. [600] In addition, "future corporate philosophy" in South Africa will be influenced by the implementation of programmes of "social responsibility". If the two main objectives of improving the economy and social welfare are to succeed, both the government and the private sector need to be aware of their responsibilities towards the community.

Changes in socio-political attitudes in South Africa have allowed pressure groups to expect changes from corporations. These changes reflect a significant responsibility towards its employees and the community. Additionally, investment programmes

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596 Ibid 91.

597 Ibid 91. See also T Levitt, "The dangers of social responsibility" in T Beauchamp & N Bowie (1983), *Ethical Theory and Business*, 2nd edn, 91.

598 Ibid 91, referring to M Friedman, *Capitalism and Freedom*, 1962, at 133.

599 Ibid 91.

600 Ibid 92.

have been launched, which do not necessarily focus upon maximising shareholders' wealth, but instead upon the "secondary, socio-economic goal". [601] Thus, the political structures in South Africa in the future will need to have significant economic dimensions - a change from the primary goal of corporations to maximise shareholder's wealth to one that includes a much higher level of corporate social and community responsibility.

It should also be remembered that many shareholders do not regard themselves as charity organisations - they want good returns on their investments. If a corporation is heavily engaged in providing facilities for communities in order to demonstrate to the world their social responsibilities and the corporation is seen to be doing this *at the expense of the shareholders,* there will be little reason for many shareholders to invest their hard-earned monies within that organisation. In this regard, a vital balance needs to be struck in terms of which the shareholders' interests are well looked after, but, at the same time, the corporation is assisting its communities and the environment (and perhaps the country itself) in a socially meaningful and significant manner.

(4.4) Directors' duties to creditors

The traditional view of company law was that the interests of the company were closely, if not exclusively, identified with those of the members (shareholders). A consequence of the fact that the interests of the company were so closely linked with those of the shareholders meant that, in the past, directors would generally not take into account the interests of anyone else having a stake in the company, such as the company's employees or its creditors. Furthermore, it was also mentioned that, provided some benefit can be found to the company, it seems to have been *accepted* that directors may consider and even advance interests other than those of the company's members.

Regarding the question of the rights and interests of creditors, Ziegel believes that many creditors cannot protect themselves adequately. Sometimes, creditors have no option but to extend credit and the debtor is either unwilling or unable to offer any security. This raises the question of whether it would not be unreasonable, in exchange for the benefit of limited liability, to impose a duty on directors to consider

[601] Ibid 93.

the interests of creditors when this becomes necessary. [602] Additionally, as far back as 1939, it was stated in the US decision of *Pepper v Lutton* that directors owe a fiduciary duty to both shareholders and creditors. [603] Thus, it was noted,

> (t)he standard of fiduciary obligation is designed for the protection of the entire community of the interest in the corporation creditors as well as the stockholders.

There have been positive changes in the attitudes of the courts towards company "outsiders", such as creditors, consumers, employees and the State. The courts are taking social values into account and are therefore moving away from the traditional company law concepts enshrining maximum profits for shareholders. [604] Dawson, for example, notes that during the past twenty to thirty years, modern companies have been, to a greater extent, obliged to take into account the rights and interests of stakeholders other than the shareholders. This signals a greater concern regarding the "appropriateness" of a company law model that considers that its primary goals would be to only make profits for its shareholders. [605] Hodes, therefore, notes that it is important to determine whether company legislation has developed to meet the new social demands, which are imposed by society. [606] Nowadays, directors are expected to take into account the interests and rights of all the stakeholders in a "socially useful" way. Then, the courts will not interfere. [607] Thus, it has been argued that, in developing principles in recent years, the courts have not considered the company as an entity distinct from its creditors or employees, but have included these groups within the definition of a "company". [608]

In the Australian High Court decision of *Walker v Wimbourne*, Mason J notes,

> it should be emphasised that the directors of a company, in discharging their duty to the company, must take account of the interest of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. [609]

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602 JS Ziegel, "Creditors as corporate stakeholders: The quiet revolution – an Anglo-Canadian perspective", (1993) *University of Toronto Law Journal*, 43, 530.

603 *Pepper v Lutton* (1939) 308 US 295.

604 FT Newham, "Directors' duties to creditors: What are they and are they part of our law?" (1992) *UCT*, 20.

605 Ibid. See also Dawson, "Acting in the best interests of the company – for whom are directors 'trustees'?", (1984) 11 *New Zealand University Law Review* 68.

606 Ibid 21. See also L Hodes, "The social responsibility of a company", (1983) 100 *SALJ* 468.

607 Newham, above n 604, 21.

608 Ibid 21.

609 Ibid 22. See also Mason J in *Walker v Wimbourne* (1976) 50 ALJR 446 at 449.

This was the first case in Australia to establish that directors should consider the consequences of their actions towards creditors. Thus, it was stated in this case that directors must, when discharging their duty to the company, take into consideration the interests of its shareholders *and* its creditors. Failure by directors to take creditors' interests into account would result in unfavourable consequences not only towards the creditors, but to the company as well. However, Mason J did not indicate whether, what he had decided, applied only to insolvent companies, or whether it applied equally to solvent corporations as well. Had he intended his statement to apply only to insolvent companies, it is expected that he would have made this very clear. It can therefore be assumed (unless shown to be otherwise) that he intended the position to apply to solvent companies as well. This judgment would therefore extend the notion of fiduciary duties in such a manner that it would include the rights of creditors as well.

In *Lonrho Ltd & Another v Shell Petroleum Co Ltd & Another* the House of Lords also suggested that the company's interests could include those of the creditors. No prerequisite was mentioned that special circumstances, such as insolvency, would be necessary for such a duty to exist. [610]

However, in England, in the case of *Multinational Gas and Petrochemical Co. v Multinational Gas and Petrochemical Services Ltd*, Dillon LJ indicated that a company does not owe a duty of care to creditors and neither do they owe a fiduciary duty to present or future creditors. [611]

A later decision in New Zealand of *Nicholson v Permakraft* did not set out the duties of directors towards its creditors in such broad terms. [612] Cooke J held that the duties of directors might include a consideration of the interests of creditors. This is so, notes Cooke J, if the company is insolvent, nearly insolvent, doubtfully solvent, or if a payment would jeopardise its solvency. Cooke J *supra* restated the principle that the directors' duties are owed to the company, although this may require them to consider the interests of creditors. In addition, it was held that the duty to consider the interests of creditors arose only when the solvency of the company was in question. It was also indicated that this duty was owed to existing rather than

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610 *Lonrho Ltd & Another v Shell Petroleum Co Ltd & Another* (1980) 1 WLR 627 (HL), 634.

611 *Multinational Gas and Petrochemical Co. v Multinational Gas and Petrochemical Services Ltd* (1983) 2 ALL ER 563.

612 *Nicholson v Permakraft* (1985) 1 NZLR 242, 249-250.

future creditors. Thus, insolvency was a condition to be satisfied before directors could take the interests of creditors into account.

In the Australian Court of Appeal judgment of *Kinsela and Another v Russel Kinsela Pty. Ltd (in liquidation)* Street CJ held that in a solvent company the interests of the shareholders entitle them to be regarded as the company when questions of the duty of directors arose. The directors could therefore authorise or ratify a particular action without any challenge to the validity of their actions. Where a company is insolvent, however, the interests of creditors become significant, as they become entitled, through liquidation proceedings, to deal with the company's assets. This is because the assets now belong to the creditors and not the shareholders. [613] Thus, Street CJ indicated that members could not validate an act, which amounted to a fraud on the creditors. Street CJ held that where the interests at risk are those of creditors, shareholders would not be able to authorise any breach of action against them. Thus, the shareholders do not have the power or authority to absolve the directors from breach against the creditors. Thus, the director' duty to a company as a whole extends, in insolvency cases, to not prejudicing the interests of its creditors. [614]

Thus, although the court did not formulate a general test, which could be imposed upon directors to oblige them to consider the interests of creditors, the court did accept that, at the very least, the duty does arise when a company is insolvent, as it is the creditors money, which is now at risk in contrast to the shareholders' proprietary interests. Hence, this judgment identified that the duty to consider the interests of creditors arises, at the very least, in insolvent circumstances, which is to be seen as part of the duty of directors to act in the interests of the company.

However, in the English decision of *Winkworth v Edward Baron Development Company Ltd and Others* Lord Templeton noted,

> a company owes a duty to its creditors, present and future. … (T)he company owes a duty to its creditors to keep its property inviolate and available for the repayment of its debts. … A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not … exploited for the benefit of the directors … to the prejudice of the creditors. [615]

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613 *Kinsela and Another v Russel Kinsela Pty. Ltd (in liquidation)* 1986 4 NSWLR 722, 730 per Street CJ.

614 Ibid 732.

615 Newham, above n 604, 29. See also *Winkworth v Edward Baron Development Company Ltd and Others* (1987) 1 All ER 114 (HL), at 118.

In this context, Lord Templeton noted that a company owed a duty to its creditors, both present and future. The court seemed to contemplate distinct duties owed by the directors to both the company and to its creditors. Hence, although the *dicta* in a decision such as *Walker v Wimbourne supra,* were expressed rather cautiously and narrowly, the *dicta* of Lord Templeton are, according to Sealy,

> couched in more extravagant terms, which strike at the very foundations of that policy. [616]

The "policy" referred to here are the principles of company law requiring directors to act in the interests of the company and the company alone. Therefore, the inference to be drawn is that a duty to creditors exists at *all* times and not only in insolvency circumstances.

The suggestion that duties are owed to present and future creditors is arguable. It may be impossible for the directors to take risks then. What would be the position if directors entered into a transaction resulting in a loss? Would this then imply that the directors had disregarded the interests of its creditors? It may well be unreasonable to place a burden on directors to maximise the profits of the corporation by undertaking risks, yet at the same time, cast a duty upon them "to keep its property inviolate and available for repayment of its debts". Consequently, it may well be quite difficult, if not impossible at times, for a director to strike a balance between the interests of its shareholders and those of its creditors.

In a further English decision of the Court of Appeal, Nourse LJ in *Brady and another v Brady and another* examined the expression "in the interests of the company" and held that this phrase may have different meanings in different contexts. [617] He noted that when a company is solvent, the interests and rights of the shareholders, both present and future, are to be considered first. Thus, in the situation where the company has many assets and the debts are few, "the interests of the creditors ought not to count for very much". However, where the company is insolvent, nearly insolvent or doubtfully solvent, the interests of the company would then become solely the interests of existing creditors. [618] This decision is significant because it recognises the wider concept of the "company" as one that would include groups

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616 LS Sealy, "Directors' duties – an unnecessary gloss", *The Cambridge Law Journal* (1988) 175, 176.

617 *Brady and another v Brady and another* (1988) BCLC 20.

618 Ibid at 40.

other than the shareholders. The decision also attempts to provide guidelines as to when the duty to creditors arises. [619]

As stated in the *Permakraft* case any proposed course of action, which would prejudice the company's solvency and thereby impact directly upon the interests of creditors, would require due consideration by the directors. [620] This may well have far-reaching implications for directors, as most ventures that are undertaken by them will be of some risk to creditors.

It is through the extension of the concept of the company to include those groups, which traditionally have been considered outsiders, that the courts have been able to state that directors, when complying with their duties to the company, need to consider the interests of stakeholders other than the shareholders themselves. This indicates that there has been a movement away from identifying the interests of the company with the financial interests of its shareholders to a situation where the courts have ordered directors to consider the interests of other stakeholders. Thus, the duty to consider the interests of creditors is owed to the company. [621]

The decision of *Jeffree v National Companies and Securities Commission* considered the question of the duties towards creditors. [622] In this case, proceedings were brought against Jeffree on the basis of section 229(4) of the Australian Companies Legislation, which provides that

> (a)n officer or employee of a corporation shall not make improper use of his position as such an officer ... to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the corporation.

Jeffree was found liable on the basis of this section. The court also based its decision on *Walker's and Kinsela's cases supra* where it was noted that, in certain circumstances, especially where a company is in financial difficulties, directors owe an obligation to their creditors. The court *a quo's* decision was confirmed on appeal where it was noted that the duties of directors extend to both creditors and to prospective creditors.

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619 Newham, above n 604, 31.

620 *Nicholson v Permakraft*, above n 611, at 250.

621 Ibid 45.

622 *Jeffree v National Companies and Securities Commission* (1989) 15 ACLR 217, 7 ACLC 556.

Hence, the learned judges did not restrict their statement only to companies, which were in the process of being liquidated, but adopted rather a more general approach as laid down by Lord Templeton in *Winkworth's case supra* where it was specifically noted that directors owe a duty to present and future creditors.

The approach of the court in *Jeffree* was the same as that adopted by the Court of Appeal of New South Wales in *Ring v Sutton* where it was held that directors owe a duty to creditors *even* when the company is solvent. [623] However, the opposite view was held in *Re Horsley v Weight*, where the court held that the directors' duty to creditors arose *only* when the company is insolvent. [624]

In a more recent Australian decision of *Spies v The Queen* the court held per Gaudron, McHugh, Gummow and Hayne JJ that directors do not owe an independent duty to, nor is it enforceable by, creditors of the company. [625] This is so even though such creditors may also be directors of the company. [626] The court refers to the *Walker* decision and notes,

> (i)t is "extremely doubtful" whether Mason J "intended to suggest that directors owe an independent duty directly to creditors". To give some unsecured creditors remedies in an insolvency, which are denied to others would undermine the basic principle of *pari passu* (my italics) participation by creditors. [627]

Thus, the court noted that any suggestion that directors owe an independent duty to creditors, by reason of their position as directors, "are contrary to principle and later authority and do not correctly state the law". [628]

Hargovan discusses the decision of *Spies v The Queen*. [629] He focuses on whether the majority judgment in *Spies* was significant in confirming whether directors owe an independent duty to creditors to consider their interests.[630] Hargovan submits,

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623 *Ring v Sutton* (1980) 5 ACLR 546.

624 *Re Horsley v Weight* (1982) 3 ALL ER 1045.

625 (2000) 201 CLR 603.

626 Ibid at 604.

627 Ibid at 636, paragraph 93.

628 Ibid at 636-7, paragraph 95.

629 A Hargovan, "Directors' duties to creditors in Australia after *Spies v The Queen* – is the development of an independent fiduciary duty dead or alive?" (2003) 21 *C&SLJ* 390.

630 Ibid 390.

> the context, explicit language and the strength of the majority's statements makes *Spies* the strongest authority on the Australian position concerning directors' fiduciary duties to creditors. [631]

Thus, Hargovan maintains that the decision in *Spies* affirmed the position that directors do not owe an independent duty directly to creditors. [632] He notes that the "deliberate and emphatic language used" clearly indicated that the *Spies* case was "an authoritative judicial statement", which rejected independent fiduciary duties to creditors. [633]

He also notes that the judges *in casu* expressly rejected the decision in *Nicholson v Permakraft (NZ) Ltd*, which indicated that directors owe an independent duty to creditors. [634] However, Hargovan does note that the majority in Spies confirmed that directors owed a duty of imperfect obligations to creditors, which creditors cannot enforce except through the company itself or appointed liquidator. This recognises the rights of creditors in the interests of the company in insolvency situations. [635]

The term "imperfect obligation" was traditionally used in contract law to describe arbitration agreements. It was only used recently in company law to describe the relationship between directors and creditors. In describing imperfect obligations, this means that directors must take into account the interests of creditors, but creditors cannot seek action against those directors who act contrary to their interests. [636] Thus, rather than the directors owing a direct duty to creditors, an indirect duty is owed to creditors to consider their interests through the company. [637]

Thus, although the decision in *Walker* in its own right will remain influential for future cases, it can no longer stand alone as influential authority regarding the question of an independent fiduciary duty to creditors. It needs to be considered along with the decision in *Spies*. [638] Thus,

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631 Ibid 391.

632 Ibid 396.

633 Ibid 402.

634 Ibid 398.

635 Ibid.

636 J McConvill, "Directors' duties to creditors in Australia after *Spies v The Queen*", (2002) 20 *Company and Securities Law Journal*, 6.

637 Ibid.

638 Hargovan, above n 629, 404.

> the prospect of judicial development of an independent fiduciary duty to creditors is without strong foundation. [639] … Whilst a future Australian High Court is always free to depart from its previous judgments, it is submitted that based on the detailed analysis of *Spies* … it is unlikely to lightly disregard the unanimous and reasoned statements of four High Court judges and resuscitate the issue of independent fiduciary duty. [640]

McConvill, on the other hand, still believes that despite the decision in *Spies*, there is still "a degree of uncertainty" regarding the relationship between directors and creditors. More specifically, he writes that the decision in *Spies*, regarding the duties of directors towards its creditors, was "merely *obiter*". [641] Accordingly, he writes, "there is a possibility" that "Australian company law" would support the view that the directors owe a separate fiduciary duty to creditors. He notes that there are policy reasons for recognising this fiduciary duty. That is, if creditors are owed merely a duty of imperfect obligations, creditors would need to rely extensively upon the *Corporations Act 2001* to adequately protect their rights and interests. [642]

Thus, McConvill maintains that the decision in *Spies* does not depart from the comments of Mason J in the *Walker* case. In this way, the decision in *Spies* "no way changes or clarifies" this relationship. If anything, he states that the *Spies* decision has encouraged "greater use of remedies under the (Australian) *Corporations Act 2001*". [643] However, he notes that whereas the insolvent trading provisions of the Australian *Corporations Act 2001* are only triggered when the company is insolvent, an independent fiduciary duty to creditors would become available even prior to insolvency. [644] Creditors, under section 588R(1), must first obtain the consent of the liquidator or be granted leave by the court before they can enforce the duty of directors under section 588G not to trade during insolvency. [645] Thus, the "utility" of section 588G and the other "insolvency trading provisions for creditors is not as substantial as some commentators (particularly Hargovan) have suggested recently". [646] Thus, McConvill sums up that

> (t)here is no question that following the High Court's decision in *Spies*, directors, when exercising their powers, owe a duty to consider the interests of creditors of the company when the company is

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639 Ibid 405.

640 Ibid 406.

641 McConvill, above n 636, 4.

642 Ibid 15.

643 Ibid 5.

644 Section 588G *et seq*.

645 McConvill, above n 636, 19.

646 Ibid.

> insolvent or in the vicinity of insolvency. Despite the decision in *Spies*, however, the long-standing question concerning the nature and extent of this duty to creditors remains unresolved. … (T)he decision in *Spies*, unfortunately, raises more questions than it resolves. The High Court did not make any authoritative determination on … a director's fiduciary duties to creditors, and it cannot be said that the *Spies* decision provides any real indication of the approach, which the court may indorse if and when the issue is raised for determination in a future case. All that can be said for certain at present is that the … statement of Mason J in *Walker* … remains the strongest authority on the Australian position concerning directors' fiduciary duties to creditors. [647]

There are, as noted above, commentators that disagree with the reasoning and interpretation of McConvill regarding the *Spies* Case.

In a later article, McConvill again addresses the director's duty to company directors.[648] In this regard, he analyses the decision of *Geneva Finance Ltd v Resource & Industry Ltd*. [649]

McConvill notes that the *Geneva Finance* case was the first decision in Australia since the case of *Spies* to deal with the nature of the directors' duties towards its creditors. Heenan J reaffirmed the principle in the *Spies* decision that directors' duties to creditors amounts to no more than an imperfect obligation. [650] Thus, the duty is not owed directly by directors to or enforceable by creditors. It is rather to be described as an indirect duty owed not to the creditors, but to the company to consider the interests of creditors. This imperfect obligation will "spring into action" on insolvency or when a director suspects this. In such circumstances, the creditors "become the main stakeholders in the company" because they would then be entitled to those funds, which the company is using to trade. [651]

McConvill also believed that section 1324 of the Australian *Corporations Act 2001* remains "under-utilised". Section 1324 allows a person whose interests are affected by a breach of the Act to apply for injunctions and/or damages. [652] In this way, McConvill believes that creditors may take action against directors when their interests are affected. The parties in the *Geneva Finance* case did not use section 1324. [653] McConvill notes, however, that some writers, including Hargovan, believe

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647 Ibid 24.

648 J McConvill, "Geneva finance and the 'duty' of directors to creditors: imperfect obligation and other imperfections", (2003) 11 *Insolvency Law Journal*, 7.

649 (2002) 20 ACLC 1427.

650 McConvill (2003), above n 648, 7.

651 Ibid 8.

652 Ibid 7.

653 Ibid 14.

that because the *Spies* decision states that the interests of creditors are not directly enforceable by them, the courts are likely to state that section 1324 would be unavailable to creditors as well. [654]

Keay has also recently pondered over the issue as to whether fiduciary duties should be extended to creditors. [655] From a British point of view, he writes that commentators "are sharply divided" as to whether such fiduciary duties should be extended to creditors as well. Thus, those commentators that adopt a contractarian approach believe that there are already sufficient factors in play, such as the market itself and freedom to contract, to protect the rights and interests of creditors. The communitarians, however, believe that creditors are amongst the stakeholders of companies and are therefore in as vulnerable position as anyone else. Thus, creditors should be protected by mandatory rules. [656] Keay submits that *fairness* must be considered and thus directors need to consider the interests of creditors when companies hit hard times. This is because creditors are in vulnerable positions (especially the employees, customers, involuntary creditors and trade creditors) and have expectations that their interests will be considered at this stage. [657] Also, a duty to creditors can be substantiated on the basis of *efficiency*. [658] Keay explains that whilst a duty to creditors might increase some transactions costs, other costs, such as those associated with drafting contracts, would be reduced. [659] Thus,

> … it seems fair that directors should be under a responsibility to consider creditor interests where financial difficulty exists, in order to reduce 'information asymmetries between companies and their creditors'. … (T)he contractarian arguments alone are not sufficient to reject the imposition of a duty to take account of the interests of creditors. [660]

Havenga, however, believes that the fiduciary duties of directors should only be "owed to the company as a whole and not to individual shareholders, creditors or other stakeholders". [661] She believes that legislation, which is aimed specifically at a particular stakeholder, provides "better protection" than a simple extension of a director's fiduciary duty. For example, in the South African context, she is of the

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654 Ibid 16.

655 A Keay, "Directors duties to creditors: Contractarian concerns relating to efficiency and over-protection of creditors", (2003) 66 *The Modern Law Review*, 665.

656 Ibid 666.

657 Ibid 698.

658 Ibid.

659 Ibid 699.

660 Ibid.

661 Havenga, above n 36, 324.

opinion that section 424 of the South African *Companies Act* provides "substantial protection to company creditors". [662] In this section, the court may impose personal liability on any person who knowingly and in a fraudulent or reckless manner carried on business to defraud creditors or other persons. [663] See also parts 2.1, 4.4.1, 4.4.2 and 4.5.2.

(4.4.1) STATUTORY PROTECTION OF CREDITORS AND OTHER INTERESTED STAKEHOLDERS

The English *Companies Act* of 1948 contained a provision similar to section 424 of the present South African *Companies Act* 61 of 1973 except that the former was only applicable with regard to fraudulent conduct, whilst the latter was also applicable with regard to reckless conduct. [664] The subsequent recommendations of the Cork Committee led to the enactment of section 214 of the English *Insolvency Act*. [665] This section imposed liability on directors for conduct similar to negligence. [666] This Act provides that a director may, in certain circumstances, be held liable for a company's wrongful trading. Thus, the courts may declare a director liable to contribute towards a company's assets if

> (a) The company has gone into insolvent liquidation;
>
> (b) At some time before the commencement of the winding up of the company that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and
>
> (c) That person was a director of the company at that time.

This section is therefore clearly intended to benefit creditors. However, the court will not make a declaration of personal liability if it is satisfied that the director concerned, at the earliest opportunity, "took every step with a view to minimising the potential loss to the company's creditors as ... he ought to have taken". [667] Likewise, it needs to be noted that section 424 of the South African *Companies Act*,

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662 No 61 of 1973.

663 Havenga, above n 36, 321.

664 Strydom, above n 214, 179.

665 Cork Committee, Report of the Insolvency Law and Practise Review Committee (Cmnd 8558) June 1982, Ch.44.

666 Section 214 of the English *Insolvency Act* of 1986.

667 Newham, above n 604, 57. See also the English *Insolvency Act* of 1986, section 214.

1973 provides such a *powerful* statutory remedy for creditors that, because of it, the common law duty to creditors has not yet been developed in South Africa. [668] (See also parts 2.1, 4.4, 4.4.2 and 4.5.2 above.)

Section 424 provides that,

> (1) When it appears, whether in the winding-up or judicial management of a company, or otherwise, that any business of the company concerned was or is being carried on recklessly or with the intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the court may, on application, declare that any person who was knowingly a party to the carrying on of the business in such manner be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court may direct. [669]

The Master, the liquidator, the judicial manager, any member or creditor or contributory of the company may bring the application.

It is important to establish the extent to which section 424, which is aimed at the protection of creditors and other interested parties, actually achieves this objective.

In terms of South African law, a civil sanction applies to both fraudulent and reckless carrying on of the business of the company.

Havenga notes, [670]

> Du Plessis regards s424 (1) as one of the most powerful instruments in the hands of creditors. ... But its effectiveness will depend largely on cost implications and the likelihood that the particular creditor's claim against the company will be settled if her application under the section is successful. [671]

Section 424, compared to section 214 of the English *Insolvency Act*, is a very powerful legislative enactment. In addition, the application of the section to circumstances other than those where the company is in the process of being wound up, are indicative that it is intended to provide a meaningful remedy. It can be argued that creditors are, as a result of section 424, "adequately protected against misuse of their powers by company controllers". Because of uncertainty as to whether fiduciary duties owed by directors to the company can be extended to

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668 Ibid 58.

669 Strydom, above n 214, 179.

670 M Havenga, "Creditors, directors and personal liability under section 424 of the *Companies Act*", (1992) *SA Mercantile Law Journal* Vol. 4, 65.

671 Ibid. See also JJ du Plessis, "Maatskappyregterlike Grondslae van die Regsposisie van Direkteure en Besturende Direkteure", unpublished LLD thesis, University of the Orange Free State (1990), 126.

creditors, creditors may well have to rely on section 424. However, uncertainty may arise because it is unclear to whom the court may order the payment under the section. Thus, the section should be interpreted or *amended* to permit payment directly to the applicant creditor if it would not prejudice other parties. [672]

South African law has accepted that section 424 confers a wide discretion on the court. The words "or otherwise" in this section are broad and are therefore not only applicable in liquidation or judicial-management proceedings. Thus, unlike the previous *Companies Act*, [673] which contained very restrictive wording, the present Act extends the scope of the section admirably. Thus, de Kok J in *Gordon No. and Rennie No v Standard Merchant Bank Ltd* noted,

> (t)he new *Companies Act* of 1973 ... expressly extends the section to apply to reckless, as well as fraudulent trading and it is made applicable to circumstances other than those where the company is in the process of being wound up. [674]

It can therefore be suggested that the section has been deliberately phrased in wide terms so that the courts may bring to account fraudulent and reckless directors for their actions towards their creditors even *before* the company becomes insolvent.

The fact that the words "or otherwise" were adopted implies that, at all material times, creditors are entitled to expect that the affairs of the company are conducted properly. Thus, should directors commit fraudulent or reckless acts even prior to insolvency, the creditors would have the right to institute legal action against the directors. The provisions of section 424 provide a meaningful remedy against the abuse contemplated by the legislature. A creditor of the company may make the application or, where the company is being wound-up or has been placed under judicial management proceedings, by its liquidator or judicial manager.

However, creditors may decide not to use section 424 if payment, in the event of a successful application, is likely to be ordered to the company. There would be uncertainty as to whether they would actually receive payment, and whether they may have to make a contribution towards the costs of the application or even furnish security for it. Thus, the court should be able to order that payment be made directly to creditors. Thus, it is only through an amendment to this section, that the position,

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672 Havenga (1992), above n 670, 69.

673 No 46 of 1926.

674 *Gordon No and Rennie No v Standard Merchant Bank Ltd* (1984) 2 SA 519 (C).

with regard to the order for payment, will be clarified. Only at that stage, would section 424 become a totally effective remedy for the creditors.

In addition to section 424 of the *Companies Act*, creditors' interests are also protected in terms of section 135 of the *Insolvency Act*, which provides that a director will be held criminally liable if he or she is found to have preferred one or more creditors above the other. [675] Thus, a possible argument may arise that, by virtue of these provisions, an extension of the directors' duties towards its creditors, is unnecessary because the interests of creditors are sufficiently safeguarded, both during and prior to the company becoming insolvent.

Section 354(2) of the *Companies Act* also allows the court to take into consideration the wishes of the creditors in all matters relating to the winding up of the company.[676] The purpose of issuing a provisional winding-up order is to afford creditors an opportunity to show cause why it would serve no benefit to them and why it should not be made a final order of liquidation. In this regard, Stegmann J in the decision of *Ex Parte Clifford Homes Construction (Pty) Ltd* noted,

> (t)he reason for the practice (of ordering a provisional winding-up order) would appear to be that the provision in the *Companies Act* empowering the court to have regard to the wishes of creditors as to all matters relating to a winding-up applies not only to matters arising after the winding-up has begun, but also to the question whether there should be a winding-up by the court at all. [677]

The court may further protect the interests of creditors by permitting an already insolvent company to continue trading, and the court does this by postponing the winding up order. Thus, in the decision of *SAA Distributors (Pty) Ltd v Sport en Spel (Edms) Bpk*, the respondent filed an affidavit in terms of which it was stated that the liquidation of the company would have an adverse effect on creditors. [678] The creditors, who were in the majority, supported the respondent and requested postponement of the winding-up order for financial reasons. The court held that the wishes of the creditors should be taken into consideration.

Finally, section 20(5) of the *Public Accountants' and Auditors' Act* also has the effect of protecting creditors. [679] This section provides that an auditor is required to

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675 *Insolvency Act* 24, 1936, section 135.

676 *Companies Act* 61, 1973, section 354(2).

677 *Ex Parte Clifford Homes Construction Pty Ltd* (1989) 4 SA 610(W), 612.

678 *SAA Distributors Pty Ltd v Sport en Spel (Edms) Bpk* (1973) 3 SA 371 (C).

679 *Public Accountants' and Auditors' Act* 80 (1991) section 20(5).

intervene if he is satisfied or has reason to believe that a material irregularity has taken place in the conduct of affairs of the company, which has caused or is likely to cause financial loss to the undertaking or any of its members.

Shareholders, however, are deemed to have authorised the directors to expose the company's capital to risks when embarking upon trading ventures potentially in the interests of and for the benefit of the company. Thus, should a director's actions in these circumstances result in financial loss to the company, the same would not constitute an irregularity as contemplated under section 20(5) of the said Act since the actions of the director were lawfully authorised. However, had the company been insolvent at that time, and notwithstanding this, the directors decide to expose the company to further risks, this conduct would then constitute a material irregularity in terms of the said section.

(4.4.2) THE CURRENT POSITION OF DUTIES TOWARDS CREDITORS IN SOUTH AFRICA

Newham notes that the duty to creditors has not been developed in South Africa because of the protection enjoyed by creditors under Section 424 of the Companies Act. [680] See also parts 2.1, 4.4, 4.4.1 and 4.5.2. The basis for the proposition that there is no direct fiduciary duty relationship between directors and creditors is based upon the proposition that the company is a separate legal entity and therefore has its own rights and duties. Consequently, the director has a fiduciary relationship towards the company primarily and creditors must protect their interests "by bargaining with the company". When the company is being wound up, various statutory provisions ensure that creditors are treated fairly. [681]

In referring to the additional remedies arising from an application of the common law principles of fraud, Stegmann J in *Ex Parte Lebowa Development Corporation Ltd*, notes that for a company to obtain credit without it disclosing a known risk to the creditor or that payment may not be made, would amount to fraud on the creditor. Furthermore, the fact that the company director may not have intended to cause a loss and may have honestly believed that the debt would be paid, does not exonerate the actions of the director. Thus, any dishonest exposure to a known and

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[680] Newham, above n 604, 65. See also HS Cilliers, ML Benade, JJ Henning, JJ du Plessis and PA Delport (1987), *Corporate Law*, 1st edn, 244, and OJS Fourie, "Die Plig van Direkteure Teenoor Maatskappy-Skuldeisers", (1992) 4 *SA Mercantile Law Journal* 25 at 47-8. See also Cilliers et al (1992), above n 309, 156, and Cilliers et al (2000), above n 213, 162.

[681] Cilliers et al (1992), above n 309, 156. See also Cilliers et al (2000), above n 213, 25.

undisclosed risk of loss would amount to fraud on the creditor. [682] The conduct of the company in taking goods on credit when it knows that it is, or is likely to become, insolvent, is labelled as a serious wrong and against public policy. Consequently, the extent to which the courts would be willing to protect the interests of company creditors would determine whether the courts recognise that fiduciary duties are owed to creditors. This could be achieved by including the rights of creditors within the concept of "the company" or in some other way. [683]

In addition, in the decision of *Ex Parte Lebowa Development Corporation Ltd*, Stegmann, distinguishing at length between claims, which creditors may enjoy against directors at common law arising from their fraudulent conduct and their statutory remedy contained in section 424, noted that there was a fundamental distinction between exposing a company's capital to the risks during the course of its business and exposing a company's creditors to those risks. The former exposure is authorised by the company's members and is therefore lawful. However, there is frequently no authorisation for the latter and is therefore unlawful. [684]

The decision of *Singer NO v M J Greeff Electrical Contractors (Pty) Ltd* Stegmann noted that trading in insolvent circumstances might not be always unlawful. Thus, an insolvent company might still be able to trade lawfully in insolvent circumstances by ensuring that it always pays cash for all goods and services it receives or by always disclosing its insolvency to a supplier before receiving any credit. However, such open and honest conduct of an insolvent company is not generally expected. Thus, to use an insolvent company to trade and bring risk to suppliers may result in either personal liability for the company's debts or in criminal liability or both. [685]Therefore, a court may recognise a possible claim by the creditors against the directors based either on negligence or fraud or both. Although Stegmann did not hold specifically that directors had a fiduciary duty towards the creditors, he did indicate what sanctions could result if directors unlawfully caused the creditors to expose themselves to risk. [686]

In the landmark decision of *Ex Parte De Villiers & Another N.N.O: In Re Carbon Developments (Pty) Ltd (in liquidation)* Stegmann J noted that if the directors

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[682] Newham, above n 604, 66. See also *Ex Parte Lebowa Development Corporation Ltd*, 1989, (3) SA 71 (T) at 105.

[683] Newham, above n 604, 66.

[684] *Ex parte Lebowa Development Corporation Ltd* 1989 (3) SA 71 (T), 106E-F.

[685] *Singer NO v M J Greeff Electrical Contractors Pty Ltd* (1990) (1) SA 530 (W), 538-539.

[686] Newham, above n 604, 70.

permitted the corporation to trade whilst its liabilities exceeded its assets, then the directors neglected their duties either to restore its solvency or to wind it up. [687] Thus, directors, in this way, would have operated outside the legal framework of the *Companies Act* and the memorandum and articles of association and would, therefore, be unable to claim protection from personal liability, which would attach to those directors who conduct the business within the legal framework of the company legislation. Stegmann notes that there may be liability in terms of an Aquilian action. This is based on the fact that, in accordance with the reasonable man test, the directors negligently failed to perform their duties either to raise the capital of the company to restore its solvency or to wind it up. As a consequence, this has caused the trade creditors, who have remain unpaid, to suffer foreseeable loss. [688]

In *Re Carbon Developments* case, Stegmann, J suggested that the directors had a duty to either raise funds to restore the solvency of the company or to wind it up in the event of insolvency. If directors neglected their duty they would be operating outside the law and would therefore not be protected by the benefits of limited liability. This might indicate the possible "germination of the seed of a duty to creditors". However, it is clear that Stegmann J was referring only to a "duty of care" owed to creditors, and not the company, which, if breached, would give rise to a delictual action. This is nothing new in South African law. Thus, Stegmann J

> has not taken our law any further along the road ... in formulating and developing a common law duty to creditors. He has rather … examined … the various ways in which creditors have always been able to obtain relief from the directors of debtor companies. … This is not to say that there is no need or place for a duty to creditors in our law. ... [689]

(4.4.3) CONCLUSION

Until recently, little attention has been paid to the interests of creditors forming part of directors' duties because the duties of good faith and that of care and skill, were seen to be owed to the company *alone*. Consequently, the director is seen to be under a duty to exercise that degree of care and skill to the company that can reasonably be expected of a person with this knowledge and experience. The director

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687 *Ex Parte De Villiers & Another N.N.O: In Re Carbon Developments Pty Ltd (in liquidation)* 1992 (2) SA 95 (W), 136I-137B.

688 Newham, above n 604, 75. See also Stegmann J in *Ex parte De Villiers*, above n 687, at 144.

689 Ibid 76.

therefore stands in a fiduciary relationship to the company embracing duties of loyalty, confidence and trust.

Prentice notes,

> (i)t has long been a central tenet of company law that directors owe their duties to the company and not the company's shareholders or its creditors. [690]

The philosophy and logic behind this submission was that when the company's financial position was sound, the main objective was to advance the shareholders' interest by maximizing the profits of the company. The creditors' interests only became significant when the company was in a state of insolvency. Hence, this reasoning takes cognisance of the fact that a heavy burden would be placed upon directors if they were bound to consider the interests of creditors when venturing into transactions. Directors might then be reluctant to take risks, which could affect the company's financial position. However, if directors needed only to consider the interests of shareholders when the company is solvent, they would be able to exercise an independent decision without fear of being sanctioned by the creditors should such decision prove to be erroneous or prejudicial to the interested parties. Thus, this submission argues that the interests of the shareholders and those of the creditors must be mutually exclusive and should not be reconciled to allow both groups to be entitled to duties of good faith and care and skill from directors. Moreover, the creditors' main concern is to receive payment for any debts incurred to them by the corporation (unlike the shareholders). It is further argued in this submission that should directors be obliged to show duties of good faith and care and skill to creditors, a conflict of interest and duties would then exist between the shareholders and creditors, which would thereby place directors in untenable positions, as they would not know which group's interests should take precedence when making a decision.

It is apparent from the various cases and discussions, that much uncertainty and conflict remains with regard to the question as to whether directors' duties to the company extend to its creditors as well, or whether the interests of the creditors should only be considered during the period of insolvency. There may well be room for the argument that there is no need for the fiduciary duties of directors to be extended to creditors because of the fact that the latter's interests are sufficiently safeguarded by the law as it currently stands. Thus, the extension of such duties to

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690 DD Prentice, "Creditor's interest and director's duties", (1990) *Oxford Journal of Legal Studies*, 273. See also Blackman et al, above n 499, paragraph 208, 8-8.

creditors may well create a conflict of interests between the shareholders and creditors - the former being interested in maximising its profits, while the latter interested in being paid by the company for its debts. The *Companies Act*, the *Insolvency Act* and the *Public Accountants' and Auditors' Act* may well be sufficient in safeguarding the interests of creditors. In addition, creditors may always resort to civil litigation while the company is solvent when payment of debts to them by the company is outstanding. Thus, arguably, the only period during which the company should be obliged to consider the interests of creditors, may be at that time when the company is insolvent or approaching a state of insolvency. Furthermore, one could argue that the interests of creditors could also be considered in a situation where directors embark upon a venture, which could threaten the solvency of the corporation. Thus, the interests of creditors should be primarily considered in insolvent circumstances and in solvent circumstances when the proposed transaction to be entered into by the directors may indeed affect the solvency of the corporation.

Furthermore, Sealy succinctly sums up the position when he notes,

> (c)reditors are more favourably placed, in that they have a statutory class available through their representative, the liquidator; and it is almost certainly only in a liquidation that any claim in respect of their interests would arise. … For this reason, it is probably unsound … to formulate the directors' duty with reference to any stated category of creditor … (as) the proper object of any duty … should be the corporate estate. It would also run counter to established insolvency policy considerations if the law were to give remedial advantages to particular creditors. And if individual creditors are put by the law into a position where they may use threats to sue directors personally, as a form of pressure to have the company pay their debts in priority, the object of the insolvency law is undermined. In the light of these considerations there should be some resistance to any extension of the traditional directors' liability. … [691]

This is perhaps the reason why Stegmann J in *Carbon Developments'* case has decided not to take South Africa any further in formulating and developing a common law duty to creditors. [692] Thus, there is no South African case law, which explicitly indicates that directors have a fiduciary duty towards creditors when a company is solvent and a going concern.

Consequently, if South African courts were to decide to eventually follow the trends in the decisions in some of the foreign cases noted *supra* and thereby recognise a fiduciary duty towards creditors when then company is solvent and a going concern,

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691 Sealy, above n 616, 178 et seq.

692 *Ex Parte De Villiers & Another N.N.O: In Re Carbon Developments Pty Ltd (in liquidation)* (1992) (2) SA 95 (W).

the question arises as to the likely areas of conflict between the interests of shareholders and creditors. In other words, if our courts were to protect the interests of each group and, in this way, legally recognise the directors' fiduciary duty towards creditors, the nature and extent of the interests of creditors, which could be prejudiced, would have to be determined.

(4.5) Bondholders and debenture holders

(4.5.1) DEFINITIONS

A bond is a "(f)inance certificate of debt issued to raise funds". [693] It is also

> (a) deed by which one person (the obligor) commits himself to another (the obligee) to do something or refrain from doing something. If it secures the payment of money, it is called a common money bond; a bond giving security for the carrying out of a contract is called a performance bond. (It includes) a document issued by a government, local authority, or other public undertaking to repay long-term debt with interest. [694]

Furthermore, a debenture is a

> (a) document that states the term of a loan, usually to a company, including the date of repayment and the rate of interest. The debt, which is usually long-term, may be secured by a charge on company property. … A debenture may be issued to an individual creditor (a debenture holder) or a debenture trust deed may be drawn up in favour of trustees for a large group of creditors (debenture stock holders). [695]

(4.5.2) DIRECTORS' DUTIES TO BONDHOLDERS / DEBENTURE HOLDERS

It can be argued that bondholders and debenture holders may suffer economic loss if the company, in which they have invested, is subject to risky borrowing. Thus, these groups may be exposed to risks in the value of their bonds. The question arises as to whether directors have fiduciary duties to bondholders (or debenture holders).

In practice, any loss in the value of the bondholders' investments would accrue to the benefit of the shareholders, as share prices increase. This factor enables management to transfer wealth from bondholders to shareholders. Contractual constraints are generally *inadequate* in protecting the interests of bondholders because, predicting the future developments of a company, are difficult. Thus, it remains to be determined whether the interests of bondholders require further protection, and, if so, what the nature of such protection should be in relation to

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693 *Collins Gem English Dictionary*, 1995, HarperCollins Publishers, UK, 57.

694 *Oxford Reference: A Concise Dictionary of Law*, 2nd edn, 1990, Oxford University Press, UK, 44.

695 Ibid 115.

corporate governance issues. The question is whether or not directors should have a fiduciary duty to protect *both* shareholders' and bondholders' interests. [696]

Bondholders and debenture holders are creditors and traditionally contract law protects their interests. Thus, in cases of conflict, contract law protects creditors' rights against shareholders. Botha notes, however, that South African law has attempted to protect creditors' interests statutorily. [697] In section 102 of the *Insolvency Act* the rights of the creditors are given precedence over the rights of the shareholders in terms whereof the creditors become the owners of the corporation and are permitted to deal with the assets of the company on insolvency. [698]

As noted above (see parts 2.1, 4.4, 4.4.1 and 4.4.2), section 424 of the *Companies Act* holds the directors personally liable in favour of the creditors, as the directors have been involved in conducting the business fraudulently or recklessly. [699] However, this protection is only available in specific instances and creditors do not receive such protection whilst the firm is a going concern. A problem manifests itself at this point, as the interests of the creditors are often violated by managerial action, which cannot be construed as being either of a fraudulent or reckless nature. Thus, the potential for conflict exists between bondholders/debenture holders and shareholders because bondholders/debenture holders have prior, but fixed, claims to the assets of a company, which crystallise upon insolvency, whilst shareholders have limited liability with regard to a company's debts during its solvency. Thus, as Botha notes,

> as the ratio of debt to equity increases, so does the probability and magnitude of an actual conflict between these two interest groups. ... The fruits of success ... will accrue to shareholders in that the increase in market value of the company will mainly benefit shareholders' interests. Failure of such risky projects will be borne by the debt holders as the market value of the company will decline and will impact accordingly on their interests. ... A conflict arises as the duty to maximise shareholders' wealth is pursued to the prejudice of bondholders' interests. [700]

Botha argues that this conflict will be resolved, *inter alia*, by directors functioning as agents of the company whose function is to maximise 'the value of the company'. He notes that this entails maximising its net present value for the benefit of all providers

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696 D Botha, "Directors' fiduciary duties to bondholders? some relationships between corporate financial management and fiduciary law" (1993) 5 *SA Mercantile Law Journal*, 287.

697 Ibid 290.

698 *Insolvency Act* 24, 1936, section 102.

699 *Companies Act* 61, 1973, section 424.

700 Botha, above n 696, 294.

of long-term capital regardless of their personal wealth. Thus, in this way, bondholders (and debenture holders) and shareholders would have 'first and residual claims respectively on the corporation's assets and cash flow' and are therefore equitable owners of it. This means that directors and officers would owe fiduciary duties to the equitable owners of the corporation's assets - the bondholders/debenture holders and shareholders. Furthermore, however, in spite of the rule to maximise shareholder profits, directors may transfer wealth from bondholders to shareholders. [701] This means that the company's shareholders and bondholders/debenture holders must be free to compensate one another for the effects of operating decisions that increase the wealth of one group, but not the wealth of the other. This, in effect, "neutralises" any such wealth transfers. Botha notes,

> the theories of financial economists have ... had an impact on resolving the conflict between bondholder and shareholder interests. Their approaches … have been the bases for recasting the traditional objective of the company from the maximisation of shareholders' wealth to the maximisation of the net present value of the company, accompanied by neutralisation of wealth transfers. This objective in modern financial theory is consistent with fiduciary duties to both bondholders and shareholders and allows the market value of their investments to be maximised without one party benefiting at the expense of the other. [702]

According to Botha, however, these "conflicts" between shareholders and bondholders (and debenture holders) have, thus far, not received much attention at all in South Africa, unlike in other overseas countries where it has been addressed rather vigorously. Hence, it may be necessary to review the existing system of debts contracts in South Africa, as the only form of bondholder protection. This would be in line with other western capitalist-orientated countries where fiduciary duties to bondholders exist. A failure to do so would be to ignore the fact that, internationally, fiduciary duties to bondholders are being recognised. This is because it is regarded as being

> an overdue development in the twentieth century expansion of fiduciary law. [703]

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701 Ibid 297.

702 Ibid 298.

703 Ibid.

(4.6) Directors' duties to the community and to the environment

It is important to determine the extent of the directors' duties in modern corporations to the environment. As Winstanley notes,

> (t)he message is clear: although development is essential for the country's economy, no future government will wish it to prevail without consideration for environmental integrity. And growing public awareness of environmental issues will probably increase pressure on corporate bodies to clean up all potentially polluting operations. [704]

As public concern about the environment is growing, *environmental audits* have become commonplace. This has become an accepted management tool to assist directors preventing the degradation and exploitation of the environment. [705]The International Chamber of Commerce states that an environmental audit can best be defined as a

> management tool comprising a systematic, documented, periodic and objective evaluation of how well environmental organisation, management systems and equipment are performing with the aim of: (1) facilitating management control of environmental practices; (2) assessing compliance with company policies, including meeting regulatory requirements. [706]

Moreover, when an environmental audit has been completed and referred to the directors of the corporation, it is expected that they will take cognisance of and seriously consider implementing any recommendations noted therein. If directors do not and harm results, the *Environmental Conservation Act* allows courts to order that the costs of any damages to the environment, which results from the commission of an offence as defined in the Act, be borne by the party so convicted. In this case, the person so convicted will be the director of the company, whether executive or non-executive. [707]

In a similar situation, Raney refers to the Appellate Division decision of *Howard v Herrigel & Another NNO* where it was noted that a director of a company has a duty to observe the utmost good faith towards the company and to exercise reasonable

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[704] T Winstanley, "Environmental provisions within a future bill of rights", *JBL* Vol. 1 No. 3, 113.

[705] S Raney, "Environmental audits – directors and auditors beware", *JBL* Vol. 1 No. 1, 19.

[706] Ibid, referring to the International Chamber of Commerce.

[707] *Environmental Conservation Act* 73, 1989, section 29(7).

skill and diligence. [708] Thus, a director may not be indifferent or hide behind ignorance or a failure to understand the affairs of the company. A director, who has been aware of an environmental audit report, cannot therefore simply ignore the contents of it and thereby allow environmental degradation to continue. He or she has a duty to safeguard and protect the affairs of the corporation. If he or she does not do so, either in his or her capacity as an executive or a non-executive director, he or she could be viewed as having contravened the Act, and, consequently, be convicted. In this way, directors may be held liable for failing to act on the report of the environmental auditor, either at the instance of the State, where criminal charges could be proffered against them, or at the instance of the shareholders, who could institute a civil action against them, as a result of the corporation having had to pay over monies to restore the environment. In addition, should the company be placed in liquidation, the liquidator may hold the directors personally liable where it is clear that they had disregarded the recommendations contained in the environmental audit and, as a result, recklessly continued to conduct the business of the company.

Environmental auditors have an important function in regulating the control of the environment, which, to a large extent, has been placed in the hands of company directors. Environmental auditors must therefore develop standard procedures for the conduct of the audit. Additionally, they will need to establish minimum-qualification requirements to gain respectability. However, environmental auditing can be seen as a positive step in regulating and controlling the exploitation of the environment. Furthermore, environmental audits must be conducted openly and their results publicly disclosed. Thus, companies that damage the environment should be forced to observe less environmentally damaging business practices. Thus,

> the environment will ultimately be the beneficiary of successful and thorough editing. [709]

In addition, the prospect of litigation and growing public concern will greatly pressurise companies to have due regard to, and also to adhere to, the recommendations contained in environmental audits and, in so doing, evolve and maintain environmental standards.

Moreover, Williams, refers to the question of environmental issues in commercial transactions and the possible liabilities that may result. [710] He notes,

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[708] Raney, above n 705, 20. See also *Howard v Herrigel & Another NNO* (1991) 2 SA 660 (A).

[709] Ibid 21.

> (a)n item that has recently attained increasing importance in due diligence investigations, particularly in commercial transactions involving American or European parties, is environmental issues. There is a high awareness of these issues in the United States of America and the European Union countries, which has been accompanied by an understanding of the civil and criminal liabilities that may arise where the nature of a business is potentially hazardous to health or the environment.

Williams submits that the exposure of parties to environmental claims, should be investigated as part of a legal "due diligence" investigation, and then, if necessary, by the environmental auditing procedure discussed *supra*. This "due diligence" investigation, he notes, should have regard to the following environmental issues:

1. Any liability, both civil and criminal, that could arise from activities, which have detrimental effects on the environment; and

2. Any liability, both civil and criminal, that could arise from an infringement of or threat to the right of every person to an environment, which is *not* detrimental to his or her well-being in terms of the Constitution of South Africa; and

3. Documentation relating to any environmental impact assessment, environmental audit or any other reports or documents concerning any environmental issues received or sent during the past five years; and

4. Details of any criminal convictions pertaining to any environment-related charges during the past five years.

The exposure of parties to claims arising from environmental issues is becoming an important issue in commercial transactions in South Africa. These issues should be investigated in the first instance as part of a legal "due diligence" investigation, and then, if necessary, by means of an environmental audit. [711] Thus, it is evident that "due diligence" investigations and "environmental audits" are seen to be critical tests in safeguarding the environment against abuse by directors of corporations. Furthermore, the safeguarding of the environment using these means could be best achieved where at least two of the following three components are included within the constitution. These components are: [712]

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[710] D Williams, "'Due diligence' investigations and environmental audits", *JBL* Vol. 3, part 1, 43.

[711] Ibid 44.

[712] Winstanley, above n 704, 112.

1. The right of all citizens to a clean environment; and

2. The duty on all citizens, and probably the State, to protect the natural environment. This duty, which is stated either expressly or impliedly, would entitle citizens to go to court when they believe that the environment is being degraded. This right will resolve the problem with regard to the right to sue, which currently exists in South African law. Thus, at present in South Africa, unless someone has a direct interest (which usually means the right to use and enjoy property) in the environment, he or she is not entitled to approach the court for relief with regard to environmental degradation. If this right were given, however, anyone would be able to litigate to prevent environmental degradation, even though he or she neither owns, nor rents, the property that is, or may be, degraded. This would open up the flood gates to a multiplicity of claims being launched against companies, however remote these claims might be; and

3. The establishment of a land or environmental court to deal with environmental degradation caused by corporate abuse. In New South Wales, Australia, the establishment of courts of this kind, have proven to be very effective. In this regard, the court does not award costs against the plaintiff unless it considers the action brought by the person to be frivolous or unreasonable. Thus, any concerned person would be able to approach the courts for relief confidently knowing that an adverse order of costs against him or her is not likely.

Thus, these developments would have important and far-reaching effects on business and industry. Winstanley notes that as a result

> ... the prospect of litigation and growing public awareness will increasingly pressure companies to ... publicize environmental policies and maintain environmental standards. To show their compliance with these policies and standards, they will have to begin environmental audits. [713]

Logically, although there is "clearly a need for tight environmental accountability", there is also a need to *work* with businesses (rather than to fight them) in order "to clean up corporate practices". Companies should also "do the same". Companies are

[713] Ibid.

realising more and more today "that no matter how justified their decisions are, they have to react, and be seen to act, very quickly to public feelings".

Thus, "ethical issues are being absorbed into the corporate governance system from top down". Companies need to incorporate "ethics and morals" "into their way of life", otherwise they "will get their fingers burnt". [714]

> We have placed a lot of emphasis on the Green/ethical issue because we believe it will be one of the most significant influences on corporate governance in the years to come. … (T)he finger is no longer being pointed just at senior executives, but also at the shareholders, and as pressure to the make the company more socially responsible increases, it will surely be in this direction. [715]

(4.7) Conclusion

Traditionally, South African company law assumes that the directors' role is to run their company for the benefit of its shareholders *alone* and to maximise profits for them. It can be argued, however, that this view is too narrow and outdated; that is, directors should have regard to the rights and interests of a broader range of corporate stakeholders. More specifically, directors should have concern not only for their shareholders, but also for employees and customers. This idea, by extending its application, also refers to and includes the natural environment and the community at large. Hence, the question is whether we should change our perception of the corporation from one run by directors dedicated *exclusively* to serving the interests of shareholders to that of a corporation whose main purpose is to bring benefit not only to its owners and creditors, but also to its employees, the community and the environment. Furthermore, given that reforms concerning directors' duties in light of the above have found their way into legislation across the globe, the core issue to be considered is how and to what extent legal rules and policies should develop in South Africa to place directors under a positive duty to take account of the interests of bodies other than shareholders.

It is argued that directors should be *under a duty* to have regard to the interests of these other groups. Thus, many writers have challenged the traditional rules of company law regarding directors' duties. It is only with creditors that sentiments

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[714] Kendall & Kendall, above n 102, 117-18.

[715] Ibid 117-19.

have been expressed through the courts and writers that the fiduciary duties of directors need not necessarily be extended. Some writers argue that creditors' interests are sufficiently safeguarded by the law as it currently stands. If South African courts, however, decide to eventually follow the trends in some of the foreign cases and recognise a fiduciary duty towards creditors, questions will arise as to the likely areas of conflict between the interests of shareholders and creditors.

CHAPTER 5:

(5.0) CORPORATE GOVERNANCE IN SOUTH AFRICA: AN IMPROVED MODEL OF WORKPLACE PARTICIPATION FOR EMPLOYEES

In the next four chapters of this thesis four major building blocks or steps, which will *promote* the creation of a new and highly improved corporate governance model for South Africa, are examined in greater detail. It has been argued that the current unitary board structure operating in South Africa is unsatisfactory, as it does not provide employees with rights enabling them to engage in the decision-making processes with their employees at an adequate level. To this end and based upon discussions and arguments in the preceding chapters of this thesis, the four building blocks are considered as essential *steps* in the process of designing an improved system of corporate governance for South Africa. These steps should *all* be viewed by the legislative, governmental, judicial and business powers in South Africa as being instrumental to the attainment of an improved system of corporate governance. Consequently, an improved system of corporate governance in South Africa would be a very significant and decisive factor in bringing about a wealthier and economically brighter South Africa in the future. These steps or building blocks are:

1. The introduction and maintenance of a system of organisational development within the corporation (see chapter 5):

This is a vital first step for any organisation. A corporation's *desire* to affect positive changes in the workplace is cardinal if the introduction of a new model of corporate governance is to be successful. Businesses should, therefore, become passionate about introducing effective organisational developmental systems; and

2. The introduction of new legislation in South Africa, which promotes an improved and more meaningful system of worker participation in the corporation:

   In chapter 6 below I provide a detailed critique of the shortcomings in and deficiencies of the major South African legislative enactments and of the policy initiatives of the King Reports, which have attempted to provide employees with some rights of participation in the decision-making processes of the corporation. Changes to the relevant legislation and to the King Reports will be suggested in chapter 9 below; and

3. The introduction of changed patterns of corporate thinking and a rejection of antiquated principles of company law (see chapter 7 below):

   It is necessary to seriously consider the views of authors who support the contention that employees should have greater rights in the decision-making processes of the corporation at all levels. This is significant, as it establishes greater insight into the reasons why this has become necessary in businesses today. Thus, in this way, it is necessary for those people in power or those who have strong business influence to suggest and to advise corporate South Africa that it should rid itself of the traditional shareholder maximisation theory, as it can no longer be applicable today; and

4. The introduction in South Africa of some of the favourable features of successful international corporate governance models (see chapter 8 below):

   Three international models of corporate governance have been considered – German, Japanese and French - each of which have unique features that could be used as building blocks in the design of a new and improved model of corporate governance for South Africa.

At the end, the four building blocks, which are considered as the essential *steps,* are cemented together in chapter 9 to create a much improved and very workable model of corporate governance for South Africa.

The First Step or Building Block: Organisational Development Within The Corporation

In this chapter in discussing organisational development within the corporation, we will examine how behavioural changes amongst employees are to be managed by the corporation, the various steps that are required for changes in the workplace to be successful and the means that can be used to achieve employee empowerment.

(5.1) INTRODUCTION

Corporate governance is based on the premise that boards of directors should oversee compliance as a matter of law. Thus, boards are required to interact with management to ensure that the corporate objectives are achieved. Consequently, corporate governance has two main functions. Firstly, it involves the day-to-day operation of a corporation by its senior executives and, secondly, it involves the monitoring and control of those continuous management functions. [716] Hence, good organisational development in any organisation or company is vital for good corporate governance generally. Furthermore, it has been said that

> (i)f you don't know where you are going, anywhere will take you there! [717]

Effective customer service, which provides good value and support to customers, is generally accepted as an instrumental factor in the future success of any organisation. Many customers are prepared to pay more for goods in exchange for good service, which is convenient to them. Likewise, there are many organisations worldwide that endorse the view that staff development and empowerment are key attributes of the most successful organisations and companies. Consequently, employees who are better rewarded are generally more satisfied with their jobs. This has two main benefits for organisations. Firstly, employee job satisfaction is directly related to customer satisfaction. Thus, satisfied customers are more likely to remain loyal, become repeat purchasers of goods and services and recommend the company

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[716] R Osborne & B Houghton (1998), "Corporate governance/legal compliance – obtaining a business advantage", Professional Development course paper, No. S.585, 21-22.

[717] Stephen P Robbins et al (1998), *Organisational Behaviour: Leading and managing in Australia and New Zealand*, 2nd edn, Ch 18, 667.

to other customers. Secondly, employees who are satisfied with their pay are less likely to be absent from their workplace. Thus, in monitoring the satisfaction reports of employees, this could serve as an early warning for any organisational problems that may arise later in the corporation. [718]

Robbins *et al* argue that staff can play a vital part in the success of the business. Thus, "empowerment" or an authorisation conferring specified powers on staff members is essential to employee satisfaction and in improving customer service. By empowering their employees, the organisations are actively promoting their training and development "so that they keep up to date". Empowerment also provides job security for employees so that they do not fear losing their jobs if they make mistakes. It also encourages employees to try new and different methods of improving their outcomes. The authors note, for example, that Chrysler Corporation has been empowering its employees and has, as result, attained excellent results in this way. Consequently, Chrysler Corporation has encouraged their employees to use their initiatives to save the organisation money annually. Interestingly, in this way, employees have "designed a self-calculating branch cash system" on home personal computers saving the organisation US$525,00. Other employees have created "a sound deadener" for car and truck doors saving the organisation US$2 million per year. They have also improved the quality of vehicle paint saving the company US$115 million per year. Additionally, Robbins *et al* say that empowerment can also work even in small organisations. Consequently, empowering employees has positively affected the performance of corporations both small and large. The authors note further that even the public sector is responding to the empowerment of employees. In this regard, one state government in the United States has a programme, which involves a shift of power to teachers. Teacher-dominated governing councils in each school are given the authority to override a wide range of state and union rules. Reformers hope that empowering teachers would allow better ideas in education to be produced. Such empowerment allows organisations to become more efficient and more effective so that they are able to do more with less. In this regard, to be successful, Robbins *et al* note that corporations must focus on three areas. These are business strategy and improvement, staff development and empowerment and customer service. All three of these areas have to be managed well, or the corporation will experience difficulties. [719]

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[718] K Macky and M Wilson (1999), *Strategic Pay: A manager's guide to rewards and remuneration*, CCH New Zealand Limited, Auckland, New Zealand, 19.

[719] Robbins et al, above n 717, 669-70.

Thus, organisational development is a planned, long-range improvement process, based on democratic values, which seeks to improve organisational effectiveness and the welfare of employee. [720]

This chapter will focus on one of the three areas noted above, namely staff development and empowerment. Robbins *et al* strongly endorse the view that staff empowerment and the participation of employees in the organisation in those affairs that are significant, are critical to the future success of that organisation. This gives organisations enough leverage to respond and adapt to changes in its environment, especially if those changes prove to be debilitating.

Robbins *et al* note,

> (s)ince an organisation's success or failure is essentially the result of the things that its employees do or fail to do, planned change is also concerned with changing the behaviour of individuals and groups within the organisation. [721]

A necessary first step in achieving effective employee participation in the workplace and in gaining employee job satisfaction as a result is through appropriate organisational development. The more that the employees are involved in the decision-making processes surrounding proposed changes, the more likely those employees will respond positively to those changes. This is likely to lead to improvements in productivity and, in the long-term, economic success. It is now an issue of national importance. However, growth in productivity cannot happen at a "national" level or even regionally. It is in the workplace that an improvement in productivity must occur if it is to happen anywhere at all. [722] Thus, in South Africa, strategies must be developed to ensure that the enterprise has competent and committed people who are able to meet the targets set by the corporation. Thus, principles and practices must be developed to improve performance and reduce operating costs, while enhancing motivation and the satisfaction of employees. Thus,

> every business has hidden treasure waiting to be uncovered in the form of its employees and its procedures. Any effort directed towards uncovering these treasures will be rewarded. [723]

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720 Ibid 691.

721 Ibid 672.

722 Confederation of Australian Industry (CAI) (1989), *How To Raise the Productivity of Your Workplace*, 5.

723 G Rabey (1999), *Achieving More, Costing Less: A manager's guide to improving productivity*, CCH New Zealand Limited, Auckland, New Zealand, 1.

Organisations that run well "de-emphasise hierarchical authority". Thus, employees and managers should be empowered to be responsible for their development. [724] Organisational development is therefore a "road to empowerment". Consequently, it provides "the change vehicle" to ensure that people are comfortable with empowerment. [725]

Before one considers how legislation in South Africa can contribute to or has contributed to achieving greater organisational stability and well being amongst the employees, it is necessary for the organisation to *firstly* consider its own solution that will achieve greater economic productivity for itself. This can be achieved through staff development and empowerment.

(5.2) HOW ARE BEHAVIOURAL CHANGES MANAGED?

Change agents are those persons who act as the "catalysts" to manage change within the corporation. They can be managers, employees of the corporation or even outside consultants. The four categories of changes encompass the structure, technology, physical setting and people in the corporation. In changing the structure, this involves making alterations to factors such as the authority or job specification given to employees. In changing the technology, this involves modifications in the way that work is processed and also in the methods and equipment that are used. In changing the physical setting, this involves an alteration to the physical arrangements in the workplace, such as the space given to employees to perform their work. Changing people involves changing the employee attitudes, skills, expectations, perceptions and behaviour. [726]

Thus, through change agents affecting the 'feel' of the workplace, employee satisfaction may be enhanced with a resulting increase in overall employee productivity. For example, the organisation could become less bureaucratic simply by change agents combining departmental responsibilities, which would give employees the opportunity to communicate with one another and to work more effectively together in a team-building structure, or by reducing and eliminating rules and

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724 Robbins et al, above n 717, 691.

725 Ibid 692.

726 Ibid 672.

procedures, which frustrate rather than promote employee productivity. Employee satisfaction could also be improved by introducing greater flexibility into their working schedules or by introducing a system of incentives based on their work performance. Introducing modern equipment and tools into the workplace would also promote greater workplace satisfaction amongst the employees.

(5.3) WHAT STEPS ARE REQUIRED FOR CHANGES IN THE WORKPLACE TO BE SUCCESSFUL?

Robbins *et al* have identified *seven steps* to implement a successful change in the workplace. [727] These steps focus on what managers need to do to show the various stakeholders of the organisation that they are flexible enough to introduce progressive changes to the workplace and to adapt to a changing environment. These steps are critical in establishing not only effective employee participation in the workplace, but also in enhancing a system of improved employee satisfaction in their jobs.

It is to be noted that *all* of these seven steps need to be complied with in order for any successful change to be implemented. Each one of these seven steps will be briefly discussed.

(5.3.1) Pressure for Change

This is a very significant factor, as employees will not place a high priority on change without it. Usually, without pressure, any suggested change in the workplace would become a “bottom-of-the-box, low-priority change”. It may also eventually become shelved due to no or low activity in implementing it.

Pressure to perform can arise from customer or employee dissatisfaction, government intervention through the introduction of new legislation, increased competition, changes in the financial status of the organisation or through any other of the many catalysts that could trigger the desire to change.

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[727] Ibid 686-9.

(5.3.2) A Clear, Shared Vision

Employees need to be able to understand clearly and share in the vision that is being communicated to them by their managers. If the employees fail to understand clearly or to share in a vision, more often than not, the vision may never become a reality. It is vital that employees are permitted to participate and express their ideas and views in a vision rather than having a set of ideas being thrust upon them by management.

(5.3.3) Capacity for Change

This refers to the resources, such as the budget, and the skills, such as the training, which are necessary to bring about the changes required. It is important for management to ensure that they give the employees enough time to participate in the changed activities rather than expecting them to automatically adapt to them and to be able to cope with changes on top of their existing workloads.

(5.3.4) Actionable First Steps

Actionable first steps, which are sometimes referred to as the process of "encouraging small wins", allow employees to feel positive about their achievements, especially in the beginning phases of a new order. This inspires them to achieve even greater and better results, as the programme progresses. Without "encouraging small wins" employees soon lose interest in the vision, which ultimately ends up as another failed, and often costly, initiative. A frequently supervised and encouraging hands-on approach by management is preferred rather than management allowing several years to pass by before they scrutinize the success or failure of the vision. Thus, without actionable first steps, employees may make "false starts".

(5.3.5) Model the Way

This is the step in terms of which the manager of the organisation puts into practice those characteristics that would endorse and support the new initiative. It is vital that the manager acts in an exemplary fashion so that the employees can see for themselves that the organisation is serious about the vision that they are striving to achieve.

(5.3.6) Reinforcement of the Change

Processes and procedures are modified so that the changed initiative becomes etched into the working environment of the employees. Encouragement for obliging employees in this regard may be in the form of a reward or some other type of recognition from management. It could also be discouraging for those employees who resist change, as this may result in their transfer or demotion.

(5.3.7) Evaluate and Adapt

It is important to evaluate new initiatives once it has been going for some time, usually 12 to 18 months. The evaluation has to be accurate and meaningful, as it need to be determined whether improvements are required, or whether it may no longer be in the interests of the organisation to pursue it. After the initiative has been going for about 12 to 18 months, managers, owners and employees need to ask whether the empowerment programme has really improved anything at all. Thus, establishing "before-and-after measures" is necessary in order to judge the effectiveness of the value of the change programme. [728]

Robbins *et al* have produced an interesting diagram, reproduced as table 1 below, which illustrates the *symptoms* that may appear in each case if *one* of the seven aforementioned steps is not brought into play during the change process. The authors have indicated that organisations, such as the Water Corporation of Western Australia and Australia Post, have used this approach. [729]

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[728] Ibid 688.

[729] Ibid.

Table 1: Varying Symptoms Associated With Each Of The Missing Steps That Affect Successful Change In The Workplace Of A Corporation (Robbins *et al*, page 689)

X + Clear, shared vision + Capacity for change + Actionable first steps + Model the way + Reinforce and solidify change + Evaluate and improve = *Bottom of the box*
Pressure for change + **X** + Capacity for change + Actionable first steps + Model the way + Reinforce and solidify change + Evaluate and improve = *A quick start that fizzles*
Pressure for change + Clear, shared vision + **X** + Actionable first steps + Model the way + Reinforce and solidify change + Evaluate and improve = *Anxiety, frustration*
Pressure for change + Clear, shared vision + Capacity for change + **X** + Model the way + Reinforce and solidify change + Evaluate and improve = *Haphazard efforts, false starts*
Pressure for change + Clear, shared vision + Capacity for change + Actionable first steps + **X** + Reinforce and solidify change + Evaluate and improve = *Cynicism and distrust*
Pressure for change + Clear, shared vision + Capacity for change + Actionable first steps + Model the way + **X** + Evaluate and improve = *Go back to old ways*
Pressure for change + Clear, shared vision + Capacity for change + Actionable first steps + Model the way + Reinforce and solidify change + **X** + = *Skepticism and stagnation*

(**X** indicates the missing step in each situation)

(5.4) WHAT MEANS CAN BE USED TO ACHIEVE EMPLOYEE EMPOWERMENT?

In order to succeed in the empowerment of employees, Robbins *et al* identify various means to accomplish this. [730] They are listed briefly as follows:

1. Group feedback sessions develop a greater willingness to understand the problems at work encountered by employees. Through the process of unstructured group interaction in a free and open environment, employees develop the skills to listen to and to become more tolerant of individual differences.

2. Feedback questionnaires provide the means to pin point various problems encountered by the employees in the organisation. Employees could be involved in deciding which issues should form part of the feedback questionnaire. The data obtained from them can then be used to remedy discrepancies and provide solutions to improving employee satisfaction.

3. Process consultation employs the services of an external consultant who steps into the firm temporarily in order to assist management in identifying issues that are causing problems and grievances in the workplace. In cooperation with management, a joint effort is made to suggest changes that would be more acceptable to the workforce. The consultant is therefore a guide who advises management on the best processes it can use to solve its own problems. The consultant does not solve the problems for management.

4. Team-building processes allow employees in an organisation the opportunity to work together in order to achieve a common goal. This would ultimately lead to improved employee productivity through greater employee job satisfaction. It can also lead to a greater understanding amongst individual employees as to what their individual roles are in the whole process, which, in turn, affords them with a greater appreciation of their individual significance and value in the organisation. These processes may improve the overall team effort.

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730 Ibid 692-5.

5. Intergroup development focuses on improving the relations between various groups and how they perceive one another.

6. Organisational restructuring allows greater employee participation in the workplace. It does so through the development of employee assistance programmes and bodies, which are designed to give employees greater empowerment in the organisation.

7. Total quality management is a specific type of organisational development process that deals with issues such as customer responsiveness, continuous improvement, empowering teams to find solutions to problems and a central organisational philosophy to perform quality work as economically as possible. [731] It often focuses on quality standards and ensures that such standards are maintained.

(5.5) CONCLUSION

Organisational development endorses the principles that employees are generally responsible people and should be treated with respect. Employees should, as far as possible, be able to participate in the decision-making processes, which would affect the organisation and ultimately themselves. Employees are more likely to respond positively to changes if they had a role in the decision-making processes affecting them. A healthy organisation is one that acknowledges trust, honesty and openness amongst its employees. It de-emphasises hierarchical authority and control while encouraging change agents to use their knowledge and suggest improvements to the workplace. This can result in improved employee productivity. The change options can be a selection or combination of aspects dealing with the structure, technology, physical setting or the very people within the organisation.

Seven steps were identified that need to be complied with in order to ensure successful changes in the workplace. It is interesting to note that different symptoms result in each case, if one of the seven steps is not present. Finally, various organisational development means were discussed to bring about the changes resulting in greater employee empowerment. Thus, by empowering employees and allowing them to participate in the decision-making processes, which would lead to

[731] Ibid 695.

changes in their working environment, and, by promoting the sense of well-being of its staff members, organisations would generate greater job satisfaction, improved customer service and enhanced profitability.

CHAPTER 6:

(6.0) THE SECOND STEP OR BUIDING BLOCK: SOUTH AFRICAN LEGISLATIVE ENACTMENTS AND THE KING REPORTS

In this chapter of the thesis, the most significant South African legislation governing the rights and interests of employees in their participation of the affairs of the corporation will be reviewed. In this regard, the effectiveness of workplace forms created by the *Labour Relations Act* 66 of 1995 will be thoroughly discussed. The rights of employees to freedom of association under the Act will also be considered. Additionally, what will be examined is the extent to which the 1996 Constitution facilitates and advances the rights of employees under the *Labour Relations Act*.

The two King Reports of 1994 and 2002, which provide guidelines on corporate governance, will be analysed in detail to determine whether either or both of these Reports have influenced positively or negatively the development and growth of worker participation in the decision-making processes of the corporation in South Africa. Examples of companies in South Africa applying corporate governance principles based upon the recommendations of the first King Report will be provided. KMPG corporate governance surveys will be discussed and analysed with regard to worker participation and corporate governance practices in South Africa. The significance of the Ethics Institute of

South Africa is considered in so far as it facilitates the development and implementation of a code of ethics within corporations for its employees and other stakeholders.

(6.1) INTRODUCTION

> Corporate failures occur because of subtle failures in the decision-making process – in how boards and managers make decisions and monitor corporate progress. Power-based reforms are not the key to correcting the problem. To be sure, the balance of power is important. But, at its core, corporate governance is not about power; it is about ensuring effective decision-making. Corporate governance reform should seek ways to create and maintain an efficient decision-making process. [732]

The manner in and extent to which South African legislation has thus far responded to the need to empower employees in the workplace and to provide them with a statutory right to be involved in the decision-making processes of the organisation, will now be discussed. Participative practices should ensure that everyone in the corporation understands what the goals of the business are and that employees are able to participate in the decision-making processes.

There are *three basic forms* of employee participation. The first form is *shopfloor participation*, which affords employees with an opportunity of having a direct say about the decisions affecting their immediate work environment. For example, these types of decisions would include participation affecting the reduction of costs, improvement of efficiency, work methods, work quality, job design, physical layout of the workplace, health and safety and training. The second form of employee participation is based upon *representative consultation*. This allows employee representatives the opportunity of being involved in decisions that govern the operation of the organisation. The third form of employee participation involves *financial reward*, by providing employees with an opportunity to participate in the financial success of the corporation. The main types of representative participation would be based upon the formation of "specific issue committees", which would be designed to deal comprehensively with issues affecting the corporation widely. The composition of this committee would consist of representatives of those stakeholders directly affected by any issue. Furthermore, "joint consultative committees" would allow regular, formal meetings to be held between employee representatives and senior levels of management. "Board representation of employees" involve an employee representative to be elected onto the company's board of directors. Additionally, the main types of financial participation are based upon "profit sharing schemes"

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[732] J Pound (2000), "The promise of the governed corporation", *Harvard Business Review on Corporate Governance*, 81.

where, in addition to their usual salaries, employees would receive special payments, which would be based upon the corporation's profitability. Moreover, "productivity-sharing schemes" would be based upon an individual or a group's productivity performance, rather than upon the performance of the company as a whole. "Employee share schemes" would permit employees to buy company shares at cheaper rates than that set by the market. [733]

The extent to which employee participative practices have thus far developed in South Africa through the requisite legislation will be thoroughly examined in this chapter. It is important to note that historically, Acts of Parliament were not subject to substantive judicial review. However, in terms of the Constitution of the Republic of South Africa, [734] courts now had the power to test legislation against the provisions of the Bill of Rights that governed labour relations and unfair labour practices. [735]

On 4 February 1997, the Constitution came into force. [736] In addition, the *Labour Relations Act* (LRA) was introduced, making the industrial council (now referred to as the bargaining council) the main focus in the Act. It is not obligatory to participate in the council. [737] Employees, however, may then be subject to a Wage Board or statutory council meeting, which the Minister may impose upon them. [738]

Chapter V of the LRA makes provision for the establishment of workplace forums for its employees by a representative union. Disputes must now go either to the Commission for Conciliation Mediation and Arbitration (CCMA) in the unorganised sector, [739] or to the bargaining council. [740]

In addition, in 1997, the new *Basic Conditions of Employment Act* (BCEA) came into being, which attempts to entrench basic worker rights. [741] Consequently,

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733 Confederation of Australian Industry, above n 722, 8-10.

734 *Constitution of the Republic of South Africa* Act 108, 1996 (the 1996 Constitution), section 23.

735 Ibid section 23(1).

736 Proc 6 GG 17737 of 24 June 1997.

737 *Labour Relations Act* (LRA) 66 (1995).

738 LRA, Ch. III, Part E.

739 LRA, Ch. VII, Part A.

740 LRA, section 65(1)(b) and (c).

741 *Basic Conditions of Employment Act* (BCEA) 75 of 1997.

> (a)t plant-level, a significant number of companies are introducing worker participation schemes, in the hope of winning greater co-operation from their employees. … For the first time, greater co-operation with both state and employer is now possible. Unions have the chance to … determine what happens to their members at home and at work. [742]

In this chapter, relevant sections of those acts, which attempt to provide employees with a participatory role in the running of the organisation, will be discussed.

(6.2) WORKPLACE FORUMS

(6.2.1) Introduction

It is useful to note that

> (t)he (New Zealand) Law Commission has taken the view that a Companies Act is not the appropriate vehicle for the imposition of general social reforms such as the requirement of worker participation in management or the imposition of environmental goals upon companies – '[t]hese matters should be pursued through specific legislation imposed upon all employers and business enterprises'. [743]

In South Africa workplace forums, created by the *Labour Relations Act*, attempted, for the first time, to legally involve employees of corporations in the decision-making processes. [744] The extent to which this ideology became a reality will be carefully examined and analysed. In this regard, it is argued that the best method of thoroughly examining the features of workplace forums is to consider the relevant sections one at a time. In each case, a key question is asked and suggested answers have been provided (together with commentaries and critiques where applicable). Thus, this process of evaluation and discussion, will clearly define the purview, limitations and effectiveness of workplace forums in South Africa.

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742 J Baskin, "The trend towards bargained corporatism", (1993) *South African Labour Bulletin* 17(3) 64-65.

743 JPG Lessing, "Analyses: Company-law reform in New Zealand", (1990) *South African Mercantile Law Journal*, 2, 49.

744 *Labour Relations Act* (LRA) 66 (1995).

(6.2.2) The Major Features of Workplace Forums

(6.2.2.1) Who is an Employee?

> (An) 'employee' means any person who is employed in a workplace, except a senior managerial employee whose contract of employment or status confers the authority to do any of the following in the workplace … represent the employer in dealings with the workplace forum or determine policy and take decisions on behalf of the employer that may be in conflict with the representation of employees in the workplace. … [745]

(6.2.2.2) What is a Representative Trade Union?

> (A) 'representative trade union' means a registered trade union, or two or more registered trade unions acting jointly, that have as members the majority of the employees employed by an employer in a workplace. [746]

It is noted that if employees work outside of the workplace, they will not be deemed to be an employee in terms of the section. [747] There can only be one workplace forum established per workplace. A 'senior managerial employee' is defined in the BCEA as an employee who has the authority to hire, discipline and dismiss employees and to represent the employer internally and externally. [748]

(6.2.2.3) What are the General Functions of Workplace Forums?

Under section 79 of the LRA,

> A workplace forum established in terms of this Chapter –
>
> (a) Must seek to promote the interests of all employees in the workplace, whether or not they are trade union members;
>
> (b) Must seek to enhance efficiency in the workplace;
>
> (c) Is entitled to be consulted by the employer, with a view to reaching consensus, about the matters referred to in section 84; and

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745 LRA, section 78(a).

746 LRA, section 78(b).

747 Martin Brassey et al, "Commentary on the *Labour Relations Act*", (1999) *Employment and Labour Law*, Vol. 3, ch. V, A5, 3.

748 Ibid A5, 5.

> (d) Is entitled to participate in joint decision-making about the matters referred to in section 86. [749]

Non-statutory forums do not fall within the purview of section 79 of the LRA. [750]

However, Brassey *et al* note,

> the content … that the Act gives the forum is almost infinitely adaptable … which the parties are free to depart (from) whenever they choose by the conclusion of a collective agreement. [751]

Section 79, however, does not go far enough for employees. The question to be asked is whether the Act should be modified in such a way so as to provide its employees with the right to participate in decision-making processes *at all levels* in the organisation, including board level. Brassey *et al* note that South African workplace forums, unlike those that operate in Germany, do not provide employees with a two-tier board structure that would achieve this. However, they note that workplace forms are set up to be beneficial to all of the organisation's stakeholders, including the employer, employees, creditors, debtors, the public and the economy.[752]

(6.2.2.4) How Can Statutory Workplace Forums be Established?

Subsection 1 of section 80(1) of the LRA states that a workplace forum may be established in any workplace in which an employer employs more than 100 employees. [753] Subsection 2 states that any representative union may apply to the Commission in the prescribed form for the establishment of a workplace forum. [754] There must also be no functioning workplace forum already established at the workplace in question. [755] If these requirements are met, the Commission must then appoint a commissioner who would then assist the parties in establishing a workplace forum either by collective agreement or in terms of this chapter. [756] The commissioner must convene a meeting with the applicant, the

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749 *Labour Relations Act* 66 (1995), section 79.

750 Brassey et al, above n 747, A5, 7.

751 Ibid A5, 8-9.

752 Ibid A5, 9.

753 *Labour Relations Act* 66 (1995), section 80(1).

754 LRA section 80(2).

755 LRA section 80(5)(b)(iii).

756 LRA section 80(6).

employer and the registered trade union having members in the workplace to facilitate the conclusion of a collective agreement between the parties, or at least, between the applicant and the employer. [757] If a collective agreement is concluded, the provisions of this Chapter do not apply. [758] In this event, the commissioner must meet with the parties to facilitate agreement between them, or at least between the applicant and the employer, with regards to the provisions of a constitution for a workplace forum, which takes into account the guidelines referred to in Schedule 2. [759] If no agreement is reached in this regard, the commissioner must establish a workplace forum and thus determine the provisions of the constitution in accordance with this Chapter and Schedule 2. [760] After the establishment of a workplace forum, the commissioner must set a date to elect the first members of the workplace forum and to appoint an election officer to conduct the election. [761] Section 80 does not apply to the public service, as workplace forums here will be regulated in a Schedule promulgated by the Minister for the Public Service and Administration in terms of section 207(4). [762]

An important point to be noted is that even if a corporation employs more than 100 employees, a workplace forum *may* be established. Consequently, there is no mandatory requirement to do this. This greatly dilutes the significance and effectiveness of workplace forums under the LRA. This section should therefore be amended in such a way that the establishment of workplace forums becomes a statutory requirement under the Act where *more than ten* employees are employed in a given workplace. In close corporations with ten or less employees, it is suggested that an employee representative must be nominated and elected to office by the employees.

Brassey *et al* note that a union, or unions acting jointly, having more than 50 per cent of its employees as members must make an application for the establishment of a workplace forum. [763] If parties do not meet the requirements of section 80, they may still establish non-statutory workplace forums, but the provisions set out in this Chapter will not protect these structures. An immediate shortcoming of the Act is that it requires more than 100 employees to be

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757 LRA section 80(7).

758 LRA section 80(8).

759 LRA section 80(9).

760 LRA section 80(10).

761 LRA section 80(11).

762 LRA section 80(12).

763 Brassey et al, above n 747, A5, 11.

employed at a workplace before a statutory workplace forum can be established. Statutory workplace forums should be available to all types of organisations, especially to the smaller private companies and close corporations (where the number of employees exceed ten). This would ensure that employee participation in the decision-making processes of the organisation and, consequently employee job satisfaction, are not only confined to and regulated by larger organisations.

Another issue that deserves to be questioned is why the Act insists only upon a registered trade union being able to apply for the establishment of a workplace forum, and why a majority of its members is required to do this. Surely, it would be in the best interests of employees for them to be able to apply for the establishment of a workplace forum themselves either collectively or individually? Similarly, it may be in the better interests of employees for their trade union to be able to apply for the establishment of a workplace forum even in those situations where it has less than 50 per cent of its employees as members, or where the unions are unregistered or where the employee organisation does not qualify as such to be a union. If, for example, a workplace has 120 employees of whom 100 employees wish its trade union to apply to the Commission for the establishment of a statutory workplace forum, in terms of the Act, the trade union in this situation would not be able to do so. This is because the Act insists upon “more than 100 employees” being employed by any one employer. This is so despite the great majority of employees in the workplace wishing the establishment of a workplace forum. This limitation appears not to be in the best interests of employees in South Africa. In this case “more than 100 employees” is simply an arbitrary determinant that bears no real connection to the needs of employees in any given situation. It should therefore be abandoned, as employee participation in the decision-making processes of the company promotes greater job satisfaction for its employees, improved customer service and increased profits for the employer.

It can further be argued that more than one workplace forum can be established at the same time in any workplace, provided that such workplace forum is not a “functioning” one. [764] This may become an issue at a later stage if the non-functioning workplace forum becomes a “functioning” one and exists alongside the newly established workplace forum. Brassey *et al* note that the section makes no provision for the termination of a workplace forum, which is “a serious

[764] *Labour Relations Act* 66 (1995), section 80(5(b)(iii).

shortcoming in the statute". [765] This is especially so if the two workplace forums operate in opposition to one another. For example, where one workplace forum argues for the maximum participation of employees in the decision-making processes of the organisation, and the other, opposes it, for some reason, this would not be very constructive in determining, negotiating and safeguarding the rights of its employees.

If the CCMA determines, however, that the requirements for the establishment of a workplace forum are met or are not met, its decision is reviewable to the Labour Court in terms of section 158(1)(g) read with section 157(1) on the basis of its irregular and irrational nature. [766]

It is clear from section 80 that a statutory workplace forum can either be governed by collective agreement or by the provisions of the Chapter. [767] The collective agreement would govern issues such as its composition of members, its powers, including the detailing of its procedures and processes to resolve issues, and its termination. Brassey *et al* note that once agreement is reached, the CCMA loses its powers to interfere with it and can therefore not solve any deadlocks for the parties. [768] Minority unions may be a party to the collective agreement between the employer and the union, but they do not have any rights of veto. [769] On the other hand, a workplace forum established in terms of the provisions of the Chapter would mean that the Act would have to govern. Then, there must also be an adherence to the guidelines set out in terms of Schedule 2.

(6.2.2.5) What is a Trade Union–based Workplace Forum?

The LRA states that if a collective agreement by an employer recognises a representative trade union for the purposes of collective bargaining regarding all employees in its workplace, the trade union may apply to the Commission in the prescribed form for the establishment of a workplace forum. [770] The applicant trade union may choose its members of the workplace forum from its elected representatives in the workplace. [771] The provisions of this Chapter will then

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765 Brassey et al, above n 747, A5, 15.

766 Ibid A5, 17.

767 *Labour Relations Act* 66 (1995), section 80.

768 Brassey et al, above n 747, A5, 18.

769 Ibid A5, 19.

770 *Labour Relations Act* 66 (1995), section 81(1).

771 LRA, section 81(2).

apply, except for sections 80(11) and 82(1)(b) to (m). [772] The applicant's constitution governs the nomination, election and removal from office of elected representatives.[773] A workplace forum constituted in terms of this section will be dissolved if either the collective agreement is terminated or the applicant is no longer a representative trade union. [774] The provision of this section does not apply to the public service. [775]

It is arguable that the application of this section is very limited. This is due to the fact that it would be an exceptional situation to find that *all* the employees in the workforce subscribe to the views of the representative trade union and, consequently, allow it to promote itself as their sole bargaining agent. Equally, it is in very limited circumstances that the employer would be willing to give a union-based workplace forum "exclusive collective bargaining rights". [776] Furthermore, to fall within the purview of this section, in addition to a workplace needing to have more than 100 employees, a union must have more than 50 per cent of the employees in the workplace and in the bargaining group as members and be recognised as the collective bargaining representative of all the employees.

(6.2.2.6) What are the Requirements for the Constitution of a Workplace Forum?

The LRA details the requirements for the constitution of every workplace forum. [777] Some of the more important subsections that deal with these requirements will be discussed. Section 82 should be read with Schedule 2 of the Act, which provides the guidelines for the constitution of a workplace forum.

The constitution of every workplace forum must establish a formula to determine the number of seats and the distribution of seats, [778] which reflect the occupational structure of the workplace. [779] It must also provide for the direct election of its members by employees, [780] the appointment of an employee as the

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772 LRA, section 81(3).

773 LRA, section 81(4).

774 LRA, section 81(5)(a) and (b).

775 LRA, section 81(6).

776 Brassey et al, above n 747, A5, 22.

777 *Labour Relations Act* 66 (1995), section 82.

778 LRA, section 82(1)(a).

779 LRA, section 82(1)(b).

780 LRA, section 82(1)(c).

election officer, [781] and the election of members within 24 months of the preceding election. [782] If another registered trade union becomes representative, it may demand a new election within 21 months of the preceding election. [783]

The constitution must also establish the terms of office of members and the circumstances in which they must vacate their office, [784] the circumstances and manner of removal of members from office, [785] and the manner in which vacancies may be filled. [786] It must also provide that the employer must allow the election officer reasonable time off with pay during working hours to conduct the elections. [787] It must also allow each member of the workplace forum reasonable time off with pay during working hours to perform the functions as member and to receive training relevant to those functions. [788] The constitution also requires the employer to take any steps reasonably necessary to assist the election officer with the elections. [789] The employer must also provide facilities to enable the workplace forum to perform its functions. [790] The constitution must also designate full-time members of the workplace forum if more than 1000 employees are employed in the workplace. [791] It must also provide that the workplace forum may invite any expert into its meetings, and that such expert is entitled to receive, inspect or copy any information that the workplace forum is entitled to receive, inspect or copy. [792] It must also provide that office-bearers or officials of the representative trade union may attend meetings of the workplace forum, including meetings with the employer or the employees. [793] The representative trade union and the employer may, by agreement, change the constitution of the workplace forum. [794]

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781 LRA, section 82(1)(c).

782 LRA, section 82(1)(e).

783 LRA, section 82(1)(f).

784 LRA, section 82(1)(k).

785 LRA, section 82(1)(l).

786 LRA, section 82(1)(m).

787 LRA, section 82(1)(o).

788 LRA, section 82(1)(p).

789 LRA, section 82(1)(q).

790 LRA, section 82(1)(r).

791 LRA, section 82(1)(s).

792 LRA, section 82(1)(t).

793 LRA, section 82(1)(u).

794 LRA, section 82(1)(v).

In terms of subsection 2(a) the constitution of the workplace forum may establish a procedure for the conciliation and arbitration of matters of which the employer and the workplace forum do not agree. [795] It may also include provisions departing from sections 83 to 92, which deal with the forum's composition and the manner and type of business it can involve itself with or engage in. [796] Subsection 3 makes it plain that the constitution of a workplace forum binds the employer.

It is noted that the provisions contained in section 82, and this Chapter, do not apply to workplace forums established under a collective agreement. [797] Section 82 only applies to those situations where there is no collective agreement and a workplace forum is established by the Commissioner who then takes into account the guidelines contained in Schedule 2 of the Act. [798]

(6.2.2.7) When are the Meetings of Workplace Forums to be Held?

In terms of section 83 of the LRA, there must be regular meetings of the workplace forum [799] and also regular meetings at which the employer must present a report on its financial and employment situation, its performance since the last report and its anticipated performance in the long and short terms. [800] The employer must also consult the workplace forum on any matter arising from the report that may affect its employees. [801] Additionally, at regular and appropriate intervals, there must be meetings between the workplace forum and the employees. [802] The workplace forum must report on its activities generally, [803] on matters in respect of which the employer has consulted it, [804] and on matters in terms of which it has participated in joint decision-making processes with the employer. [805] Every year, at one of the meetings with employees, the employer must present an annual report of its financial and employment situation, its

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795 LRA, section 82(2)(a).

796 LRA, section 82(2)(c).

797 LRA, section 80(8).

798 LRA, section 80(10).

799 LRA, section 83(1).

800 LRA, section 83(2)(a).

801 LRA, section 83(2)(b).

802 LRA, section 83(3)(a).

803 LRA, section 83(3)(a)(i).

804 LRA, section 83(3)(a)(ii).

805 LRA, section 83(3)(a)(iii).

performance and its future prospects and plans. [806] Meetings of employees must be held during working hours at a time and place agreed upon by the workplace forum and the employer with no loss of pay to the employees. [807]

It is emphasised that section 83 provides for the convening of *four* types of meetings. [808] These are meetings between members of the workplace forum, members of the workplace forum and the employer, members of the workplace forum and the employees and, finally, between members of the workplace forum, the employees and the employer.

Section 83 is important because it makes provision for all parties to come to the negotiating table, and to do so at "regular and appropriate intervals". The meaning that is to be given to "regular" or "regular and appropriate intervals" could, however, become rather problematic in the sense that what might be "regular and appropriate" for one organisation, may not necessarily be the same for another. Employers, employees and workplace forums may not agree on what should be meetings at "regular and appropriate intervals". Additionally, the employers might be very involved in the day to day running and administration of the organisation, whilst it employees may feel frustrated. They may feel that they are not receiving information or having meetings, as outlined in this section, on a "regular" enough basis. Thus, the extent to which "regular intervals" might become "not so regular" in the minds of the workplace forum or employees is an issue that needs to be resolved. Because of the wide and vague nature of this wording, employers may take advantage of this fact and downplay the importance of having "regular" meetings. Furthermore, the section does not state how many meetings should be held between the workplace forum, the employees and the employer. Section 3(b) simply states "(e) ach calendar year, at one of the meetings with the employees …". Does this mean that only one meeting needs to be held in this way? This phrase is ambiguous, as it could refer to other meetings to be held between the workplace forum and the employer. Hence, it could be read to mean, 'at one of the meetings that includes the employees (the other meetings not having included the employees)'. The wording of the Act should therefore be amended in such a way in order to ascertain with more precision the periods during which the meetings should be held with the workplace forum, the employer and the employees. This clarification would assist

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806 LRA, section 83(3)(b).

807 LRA, section 83(3)(c).

808 LRA, section 83.

in achieving greater industrial democracy in the workplace. Thus, Brassey *et al* note,

> the employer should give the forum enough information" to determine the future prosperity of the organisation, the aim being "… to make the forum a partner in the fortunes of the enterprise. [809]

To what extent organisations will reveal all the facts of its "financial and employment situation, its performance generally and its future prospects and plans" to the workplace forum and employees is a key question that workplace forums will be faced with. This includes the question of the degree to which the employer will regularly consult the workplace forums on matters that may affect employees in the workplace in terms of subsection 2(b).

(6.2.2.8) What Matters Must the Employer Consult a Workplace Forum on?

Section 84 of the LRA states that unless a collective agreement is in force with a representative trade union, a workplace forum is entitled to be consulted by the employer on various proposals, the more important ones of which will be discussed below. [810]

A workplace forum must be consulted on those proposals dealing with restructuring the workplace, including introducing new technology and work methods, [811] changes in the organisation of work, [812] partial or total plant closures, [813] mergers and transfers of ownership that would affect employees, [814] the dismissal of employees for operational requirements, [815] job grading, [816] criteria for merit increases or the payment of discretionary bonuses, [817] and education and training. [818]

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809 Brassey et al, above n 747, A5, 31.

810 *Labour Relations Act* 66 (1995), section 84.

811 LRA, section 84(1)(a).

812 LRA, section 84(1)(b).

813 LRA, section 84(1)(c).

814 LRA, section 84(1)(d).

815 LRA, section 84(1)(e).

816 LRA, section 84(1)(g).

817 LRA, section 84(1)(h).

818 LRA, section 84(1)(i).

Subsection 2 states that a bargaining council may confer upon a workplace forum the right to be consulted about other matters that fall within its registered scope. [819] Subsection 3 gives a representative trade union and employer the right to conclude a collective agreement permitting the workplace forum to be consulted on other matters. [820] The section is further broadened by subsection 4, which states that any other law may confer on the workplace forum the right to be consulted on other matters. [821] Subsection 5 states that a representative trade union and employer may agree that the employer must consult with the workplace forum to initiate, develop, promote, monitor and review measures to ensure health and safety at work. [822]

It should be noted that collective agreements that establish workplace forums do not fall within the scope of this Chapter. [823] This section contemplates those collective agreements facilitated by the Commissioner, which take into account the guidelines set out in Schedule 2. [824] Thus, the collective agreement must regulate all the consulting matters in terms of section 84, otherwise the collective "agreement will have to be read in tandem with this subsection … and (t)he terms of the collective agreement will take precedence when there is a clash". [825] It is open for workplace forums to try and extend the parameters of those matters upon which they may be consulted. This can occur either through the bargaining council or by direct agreement with the employer or through the operation of any law. It would then be incumbent upon the workplace forum to show cause why the bargaining council or employer, as the case may be, should give the workplace forum the right to be consulted on a matter not falling within the purview of section 84. The workplace forum would be inclined to argue that this consultation would be in the best interests for all concerned, including the organisation, its employees and other stakeholders and that it would democratise the industry even further for all parties concerned.

It is also important to note that the section specifically uses the word "proposals". It is arguable that "proposals" are something different from established or settled issues, or issues requiring immediate attention and, therefore, the workplace

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819 LRA, section 84(2).

820 LRA, section 84(3).

821 LRA, section 84(4).

822 LRA, section 84(5).

823 LRA, section 80(7).

824 LRA, section 80(9).

825 Brassey et al, above n 747, A5, 34.

forum has the right to be consulted *only* over those matters amounting to "proposals" and not over the other. However, in practice, it may, in some of the more difficult cases, be a rather onerous and complicated task to decide where the line should or should not be drawn between the two. That is, what might be viewed as a "proposal" for the employees or the workplace forum at that point in time, might have already been viewed by the employer as a settled issue and therefore not falling within the provisions of the section and is therefore not a matter for consultation. This may then result in dissatisfaction amongst the employees and bring about a sense that the organisation is using legal loopholes to legitimately apply undemocratic values through its organisation. Thus, the section should be amended in such a way that it does not simply restrict itself to matters that are only "proposals". This would ensure that pertinent matters in terms of the section are consulted upon expeditiously.

The list of "proposals" set out in subsection 1 is long and fairly exhaustive. However, a *deeming provision* should be added to the subsection. In terms of this, the workplace forum would be given the autonomy to insist upon the fact that it is consulted by the employer on matters that do not ordinarily fall within the provisions of the section if it deems it so urgent that, if not dealt with expeditiously, it would cause severe hardship to the employees or to the organisation concerned. Additionally, there should be disclosure of information if the workplace forum deems this to be in the best interests of the corporation. That is, the workplace forum would not need to have the rights conferred upon it either by the bargaining council or through the operation of some law or by entering into an agreement with the employer in terms of the provisions of the section.

(6.2.2.9) How do the Workplace Forum and Employer Reach Agreement on a Proposal?

Section 85 expands the duty to consult set out in section 84. [826] The employer must consult the workplace forum in order to reach consensus on a proposal under section 84(1) before it can implement it. [827] The employer must allow the workplace forum an opportunity to make representations and to advance other proposals. [828] The employer must consider these and respond thereto and, if the

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826 *Labour Relations Act* 66 (1995), section 85.

827 LRA, section 85(1).

828 LRA, section 85(2).

employer does not agree with them, the employer must state the reasons for disagreeing. [829] If the employer and the workplace forum cannot agree, the employer must invoke any agreed procedure to resolve any differences before implementing the employer's proposals. [830]

This provision affords the workplace forum and employer the opportunity to come to the negotiating table and to negotiate proposals made by one another in order to try and reach consensus on various issues. The provision imposes *duties* on the employer to try and reach consensus in the best interests of all parties concerned. An obvious possibility in this regard is that the parties would reach a deadlock situation. Therefore, a further provision should be added into this section that deals with this possibility. That is, in the event that any agreed procedure cannot be reached between the employer and the workplace forum, the Commission through conciliation should in the first instance, resolve this dispute. If the dispute remains unresolved, the matter must be resolved through arbitration. This would take into account the specific types of issues that could typify a deadlock situation of this nature.

(6.2.2.10) To What Extent are Employees Legally Entitled to Have a Part in the Decision-making Processes within the Organisation?

Regarding any contention in law and practice to maximise the rights of employees in the decision-making processes of the organisation, section 86 of the LRA falls at the heart of the matter. [831] This is significant, as it expressly provides for the first time in South African labour law that employees have *some* rights in the decision-making processes of their employ. Certainly, the provisions in the section are arguably groundbreaking in that previous labour legislation has not come close to expressly providing these rights to employees. A key question, however, is whether the legislation goes far enough. It is arguable that it probably does not, as these rights, which are given to employees under section 86, are confined to *line management level*, and, therefore, unlike the two-tier board system operating in a country such as Germany, do not give employees the right to be involved in decision-making processes at board level. Furthermore, the provisions in the subsection themselves are very limited and give very little support to the workplace forum and, in turn, to the employees of an organisation.

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829 LRA, section 85(3).

830 LRA, section 85(4).

831 *Labour Relations Act* 66 (1995), section 86.

Section 86(1) states that unless matters for joint decision-making are regulated by a collective agreement with the representative trade union, [832] the employer must consult and reach consensus with a workplace forum before any proposal is implemented relating to disciplinary codes and procedures, [833] rules for the proper regulation of the workplace that apply to conduct not connected to the work performance of employees, [834] measures to protect and advance persons who are disadvantaged by unfair discrimination, [835] and changes by the employer or its appointed representatives on trusts or boards of employer-controlled schemes to the rules regulating social benefit schemes. [836]

A representative trade union and an employer may conclude a collective agreement that confers upon the parties the right to participate in joint decision-making on other workplace matters and remove any matters listed in subsections (1)(a) to (d) from the matters requiring joint decision-making. [837] Any other law may confer on a workplace forum the right to participate in joint decision-making on other matters.[838] If no consensus is reached with the workplace forum, the employer may refer the dispute to arbitration in terms of an agreed procedure, [839] or, if there is no agreed procedure, refer the dispute to the Commission, [840] which must try and resolve the dispute through conciliation. [841] If the dispute remains unresolved, the employer may request that the dispute be resolved through arbitration. [842]

It is arguable that section 86 gives *limited* rights to the workplace forum, and, in turn, to the employees that are to be involved in the decision-making processes at line management level. As in section 84, the section immediately limits its purview, by confining itself to “any proposal” rather than including an issue that has become an immediate concern and, consequently, one which is not deemed

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832 LRA, section 86(1).

833 LRA, section 86(1)(a).

834 LRA, section 86(1)(b).

835 LRA, section 86(1)(c).

836 LRA, section 86(1)(d).

837 LRA, section 86(2)(a).

838 LRA, section 86(3).

839 LRA, section 86(4)(a).

840 LRA, section 86(4)(b).

841 LRA, section 86(6).

842 LRA, section 86(7).

to be a “proposal” in terms of the section. Although section (1)(b) is rather vague and applies to “conduct not related to the work performance of employees”, it is unlikely that employees would be able to argue that they were entitled to be involved in any decision that relates to the directors of the organisation choosing to take on business ventures or to take business risks in what they believe to be in the best interests of the organisation. It might also be difficult, in some cases, to reach agreement on what is in fact “conduct not related to the work performance of employees”. Some conduct might be very remotely or indirectly related to the work performance of employees. It would therefore be, in many cases, an arduous task on the part of the workplace forum or employees to be able to show or to prove that a proposal relates to “conduct not related to the work performance of employees” in order to fall within the purview of the subsection.

The other three parts to subsection 1 are plain. These parts have very limited scope and apply to “disciplinary codes and procedures”, “persons disadvantaged by unfair discrimination” and “changes … to the rules regulating social benefit schemes”. The other limiting factor is that it remains in the hands of the employer to decide, if consensus is not reached with the workplace forum, whether it will drop the proposal completely or refer it to arbitration or to the Commission. Thus, the employer has overriding power in terms of this section to dismiss the proposal or take it further. Therefore, better dispute resolution practices would arise and greater industrial democracy would be evident if the word “may” in subsection 4 is replaced with the word “must”. In this way, if the employer does not reach consensus with the workplace forum regarding a proposal, it must then refer the dispute either to arbitration or to the Commission, as the case may be. This would better balance this subsection and would remove its current one-sided nature, which is configured expressly in favour of the employer. Therefore, it is arguable that section 86 is groundbreaking in the sense that it forces the parties to be involved in joint decision-making ventures on various, but limited, proposals. However, it could ultimately bring about limited, if any, results, especially if the employer decides to pull away from the process at the stage when consensus is not reached with the workplace forum. It is likely that the legislature had fully intended this to be the case when this legislation was drafted. It ensured that the power and sovereignty of the workplace remains deep-seated in the hands of the employer.

Arguably, this section is simply a device to make employees believe that they are being involved in the joint decision-making processes of the organisation. In fact, employees are getting very little out of this section. As long as the employer has a legal entitlement to opt out of the process when consensus is not reached with the workplace forum, it would have the power to dictate to the other parties, as it deems fit. Employees could then declare a dispute in terms of section 134 of the LRA and strike over the disputed issues, but this would defeat the whole object of this provision, which is to have a collective process of joint decision-making. So, although subsection 1 states that "an employer must consult and reach consensus with a workplace before implementing any proposal", subsection 4 waters down subsection 1 by allowing the employer to abandon the process and leave matters as they are, if it does not reach consensus with the workplace forum. This is not satisfactory and, as noted above, needs to be revisited by the legislative draftsman as soon as possible.

(6.2.2.11) When May a Workplace Forum Request Review Procedures to Take Place with the Employer?

In terms of section 87 of the LRA, [843] a newly established workplace forum may request a meeting with the employer to review the criteria for merit increases or the payment of discretionary bonuses, [844] disciplinary codes and procedures, [845] and the rules to properly regulate the workplace for conduct not related to the work performance of the employees. [846] Employers are obliged to submit in writing the criteria, codes and procedures and rules it has to the workplace forum. [847] A review of the criteria must be conducted in terms of the provisions of section 85. [848] A review of the disciplinary codes, procedures and rules must be conducted in terms of the provisions of section 86(2) to (7) except that, in applying section 86(4), either the employer or the workplace forum may refer a dispute between them to arbitration or to the Commission. [849]

However, unlike those provisions contained in section 86, the Act provides that the workplace forum may bring two of the previous four proposals stated in

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843 *Labour Relations Act* 66 (1995), section 87.

844 LRA, section 87(1)(a).

845 LRA, section 87(1)(b).

846 LRA, section 87(1)(c).

847 LRA, section 87(2).

848 LRA, section 87(3).

849 LRA, section 87(4).

section 86 to arbitration or to the commission under subsection 4. It was specifically barred from doing this under section 86. The words “and rules” presumably refers to “the rules” for “the proper regulation” of the “conduct not related to work performance of employees in the workplace”. These matters deal with the same “disciplinary codes and procedures” and rules to regulate “conduct not related to the work performance of the employees” detailed under section 86. This is because the wording of these two subsections (86(1)(a), (b) and 87 (1)(b) and (c)) in each of the two sections is identical. However, subsection 3 deals with a “review of the criteria” that “must be conducted” in terms of “the provisions of section 85”. This presumably refers to the “criteria for merit increases or the payment of discretionary bonuses”. This means that workplace forums would be barred from referring matters dealing with subsection (1)(a) to arbitration or to the commission, as the review of the “criteria” must be conducted in terms of section 85 that deals with the consultation procedures to be engaged in between the employer and the workplace forum.

The employer may also, in terms of section 86, refer the two matters detailed in subsections (1)(b) and (c), dealing with “disciplinary codes and procedures” and “the rules” for “the proper regulation” of the “conduct not related to work performance of employees in the workplace” to arbitration or to conciliation through the commission. Consequently, there is an overlap on two of the matters in terms whereof the employer has the right to refer matters to arbitration or to the commission. This amounts to unnecessary duplication and the Act needs to be amended in such a way that either the two sections are consolidated as one section, or the duplication is removed through a streamlining of the two sections. This would lead to greater understanding by the various parties as to what their rights are under the Act.

The section, in its short title, also refers to a “newly established workplace forum”. Does this mean a workplace forum that has just been constituted under the Act, or one that has been established for a few months or even a year and, consequently, one that a party or the parties may still argue is “newly established”? This is vague and may cause problems at a later stage if there is a dispute between the parties or between the parties and the commission or those conducting the arbitration as to whether the workplace forum is a “newly established” one or not. If it is deemed to be “newly established”, in the event of a dispute arising, either the workplace forum or the employer, may decide to refer the matter or matters detailed in subsection 1(b) and (c) to arbitration or to

the commission. If not, presumably the workplace forum or employer would not have these rights.

Further vague wording within the section suggests that another problem can arise. Subsection 1 refers to “after the establishment of a workplace forum. …” The obvious question is how soon after the establishment of a workplace forum, may the workplace forum request a review on the matters stated in subsection (1)(a) to (c) with the employer. That is, does a request for review as noted in section 1 have to be made immediately, within a month or months or within a year or at a period even longer than this? Brassey *et al* believe that the workplace forum must request a review with the employer within a reasonable time after its establishment otherwise it will lose the right of review envisaged in terms of the provisions of this section. [850] Accordingly, the Act has, once again, not gone far enough in this section in protecting, balancing and equalising the rights that the workplace forum has, as against the rights of the employer. The Act should amend this section in such a way that its purview should be extended to those workplace forums which are clearly not, or, which are deemed not to be, “newly established” ones. Thus, if employers can decide whether to take certain matters or proposals under dispute to arbitration or to conciliation, workplace forums should also have equal rights to do this in this regard. It makes little sense not to do this. Depriving workplace forums, and, in turn, the employees of equal bargaining power, would not, in the long run, achieve employee job satisfaction and acceptable industrial democracy. This is the case when employees have no need to strike and employers have no need to lockout its employees from the workplace. A good point about subsection 2, though, is that it requires the employer to submit *in writing* its criteria, codes, procedures and rules stated in subsection 1. There is a good, old saying that ‘if it is not in writing, it has not been said’. This ensures that there is no ambiguity, confusion and misunderstanding at a later date between the respective parties.

(6.2.2.12) To What Extent Must the Employer Disclose Information to the Workplace Forum?

In terms of section 89 of the LRA, [851] an employer must disclose to the workplace all relevant information that will allow the workplace forum the opportunity to

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[850] Brassey et al, above n 747, A5, 43.

[851] *Labour Relations Act* 66 (1995), section 89.

engage effectively in consultation and joint decision-making processes. [852] An employer is not required to disclose information that is legally privileged, [853] or that the employer cannot disclose without contravening a prohibition imposed on it by law or an order of court, [854] or that is confidential, and, if disclosed, would cause substantial harm to an employee or employer, [855] or that is private personal information relating to an employee, unless that employee agrees to the disclosure thereof. [856] The employer must notify the workplace forum in writing if it believes that the information is confidential. [857] If there is a dispute about the disclosure of information, any party may refer the dispute in writing to the Commission, [858] which must attempt to resolve the dispute through conciliation. [859] If the dispute remains unresolved, any party may request that the dispute be resolved through arbitration. [860] The commissioner must decide whether or not the information contemplated in subsection (3) is relevant. [861] If the commissioner decides that the information is relevant, but is that which is contemplated in subsection 2(c) or (d), the commissioner must balance the harm that the disclosure is likely to cause to the employer or employee against the harm that the failure to disclose the information is likely to cause in the ability of the workplace forum to engage effectively in consultation and joint decision-making. [862] If the commissioner decides in favour of disclosure, the commissioner may order the disclosure thereof on terms designed to limit the harm likely to be caused to the employer or employee. [863] The commissioner may, however, take into account any breach of confidentiality and thus may refuse to order the disclosure of information for a period specified in the arbitration award. [864]

It would appear from this section that the obligation of the employer to disclose information to the workplace forum is qualified by various conditions and is

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852 LRA, section 89(1).

853 LRA, section 89(2)(a).

854 LRA, section 89(2)(b).

855 LRA, section 89(2)(c).

856 LRA, section 89(2)(d).

857 LRA, section 89(2)A.

858 LRA, section 89(3).

859 LRA, section 89(5).

860 LRA, section 89(6).

861 LRA, section 89(7).

862 LRA, section 89(8).

863 LRA, section 89(9).

864 LRA, section 89(10).

restricted in certain situations. It is foreseeable that a dispute may arise between the workplace forum and the employer about the disclosure of information. It might be convenient and easy for the employer to assert that information, which it does not wish to disclose, is confidential and could, if disclosed, cause substantial harm to it or to an employee. One test to determine whether information of this nature should be disclosed or not, is based primarily upon the question of relevance, which is determined by the commissioner. Thus, it would be far more difficult for the commissioner to try and ascertain whether information is in fact confidential or not. This is because what might be confidential in the view of employers may not be similarly viewed as confidential information by the workplace forum. Thus, even though the commissioner may decide that the information legitimately falls within the parameters set out in subsections 2(c) or (d), the commissioner may nonetheless order such information to be disclosed and in such manner as would be likely to minimise the effects of such disclosure. Hence, there is no safe haven for employers in so far as confidential information is concerned. This is a fairly broad-ranging section of the Act and provides the workplace forum with effective means to have information disclosed to it, which it might otherwise not have had access to. Over and above the remedies obtainable through conciliation, the aggrieved party may refer the matter to arbitration.

(6.2.2.13) To What Extent May Documents be Inspected and Copied by the Workplace Forum?

Section 90 of the LRA is self-explanatory. It provides that any documented information that must be disclosed by the employer in terms of section 89, must be made available on request to the members of the workplace forum for inspection. [865] The employer must provide copies of this to the members of the workplace forum on request. [866]

It is important to note that this can be a powerful section in the hands of the workplace forum. The request is tantamount to a demand. This is due to the fact that once the members of the workplace forum have requested this documentation from the employer it must provide it and must do so immediately. The wording of the section also suggests that each and every member of the

[865] LRA, section 90(1).

[866] LRA, section 90(2).

workplace forum is entitled to inspect and to receive a copy of the documentation from the employer, as is required.

(6.2.2.14) When May the Workplace Forum Designate to its Office a Full-time Member?

In terms of section 92 of the LRA, where 1000 or more employees are employed in a workplace, the members of the workplace forum may designate one full time member. [867] The employer must pay the full-time member of the workplace forum the same remuneration that that member would have earned in the last position before becoming a full-time member. [868]

It should be noted that there is some inconsistency between section 92(1) and section 82(1)(s). Firstly, although section 92(1) couches the designation of a full-time member to the office of a workplace forum, where 1000 or more employees are employed in a workplace, in wording that is voluntary, section 82 (1)(s) is peremptory. Section 82(1)(s) notes that the constitution of every workplace forum *must* provide for the designation of full-time members of the workplace forum if there are more than 1000 employees in a workplace. Secondly, although section 92(1) envisages one full-time member being designated to the office, section 82(1)(s) prescribes "the designation of full-time members. …" Thirdly, although section 92(1) provides for the designation of a full-time member once "1000 or more employees are employed", section 82(1) provides for the designation of more than one full-time member only once there are 1001 or more employees in a workplace.

In order to avoid confusion, the Act needs to amend or delete either of these sections to bring about consistency. It is suggested that the more onerous of the two provisions, section 82(s), should be deleted. In line with achieving greater industrial democracy, it should be the option of the workplace forum to decide whether or not to appoint a full-time member to its office. Additionally, section 92(1) should be amended so as to afford the workplace forum with the opportunity to appoint more than one full-time member if it so wishes. Furthermore, the Act should not restrict itself only to the situation where 1000 or more employees are employed in the workplace, but should be wide enough to

867 LRA, section 92(1).

868 LRA, section 92(2)(a).

cover the designation of a full-time member or members in any circumstance that the workplace forum may be faced with.

(6.2.2.15) How May a Workplace Forum be Dissolved?

Section 93 of the LRA states that a representative trade union may request a ballot to dissolve a workplace forum. [869] At this point, an election officer must be appointed in terms of the constitution of the workplace forum. [870] Within 30 days of the request in subsection 1, the election officer must prepare and conduct the ballot. [871] If more than 50 per cent of the employees having voted in the ballot support the dissolution of the workplace forum, then it must be so dissolved. [872]

Read in conjunction with section 81(5), a trade union based workplace forum will only be dissolved if its collective agreement is terminated or the applicant is no longer a representative trade union. These two provisions set conditions for the dissolution of a trade union based workplace forum, which are arguably onerous to fulfill. Thus, it may be difficult to dissolve a workplace forum that meets these conditions, even if such workplace forum is not really working in practice to the advantage of its members. This is so despite section 93, which does not oblige the representative trade union to request a ballot to dissolve a workplace forum if it does not wish this. Furthermore, under this section, even if a large minority of voting employees wish the workplace forum to be dissolved, say 49,9%, it would still remain in existence if 50,1% of them decide this to be the case. If there were more than 1000 employees employed in the workplace, this could be disastrous for all parties concerned. In this situation, a workplace forum would be kept alive but would most likely enjoy insufficient support to be effective or to be a significant bargaining tool against the employer. As mentioned previously, the Act really does not provide sufficient mechanisms for the dissolution of workplace forums.

(6.2.3) Conclusion

From the analysis and discussion of the provisions relating to the establishment, functions and operating mechanisms of workplace forums, it is evident that these

869 LRA, section 93(1).

870 LRA, section 93(2).

871 LRA, section 93(3).

872 LRA, section 93(4).

provisions are *inadequate* in protecting and equalising the rights of employees. This is the case for three main reasons.

The first reason is that it is fair to say that *ex facie* the legislation there are provisions in the sections that are ambiguous, vague or in conflict with one another. Examples of this have been discussed and referred to. As a result, in many cases, this factor would delay the parties in reaching the settlement or finalisation of issues. Consequently, in this way, the parties would need to first ascertain the intention of the legislature before the provisions can be implemented. This may occur in its simplest form through the process of negotiation, or, if this cannot work, through the processes of conciliation and arbitration.

Various provisions in the legislation should therefore be modified, amended or deleted so as to bring about consistency and greater understanding and clarity for all the parties concerned.

Secondly, it is important that the establishment of workplace forums is made a mandatory requirement under the Act for those corporations that have more than ten employees. In those corporations with ten or less employees, an employee representative must be nominated and elected to office by the employees. As it currently stands, only those workplaces with one hundred or more employees *may* establish workplace forums.

Thirdly, the legislation only allows for joint decision-making between the workplace forum and employer at line management level and, then, in only very limited and defined circumstances. The provisions are groundbreaking in this regard, but have not gone far enough in equalising the bargaining rights of all parties. Legislation needs to capture the spirit of industrial democracy in a greater and more meaningful way for all the parties concerned, especially for the employees. Thus, it needs to expand in such a way that it opens the doors for workplace forums to be involved in *many more* matters as part of the joint decision-making processes. This means allowing the workplace forum and its employees a joint decision-making role in those matters decided even at board level. If the employees were happy and satisfied, this would most likely lead to improved customer satisfaction, and, through this, improved profitability of the organisation.

(6.3) THE KING I REPORT

(6.3.1) Introduction

The chairman of the King Committee on Corporate Governance, Mervyn E King, launched the first King Report on 29 November 1994. The King Report on Corporate Governance consisted of 23 chapters, notes, appendices and a code of ethics for enterprises and also a set of affirmative action guidelines.

In this section, it will be considered whether these chapters of the Report have influenced, either positively or negatively, the development and growth of worker participation in the decision-making processes of the organisation in South Africa.

The King Report is of the view that in modern companies

> employees have become far more involved in decision making. [873]

Unfortunately, the King Committee does not take the matter any further at this point and therefore omits to explain on what basis, and especially to what extent, the Committee believes this to be the case. It therefore remains necessary for interested parties to sift through the entire Report of 70 pages to establish the reason or reasons for the King Committee having made this statement.

The King Report further states,

> the interests of customers, suppliers and the community are now far more relevant to corporate decision making. [874]

This time, however, the King Committee does elaborate further on this statement. The King Committee correctly asserts that other interested stakeholders have become a part of the corporation in its governance processes. Therefore, the interests of all of the stakeholders, not just the shareholders, need to be considered.

The King Report echoes these sentiments further by stating,

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[873] *King Report on Corporate Governance*, 1994, ch.1, 1, n.2.3.

[874] Ibid, n.2.4.

> modern corporations can be described as a link where the interests of the mutual rights and interests of the various stakeholders are brought together. … In their own interests these different groups should co-operate to further the well being of the corporation. … The concept of directors' reports being directed solely to shareholders is changing into a report to all stakeholders. Society now expects greater accountability from companies in regard to their non-financial affairs, for example, in relation to their employees and the environment. [875]

However, the King Report then reduces the effects of these sentiments by stating,

> enterprise and profitability must be among two of the important driving forces" (and) "if shareholders cannot earn an acceptable return on their funds, they will not invest, and there will be no growth in commercial or industrial activity. [876]

Thus, whilst the King Report mentioned two important considerations that contribute towards and create good corporate governance, these latter considerations are diametrically opposite in nature, content and application. Therefore, the King Report should have *emphasised* and thoroughly explained in detail at this point that a *system* needs to be created by the organisation by which *all* these considerations may work and flourish well together in harmony. Unfortunately, the King Report only states,

> whilst striving for growth … the corporation must deal with its stakeholders fairly. … (E)mployees have a large interest in the company's operations and activities. Of vital concern to … modern … South African companies … is a well-balanced mechanism in which employees can participate in management. … [877]

And

> in the context of corporate governance, a proper balance needs to be achieved between freedom to manage, accountability and the interests of the different stakeholders. [878]

Furthermore, although the King Report asks the important question whether companies should include in their annual statements a report relating to the social endeavours of the corporation and the opportunities and benefits available

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875 Ibid 2, n.10.

876 Ibid, n.11 and n.12.

877 Ibid, n.12.

878 Ibid 3, n.16.

to employees, it does not attempt to answer the question. [879] The value and significance of this view then becomes reduced as a result of it not being discussed any further. This is just but one example in the King Report of important concepts being diluted through a lack of continued and thorough discussion.

Chapter 3 of the King Report highlights the application of the recommendations. More specifically, the recommendations of the King Committee are directed only at "the affected corporations", which include companies listed on the main board of the Johannesburg Stock Exchange, the large public entities as defined in the *Public Entities Act*, banks, financial and insurance entities, as defined in the various Financial Services Acts, large unlisted dependent companies and large quasi-state entities, such as control boards and co-operatives.

The King Committee believes that "large" entities should include companies with shareholders' equity of 50 million Rand or more. It is arguable that this view is far too restrictive. The King Report's recommendations should be applicable to all sizes of companies, both public and private, and also to close corporations. There are far more private companies and close corporations constituting the South African corporate world than the number of "affected corporations". Furthermore, it is far too vague and uncertain a statement for the King Report to note,

> it may be that companies with an equity base of less than R50m have very large turnovers and/or employ thousands of people and their successful functioning is important to the wider community. These companies should adhere to the recommendations but it is difficult to formulate a definition of such corporations. [880]

It is not easy to understand the reason for the King Report having made this statement. It is arguably incorrect to categorise corporations in accordance with the approach used by the King Report. The King Report does not state the basis upon which it decided that 50 million Rand would be the threshold amount in order to distinguish between "large" companies and those that are *less* than "large". The list formulated by the King Report as to what constitutes "affected companies", makes little sense and should be rejected. To ensure enforceability, it is arguable that the King Report's recommendations should be more than mere recommendations. They should be *peremptory* in nature. The recommendations would then become legislation and would be applicable to all sizes and types of

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879 Ibid, Ch.2, 4, n.9.

880 Ibid, Ch. 3, 5.

corporations making up the South African business world. In this way, marked and useful changes in the workplace for employees would be generated. To this extent, employees would have a very real, and not fictional, role in the running of the corporation and in its decision-making processes. The way in which the King Report has chosen to formulate *only* recommendations to "affected corporations" means, in practice, that all of the non-affected corporations need not apply the recommendations of the King Report. It also means that since the King Report only formulated recommendations, they are not mandatory and, therefore, even "affected corporations" need not apply them if they do not wish to. The recommendations of the King Report are, therefore, arguably legally unenforceable.

(6.3.2) Worker Participation According to the King I Report

The King I Report indicates that,

> … the focus must be on a participative entrepreneurial approach rather than a dominant one. (However), … the participation process must not become so dominant that it stifles or obstructs the notion of business risk for reward in a free enterprise system. [881]

Unfortunately, the King Report does not explain this statement any further. It is, however, clear that the King Report supports worker participation, but only to the extent that it does not affect the "reward" of the company. Thus, difficulties would arise in establishing conclusively that worker participation does "stifle or obstruct" the gaining of rewards for the company. Presumably, the King Report, in using the term "reward", is referring to the profitability of the corporation. Additionally, when the King Report uses the phrase "a dominant one", it is probably referring to the issue of shareholder dominance, which it does not sanction.

Chapter 4 refers to the issues governing the board of directors, making it very clear that the King Report does *not* support the German two-tier board structure, consisting of a supervisory and management board. [882] This is so despite the fact that the King Committee acknowledges that the two-tier board structure, with employee and shareholder representatives dominating the supervisory board and managers the management board, has succeeded in Germany. The reasoning of

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[881] Ibid, Ch. 3, 5, n.5.

[882] Ibid, Ch. 4, 6, n.10. See also Blackman et al, above n 499, paragraph 208, 8-16-1.

the King Committee, which is unconvincing and arguably incorrect, is based upon the belief that

> the question must be asked whether there is any advantage to be found in a two-tier structure, which cannot be attained, in a unitary structure. There are, moreover, distinct advantages in a unitary board structure. It is the Committee's view that every objective of the two-tier structure can also be attained in a unitary structure. The significant advantage of a unitary structure in contradistinction to a two-tier board is that it avoids the artificial compartmentalisation that occurs in a two-tier structure. [883]

The King Report then continues this discussion by stating,

> in South Africa the unitary board structure has always been adopted. With appropriate enterprise, integrity and controls in a company a newcomer learns much in a unitary board structure. Also there are few management tools better than personal interaction. Whether there is a two-tier or a unitary board management will meet separately. We believe that the interaction present at a unitary board is vital for the progression of corporate governance in South Africa. [884]

Unfortunately, referring to the quotation above, the King Committee does not refer to any of the advantages found in the two-tier board system. The advantages of the German two-tier board system will be discussed in this thesis under a separate heading. At the very least, the two-tier board system obliges the corporation to involve its employees and shareholders in the decision-making processes at board level. This is because a structure it set up right from the onset, which caters for the involvement of employee and shareholder representatives on the supervisory board. Employees are thus endowed with the status as board members. This, however, is not the case with a unitary board system. As it is currently run in South Africa, employees, under the unitary board system, do not acquire the status of board members and therefore do not sit on the board. The most that has happened in South Africa at this juncture is the involvement of representative employees through the establishment of workplace forums under the *Labour Relations Act* 66 of 1995. Through this process, as we have seen, employees are afforded very limited rights in the decision-making processes of the corporation. They are certainly not entitled to be involved in the decision-making processes at board level, and certainly not to the extent that they would be entitled to do so if they were sitting on a supervisory board under the two-tier board system. However, it is arguable that this degree of employee involvement at board level is unachievable, as suggested by the King Committee,

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883 Ibid 6. See also Blackman et al, above n 499, paragraph 208, 8-16-1.

884 Ibid, n.11, 7. See also Blackman et al, above n 499, paragraph 208, 8-16-1.

through the current unitary board system. Generally, South African corporations are not about to open their doors to permit worker participation in the decision-making processes at board level through the current unitary board system. Worker participation at board level in South African corporations will only be achieved in the near future if the structure of the unitary board system is changed, which compels the employers to admit worker representatives to its boards, or, if the two-tier board system is adopted, which caters for the creation of supervisory boards right from the onset. The latter option is more viable and has a greater chance of being successful, as it has been in Germany. A two-tier board system is unlikely to be an "artificial compartmentalisation" as suggested by the King Committee. However, what may in fact be described as an "artificial compartmentalisation" is the King Committee distinguishing between those corporations that are "affected corporations" and those that are not.

South Africa should take cognisance of those systems developed in other countries, which have worked well. For example, in Germany, the two-tier board structure has been successful. There is no reason to believe that it cannot work in South Africa. The fact that South Africa has always adopted a unitary board system should not be a reason to dismiss a change of system that could work better. It is also arguable that the unitary system has not been too successful in South Africa. It is possible that many companies may not have been liquidated if employees were treated better and, as a result, were more loyal towards the corporation. Happier employees result in greater turnover and productivity and increased profitability of the corporation. A good way to achieve greater respect and loyalty from employees is by affording them a voice in the joint decision-making processes at board level. The King Committee does not specifically state whom "the newcomer" may be that "learns much in a unitary board structure". It is, however, very unlikely that the "newcomer" will be an employee sitting at board level. Thus, "personal interaction" is good and can be achieved through a two-tier board structure, as the two board groups cross communicate in matters that are common to each group. The King Report unfortunately does not advance their argument any further on why they believe "… that the interaction present at a unitary board is vital for the progression of corporate governance in South Africa". [885]

[885] Ibid 7. See also Blackman et al, above n 499, paragraph 208, 8-16-1.

Note 12 forms a central part of the King Report regarding worker participation in matters of corporate governance. [886] It is not absolutely clear as to what extent these proposals were the actual recommendations of the King Committee. This is because the King Report notes, "many submissions were received on the subject". This is then followed by various contentions governing this issue. The more significant proposals will be highlighted.

Firstly,

> … a company is a nexus of inter-relations between its various stakeholders and the board is really representing these stakeholders. Consequently, the various stakeholders of a corporation are entitled to representation on the board. [887]

This contention makes good sense if defined correctly. The traditional approach to company law, which endorses almost exclusively the rights of its shareholders and the maximisation of their wealth, has been severely eroded in modern times. Thus, today, the board of directors needs to consider the rights and interests of other stakeholders in the corporation. Additionally, employees should be represented at board level. However, it would be illogical to allow customers, suppliers or even the State to representation at board level. This does not mean that the interests and rights of these parties should be ignored. Directors should be seen to have taken an active role in considering the interests of these stakeholders. The King Report captures these sentiments when it notes,

> logically, this would result in an entitlement to representation on the board for customers, suppliers and the State – with patently unacceptable conflicts of interest. [888]

However, the King Report convincingly asserts,

> while a company is a nexus of stakeholders' interests it is a separate legal entity. Its assets belong to the company and to no one else. It is, therefore, incorrect to say that the assets belong to the shareholders or any or all of a company's stakeholders. The stakeholders, however, all have an interest in the operation of the company's business and the deployment of its assets. [889]

Additionally, as mentioned above,

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886 Ibid 7, n.12.

887 Ibid, n.12.2.

888 Ibid 7.

889 Ibid, n.12.3.

> there are … three stakeholders who have an identity of interest and they are the shareholders, managers and workers. That identity of interest is to pool resources and skills for the purpose of ensuring that the corporation survives and thrives. It is for this reason that we believe that workers should participate in the governance of corporations. [890]

Unfortunately, the King Report does not state *how* this may be achieved. It also does not specifically state that it believes that workers should be permitted to occupy positions or be represented at the board level of corporations. It merely mentions, in very broad terms, that workers should be able to participate in corporate governance issues. The Report is unfortunately silent on the extent to which and the way in which the King Committee believes that this may be achieved or be useful to a corporation.

The King Report acknowledges the fact that worker participation is important. [891] However, the King Report does not attempt to suggest how this may be *practically* achieved in a corporation or, put another way, how worker participation should become a reality. Therefore, the King Report simply indicates,

> the question of worker participation is of vital importance in South Africa. …
> (U)ltimately a system suitable to each corporation will have to be found to permit worker participation in governance of that corporation. It does not necessarily mean that there will be one system. What may be a workable system in one corporation may not be workable in another corporation. [892]

The King Report reiterates this point by emphasising,

> the system of worker participation in governance decisions should grow out of the nature of the corporation's business, the culture of the corporation, the culture of management and the workers' organisation. [893]

The King Report finally does attempt to give *some* pointers to corporations as to how worker participation may be achieved. [894] However, these pointers tend to be general and vague and do not provide much assistance to those corporations wishing to adopt a system of worker participation. These pointers are not mandatory and are therefore unenforceable from a legal point of view. They also

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890 Ibid, paragraph 12.4.

891 Ibid, n.12.6, 7.

892 Ibid 7.

893 Ibid, n.12.7.

894 Ibid 7-8, n.12.8.

do not indicate clearly whether employees ought to be involved in the joint decision-making processes of the corporation or the level(s) at which worker participation systems ought to be adopted. What the King Report ought to have suggested instead was the creation of a mandatory system that obliges the corporation to admit worker representatives to board level so that they can legally be involved in the joint decision-making processes of the corporation. It could then be the responsibility of the interested stakeholders, management and workers to design a system of internal rules and procedures to regulate worker participation. Any point of conflict between the interested parties in designing the rules and procedures, based on the "corporation's business, the culture of the corporation, the culture of management and the workers' organisation" could be addressed in terms of the current *Labour Relations Act*. This is the case with the establishment of workplace forums under the Act where a conciliation board or an arbitrator can resolve issues of dispute in this way. This mandatory system of admitting employee representatives to board level should be applicable to all types and sizes of corporations, including close corporations. The manner in which this note in the King Report is written is such that it does not capture these sentiments. In fact, the "affected corporations" could simply choose to disregard the recommendations in their entirety without any fear of reprisal.

The recommendations in the King Report are listed as follows:

> Corporations should evolve their own system of worker participation whether by way of workers' committees or at management, executive committee or board level. Whatever the system it should develop: [895]
>
> 12.8.1 Practices that lead to the effective sharing of relevant information, to enable employees to gain a better understanding of the corporation for which they work;
>
> 12.8.2 Effective consultation by management with the workforce before taking decisions that affect the workers;
>
> 12.8.3 Speedy identification of conflict and its effective and prompt resolution.

Regarding the issue of the "effective sharing of relevant information", there are, unfortunately, many unanswered questions that arise from this phrase through the loose and vague wording of the King Report. [896] These are:

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[895] Ibid, n.12.8.

[896] Ibid, n.12.8.1.

1. Is the King Committee prescribing, through the use of this phrase, that employees should be permitted to participate *frequently* in the governance of the corporation, and, if so, to what extent and at what level(s)?

2. What does "effective sharing" mean?

3. When does the corporation have to share "relevant information" with its employees?

4. What is meant by "relevant information"?

5. When is information deemed not to be "relevant" and who decides?

Furthermore, although Chapter 5 deals with aspects relating to directors, the King Report refers again to the question of disclosure, [897] but does not add any further details of a significant nature to this issue. It gives rise to more questions than answers and the contents are therefore of not much use. That is,

> directors must ensure that all interested parties are fully informed of any material matter affecting the company's business with openness and substance over form being their guideline. [898]

Questions arising from this statement are:

1. When are the "interested parties" deemed to be "fully informed"? In other words, how much information and what depth of information should be disclosed before this requirement is satisfied?

2. How do the parties decide whether a matter is a "material" one or not?

3. What happens when the "interested parties" disagree over the materiality or otherwise of a matter(s) affecting the company's business?

4. How do directors "ensure that all interested parties are fully informed of any material matter affecting the company's business"? In other words, what procedures or rules must the directors follow to ensure that this factor is adequately satisfied?

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[897] Ibid, ch. 5, 8, n.2.8.

[898] Ibid 8. See also Blackman et al, above n 499, paragraph 208, 8-16-8.

5. In the context of worker participation and disclosure and to enable a better understanding by corporations, what does the King Report mean in ordinary language by its use of the phrase “openness and substance over form being their guideline”?

6. At what point could interested parties claim that the corporation is not acting in an open and transparent way?

Chapter 19, in discussing the recommendations of the King Report, refers to the issue of disclosure and stakeholder communications. [899] These are:

> 19.1 It is the board’s duty to present as simple a report as possible to stakeholders, but the quality of the information must be based on the guidelines of promptness, relevance, openness and substance over form.
>
> 19.2 Reports and communications must be made in the context that society now demands transparency and greater accountability from corporations in regard to their non-financial affairs, for example, their workers and environmental issues.
>
> 19.3…
>
> 19.4 In any communication with stakeholders the directors should ask themselves the following four questions:
>
> 19.4.1 Is the communication open or transparent?
>
> 19.4.2 Is the communication prompt?
>
> 19.4.3 Is it relevant and substantial or merely a communication of form?
>
> 19.4.4 Does it fairly set out the position?
>
> 19.5 If the answer to any of the above four questions is in the negative, the directory must amend the communication properly. [900]

It is worth noting that the recommendations of the King Report in 19.1 *add* a further set of criteria to the issue governing the disclosure of information. That is, note 12.8.1 in chapter 4 above emphasises *only* the relevancy of such information. Therefore, in note 19.1, issues of transparency, openness,

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[899] Ibid, ch.19, 29, n.19. See also Blackman et al, above n 499, paragraph 208, 8-16-8.

[900] Ibid. See also Blackman et al, above n 499, paragraph 208, 8-16-8.

promptness, fairness and substance are added to the list for the disclosure of information during stakeholder communications. It does not, however, mention the issue of the materiality of such information, which was noted in 2.8 of chapter 5. It is therefore clear that the King Report has inconsistently attempted to define how, when and what type of information needs to be disclosed to the stakeholders of the corporation during stakeholder communication. In this way, it is clear that the various recommendations outlined above have to be read together and thus a version adopted, which takes into account all the criteria mentioned in the various notes of the King's Report.

In addition, the following questions arise out of note 19: [901]

1. What factors need to be taken into account in deciding whether the communication is "open", "transparent", "prompt", fair, "relevant and substantial"?

2. What happens in the situation where there is a dispute between the stakeholders, especially one arising between the employees and management, as to whether the communication is "open", "transparent", "prompt", fair, "relevant and substantial"?

3. What is envisioned by the word "prompt" in the context of the report being made available to the stakeholders – a day, a week, a month or some other time period?

The statement in 12.8.2 also gives rise to unanswered questions for the same reasons as those noted in 12.8.1 above. [902] These are:

1. When would consultation by management in the eyes of the workers be deemed to be "effective?"

2. If a dispute arises as to whether there was "effective consultation by management", which process is used to decide whether this was the case or not?

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[901] Ibid.

[902] Ibid, nn.12.8.1, 12.8.2.

3. How is it to be decided in difficult cases whether a decision could "affect the workers"?

4. Does a decision have to "affect the workers" *only* directly, or does "consultation by management" even have to take place in those situations when this would only "affect the workers" indirectly or very remotely. It is arguable that any decisions that management takes would, at least, impact upon workers in the most remote of ways.

Additionally, chapter 16 of the King Report, which deals with stakeholder links, suggests that with regard to contractual stakeholders,

> employees in particular should be entitled to be not only motivated and led, but to be as fully informed as possible about the company for which they work. Communication should be on a regular basis and include written information on employee rights, benefits and obligations as well as on company plans, targets and policies. … [903]

Questions arising from this are:

1. At what point can the corporation claim that employees have been "as fully informed as possible about the company for which they work"?

2. If a dispute arises as to whether the employees have been "as fully informed as possible about the company", which process is used to decide whether this was the case or not?

3. What is meant by "a regular basis"?

There is a difference in meaning between the words "prompt" and "regular", which denotes further inconsistencies in the length of periods recommended by the King Committee in stakeholder communications. That is, although note 19.1 above, dealing with stakeholder communications, requires a report to be presented to stakeholders in communication that is "prompt", note 2.1 above, dealing with contractual shareholders, requires that communication with "employees in particular should be … on a regular basis". [904]

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[903] Ibid, ch.16, 23, n.2.1.

[904] Ibid 23, n.2.1.

The word 'regular' is defined as "conforming to a rule of equal disposition in space or time, …frequently received over a long period. …" On the other hand, the word "prompt" is defined as "quick to respond and act without delay … immediate, instant …". [905]

One question that needs to be asked is whether the King Report intended that communication that is to be made to employees should be made on a "prompt" basis or only a basis that is something less than this, which is on a "regular" basis. In the interests of efficient communication between management and the various stakeholders, the word "prompt" should be preferred.

Furthermore, note 12.8.3 also gives rise to unanswered questions. [906] These are:

1. When would the "identification of conflict" be deemed to be "speedy" – a week, a month, six months, a year or longer?

2. What factors need to be taken into account in assessing whether the "identification of conflict" has been a "speedy" one or not?

3. When can we say that there has been an "effective and prompt resolution" of conflict?

4. What factors need to be taken into account in assessing whether there has been an "effective and prompt resolution" of conflict?

It is also useful to point out that generally speaking note 9 (stakeholder communications), [907] dealing with the Code of Corporate Practices and Conduct, is similar to note 19 (stakeholder communications). [908] However, note 9.1 is quite different from note 19.1 in content. Note 9.1 reads,

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905 *The New Lexicon Webster's Dictionary of the English Language*, Encyclopedic Edition, 1988, Lexicon Publications, Inc., New York, 800, 839.

906 *King Report on Corporate Governance*, above n 873, n.12.8.3, 7.

907 Ibid, ch. 20, 33, n. 9.

908 Ibid 29, n. 19.

> it is the board's duty to present a balanced and understandable assessment of the company's position in reporting to stakeholders. The quality of the information must be based on the guidelines of openness and substance over form. Reporting should address material matters of significant interest and concern to all stakeholders. [909]

Thus, comments on the three versions of the King Report on stakeholder communications (including the version found in chapter 12) can be noted as follows:[910]

1. The King Report has found it necessary to change what it had said in a different part of the Report. Should one of the versions then not have been deleted? As it stands, there is once again inconsistency as to what the King Report is actually recommending. For example, reading the King Report as a whole, the question arises as to whether the board is duty-bound in 19.1 to "present as simple a report as possible to stakeholders", or duty-bound to present a report that is not necessarily as simple, but one in 9.1 which is only "a balanced and understandable assessment of the company's position … to stakeholders"? Surely, this does make a difference as to what the stakeholders can expect regarding the question of disclosure by the board?

2. Regarding the question of the "quality of the information", note 9.1 only mentions two of the four criteria referred to in note 19.1, this being only the criteria of "openness" and "substance over form". It does, however, insert the question of materiality of matters into the discussion, which is lacking under note 19.1 and note 17. The criteria not raised under 9.1, being that of "promptness" and "relevance", is, however, raised under note 9.4, which is almost identical to note 19.4. It is also identical to the note repeated in the King Report in chapter 12 in note 17. Therefore, taken as a whole, these four criteria are stated under notes 17, 19.4 and 9.4. In this way, these notes take into account all of the four criteria regarding the basis upon which the quality of information is disclosed. The difference in meaning between the notes on *this* aspect is therefore only academic except in so far that note 9.1 includes as well the question of the materiality of such information. Also, note 17 includes the criterion of "truth". That is,

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909 Ibid 33, n. 9.1. See also Blackman et al, above n 499, paragraph 208, 8-16-8.

910 Ibid, ch. 12, 18, n. 17.

> the guidelines of information to stakeholders must be promptness, relevancy, openness, substance over form, truth and fair presentation. The company must constantly strive for transparency. … If there is any doubt about the content of the communication, the directors, having transported themselves into the shoes of the uninformed shareholders, should ask … the following questions:
>
> 17.1 Is the communication open or transparent?
>
> 17.2 Is the communication prompt?
>
> 17.3 Is it relevant and substantial or merely a communication of form?
>
> 17.4 Does it fairly set out the position? [911]

3. It is of some concern as to why the King Report decided to include in its Report variations of the statements it proposed. Why did the King Report change the criteria regarding the disclosure of information at different junctures? Why did it drop the criterion of "truth"? Surely it would have been simpler and more preferable for the King Report to state its remarks *only once* and in terms that were positive and encouraging, yet directory in nature?

4. Note 19.5 reads, "if the answer to any of the above four questions is in the negative, the directors must amend the communication properly". [912] This question was dropped in note 9. It is not clear why this was so, as 9.5 has been replaced with a series of statements on what the directors should report on in their annual report.

The above recommendations of the King Report regarding the system(s) that corporations should develop with respect to worker participation models are riddled with problematic uncertainties and inconsistent statements. This is arguably not the way forward in ensuring that effective worker participation takes place within the corporation. Furthermore, it does not oblige the corporation to take account of the workers' views in any legal way nor does it provide the workers with a admission ticket enshrined in legislation to engage in the joint decision-making processes of the corporation either at board level or otherwise.

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911 Ibid, ch.12, 18, n.17.

912 Ibid, nn.19.4.1-19.4.4.

The King Report in 12.9 reinforces its ideology that "…each corporation will have to evolve a system of such participation. …" [913] As mentioned previously, although the stakeholders in the corporation should get together and agree on a set of rules and procedures for worker participation, the King Committee in its Report should have set out to achieve this by *obliging* corporations to engage in this process. This could then become legislation with which corporations would have to comply.

[913] Ibid, n.12.9.

(6.3.3) Further Comments on the King I Report

Chapter 9 deals with nomination committees, which should constitute only non-executive directors of whom the majority must be independent, and the composition of the board. In this regard the King Report notes,

> in the Business Quarterly of summer 1993, the authors opine that there are three keys to a good board. The members understand and agree on what are the proper functions of the board; the board is composed of people of integrity who bring a blend of knowledge, skills, attitudes, experience and commitment to the job; and finally the board is led by a capable chair who brings out the best – individually and collectively – in the directors. [914]

The King Report further notes that to achieve these three key qualities, it is crucial to have a proper director selection process, [915] where "…the selection of the board must be managed. …" [916]

The King I Report acknowledges that boards need to be composed of people from diverse backgrounds. In this, the King I Report may be implying that employees should also be involved in worker participation processes at board level and that it is possible for directors to admit employees to the board. Employees would bring with them knowledge, skills, attitudes and experience not found elsewhere. It is a pity, though, that the King Report does not *expressly* recommend the inclusion of employees at board level.

Another revealing comment is made in Chapter 11 of the King Report, which deals with board sub-committees. At the very least, it would be a useful exercise for the corporation to allow employees to form employee sub-committees of the board. Although the King Report does not specifically recommend the formation of sub-committees, it does note that

> the board of directors might find it useful to establish sub-committees such as an agenda or a chair's committee. [917]

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914 Ibid, ch.9, 15, n.6. See also Blackman et al, above n 499, paragraph 208, 8-16-2.

915 Ibid, n.7.

916 Ibid, n.9.

917 Ibid, ch.11, 16, n.1.

In this way, the board could delegate some of its functions that deal with employee issues to the employee sub-committee of the board. Precisely which issues would be delegated to the employee sub-committee would probably have to be discussed between management and the employee representatives in the various corporations. Thus, having employee sub-committees of the board would be a positive development towards greater industrial democracy and certainly would give employee representatives more credibility and power than they have under the existing model of workplace forums. Furthermore, this sub-committee should consist solely of employee representatives nominated and elected to the sub-committee of the board by interested stakeholders, including fellow employees, shareholders and directors and officers of the corporation. At this stage, it is best to involve management in the nomination and election process governing the appointment of employee representatives to a sub-committee of this nature. This process would contribute towards increasing the likelihood that such sub-committees of the board become a reality. However, management should not have a similar role in the election process in the event that a two-tier board structure develops, which would consist of a supervisory board.

Consequently, through the development of employee sub-committees, decisions could be taken by the employee sub-committee of the board without having to go through the processes of organising a board meeting. Any employee-related matter that requires the input of the board itself could then be discussed at a scheduled board meeting with representatives of the employee sub-committee being present. An employee representative, who has been nominated and elected to this position by the interested stakeholders in the corporation, should chair the sub-committee.

Referring to a chair's or executive subcommittee, the King Report further believes,

> the authority of such a committee should be in writing from the board setting out the parameters and context within which such powers are conferred. Strictly, this authority should also be incorporated in the corporation's Articles of Association. [918]

Likewise, these terms of reference could easily be applied to employee sub-committees of the board once formed. Certainly, if South Africa intends to retain the unitary board system then the next best option would be to consider the

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[918] Ibid 16, n.3.3.

formulation of a system allowing the creation of employee sub-committees of the board. This is so assuming that the current unitary board system does not modify itself in such a way that it admits employee representatives to the board itself and thereby permits employee representatives to participate in the decision-making processes at this level.

Furthermore, the King Report endorses good corporate relationships with the non-contractual stakeholders, which include its neighbours, local authorities and the government. It recommends,

> companies should be encouraged to view themselves as residents in a particular area, to act in a spirit of good neighbourliness and to reach out to and be sensitive to the needs of their local communities.[919]

These are attributes to which all corporations should aspire. Certainly, today, with many carefully designed environmental initiatives taking place, there is a greater likelihood that corporations will move in this direction than ever before.

In this way, the King Report properly asserts that the directors and all of the stakeholders of the corporation are expected to act in good faith and in the best interests of the corporation. In the context of stakeholder relations, especially employee-management relations, this is of cardinal importance. In this regard, in chapter 18, which deals with the question of ethics, the King Report recommends,

> the essence of corporate governance is based on enterprise and integrity. The fiduciary duty of directors is paramount. The duty to act in good faith in the interests of the company does not stop with the board. All stakeholders should deal with the company in good faith. After all the company is the link between the stakeholders. The relationships between the stakeholders require honesty, openness and fairness. [920]

However, the duty of good faith needs to be shown in the first instance by the directors, who need to be exemplars of good conduct. If this is lacking, this may give rise to a situation where there is an absence of conduct in good faith by the other stakeholders. The King Report echoes these sentiments further when it emphasises,

> directors have a responsibility as part of corporate governance to create and to lay down guidelines for the moral and ethical conduct of the business of the company. It is management's responsibility

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919 Ibid 23, n.3.1 .

920 Ibid, ch.18, 24, n.2.

> to ensure that the guidelines are embraced by all in the company – every stakeholder must become a party to the guidelines. [921]

It would be very useful to receive input from the other stakeholders as well, especially from the employees, as to how these 'guidelines' could be formulated to suit the interests of all of the stakeholders and not only of the interests of the directors and of management. The King Report does recommend that

> a code should be developed in such a way as to involve all employees from union management down so that ethical culture is infused into the organisation. [922]

Unfortunately, the King Report does not formulate an ethical model for corporations. It believes that the needs of corporations are uniquely different and therefore,

> no strict model should be laid down … and … companies (must develop) their own codes. [923]

It does, however, lay down very brief and rather vague guidelines, which are:

(1) Responsibilities to shareholders and financial community; disclosure, accounting practices, insider trading and conflicts of interest, etc;

(2) Relations with customers and suppliers; marketing issues, use of market power, pricing practices, description of goods and services, quality and safety of goods, recall and related practices, etc;

(3) Employment practices, equality of employment opportunity, occupational health and safety, and other principles relating to employees and employment; and

(4) Responsibilities to the community, including support for community activities, and attention to neighbourhood impacts. [924]

Unfortunately, it appears as if the King Report dealt with the aforementioned guidelines hastily. The guidelines are generally superficial in nature and content and do not give a clear indication to corporations as to their ethical and moral responsibilities and obligations. Being so vague in content, the guidelines do not give adequate attention to the issues raised, which, for the most part, remain unexplained in the context of ethical and moral considerations. It is arguable that

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921 Ibid, n.7.

922 Ibid 25, n.8.1.

923 Ibid, n.8.2.

924 Ibid 25.

after reading these guidelines, the King Report, from an ethical and moral perceptive, has *not* recommended or added anything new or groundbreaking to the issues governing moral and ethical obligations and responsibilities of corporations.

Furthermore, chapter 19 deals with the recommendations of the King Committee. Of interest is note 6, especially paragraphs 6.1 and 6.2. According to paragraph 6.1,

> the unitary board structure is appropriate in South Africa especially with affirmative action programmes as the unitary board results in new board members interacting with experienced board members dealing with matters such as enterprise, intellectual honesty, strategy, planning, communicating with stakeholders, etc., rather than having a monitoring function only as supervisory board members. [925]

Furthermore, paragraph 6.2 recommends,

> the unitary board should have a balance of executive and non-executive directors. [926]

Reasons based primarily upon affirmative action policies contained in note 6.1 above were almost certainly actuated by the terms of reference section contained in Appendix II of the King Report. Note 1.4 thereof states,

> in applying its terms of reference the committee should have regard to the special circumstances existing in South Africa, more particularly the entrance into the business community of members of disadvantaged communities. [927]

This is further supported by a lengthy discussion on affirmative action guidelines (a summary of the SACOB proposals on affirmative action). [928] Unfortunately, because the committee was mandated to take cognisance of affirmative action policies in such an overwhelming manner, it can be argued that the King Report has lost track of other more significant issues that affect labour and business, such as those factors that stimulate the economy through overall stakeholder satisfaction when dealing with corporations.

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925 Ibid 26-27, n.6.1. See also Blackman et al, above n 499, paragraph 208, 8-16-1.

926 Ibid, n.6.2.

927 Ibid, Appendix II, 43, n.1.4.

928 Ibid 66-70.

Additionally, notes 6.1 and 6.2 above, [929] bring to mind the following important questions:

1. Would there be any meaningful differences, which would impact upon and directly affect the corporation, if affirmative action programmes were introduced under a two-tier board system rather than a unitary board system, and, if so, what would these differences be and how would they impact upon the way in which the company conducts its affairs?

2. Are affirmative action programmes then the main (or only) reason why the King Report does not support the introduction of a two-tier board system?

3. If a two-tier board system were to be put into place in South Africa and new members were placed on the supervisory board, rather than on the management board, how would this reduce or limit the interaction that the new members would have with experienced board members (as implied in the King Report)?

4. Since labour in South Africa is generally not involved in the decision-making processes at board level, is the King Report, by endorsing the retention of the existing unitary board structure, suggesting that employees should not be admitted to board level?

5. Does the King Committee not believe that the two-tier board system is necessary to create a structure to allow employees to be involved in the decision-making processes at board level, through the establishment of, for example, a supervisory board?

6. What does the King Report mean exactly by the phrase “intellectual honesty”?

7. Why should supervisory board members only be entrusted with “a monitoring function”? Surely, in a unitary board structure, the board itself has *also* a “monitoring function”?

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[929] Ibid, ch.19, 26-27, nn.6.1, 6.2.

8. Is the King Report implying that by having “a balance of executive and non-executive directors”, other stakeholders should not be admitted to the board, such as the employees?

These questions raise uncertainties concerning the sentiments expressed by the King Committee regarding the board structure of corporations. In this way, it also creates uncertainties about the ultimate intention of the King Report. Surely, affirmative actions reasons cannot, and should not, be the main or only reason for the King Committee deciding that a unitary board structure should be retained in South Africa? A system implemented to achieve greater employee satisfaction and greater industrial democracy, which would, in turn, yield greater economic productivity for corporations and generally for South Africa as a whole, together with improved customer relations, is more important than a system that is based upon affirmative action policies.

Affirmative action policies could still be implemented successfully under a two-tier board structure. Consequently, new board members would, in this way, be able to interact successfully with more experienced board members. It is conceivable that the supervisory and management board members would be obliged to cross-communicate with one another within the corporation at regular intervals. This would ensure that the board groups not only act bona fide in the best interests of the company at all times, but also that a system of good corporate governance is created and maintained. Thus, ‘Chinese walls’ cannot, and should not, be created between the supervisory and management boards of corporations.

Chapter 20 of the King Report deals with the Code of Corporate Practices and Conduct. [930] Although the previous chapters of the King Report are written, for the most part, in terms of recommendations, and, as such, are arguably unenforceable against the corporation from a legal point of view, the Code of Corporate Practices and Conduct contained within the King Report appears to be more *directory* in nature towards the “affected corporations”. Whether this fact changes the status of the King Report from a document merely giving advice to one *requiring* “affected corporations” to comply with the parameters set out in the whole Report, is arguable. In viewing the King Report as one unit, it is doubtful whether its status can be construed as anything more than a document providing suggestions, advice and recommendations to “affected corporations”. It

[930] Ibid, ch.20.

is only the JSE that later required "affected corporations" to disclose their compliance or non-compliance with the Code of Corporate Practices and Conduct contained within the King Report. That is, the JSE endorsed the King Report and required that all "affected corporations" must provide a statement in their annual reports, which comments on the extent of their compliance or non-compliance with the Code of Corporate Practices and Conduct. This requirement became effective for all financial years ending on or after 30 June 1996. Thus, in the financial year of 1995/1996, corporate governance reporting was not mandatory in so far as the JSE was concerned. The JSE required disclosure from the "affected corporations" as from the beginning of the financial year 1996/1997. It did *not*, however, require that the corporations actually comply with the Code of Corporate Practices and Conduct. It only required that the "affected corporations" disclose the *extent* to which, if any, they had so complied or not.

Thus, relevant portions of the Code of Corporate Practices and Conduct read as follows:

Note 1 states (and repeats): [931]

1.1 The Code will apply to the following business enterprises:

1.1.1 All companies listed on the main board of the Johannesburg Stock Exchange;

1.1.2 Large public entities as defined in the *Public Entities Act*;

1.1.3 Banks, financial and insurance entities as defined in the various Financial Services Acts; and

1.1.4 Large unlisted public corporations.

1.2 In the South African context, large companies are those with a total shareholders' equity greater than R50 million.

1.3 All companies should, however, be encouraged to adopt the Code.

1.4 The Code is a set of principles and does not purport to determine the detailed course of conduct of directors on any particular matter.

In the Foreword section of the King Report, signed by the Chairman of the King Committee, Mervyn E King S.C, it is noted,

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[931] Ibid 31-32, n.1. See also Blackman et al, above n 499, paragraph 208, 8-15.

> at times certain points are repeated in this Report. This is because we found it necessary to make the same point under different chapter headings and believed it would aid in the application of the recommendations to distil them into a code of governance. [932]

It can be argued, however, that it would have been preferable for the King Committee not to repeat their points across the Report. Rather than aiding the reader it has, in many cases, confused the points of recommendation being made. Many of the points of recommendation that are repeated are inconsistent in content, nature and especially in application. A shorter, more succinct and less vague Report, expressed in terms that are undeniably directory in content, nature and application, would have been preferable. Additionally, the entire Report should have been written as one unit. As it currently exists, chapter 20, dealing with the Code of Corporate Practices and Conduct, stands almost as an independent and separate part of the King Report. This is because it is written using directive terms, for example, "the code will apply to the following business enterprises. …" Chapter 3, on the other hand, dealing with the application of the recommendations, is written in non-directory terms, for example, "the recommendations of the King Committee are directed at … the affected corporations. ..." Again, in chapter 19 under the heading "The recommendations", note 2.1 expresses this same point.

It is arguably insufficient for the King Report to merely "encourage" all companies to adopt the recommendations and the Code. It should have *required* all corporations, whatever their nature or size, to engage in corporate governance processes, especially those that related to worker participation matters.

Note 2.1, dealing with the board of directors, states,

> the unitary board structure is appropriate in South Africa rather than a management and supervisory board structure. The unitary board structure provides greater interaction among all board members when dealing with matters such as strategy, planning, performance, resources, standards of conduct and communication with stakeholders. [933]

The King Report has provided its sentiments for the retention of the unitary board structure within the corporation. Other than ascribing its reasons for this view to affirmative action policies and those that it believes would assist new members

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[932] Ibid, Foreword.

[933] Ibid 32, n.2.1. See also Blackman et al, above n 499, paragraph 208, 8-16-1.

that are introduced to the board through 'personal interaction', the King Report has *not* provided any further reasons, which, are arguably of any substance or merit.

Notwithstanding the above rejection of the two-tier board structure, in notes 6 to 8 of Chapter 1, the King Report mentions *good* reasons why the German model of the two-tier board system was developed. That is,

> … the Anglo-American model is predicated upon shareholder democracy. … In Germany and Japan the shareholder gets closer to management. The banks and the institutions are major shareholders in most large German and Japanese companies and they are also significant lenders to the companies. … With shareholders in Germany and Japan owning larger stakes in companies, they have taken a closer interest in the management of the businesses. The German banks sought to control the funds, which they had invested in corporations. In time they accepted that they could not manage the businesses. This factor, as well as the efforts, which were made to resolve clashes between management and the labour Unions, resulted in the development of the German model of the two-tier board, using the supervisory board and the management board. Employees and shareholders enjoyed and still enjoy representation on the supervisory board. [934]

Additionally, the King Report accepts that a change from the current unitary board structure is *inevitable* and arguably necessary and appropriate. In note 9 of the same chapter, the King Report writes,

> the global economy is 'shrinking' and becoming more competitive and managers are consequently more frequently involved in cross border activities. As a result managers come into contact with different forms of corporate governance. In doing so they become exposed to the advantages and disadvantages of the three systems described above. Inevitably, this will result in an evolution of the three systems and the development of a model combining the elements of all three systems. Each country will place a greater or lesser emphasis on each of the elements having regard to its own peculiar circumstances, laws, institutional and other structures. [935]

The following comments can be made with regard to the above:

1. Other than mentioning the "three systems" (as the King Report notes), the King Committee has not attempted to develop a new workable corporate governance model for South Africa;

2. Although the King Report has listed some of the advantages in developing the German model of the two-tier board system, it does not attempt to

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[934] Ibid, ch.1, 1-2, nn.6-8.

[935] Ibid 2, n.9 .

evaluate in its Report how these factors may also be advantageous in the South African context;

3. The King Report acknowledges that an evolution of the three systems is inevitable, but it does not attempt to provide any formula, which departs from the style of the unitary board system currently operating in South Africa;

4. The King Report casts an overall impression that it does not want to interfere with the *status quo* and that, if any changes do occur in South Africa regarding the type of board structure implemented and developed, that this would evolve on its own at a much later stage.

5. The King Report unfortunately does not take South Africa any closer to achieving a system based on a two-tier board structure. Consequently, South Africa has not been encouraged to develop this into their corporate structures or to appreciate the advantages that are associated therewith. This is so despite the suggestion in note 10 of chapter 4 that

> in the committee's deliberations it was suggested that a two-tier board structure with a supervisory and management board may be desirable in South Africa. The reasoning was that the two tier structure with employee and shareholder representatives dominating the supervisory board and managers the management board, had succeeded in Germany. [936]

6. Consequently, the two reasons provided by the King Report rejecting the two-tier board system are unconvincing. It has been discussed that the King Report was incorrect in ascribing this view to reasons based upon affirmative action and "personal interaction" policies. Additionally, there is arguably further inconsistency in the King Report regarding the question of "personal interaction". This is so despite the fact that it acknowledges,

> modern corporations can be described as a link where the interests of the mutual rights and interests of the various stakeholders are brought together, for example, shareholders, creditors, managers, workers, customers, suppliers, and so forth. In their own interests these different groups should co-operate to further the well being of the corporation to which they are tied. [937]

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[936] Ibid, ch.4, 6, n.10.

[937] Ibid 2.

> The King Report, however, remarks, "whether there is a two-tier or a unitary board, management inevitably will meet separately". [938] Moreover, "(a) Code of Ethics should … (b)e developed in such a way as to involve all its stakeholders to infuse its culture". [939] Thus, the reasons of the King Report, which reject the implementation and development of the two-tier board structure, are not convincing if South Africa's future success in the labour and business world is to be assured.

Note 11 in chapter 20 of the King Report deals with worker participation. It repeats verbatim the points that are expressed in note 12.8 in chapter 4. [940] It is therefore not necessary to repeat this.

Furthermore, the King Report recommends,

> … that the affected corporations reporting in respect of years commencing after 30 June 1995, should state in the report whether they comply with the Code and identify and give reasons for any reasons of non-compliance. [941]

In accordance with the wording used by the King Committee, there is arguably nothing to suggest that their proposals are anything more than mere recommendations or advice. These statements cannot be construed as being directory in nature and application. *Ex facie* the Report, the recommendations are legally unenforceable. This is further indicated in note 1 of chapter 22 on "compliance". [942] Thus, according to note 1,

> recommendations for the Code of Corporate Practices and Conduct are valueless unless they are implemented. [943]

Furthermore, note 4 echoes these sentiments when the King Report writes,

> it is recommended that the Code should be adopted by all of the affected corporations. It follows that large mutual societies, parastatals and public entities should also comply with the code. [944]

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938 Ibid 7.

939 Ibid, ch.20, 34, n.13.2.

940 Ibid, ch.4, 7, n.12.8; ch.20, n.11.

941 Ibid, ch.21, 35, n.1. See also Blackman et al, above n 499, paragraph 208, 8-15.

942 Ibid, ch.22, n.1. See also Blackman et al, above n 499, paragraph 208, 8-15.

943 Ibid.

944 Ibid 36, n.4. See also Blackman et al, above n 499, paragraph 208, 8-15.

A further indication that the King Report is unenforceable from a legal point of view is found in notes 5 to 7. In this regard,

> associations should endorse the Code and obtain undertakings from their members to adopt the Code. … It is proposed that the adoption of the Code be achieved mainly via the support of prominent associations, which should bind their members to comply with the Code, by incorporating the principles in the listing requirements for main board companies on the Johannesburg Stock Exchange and by peer pressure. All corporations should, however, be encouraged to adopt the Code. [945]

In order to ensure compliance with the Code, the King Report has called upon the Johannesburg Stock Exchange for assistance by noting

> the Johannesburg Stock Exchange should make such a statement a listing requirement for companies listed on the main board of the Johannesburg Stock Exchange" (by them including in their annual financial statements the extent of compliance with the Code by the board). [946]

Finally, in the section of the King Report entitled "Code of ethics for enterprises and all who deal with enterprises" (dated 29 November 1994), note 9.1 of chapter 3 deals with the obligations of managers to employees of the enterprise. [947] Unfortunately, this note does not refer specifically to any requirement that permits or encourages worker participation in the corporation. Thus, a non-repetitive statement endorsing these sentiments should have been included within this paragraph.

(6.3.4) Conclusion

1. The first King Report has not gone far enough in ensuring that worker participation exists in the corporation for the following reasons:

2. The King Report cannot be construed as an enforceable legal document. It has to rely on other factors to encourage compliance therewith. Some of these factors may be viewed as unreliable, especially those that encourage compliance with the Code through peer pressure.

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945 Ibid, nn.5-7. See also Blackman et al, above n 499, paragraph 208, 8-15.

946 Ibid 36, n.3.

947 Ibid, ch.3, 62, n.9.1.

3. The King Report has made recommendations that ought to be applied to *only* "affected corporations". Hence, the majority of corporations in South Africa, whatever their nature, size or type, are generally not expected to comply with the recommendations contained within the King Report, although they may if they wish to. This is wholly unacceptable.

4. The King Report does not support the development and implementation of the two-tier board system. Although the Report acknowledges the success of this type of system in Germany, it obdurately encourages the unitary board system to be retained in South Africa. The reasons it provides for this, those being based upon affirmative action policies and greater personal interaction for new board members, are unsound and inconclusive.

5. The King Report repeats various points throughout the text with variations in content and application, which can cause much confusion to the reader. A more succinct and concise text would have been preferred in terms whereof the points are made but once and which endeavours to be directory in content and application. Therefore, the King Report suffers from too much disorganisation in structure and content to be entirely useful to corporations.

(6.4) OTHER COMMENTARIES ON THE KING I REPORT

In discussing the King Report, Botha notes that

> (t)he King Report has produced confused statements and recommendations in regard to corporate governance in South Africa. The reason is that it has failed to state clearly its philosophy in regard to the nature and role of the corporation in the South African setting. Only when this has been done – when it has been well explained and understood what is to be governed – can coherent pronouncements be made about corporate governance. [948]

This suggests that the King Report is riddled with confusing and conflicting statements, but, as Botha notes, for different reasons. Botha's reasons for this confusion are, however, arguably unconvincing. He explains this confusion on the basis of the two models, which describe whether the limited liability corporation in

[948] Botha (1996), above n 546, 39.

South Africa is based upon the contractarian or stakeholder (managerialist) model, a discussion of which is referred to elsewhere in this thesis. According to Botha, the King Report has given a set of recommendations, which draw upon "…different governance requirements applicable to different models of the corporation". [949]

The contractarian model is based upon the ideology that corporations are private and exist as a result of contracts between the directors and the shareholders (the owners of the corporation). Therefore, under a contract-based model, mandatory rules are not necessary. The main aim of this model is to maximise shareholder's wealth. As a result, this will indirectly benefit the environment, society and the other stakeholders as well. In this way, Botha points out,

> the contractarian model principles are clearly evident in the King Report where … reference is made to directors acting in the best interests of the corporation … to achieve profitability. … The Report also refers … to the fiduciary duties of directors (to) … shareholders. … (This) supports the view that the interests of the shareholders are paramount in the corporation. … Therefore, … the Report … appropriated characteristics of the contractarian model. … The nature of the Report and its recommendations were influenced by the perspective of the corporation as an entity of private concern, with the shareholders' rights and interests being paramount. [950]

The stakeholder model, on the other hand, takes into account directly the rights and interests of all of the stakeholders, not just the shareholders. In this way, directors do *not* owe duties exclusively to the shareholders. The corporation is viewed as a public concern. As Botha points out,

> … (a)nother interest group is the employee group, which has a different claim on the corporation assets than the shareholder. … The financial contribution of this group to the corporation is in the form of human capital. This model regards it appropriate to have employees' interests protected as well. … This model regards the communities where the corporations operate as indirect contributors to the corporation's capital. … The King Report draws heavily on this model. … It seems that the Report felt duty bound to 'lay down guidelines for ethical practices in businesses in South Africa'. Furthermore, the King Committee was mandated to 'have regard to the special circumstances existing in South Africa, more particularly the entrance into the business community of members of disadvantaged communities'. [951]

The stakeholder model therefore recognises the need for the existence of a framework, which includes social, moral and ethical values. The King Report has

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[949] Ibid 28.

[950] Ibid 33-34.

[951] Ibid 35-37.

created guidelines and recommendations for corporate governance in this way and it is clear that it has taken into account those attributes, which characterise both the stakeholder and the contractarian models. The question can therefore be asked whether the King Committee set out to create a hybrid model for South Africa, which draws upon the appropriate characteristics of each type of model? Botha is incorrect when he attempts to force a set of characteristics and circumstances prevailing in South Africa into one or other of the two traditional models. By him not being able to do so and then suggesting that there was *confusion* in the King Report *as a result*, is unsound. Surely, if two models have been created, a third, a fourth or, as many models as are required, can be created in the same way? Confusion in the King Report was *not* created because its Report drew on the distinction characterising the features of the stakeholder and contractarian models. The King Report created confusion because its recommendations were repeated, but varied in content and application. It was not a sufficiently concise, succinct and organised Report, which allowed an entirely useful application by the corporation.

Botha further states,

> the composition of the King Committee, the objectives of some of the task groups, and the terms of reference for the Report provide circumstantial affirmation for the submission that the motivation for the undertaking was primarily for institutional considerations. I submit that the main incentives were to protect vested interests of the corporate groups in the South African economy and to avoid direct governmental involvement in issues of corporate governance. [952]

Botha's argument, however, remains unconvincing on this point. He does not explain the basis upon which he has made this statement. Therefore,

1. In what way does the 'composition of the King Committee' provide for a belief of this nature?

2. How do the 'objectives of some of the task groups and the terms of reference for the Report' add to this belief?

3. What do these 'institutional considerations' refer to?

4. What are the 'vested interests' that need to be protected?

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[952] Ibid 26-27.

One of Botha's further criticisms of the King Report, which has been discussed, is that

> (t)he Report floundered when it incorporated elements of both the enabling and mandatory approaches to the Code of Corporate Practices and Conduct. … This conflict between enabling and mandatory rules in the Report is clear. … Although it appears that the Report has adopted a cogent attitude towards compliance issues, it has floundered when wrestling with the problem of how to enforce compliance, or how to provide proposed recommendations to 'legislate' in regard to value systems and ethics. [953]

Botha's assessment of the King Report regarding the enforceability thereof is correct. Thus, the Report on the whole, with few exceptions, is couched in language, which is non-directive in nature. The Report provides recommendations as *advice* to corporations, which they can simply choose to accept or reject. The Report is not legally enforceable. However, there are some expressions contained within the King Report that are directory in nature, for example, the King Report states that "the code will apply to the following enterprises. …" [954] For the most part, the King Report relies on other factors to ensure compliance. These include initiatives through peer pressure, the media (drawing attention to examples of poor and good corporate governance), the JSE (making a listing requirement for companies listed on the main board of the JSE) and associations (obtaining undertakings from members).

(6.5) THE KING II REPORT

(6.5.1) Introduction

In July 1993 the Institute of Directors in Southern Africa established the King Committee on Corporate Governance. The first King Report was published on 29 November 1994. The King Committee on Corporate Governance launched the King Report on Corporate Governance for Southern Africa – 2002 (King II Report) on 26 March 2002.

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953 Ibid 37-38.

954 *King Report on Corporate Governance*, above n 873, 31.

The Code of Practices and Conduct contained in the King II Report replaces the Code contained in the first King Report of 1994 with effect from 1 March 2002. [955] There are 6 main sections comprising the King II Report. These sections deal with the boards and its directors, risk management, internal audits, integrated sustainability reporting, accounting and auditing and, lastly, compliance and enforcement. All of these sections are, in turn, subdivided into chapters, the contents of most of them falling outside of the purview of this thesis. The King II Report also includes a code of corporate practices and conduct and a set of recommendations, which require statutory amendment or some other action to be taken. A set of fourteen appendices is also included within the King II Report, some of which include a mention of the members of the King Committee on Corporate Governance, the terms of reference of review and the membership of task teams, directors' legal duties, board self-evaluation, model terms of reference for board committees, risk management and internal controls, decisions in developing a code of ethics and others.

The date of implementation of the King II Report was 1 March 2002, which coincided with the Johannesburg Stock Exchange (JSE) Securities Exchange Listings Requirement for the disclosure of individual director remuneration applicable to "affected companies", which had their financial years commencing 1 March 2002. The King II proposes that the code of corporate practices and conduct will apply to those organisations, which it refers to this time as the "affected companies". [956]

An "affected company" is either a company with securities listed on the JSE Securities Exchange of South Africa or banks, financial and insurance entities defined in terms of the legislation regulating the South African Financial Services Sector or public sector enterprises and agencies falling under the *Public Finance Management Act* and the Local Government (Municipal Finance Management Laws). Any department of State is also included. Also included is any other national, provincial or local administrative sphere of government or other institution, which exercises the power or function in terms of the Constitution or public power in terms of any legislation, but excludes a court or judicial officer. [957]

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955 *King Report on Corporate Governance for South Africa*, 2002 (the King II Report), 2.

956 Ibid 20, n.1.1. See also Blackman et al, above n 499, paragraph 208, 8-15.

957 Ibid 20, nn.1.1-1.1.3. See also Blackman et al, above n 499, paragraph 208, 8-15.

Precisely why the King Report decided to change the definition in this way from "affected corporations" in their first Report to "affected companies" in their second Report is uncertain.

The definitions of a "company" and of "corporation" are provided.

That is, a corporation is defined as,

> an entity that has legal personality. … (It) consists of a number of members who fluctuate from time to time (e.g. a company registered under the Companies Acts) (or) consists of one member only and his or her successors. [958]

On the other hand, a company is defined as,

> an association of people (company members) formed to conduct business or other activities in the name of the association. Most companies are incorporated (are corporations) and therefore have a legal personality distinct from those of their members. … [959]

It can, therefore, be assumed that the King Committee discovered, after releasing its first Report, that "corporation" *may* be capable of being defined also as an entity consisting of only *one* person. Since this may, on an extended interpretation, conflict with its specific recommendations as to what it regards as "affected" entities, the King Committee may have decided to remove any confusion that may arise in this way and therefore to replace the word "corporations" with the word "companies" in its second Report.

As was seen with the provisions in the chapter on workplace forums, once again, smaller companies seem to be excluded from any consideration. Thus, the King II Report does not include smaller companies and close corporations within its mention of "affected companies".

Most of the organisations making up the corporate sphere of South African business consist of small private companies and close corporations. Therefore, it is arguably a serious omission and, indeed, an oversight on the legislature and other bodies to exclude small business.

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958 *Oxford Reference: A Concise Dictionary of Law*, 2nd edn, 1990, Oxford University Press, UK, 100.

959 Ibid 80. See also *Black's Law Dictionary*, 2nd pocket edn, 2001, BA Garner (ed), Thomson West Publishing Co, US, 117.

(6.5.2) Further Features of the King II Report

(6.5.2.1) To What Extent Does the King II Report Recommend or Provide for the Extension of the Joint Decision-making Roles of Workplace Forums or Employees with Employers?

It appears that the recommendations contained within the King II Report are primarily aimed at ensuring that the "affected companies" comply with the Code of Corporate Practices and Conduct. [960] This is done through the King II Report proposing various amendments to the present South African *Companies Act* 61 of 1973. The Code of Conduct recommends that all companies, in addition to the affected companies, should give due consideration to the application of the principles noted therein. The King II Report further recommends that a company should report at least once annually on the nature and extent of its social, transformation, ethical, safety, health and environmental policies and practices, which is also referred to in the King II Report as the "triple bottom" of a company. [961]

Note 2.1.2 of the King II Report and note 1, chapter 1, section 1, which deals with boards and directors, proposes once again that the unitary board structure (single tiered board system) should be retained in South Africa, and, therefore, the dual board structure (two-tier board system) found in Germany, for example, should not be adopted into South African law. [962] This is arguably a non-progressive step and one that is not in the best interests of greater industrial democracy for South Africa. Reasons have been provided in this thesis why a two-tier board system is preferable, in terms whereof the employees are afforded the opportunity to be involved in the joint decision-making processes at board level. The two-tier board system is, it is suggested, the best way to achieve the greatest degree of employee job satisfaction in a given workplace. Worldwide documented evidence of this exists, for example, through the German model of corporate governance. As a result, improved customer service and increased profitability for the company are likely to occur. Thus, the members of the King Committee on corporate governance should seriously consider the adoption of the

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960 King II Report, above n 955, 20, n.1.1. See also Blackman et al, above n 499, paragraph 208, 8-15.

961 Ibid 9, n.17, and ch.1, 97, section 4, n.4. See also Blackman et al, above n 499, paragraph 208, 8-16-8.

962 Ibid 21, n.2.1.2, and chapter 1, 46-49, section 1, n.1.

dual board system into South African corporate practice. It is most important for workers to be able to have a say, not only at line management level, but also at board-level.

Moreover, business success depends upon the attitudes of the people within it. For businesses, this means making room for peoples' dreams, whilst ensuring that organisational expectations are reached. This type of governance system allows the organisation to prosper by providing the employees with an increased sense of purpose, motivation and value. Many organisations consider this aspect as a cardinal attribute to increasing business performance. That is, many employees bring themselves to work and take their work home with them. This is part of their lives and it may be very difficult to separate these two aspects of their being. Businesses that recognise this issue create a work environment that incorporates a healthier workplace environment, with better employee motivation, better customer service, a higher turnover and a healthier and more sustainable bottom line. These results are expected outcomes simply because employees care more for this type of organisational structure and therefore they perform better in everything they do. Therefore, once employees are aware that the company is not only concerned with making as much money as possible for itself and in maximising its shareholders' wealth, but that the organisation is also concerned about its employees and other stakeholders, extra energy is then created within the organisation, which allows it to enjoy a healthier bottom line. Companies that have a narrow shareholder focus are most probably the most difficult organisations to run because everyone within it, including the employees, has to look after him or herself. There is a lack of unity and purpose in this type of setting, which does not inspire employee loyalty towards the organisation.

New Zealand cereal manufacturer Dick Hubbard notes,

> there is plenty of evidence to suggest that if you take your eye beyond the short-term profit effect that the reward comes back to you in time, sometimes from unexpected directions. [963]

In the same way, Stephen Tindall, New Zealand's founder of The Warehouse, expressed these sentiments. He notes,

> but the great thing is that when people realise the company cares for more than just making money, they get really involved in the ethic and you find there is an exponential energy that didn't exist before. [964]

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963 *New Zealand Management* magazine, September 2002, 26.

Furthermore, with regard to the composition of the board, the King II Report proposes that there should be "*an appropriate balance"* between the executive, non-executive and independent directors in the board. [965] It proposes further that the executive director is someone who would be involved in the day-to-day management of the organisation and/or is someone in the full-time salaried employment of the company and/or any of its subsidiaries. A non-executive director is someone who is not involved in the day-to-day management and/or is not a full-time salaried employee of the company or its subsidiaries. They should also be those persons who have the necessary skills and experience to be able to make an independent judgment on those issues relating to the strategy, performance, resources and standards of conduct within the organisation and to be able to evaluate such performance. An independent director is a non-executive director who is not a representative of a major share owner or nominated by such share owner, has not been employed by the company or its group in any executive capacity for the preceding three financial years, is not a professional advisor or significant supplier or customer to the company or its group, has no significant contractual relationship with the company or group and is free from any business or other relationship that could materially interfere with his or her capacity to act in an independent manner. The Code also refers to the appointment of shadow directors who are considered to be persons in accordance with whose directions or instructions the directors are accustomed to act. [966]

The King II Report has not made it clear what it envisages in advocating "an appropriate balance" between the three types of directorships on the board. Does this mean that the board should be represented in having more or less or the same number of executive, non-executive and independent directors? On what basis should this correct balance be determined? Consequently, the King II Report has proposed significant amendments to the current South African *Companies Act*, but has not indicated nor clarified how these proposals may be implemented. Additionally, other than in the case where usually high-ranking full-time salaried employees are able to become executive directors, the King II report makes no proposal or provision for the participation of employees in the joint decision-making processes at board level. This is a serious omission, and for reasons discussed in this thesis, the King Committee should propose amendments

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964 Ibid.

965 King II Report, above n 955, 23, n.2.2.1; and ch.1, section 1, 47, n.3 and 50.

966 Ibid, section 1, ch. 4, 57, 60–62.

to South African company legislation in terms whereof a dual board system is put into place, which allows employees the opportunity to have their say at that level. Furthermore, regarding the appointment of independent directors to the board, the King II Report has also not made it clear what it envisages by its proposals in terms of which it recommends that independent directors should not have a significant contractual relationship with the company or the group, or be a significant supplier to the company or the group.

The King II Report proposes that a board should meet at least once per quarter and should disclose in its annual report the number of meetings it holds and which directors actually attend. [967] It emphasises that the board should ensure that it receives relevant non-financial information, which takes into account broader stakeholder issues. It also proposes that the board establishes various board committees in terms of which certain functions can be delegated to them so as to assist the board in the proper discharging of its duties and responsibilities. [968] The King II Report also notes that

> (d)elegating authorities to board committees … does not … mitigate … the discharge by the board and its directors of their duties and responsibilities. [969] … Committees can help share the board's workload. Being smaller, they can go into greater detail and deal with complex issues where the full board might not have had enough time. [970] … In establishing board committees, the board must determine their terms of reference, life span, role and function. It must create reporting procedures and proper written mandates … for its committees. [971] … Board committees should, as far as possible, only comprise members of the board. It may be necessary … to co-opt specialists as permanent members of such committees but this should be the exception rather than the rule and they should comprise a minority on the committee. … (I)n order to ensure its effective functioning, a committee will of necessity from time to time call on specialized skills to assist it with its deliberations and decisions. [972] All companies should have, at a minimum, audit and remuneration committees. Industry specific issues will dictate the requirements for other committees. The overriding principle is that boards must establish committees that are responsive to the nature of business. … Other committees may be: Chairperson's, Executive or Management, Governance, Actuarial, Information Technology, Risk, Environmental, Safety and Health, Nomination, Investment and Employment Equity. It is the responsibility of the board to consider the committees appropriate for its purposes. [973]

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967 Ibid, chapter 1, section 1, 48, n. 9, and 50.

968 Ibid, ch.8, section 1, 70, n.1. See also Blackman et al, above n 499, paragraph 208, 8-16-3.

969 Ibid.

970 Ibid, n.3.

971 Ibid, n.4. See also Blackman et al, above n 499, paragraph 208, 8-16-3.

972 Ibid, n.5.

973 Ibid, n.6. See also Blackman et al, above n 499, paragraph 208, 8-16-3.

Thus, the establishment of board committees is not mandatory in South Africa even though the establishment of audit committees in certain overseas jurisdictions is mandatory for publicly held companies. [974] Furthermore, the King II Report does not provide any further details about the description, composition and function(s) of the 'employment equity' board committee.

The King II Report also proposes that an independent non-executive director chairs a board committee, and that it should be subject to regular evaluation regarding its performance and effectiveness. [975]

(6.5.2.2) Employee Subcommittees of the Board

It is noteworthy that the King II Report proposes that with regard to board and director evaluation, a board should regularly review its mix of skills, experience and other qualities so as to assess its effectiveness as a board, its committees and the contribution of each individual director. [976] As mentioned previously with the first King Report, the King II Report ought to have proposed, *at the very least*, that an organisation establishes, as one of its board committees, an employee board committee or, to phrase it differently, an employee sub-committee of the board. This should be comprised exclusively of the employees of the organisation who have been democratically nominated and elected to this position by interested stakeholders, including fellow employees, shareholders and directors and officers of the corporation. Because an independent non-executive director need not chair this committee, it could be chaired by an employee who has been democratically elected as the chairperson of this subcommittee.

As with the other board committees, the employee board committee should be free to take on independent outside advice as it deems fit, the costs whereof would be borne by the organisation. Additionally, the employee board committee would be established with proper terms of reference, a determined life span, roles and functions, and, as a general principle, should be transparent and therefore make full disclosure to the board as this becomes necessary. Employees making up the employee board committee do not need to be high-ranking, but must be democratically elected to this office. They must also act honestly, responsibly and in good faith in the best interests of their fellow employees and of the

974 Ibid, n.2.

975 Ibid 71, n.13.

976 Ibid, ch.6, section 1, 68.

organisation in discharging their board duties. Their actions, as with other board committees, must not, in any way whatsoever, be actuated by self-centered ideals, spitefulness, dishonesty or malice. As with other board committees, the employee board committee should be subject to regular evaluation regarding its performance and effectiveness.

If the King Committee were to have expressly recommended or prescribed the establishment of employee board committees, a governance system would provide employees with opportunities to have a real decision-making role for the first time in those affairs, which would probably not have been given to them previously to consider. It is arguable that giving employees the opportunity to provide this kind of input on board-related matters would greatly contribute towards achieving greater industrial democracy in the workplace. Thus, establishing employee board committees would place South African company law on a path towards achieving a two-tier board structure, which has been implemented and fully integrated into Germany's corporate governance structures.

Additionally, as proposed by the King II Report, the company secretary plays an important role and could assist in the induction of new or inexperienced directors and therefore, in this way, provide the board as a whole and directors individually with detailed guidance as to how their responsibility should be properly discharged in the best interests of the company. [977] Consequently, it would make little difference whether inexperienced employees or inexperienced executive directors or non-executive directors or independent directors are inducted into the process and are able to serve on the board, either directly or through a board committee.

Furthermore, the King II Report refers to the risk management of the company and notes that the board of the company is responsible for this entire process. [978] Therefore, the management of a company is accountable to the board for designing, implementing and monitoring the process of risk management and also of integrating it into the day-to-day activities of the company.

The King II Report specifically notes that boards should design risk management as a company policy and that such policy should be communicated to all

977 Ibid, section 1, chapter 10, 75.

978 Ibid, ch.2, section 2, 79, n.1.

employees in such way that ensures that risk management is in fact incorporated into the language and culture of the company. [979] Furthermore, boards should use recognised risk management models to ensure that companies behave in a way that is responsible to all stakeholders with a legitimate interest. [980] The board is responsible for ensuring that a risk management assessment is undertaken at least once annually in terms whereof a public statement is made. [981] The King II Report recommends a board committee should be appointed to assist the board in reviewing the risk management procedures and the risks facing the company. [982] It also recommends that the board should establish a control mechanism or mechanisms, which are designed in such a way that the risks are mitigated and the company's objectives are attained. [983] A board of directors is responsible for disclosure of its risk management procedures in its annual report. [984]

The King II Report has recommended that the affected companies should take into account interests other than those interests confined to its shareholders. It does this firstly by suggesting that its Code of Conduct is applied to all companies (although this is aimed primarily at the affected companies) and, secondly, by recommending that risk management models are used to take into account and to reduce the possibility of risk and loss to all of the company's stakeholders. This would mean that the company should take into account any negative effects that its activities or decisions would have on its employees. By implication, it could be argued that the King II Report is suggesting in this section that the stakeholders of the company, including its employees, have a role in the decision-making processes associated with risk management procedures. However, the King Report could have made their recommendations in this section dealing with risk management processes more meaningful for employees by *expressly* recommending that employees have a joint decision-making role in the formulation of the risk management processes.

Effective systems of governance could have been achieved if the King Committee had recommended that the board committee, which is appointed to assist the board in reviewing the risk management procedures, be comprised of at least one

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979 Ibid 80.

980 Ibid, ch.3, section 2, 85.

981 Ibid, ch.2, section 2, 79, n.6.

982 Ibid, n.3.

983 Ibid, ch.3, section 2, 85.

984 Ibid, ch.2, section 2, 79, n.4.

employee of the company. In this regard, the King II Report could have suggested the appointment of an employee or employees to the board committee in such a manner and on such terms so that the board committee becomes fairly representative of labour in respect to the company's risk management processes. In this way, employees can have a meaningful role in determining the way in which risks are managed and mitigated and also in designing those control mechanisms that could achieve this.

(6.5.3) Further Issues of the King II Report with respect to corporate stakeholders

The King II Report recommends that companies should report on various "non-financial matters" and should disclose the nature and extent of its commitment to social, ethical, safety, health and environmental practices, including organisational integrity, by reporting regularly to stakeholders on those policies, procedures and systems it has in place in this regard. [985] It also notes that corporate citizenship is the commitment to contribute to sustainable economic development, working with employees, their families, the local community and society to improve their quality of life. [986] Thus, a board of directors should take account of the current business environment in South Africa. This includes the integration of business processes and safety and health and environmental management principles. [987] The King II Report further notes that there should be a committed effort to reduce workplace accidents and occupational health and safety-related incidents. [988] It recommends that criteria should be disclosed by which an organisation measures human capital and in terms of which they indicate their requirements regarding the demographics, gender and age of staff, including factors relating to people with disabilities, corporate training initiatives and employee development. [989]

Regarding the issue of communication with stakeholders, the King II Report proposes that it is the duty of the board to provide to stakeholders a balanced and readily understandable assessment report of the company's position. The information is to be based upon principles of transparency and accountability and

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985 King II Report, above n 955, ch.1, section 4, 97, n.4.

986 Ibid 96, n.3.

987 Ibid, ch.6, section 4, 131.

988 Ibid, ch.4, section 4, 115, n.3.1.

989 Ibid, ch.6, section 4, 132.

needs to be a full, fair and honest account of a company's performance. The report should include all material matters of significant interest and concern to all stakeholders. Thus, the Report notes,

> (t)ransparency implies openness in fully explaining the reasons for any decision or course of action adopted by the company. Accountability implies acceptance by the company of its responsibility for any decision or course of action adopted by it, the consequences thereof, and a commitment to resolving any issues that arise as a result. Both are fundamental tenets of corporate governance. [990]

The King II Report notes that stakeholders include the shareholders, parties that contract with the enterprise (for example, the customers, employees, suppliers, subcontractors and business partners), parties that have a non-contractual nexus with the enterprise (for example, local communities and non-governmental organisations) and the State. Thus,

> stakeholders are those whose relations to the enterprise cannot be completely contracted for, but upon whose co-operation and creativity it depends for its survival and prosperity. [991]

This approach recognises that other stakeholders must be considered when developing the strategy of a company and is therefore inclusive. The values by which the company operates should be communicated to all stakeholders and therefore stakeholders that are relevant to the company's business should be identified. The relationship between the company and its stakeholders should also be mutually beneficial. Thus,

> (a) wealth of evidence has established that this inclusive approach is the way to create sustained business success and steady, long-term growth in shareowner value. [992]

A Code of Ethics should be implemented as part of a company's corporate governance principles. These provide for a commitment by a company to higher standards of behaviour, the development of initiatives to involve the infusion of the cultures of all of its stakeholders into the company and the provision of information to assist with the behaviour of the employees in the company and a demonstration of a commitment to fairness, transparency, honesty, non-

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990 Ibid, ch.1, section 4, 100, n.14.

991 Ibid, ch.2, section 4, 103, n.1.

992 Ibid, 103-104, n.3.

discrimination, accountability and responsibility and respect for human dignity, human rights and social justice. [993]

From these recommendations, it can be argued that the King II Report places greater emphasis on a company's improved treatment of corporate stakeholders other than its shareholders. It endorses, to a greater extent than in its previous Report, the principles of transparency of information and the infusion of the cultures of the various stakeholders into the company. In this way, the Report refers to the employees, their families, the local community and society, the environment and other stakeholders. This is a refreshing break from the 'traditionalist' approaches examined earlier, in terms of which increasing shareholders' wealth was the only or main focus of the company through its directors. The King II Report also refers to corporate training initiatives and employee development, which are very encouraging and positive attributes. However, the King II Report should have expanded their discussions of these aspects. More specifically, it could have recommended expressly that these initiatives would also include employees being involved in the joint decision-making processes of the corporation with respect to those decisions, which are made at board level. Although this intention may have been implied in the King II Report, it has, unfortunately, not been expressly stated. This is because the King II Report goes to great length to emphasise the significance and participation of the other stakeholders in the company, which would include the employees. It also enshrines the principles of transparency, accountability, clarity and honesty of matters. If expressly stated, these factors would reinforce employee development and corporate training initiatives for all parties. However, as it stands, the recommendations and principles enunciated by the King II Report are encouraging, but vague. Therefore, the King Committee might find that it may be rather difficult in practice to persuade or encourage companies to implement the recommendations. Consequently, the King II Report should have, for example, indicated more specifically what it envisages by a company committing itself to higher standards of behaviour and to that of greater transparency. It should have also indicated what it meant by those reporting requirements, which are needed to address material matters of significant interest and concern to all stakeholders. If the Code of Corporate Practices and Conduct expressly and more specifically defined and explained what it recommended with regard to these non-financial matters, then it would not be so simple for companies to avoid implementing the proposed recommendations.

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[993] Ibid, ch.3, section 4, 108-109, nn.5-7.

(6.5.4) Conclusion

Despite its inherent attributes and progressive stance, the King II Report has not gone far enough in establishing the rights of employees or of workplace forums with regard to their joint decision-making roles with the employers. This is applies even at line management level. Consequently, the King II Report arguably does not substantially alter the previous picture in this way. Thus, the rights of workplace forums under the South African *Labour Relations Act* to be involved in the joint decision-making processes of the corporation have not been increased or improved in any significant manner as a result of the recommendations of the King II Report. The King II Report focuses its proposals to a large extent on issues such as accounting and auditing practices and the like. It does not pay sufficient attention to the advantages of workplace forums and of employees participating in the decision-making roles of the organisation. The King II Report is in favour of *maintaining* a unitary board system in South Africa in terms of which employees and workplace forums would not be entitled to have a participatory role in the decision-making processes at board level. It seems to dismiss the idea of a two-tier board system that is practiced in a country such as in Germany. As discussed in this thesis, however, to dismiss the two-tier board structure is unconvincing and anachronistic. At the very least, the King II Committee should have seriously considered the proposals for organisations to establish 'employee board committees'. This would commence the process of achieving a system in terms of which employees would have participatory roles in joint decision-making at board level. This could develop into a system where the employees could be invited to sit on the board itself. This governance system does not necessarily advocate that employees need to be directors. There is no reason why employees need to be directors to sit on the board. Although this is a traditional approach enshrined in deep-seated company law principles, there is no reason to assume permanency. By allowing employees a say in decisions taken at board level, would, as shown, be advantageous to all parties. It would also help to strengthen the processes of industrial democracy in South Africa, which, at times, may seem rather fragile.

Finally, although many recommendations and principles of the King II Report are encouraging, they are vague. It may thus be rather difficult in practice to persuade or encourage companies to implement the recommendations. The King II Report has chosen to formulate *only* recommendations to "affected

companies". This means, in practice, that all of the non-affected corporations need not apply the recommendations of the King II Report. It also means that since the King II Report only formulated recommendations, they are not mandatory and, therefore, even "affected corporations" need not apply them if they do not wish to. The recommendations of the King II Report are, therefore, arguably legally unenforceable.

(6.6) EXAMPLES OF COMPANIES IN SOUTH AFRICA APPLYING CORPORATE GOVERNANCE PRINCIPLES BASED UPON THE RECOMMENDATIONS OF THE KING I REPORT

(6.6.1) Introduction

There are companies in South Africa that have practiced and applied very progressive corporate governance principles with regard to their employee participation schemes. It would be useful to consider the corporate governance reports of some of these companies to determine the extent to which, if any, the traditional company law approaches in South Africa that create systems and processes to maximise shareholders' wealth and the profitability of the company, have been eroded or reduced.

(6.6.2) Companies in South Africa Enforcing Worker Participation Initiatives

(1) Argent Industrial Limited, based in Germiston on the East Rand in Johannesburg is a holding company. The group obtains its income from property, steel trading and processing, equipment fabrication, precision engineering, concrete and stone and materials handling. Argent Industrial Limited has a unitary board structure, which has full control of the organisation and monitors executive management. The company believes that it has complied with principles incorporated in the Code of Corporate Practices and Conduct, as proposed in the King I Report. The directors have recognised the need to conduct the company with integrity and in accordance with

generally accepted corporate practices. The corporate governance report lists some of its accepted corporate practices as follows: [994]

(a) The board is primarily responsible to shareholders, but is aware of other stakeholder rights and interests, including those of the employees, customers, suppliers and communities. Employees are required to maintain the highest ethical standards in ensuring that business practices are conducted in an exemplary manner.

(b) Regarding the question of employee participation, the corporate governance report of Argent Industrial Limited notes,

> (p)articipative management … relies on the building of employee partnerships at every level to foster mutual trust and to encourage people to always think about how they can do things better. We strive to liberate the initiative and energies of our people, because they are the ones who make the difference in our performance.

(c) As to the environment, the company is aware that there is always a risk of environmental damage when carrying out its activities. Thus, the company engages in education programmes to train their employees to avoid practices that could result in long-term damage to the environment.

(d) With respect to the question of ethics, the company endeavours to act with honesty, responsibility, and professional integrity with their employees, shareholders, customers, suppliers and society at large. In any instance where ethical standards are called into question, the circumstances are investigated and resolved in an appropriate and fair manner.

(e) Finally, on the question relating to professional advice, the directors have access to the company secretary, who ensures that the board procedures are followed. The directors may seek independent professional advice at the company's expense.

Although the company operates a unitary board level, it subscribes to the principles of participative management, which rely on the building of employee partnerships at *every level* to foster mutual trust and to improve the way people do things. The company is responsible to shareholders, but takes into account the

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[994] Argent Industrial Limited corporate governance report, <http://www.argent.co.za>.

interests of other stakeholders within the company, such as their employees, customers, suppliers, the community and environment. However, the board has not delegated any strategic powers.

It is evident that this company may have made significant progress in involving its employees in the joint decision-making processes of the company, but not on those matters that deal with “strategic powers”. Many other companies in South Africa have not gone so far. That is, many companies have either not contemplated the possible virtues and advantages of participative management governance systems, or have refused to give employees any more say than they need to in the decision-making processes of the corporation. Therefore, the King Committee should formally propose that the unitary board model be replaced with the dual board system. This would clarify the position regarding the model that companies should adopt with regard to employee participation schemes. This would bring about a greater amount of consistency in the workplace for employees and employers in corporate South Africa. Argent Industrial Limited have noted,

> (employees) are the ones who make the difference in our performance.

(2) Powertech (Power Technologies Limited) subscribes to good corporate governance values expressed in the King Report. The directors recognise the need to conduct the affairs of the corporation with integrity and in accordance with generally acceptable corporate practices. This is accomplished through the procedures and policies, which govern corporate conduct in the Altron group, of which Powertech is a member.

Some of the company’s key corporate principles in their governance report can be stated as follows: [995]

(a) The company secretary and the secretarial department are responsible to the board for ensuring compliance with established procedures and the relevant statutes and regulations. All directors have access to this advice.

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[995] Powertech (Power Technologies Limited) corporate governance report, <http://www.powertech.co.za>.

(b) Non-executive directors and the Chief Executive of Powertech are invited to attend the meetings of the Altron Remuneration Committee to deal with matters, which relate to the remuneration of employees.

(c) With respect to worker participation, the company notes,

> Powertech continues to promote a more participative management style and climate, which encourages its employees to reach their maximum potential. The group has a variety of participative structures, at the various operating company levels, for handling issues, which affect employees directly and materially. These structures, which have been set up with trade unions and other employee representatives, are designed to achieve good employer/employee relations through effective sharing of relevant information, consultation and resolution of conflict. …Promotion shall, where possible, take place from within Powertech and employees are given the opportunity to develop their potential.

(d) On the question of corporate codes of conduct, Powertech is committed to the highest standards of behaviour. Clear guidelines on the behaviour expected of employees are contained within the Corporate Code of Conduct. All employees are required to act in an exemplary manner. Thus,

> (t)he Altron group, of which Powertech is a part, is committed to excellence, integrity, professionalism and the growth and development of all its operations. Our people are our most important asset and we expect them to share in the group's values and beliefs, in a manner, which demonstrates:
>
> 1 Respect for one another;
>
> 2 Honesty and integrity in dealings, not only with one another, but with all the group's stakeholders;
>
> 3 Confidentiality and discretion in the use of information proprietary to the group;
>
> 4 Avoidance of any conflict of interests, which may interfere with the independent exercise of their judgment in the best interests of the group;
>
> 5 Adherence to all laws and regulations determining the group's legal and moral obligations; and
>
> 6 Fostering a non-racial, non-discriminatory work and business environment in promoting a climate of harmony and tolerance.

In analysing the principles stated in the corporate governance Report of Powertech, it is evident that certain South African companies are already following the proposals of the King Report and moving away from the almost

entrenched traditional doctrines of company law that enshrine the principle that companies exist solely to maximise their own profits and that of the shareholders.

(6.6.3) Conclusion

The principles adopted today in many South African companies echo the sentiments that "(the employees) our people are our most important asset. …" Additionally, many companies are promoting a "more participative management style and climate", as there is a realisation that this would ultimately be advantageous to all of the stakeholders of the company. This system of governance "encourages its employees to reach their maximum potential". However, the King Committee should, in the near future, consider the idea of recommending the establishment of "employee board committees", as this would entrench these principles. Employees should not be barred, for example, from sitting on the remuneration committees of companies. Allowing employees to participate in decision-making would reduce the number of industrial disputes, which are referred either to conciliation committees or to arbitration. For them to have a say in determining their own salaries, and the salaries of executives and of senior staff, would be beneficial for all parties. It would also provide greater transparency to all stakeholders. These steps would ultimately achieve "good employer/employee relations" by the "sharing of relevant information" and by the "resolution of conflict".

(6.7) WHAT DOES THE KPMG CORPORATE GOVERNANCE SURVEY STATE ABOUT THE DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES RELATING TO WORKER PARTICIPATION IN SOUTH AFRICA?

(6.7.1) Introduction

During 1996 and 1997 KPMG conducted a survey of the annual reporting disclosure practices on corporate governance. [996] The survey was used to determine to what extent, if any, listed companies had complied with the disclosure requirements recommended by the King I Report. That is, the JSE required that all listed companies comment on the extent of their compliance or non-compliance with the recommendations of the King I Report regarding its Code of Corporate Practices and Conduct. This became a compulsory requirement

[996] KPMG survey of annual Reporting disclosure practices on corporate governance, 1996-1997, <http://www.KPMG.co.za>.

for all companies that had their financial years ending on or after 30 June 1996. KPMG then compared *inter alia*

> … the difference in the level of disclosure between the first year of compulsory corporate governance reporting (1996/1997) and the previous year (1995/1996) where such reporting was (not compulsory).

The methodology used by KPMG consisted of taking two samples from:

a. The “top 100” companies ranked by market capitalisation as at 10 July 1997; and

b. The “other 100” companies selected from the remaining companies listed on the JSE.

(6.7.2) Research Findings of KPMG Regarding Corporate Governance and Worker Participation in South Africa

(6.7.2.1) Where in the Annual Report are Corporate Governance Matters Disclosed?

KPMG has obtained statistics as follows: [997]

Table 2: Disclosure of Corporate Governance Matters During the Periods 1995/1996 and 1996/1997

	Top 100 (95/96)	Top 100 (96/97)	Other 100 (95/96)	Other 100 (96/97)
(1) In a single corporate governance statement	45%	69%	39%	67%
(2) In the director's Report	21%	19%	18%	15%
(3) Other statements/ combinations	24%	8%	24%	11%
(4) No reference to corporate governance	10%	4%	19%	7%

The statistics obtained by KPMG show clearly that in both the "top 100" companies and the "other 100" companies listed on the JSE:

1. A huge increase existed in the number of companies drafting a single corporate governance statement during 1996/1997;

2. A decrease existed in the number of companies drafting their corporate governance matters in the directors' reports during 1996/1997;

997 Ibid.

3. A huge decrease existed in the number of companies drafting their corporate governance matters by using other statements or a combination thereof during 1996/1997;

4. A huge decrease existed in the number of companies making no reference at all to corporate governance matters;

5. There were still listed companies on the JSE that were not commenting on the extent of their compliance or non-compliance with the Code of Corporate Practices and Conduct, although the JSE required this; and

6. The "top 100" and "other 100" companies displayed very similar statistics on the manner in which, in the annual report, corporate governance matters were disclosed, especially during the 1996/1997 period. For example, using a single corporate governance statement, there was only a two percent difference in the 1996/1997 periods.

(6.7.2.2) Does the Annual Report Contain a Description Regarding the Manner in which Employees are Permitted to Participate in the Governance of the Company?

KPMG has obtained statistics as follows: [998]

Table 3: Employee Participation in the Decision-Making Processes of the Company

	Top 100 (95/96)	Top 100 (96/97)	Other 100 (95/96)	Other 100 (96/97)
Yes	36%	60%	19%	43%
No	64%	40%	81%	57%

The statistics obtained by KPMG show clearly, as disclosed in the annual report of the organisation that:

1. A huge increase existed in the number of "top 100" and "other 100" companies disclosing a description of the manner in which employees are

[998] Ibid.

permitted to participate in the decision-making processes of the organisation during 1996/1997;

2. There were still a large number of the "top 100" listed companies during 1996/1997 that were not complying with the proposals set out in the King I Report to establish mechanisms allowing employees a joint decision-making role in the governance of the company;

3. There were a majority of "other 100" listed companies during 1996/1997 that were not complying with the proposals set out in the King I Report to establish mechanisms allowing employees a joint decision-making role in the governance of the company; and

4. The "top 100" listed companies during 1996/1997 were complying with the proposals of the King I Report to establish employee participation mechanisms to a much greater extent than the "other 100" companies. This is evident in the difference displayed in the amount of seventeen percent.

(6.7.2.3) Does the Annual Report State that the Company Has a Code of Ethics?

KPMG has obtained the following statistics: [999]

Table 4: The Extent to which the Annual Report States that the Company Has a Code of Ethics

	Top 100 (95/96)	Top 100 (96/97)	Other 100 (95/96)	Other 100 (96/97)
Yes	49%	42%	27%	45%
No	51%	58%	73%	55%

The statistics obtained by KPMG show clearly that during 1996/1997:

1. The "top 100" companies reduced their number of statements by seven percent in their annual reports in which they stated that they had a code of ethics;

[999] Ibid.

2. The “other 100” companies increased their number of statements by eighteen percent in their annual reports in which they stated that they had a code of ethics;

3. The majority of the “top 100” and “other 100” companies were not stating in their annual reports that they had a code of ethics;

4. The extent to which the “top 100” and “other 100” companies were stating in their annual reports that had a code of ethics was statistically very similar with only a three per cent difference; and

5. More “other 100” than “top 100” companies had stated in their annual report that the company had a code of ethics.

(6.7.2.4) Does the Annual Report Provide Details of the Code of Ethics and the Manner in which it is Implemented?

KPMG has obtained the following statistics: [1000]

Table 5: The Extent to which the Annual Report Provides Details of the Code of Ethics

	Top 100 (95/96)	Top 100 (96/97)	Other 100 (95/96)	Other 100 (96/97)
Yes	20%	25%	11%	22%
No	80%	75%	89%	78%

The KPMG statistics show clearly that:

1. During the periods 1995/1996 and 1996/1997 a large majority of “top 100” and “other 100” companies did not provide in their annual reports details of a code of ethics and the manner in which it was to be implemented;

[1000] Ibid.

2. During the period 1996/1997 the “top 100” companies had only improved their disclosure of a code of ethics in their annual reports by a slight five percent, whereas the “other 100” companies had doubled their disclosure;

3. The extent to which the “top 100” and “other 100” companies during the period 1996/1997 were providing in their annual reports details of a code of ethics and the implementation thereof was statistically very similar with only a three percent difference; and

4. Slightly more “top 100” than “other 100” companies during 1996/1997 were providing details in their annual reports of a code of ethics and the implementation thereof.

(6.7.3) Conclusion

From the statistics collected by KPMG over the period 1996/1997, it is clear that many of the “top 100” companies had, to some extent, committed themselves to the proposals set out in the King I Report of November 1994 on matters of corporate governance. Only four percent of the “top 100” companies had made no reference at all to corporate governance matters. However, sixty nine percent of the “top 100” companies achieved this through a single corporate governance statement. In a similar fashion, only seven percent of the “other 100” companies listed on the JSE made no reference to corporate governance matters. This was a steady improvement from the 1995/1996 financial year, where nineteen percent of the “other 100” companies had made no mention at all to matters of corporate governance. The reason for this noteworthy increase was due to the fact that the JSE had made the 1996/1997 period the first year of compulsory corporate governance reporting. Likewise, sixty seven percent of “the other” companies achieved this in a single corporate governance statement. However, a small minority of “top 100” and “other 100” companies remained defiant in response to the proposals on corporate governance set out by the King I Report and, therefore, made no reference to corporate governance reporting at all.

Regarding the question of employee participation in the corporate governance of the company, the KPMG statistics collected reveal that, although there was a significant improvement in this regard by the “top 100” and the “other 100” companies between the two periods in question, there were still many companies that were not complying with the policies set out in this report. That is, only sixty

percent of the “top 100” and forty three per cent of the “other 100” companies produced annual reports containing a description of the manner in which employees participate in the governance of the company. The “top 100” companies need to be exemplars of the smaller companies.

Concerning proposals of the King I Report relating to corporate codes of ethics, KPMG statistics reveal alarming results. During both of the periods in question a good majority of the “top 100” companies and of the “other 100” companies did not state in their annual reports that their company had a code of ethics. In fact, the position deteriorated during the period 1996/1997 for the “top 100” companies where only forty two percent of these companies had indicated that their annual reports had stated this. Even worse, regarding the question on whether their annual reports provided details of the code of ethics and its implementation, only twenty five percent of the “top 100” and 22 per cent of the “other 100” companies responded affirmatively. Thus, most of the “top 100” companies had not adopted the proposals of the King I Report in this way.

The King II Report (2002) on Corporate Governance for South Africa was the first governance Report in any jurisdiction to include a section on Integrated Sustainability Reporting. Compliance with the Code of Corporate Practices and Conduct is a requirement for affected companies with financial years commencing from 01 March 2002. The Code addresses the JSE Securities Exchange SA Top 100 Companies compliance with the recommendations on Integrated Sustainability Reporting as contained in section 5 of the King II Report. Section 5 requires companies to report at least once annually on their sustainability performance and to demonstrate some commitment towards organisational integrity. Compliance with King II is a listing requirement and should therefore comply with section 5. Areas upon which companies should report include health and safety (including HIV/AIDS), employment equity initiatives, social investment prioritisation (including black economic empowerment), employee integrity assessment, board confirmation of compliance to ethical standards and the incorporation of global reporting initiative guidelines. [1001]

According to the 2003 KPMG Survey on Integrated Sustainability Reporting in South Africa, which showed an improvement by companies in the disclosure of

[1001] KPMG (2003), Integrated Sustainability Reporting in South Africa – executive summary, 2; <http://www.KPMG.co.za> (accessed 27 December 2004). See also Blackman et al, above n 499, paragraph 208, 8-16-8.

information and in the application of the second King Report's recommended codes of conduct, 85% of the Top 100 companies had provided annual reporting on sustainability-related issues. Furthermore, 77% of the companies had developed an internal code of ethics or code of corporate conduct. While many companies incorporated the King II recommendations, further detailed disclosure, however, as outlined by the recommendations, could still be made. Sustainability reporting refers to the "triple bottom line" of social, environmental and economic performance. It is becoming more important for companies to show responsible behaviour through transparent and credible reporting. The survey illustrates that South African companies are taking important steps to improve the quantity and quality of information available to stakeholders. It is also becoming more common for stakeholders to demand that companies provide some third party assurance on social, economic and environmental performance. [1002]

(6.8) THE ETHICS INSTITUTE OF SOUTH AFRICA (ETHICSA)

There is an organisation in South Africa called 'The Ethics Institute of South Africa' (EthicSA), which is an independent, non-partisan, non-profit making body that

> strives to be a catalyst in fostering and nurturing ethical practices among individuals and institutions in both the private and public sectors, through playing a facilitative and collaborative role, and working in partnerships with government, business, academic institutions and individuals. [1003]

The aim of EthicSA is to build an ethical South Africa and to advance ethics in professional life, business practices and public policy. EthicSA is committed *inter alia* to

> … facilitate the development and implementation of codes of ethics, contribute to ethics education and training (and) initiate and facilitate ethics research. … The creation of EthicSA is an institutional response to the worldwide recognition of … the importance of moral renewal in all societies, as well as to the current value and morality crisis in our own society. South Africa is experiencing an erosion of moral commitment and practice in a wide range of societal institutions, which not only costs the country an enormous amount in terms of resources and human suffering, but threatens the very foundations upon which both civil and political society are based. … [1004]

[1002] Ibid.

[1003] The Ethics Institute of South Africa (EthicSA), <http://www.ethicsa.org>.

[1004] Ibid.

It is interesting to note that EthicSA has broadened its perspectives to now include ethical issues in the domains of business, government and other sectors of society. Originally, it focused mainly on health care and the rights of patients.

Following the King II Report, EthicSA launched a nationwide, benchmark survey of business ethics amongst private corporations, which has been named 'Business Ethics South Africa' (BESA). The organisation notes that there are currently 51 large JSE companies participating in this project, which represent 695 000 employees in the SA economy. [1005]

Landman, the CEO of EthicSA, believes that corporate failures, which are caused by the unethical behaviour of individuals and "ethically weak corporate cultures", have weakened worldwide investor confidence. He states further,

> that ethics are not an optional extra … to normal business. … (E)thics are woven into the fabric of business (and) concern doing what is right and good, or a way of life that goes beyond the demands of the law and regulations. … We base our actions on sound values, discharge our obligations, respect others' rights and promote individual and collective well being. [1006]

Business ethics apply to all stakeholders in every business, individually and collectively, from the CEO to the most junior employee. [1007] Consequently, it may be possible, and indeed useful, for future committees, such as the King Committee, to work together with EthicSA on matters that deal with ethical considerations because EthicSA fosters and nurtures ethical practices and facilitates the development and implementation of codes of ethics.

Committees, such as the King Committee through the King Report, might find that by working with an organisation such as EthicSA its proposals on ethical considerations might, in the future, be modified and become more widely accepted and implemented by companies than had been the situation during the 1996/1997 period. There is a real need to get companies to understand that ethics must be "woven into the fabric" of the company.

[1005] Ibid.

[1006] Ibid.

[1007] Ibid.

(6.9) THE RIGHTS OF EMPLOYEES TO FREEDOM OF ASSOCIATION

(6.9.1) Introduction

The extent to which the *Labour Relations Act* (LRA) 66 of 1995 makes provision for the employees' rights to freedom of association needs to be determined. [1008] This all depends upon whether the worker is deemed to be an employee in terms of the LRA or, if not, in terms of the common law. If neither applies, then the worker, even if connected to the organisation in some way, will *not* be deemed to be an employee and therefore will not enjoy any rights to freedom of association. In this section, two aspects will be examined: the relevant sections that deal with the employees' rights to freedom of association and the statutory and common law definitions of the employee.

(6.9.2) The Relevant Statutes Enshrining Freedom of Association

Section 4 of the LRA provides, [1009] that *every* employee has the right to participate in forming a trade union or federation of trade unions, [1010] and to join a trade union, subject to its constitution. [1011] Every member of a trade union has the right, subject to its constitution, to participate in its lawful activities, [1012] to participate in the election of its office-bearers, officials or trade union representatives, [1013] and to stand for election as an office-bearer or an official, [1014] or a trade union representative in terms of this Act or any collective agreement. [1015] Every member of a trade union that is a member of a federation of trade unions has the right, subject to the constitution of that federation, to participate in its lawful activities, [1016] to participate in the election of its office-

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1008 *Labour Relations Act* 66 (1995).

1009 LRA section 4.

1010 LRA section 4(1)(a).

1011 LRA section 4(1)(b).

1012 LRA section 4(2)(a).

1013 LRA section 4(2)(b).

1014 LRA section 4(2)(c).

1015 LRA section 4(2)(d).

1016 LRA section 4(3)(a).

bearers or officials, [1017] and to stand for election as an office-bearer or official. [1018]

Section 107 of the LRA defines a federation of trade unions as being an entity that promotes the interests of employees as its primary object. [1019] Also, an office-bearer is an elected representative of the members whereas an official is an employee of the union. [1020] This provision only applies to employees. Therefore, if a person is not an "employee" as defined in the LRA, it is arguable that section 4 would not be applicable. That means only employees, as defined, would be able to participate by forming or joining a trade union or a federation of trade unions. The Act also only protects the rights of employees who partake in the *lawful* activities of the trade union. Consequently, any unlawful activity would fall outside of the protective domains of the Act. It is arguable that by the legislature using the phrase "every employer" and not "each employer" it intended that an individual employee could not *alone* form a trade union or a federation of trade unions. This is further substantiated by the phrase the "right to participate in", which gives the employee the right to "join in" when forming a trade union or a federation of trade unions. The Act, therefore, does not intend the employee "to participate" alone. Furthermore, it seems that the legislature intended to give "every employee" an automatic right "to participate in forming a trade union or federation of trade unions" unless that employee had been restricted from doing so for the reason or reasons provided for by its constitution. Generally speaking, the employee must be employed "within the industry in which the union is active". [1021] The registration of a trade union would be effectively barred if it discriminates against employees on the basis of their race or sex. [1022]

It is apparent that section 4 confers rights upon employees to be able to partake in the activities of trade unions or a federation of trade unions. Although section 4 does not provide information about the situation in which employees may wish to make use of these provisions, it can be assumed that section 4 can be used against any person wishing to infringe the rights of employees in this way. More specifically, the most likely candidate in this scenario would be the employer.

[1017] LRA section 4(3)(b).

[1018] LRA section 4(3)(c).

[1019] LRA section 107.

[1020] Brassey et al, above n 747, A2, 5.

[1021] Ibid A2, 4.

[1022] *Labour Relations Act* 66 (1995), section 95(6).

Complementing section 4 of the Act, section 5 provides for the protection of employees and of persons seeking employment. [1023] It states that no person may discriminate against an employee for exercising any rights under the Act. [1024] Furthermore, section 2 reinforces this provision by providing that no person may require an employee or a person seeking employment not to be a member of a trade union or workplace forum, [1025] or not to become a member of a trade union or workplace forum, [1026] or to give up membership of a trade union or workplace forum.[1027] No person may prejudice an employee or a person seeking employment because of past, present or anticipated membership of a trade union or workplace forum, [1028] or because of participation in forming a trade union or federation of trade unions or in establishing a workplace forum, [1029] or because of a participation in its lawful activities, [1030] or because of the disclosure of information that the employee is lawfully entitled or required to give to another person. [1031] No person may advantage, or promise to advantage, an employee or a person seeking employment in exchange for that person not exercising any right conferred by this Act or not participating in proceedings in terms of this Act. However, nothing in this section precludes the parties concluding an agreement to settle a dispute. [1032] A provision in any contract that directly or indirectly contradicts or limits any provision of section 4, or of this section, is invalid, unless the contractual provision is permitted by this Act.[1033]

It may be difficult to determine whether there has been discrimination as defined by the Act. Because the parties, typically the employer and the employee, disagree on a matter does *not* necessarily mean that there is in fact discrimination. It is important to consider all the facts in a particular case before one concludes that there has been discrimination. Section 9 of the Act states that discrimination is actionable if it is unfair. [1034] Brassey *et al* note,

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[1023] LRA section 5.

[1024] LRA section 5(1).

[1025] LRA section 2(a)(i).

[1026] LRA section 2(a)(ii).

[1027] LRA section 2(a)(iii).

[1028] LRA section 2(c)(i).

[1029] LRA section 2(c)(ii).

[1030] LRA section 2(c)(iii).

[1031] LRA section 2(c)(v).

[1032] LRA section 2(3).

[1033] LRA section 2(4).

[1034] LRA section 9.

> discrimination denotes a decision that 'has the potential to impair the fundamental human dignity of persons as human beings or to affect them adversely in a comparably serious manner'. [1035]

Neither the employer nor any other person may prevent an employee from being or becoming a member of a trade union or of a workplace forum. It is arguable, however, that *only* an entity, which is classified as one being legally *non-persona*, may prevent membership arising. This may include any organisation, which has not been incorporated. Hence, *stricto sensu*, it is arguable that this type of organisation may prevent an employee from partaking in the activities of trade unions or workplace forums. This loophole may have to be tested by the courts at some stage. Furthermore, neither the employer nor any other person can offer a benefit to the employee in exchange for that employee giving up his or her rights under the section. For example, an employee cannot be paid a higher salary in exchange for him or her agreeing not to become a member of a trade union or of a workplace forum. Thus, any agreement in which the employee and employer had agreed that the employee would not take part in the activities of a trade union or of a workplace forum would be invalid and unenforceable. The Act incorporates these provisions to ensure that the rights governing freedom of association are maintained and that they are not easily lost through the temptation of benefits made to employees. Sections 4 and 5 both emphasise and entrench the rights of employees to engage in the activities and become members of trade unions, of a federation of trade unions and of workplace forums. [1036] In this way, it compliments the provisions in the chapter of the Act on workplace forums.

Employers also have an identical right to freedom of association under the LRA. [1037] In fact, sections 6 and 7 mirror sections 4 and 5. Additionally, any disputes under these sections may be referred in writing either to a council, if the dispute falls within its jurisdiction on industrial matters, or to the Commission (CCMA), if no council has jurisdiction. [1038] The council referred to would be either the bargaining council in terms of section 27 or the statutory council in terms of section 39. The council or CCMA must attempt to resolve the dispute through

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[1035] Brassey et al, above n 747, A2, 8.

[1036] *Labour Relations Act* 66 (1995), sections 4 and 5.

[1037] LRA sections 6 and 7.

[1038] LRA sections 9(a) and (b).

conciliation or, [1039] if the dispute remains unresolved, any party to the dispute may refer it to the Labour Court for adjudication. [1040]

(6.9.3) Conclusion

Brassey *et al* succinctly sum up the position on the question of freedom of association when the authors note, [1041]

> under the new (Labour Relations) Act the rights given to employees are considerably expanded. No one may take steps to prevent or discourage an employer from becoming a member of a union or workplace forum or taking part in their activities. [1042] … Most important of all … are the provisions, which create a system of in-plant trade union representation. They empower trade union representatives to provide assistance at internal disciplinary and grievance proceedings, monitor and report on the employer's compliance with labour statutes, and perform any other function that may be agreed between the union and the employer. [1043] …

In this way, therefore, the provisions protecting freedom of association prohibit victimisation of any kind.

(6.10) WHO THEN IS DEFINED AS AN EMPLOYEE UNDER THE STATUTES?

Whether someone can be defined as an employee or not depends upon whether that person is interpreted to be as such, either in terms of legislation or in terms of the common law. If someone has been defined as an employee in this way, that person would enjoy all the benefits and advantages that are associated therewith. As far as the statutes are concerned, there are various Acts that provide a definition of an employee and of an employer in South African Labour law. It would be of value to mention the relevant sections of these Acts.

The *Wage Act* provides,

> 'employee' means any person employed by, or working for any employer, and receiving, or being entitled to receive, any remuneration and any other person whatsoever who in any manner assists

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[1039] LRA section 9, subsection (3).

[1040] LRA section 9, subsection (4).

[1041] Brassey et al, above n 746, E2, 31.

[1042] *Labour Relations Act* 66 (1995), sections 4 and 5.

[1043] LRA section 14(4).

> in the carrying on or conducting of the business of an employer. … (An) 'employer' means any person whatsoever who employs or provides work for any person and remunerates or tacitly undertakes to remunerate him or who permits any person whatsoever in any manner to assist him in the carrying on or the conducting of his business. … [1044]

The *Manpower Training Act* provides,

> 'employee' means any person employed by or who performs work for any employer in any industry and who receives or is entitled to receive remuneration from such employer"; 'employer' is any person "… (a) who employs or provides work for any other person and who remunerates or expressly or tacitly undertakes to remunerate that other person; (b) who permits any other person in any manner to assist him in the carrying on or conducting of his business; or (c) who, otherwise than in an educational institution, trains any minor in a designated trade. …" [1045]

The *Basic Conditions of Employment Act* provides that an employee is

> … any person who is employed by or working for an employer and receiving or entitled to receive any remuneration or who works under the direction or supervision of an employer, or any other person who in any manner assists in the carrying on or the conducting of the business of an employer; 'employer' means any person whomsoever who employs or provides work for any person and remunerates or expressly or tacitly undertakes to remunerate him, or who permits any person in any manner to assist him in the carrying on or the conducting of his business. … [1046]

The *Occupational Health and Safety Act* provides that an employee is

> … any person who is employed by or works for an employer and who receives or is entitled to receive any remuneration or who works under the direction or supervision of an employer or any other person"; an employer is "… any person who employs or provides work for any person and remunerates that person or expressly or tacitly undertakes to remunerate him. … [1047]

Finally, the *Labour Relations Act* provides that an employee

> means (a) any person, excluding an independent contractor, who works for another person or for the State and who receives, or is entitled to receive, any remuneration; and (b) any other person who in any manner assists in carrying on or conducting the business of an employer. … [1048]

[1044] *Wage Act* 5 (1957), section 1.

[1045] *Manpower Training Act* 56 (1981), section 1.

[1046] *Basic Conditions of Employment Act* 3 (1983), section 1.

[1047] *Occupational Health and Safety Act* 85 (1993), section 1.

[1048] *Labour Relations Act* 66 (1995), section 1.

Employees usually spend a very large part of their working lives in the workplace. From an organisational management point of view, the workplace creates relationships and attitudes. The relationships between employee and employer and between the employee and others are significant features in the development and implementation of sound labour legislation. [1049] It is apparent that the LRA enriches the other four Acts. It specifically *excludes* an 'independent contractor'. This evolved as a result of historical trends both in Roman law and in our common law. That is, in Roman law, a distinction was drawn between the rendering of personal services by the employee, termed the *locator operarum*, and the independent contractor, termed the *conductor operis*.

In the decision of *Smit v Workmen's Compensation Commissioner*, Joubert JA made this distinction clear in noting that in a contract of service the employee (*locator operarum*) provides personal services to the employer (*conductor operarum*). Thus, the employee is under a contract of employment and the employer is his or her 'boss'. Employees must therefore follow the work instructions of the employer. However, the *conductor operis* is more independent and need not do the work him- or herself but may rely on the labour of others. The *conductor operis* must also ensure that the work is done or the results achieved within the time fixed by the contract of work or within a reasonable time where no time has been specified. In this context, the *conductor operis* has equal standing with the *locator operis* and is bound by the contract of work and not by the orders of the *locator operis*. He or she is not under the supervision of the *locator operis* and need not obey any orders of the *locator operis* in regard to the manner in which the work is to be performed. The *conductor operis* is his or her own master. A contract of service is terminated when the employee dies whereas the death of the parties to a contract of work does not necessarily terminate it. Likewise, a contract of service also terminates on expiration of the period of service entered into while a contract of employment terminates on completion of the specified work. [1050]

The *conductor operis* does not enjoy any rights under the LRA because he or she is not deemed to be an employee in terms of the Act. In many cases it would be relatively easy to determine whether a contract is one of service or one of work. In other cases, it may be difficult to distinguish the one situation from the other. In this way, courts need to formulate principles, policies and rules to clarify the

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[1049] Brassey et al, above n 747, C1, 16.

[1050] *Smit v Workmen's Compensation Commissioner* 1979 (1) SA 51 (A), Joubert JA, 61 et seq.

position. For example, in Smit's case *supra*, Joubert JA considered what some of these principles, policies and rules were. He considered the test based on the right of supervision and control, which a master, the *conductor operarum*, had over his servant, the *locator operarum*. However, he believed that the right of supervision was not the only *indicium* but merely one of the *indicia*, albeit an important one. In order to determine whether someone was a 'workman' within the meaning of the Act it is necessary to decide what the nature of the legal relationship between him or her and the company was. This must be determined from the true construction of the contract, which exists between them. Factors such as the lack of supervision and control, the non-requirement of personal performance of duties, the remuneration by commission and the position of independence in the performance of his or her contractual duties are strong *indicia* that the contract is one of work (*locatio conductio operis*) and not one of service (*locatio conductio operarum*). [1051]

Additionally, Brassey *et al* state,

> … (n)owadays people worked at a distance from their employer, such as the captain of a ship, the pilot of an aeroplane, and the driver of a railway engine, motor vehicle or crane, and it would be unrealistic and almost grotesque to say that they were under the employer's control. Nowadays … people were often employed precisely because they had skills and technical knowledge that the employer lacked, like the skilled engineer or toolmaker, draftsman or accountant, and they could hardly be said to be under the employer's control. [1052]

It appears that the requirement is not that there is necessarily *actual* control, but merely a *right of or power* to control is sufficient. In effect, the right to control is *not* decisive, but only important in distinguishing between a contract of service and one of work.

Joubert JA also considered what is sometimes referred to as the 'organisation test'. According to this test, in distinguishing between the two types of contractual situations, the question that could be asked is whether the person formed part of the employer's organisation and had integrated him or herself within it as part of its business. That is, did the employee become part and parcel of the business? Joubert JA notes, however, that the organisation test is legally speaking so vague that in most cases it provides no useful assistance in

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[1051] Ibid 61-67.

[1052] Brassey et al, above n 747, B1, 24.

distinguishing between an employee (*locator operarum*) and an independent contractor (*conductor operis*). [1053]

It is evident that no single test can determine whether a contract is one of service or work. Each situation must be decided on a case-by-case basis taking into account all of the relevant factors, balancing these up and then determining in difficult cases on which side these factors lean. In determining these factors, Joubert JA notes that it is the *contract* itself that is decisive and nothing else. There is no exhaustive list of factors. However, Joubert JA submitted that the question of remuneration was a very important factor. [1054] That is, if the person is paid on a time basis, this may lead one to conclude that he or she is an employee of the organisation. If, however, the person is paid on a results basis, this may indicate that he or she has been hired as an independent contractor. Thus, Joubert JA notes that contractual provisions regarding an agent's remuneration clearly indicate that the company is only interested in the result of an agent's activities and is not concerned with the time spent by an agent in bringing about that result. [1055] Thus, Brassey *et al* note,

> the contract to be considered is obviously the one that governed at the applicable time. This may not be the original contract, for it may have been varied in the interim. … General principles would also allow evidence to be led of matters on which the contract is ambiguous or silent. But otherwise the contract should be regarded as the exclusive memorial of the relationship. [1056]

Unless one is deemed to be an employee (and not an independent contractor), the provisions of the aforementioned acts and of any other relevant acts would not be applicable. That is, if not deemed to be an employee under a contract of service the person will not be entitled to any rights as an employee under South African labour law. This includes *inter alia* the right to claim unemployment insurance (UIF), [1057] salary and benefit advantages, [1058] compensation for work-related harm and injuries, [1059] the right to participate in and join workplace forums, [1060] and the right to receive payment of salaries on the insolvency of the

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[1053] *Smit v Workmen's Compensation Commissioner*, above n 1050, 63D-G.

[1054] Ibid 67G-68A.

[1055] Ibid 67H-68A.

[1056] Brassey et al, above n 747, B2, 10.

[1057] *Unemployment Insurance Act* 53, 1946.

[1058] *Basic Conditions of Employment Act* 3, 1983.

[1059] *Compensation for Occupational Injuries and Diseases Act* 130, 1993.

[1060] *Labour Relations Act* 66, 1995.

organisation as preferred claimants. [1061] It is worth noting that although a company can be an employer, it *cannot* be an employee.

In 1993, before the *Labour Relations Act* 66 of 1995 came into existence, the Labour Appeal Court in the case of *Borcherds v CW Pearce & J Sheward T/A Lubrite Distributors* stated that the definition of 'employee' did not encompass an independent contractor. [1062] The definition of an employee under the statutory definition of the *Labour Relations Act* 28 of 1956 read,

> any person who is employed by or working for any employer and receiving or entitled to receive any remuneration, and … any other person whomsoever who in any manner assists in the carrying on or conducting of the business of an employer. [1063]

Furthermore, in *Dempsey v Home & Property*, Jansen J noted that it was trite law that the Act did not apply to the relationship between a principal and an independent contractor, as the latter did not fall within the definition of 'employee' as contained in the Act. [1064]

It is interesting to note that in terms of the *Labour Relations Act* 66 of 1995, [1065] the word 'employee' includes job applicants. This means that if job applications are considered in a manner, which is discriminatory, [1066] applicants may institute legal proceedings against the organisation concerned. Furthermore, because many labour disputes arise after employees have left the company, former employees remain employees in terms of the *Labour Relations Act* until such time that the disputes are settled or equity dictates. This was noted in *NAAWU v Borg-Warner SA (Pty) Ltd*. [1067] Thus, under the current Act, a dismissed employee remains an employee for the purposes of claiming relief arising out of his or her dismissal. [1068] This includes an employee who resigns in circumstances amounting to a constructive dismissal, [1069] and also an employee who is refused re-employment when other employees who were dismissed for the same reason are

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[1061] *Insolvency Act* 24, 1936.

[1062] *Borcherds v CW Pearce & J Sheward T/A Lubrite Distributors* 1993 (14) ILJ 1262 (LAC), 1276D-E.

[1063] *Labour Relations Act* 28, 1956.

[1064] *Dempsey v Home & Property* 1995 (16) ILJ 378 (LAC), 380I-381A.

[1065] *Labour Relations Act* 66, 1995, Schedule 7, section 2.2.

[1066] LRA section 2(1)(a).

[1067] *NAAWU v Borg-Warner SA (Pty) Ltd* 1994 (3) SA 15 (A), 23E-25B.

[1068] *Labour Relations Act* 66, 1995, section 186(a)-(c).

[1069] LRA section 186(e).

offered it. [1070] Probationary employees are also included now in terms of the *Labour Relations Amendment Act*, [1071] as well as casual employees under the *Workmen's Compensation Act*. [1072]

(6.10.1) Conclusion

The current LRA enshrines the common law principles by expressly excluding independent contractors from its employee definition section. All that remains is for the court to determine, in the more difficult cases, whether a contract is one of service or work. There would be compelling reasons for an appellant to be declared by the court as someone falling within the definition section of an employee as envisaged by the legislature.

Times are changing and the days when the employment relationship under Roman law was based exclusively upon a contract of employment are forever gone. Brassey *et al* sum up this position in noting that

> … the pendulum has been swinging back towards legislation … legislation to control … wages, hours of work and dismissal – but contract still remains the residual means of regulating the relationship. Contract has always been the 'cornerstone' of our employment law, and in the absence of a legislative intervention, it will continue to be so until the courts are persuaded that its shortcomings are so egregious as to require a jurisprudential revolution. … For the employer, contract law provides protections too, some far-reaching: for example, industrial action will be treated as duress sufficient to vitiate the resulting contract and reinstatement will frequently be refused for fear of the practical problems that can result if an employee is foisted on an unwilling employer. … (H)owever liberally it is applied, the law of contract cannot regulate all the problems that employment can generate. … (W)here contract leaves off … delict commences. … (W)hen both contract and delict fail to provide a remedy, the legislature can step in. The common law, being residual, recognises and defers to the acts of the legislature. [1073]

[1070] LRA section 186(d).

[1071] *Labour Relations Amendment Act* 9, 1991.

[1072] *Workmen's Compensation Act* 59, 1934.

[1073] Brassey et al, above n 747, C1, 22-26.

(6.11) WHAT PROTECTION DOES THE BILL OF RIGHTS IN THE CONSTITUTION PROVIDE TO EMPLOYEES?

(6.11.1) Introduction

It is useful to consider the extent to which the South African Bill of Rights in its current form (and also in the Interim Constitution) focused on the rights of employees in the workplace. More specifically, what will be examined is the *extent* to which the Constitution *facilitates and advances* the rights of employees under the *Labour Relations Act*. The extent to which, if at all, these rights are advanced in the Constitution through its reference or discussion of worker participation systems or models will be considered as well.

(6.11.2) Relevant Sections of the Constitution Governing the Rights of Employees/Workers

Section 23 of the Constitution of the Republic of South Africa deals with the question of 'labour relations'. [1074] It provides that everyone has the right to fair labour practices. This concept is not defined in the constitution and is incapable of precise definition. This is due to the varying interests of workers and employers that comprise labour relations. Fairness is to be determined in accordance with the circumstances of each case and essentially involves a value judgment. The fairness required in the determination of an unfair labour practice must be fairness towards both the employer and the employee. [1075]

Every worker has the right to form and join a trade union, [1076] to participate in the activities and programmes of a trade union, [1077] and to strike. Even soldiers enlisted in the Defence Force would be regarded as workers in terms of this

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[1074] 1996 Constitution, above n 734, section 23.

[1075] 1996 Constitution section 23(1). See also Currie, I and de Waal, J (2005), *The Bill of Rights Handbook*, 5th edn, Juta & Co, Ltd, South Africa, chapter 23, 8. See also *National Education Health and Allied Workers Union v University of Cape Town and others* (CCT2/02) 2003 (2) BCLR 154, paragraphs 33 and 38 (CC) (NEHAWU).

[1076] 1996 Constitution section 23(2)(a).

[1077] 1996 Constitution section 23(2)(b).

section. The relationship between members of the permanent force and the defence force is akin to an employment relationship. [1078]

Every employer has the right to form and join an employer's organisation, [1079] and to participate in the activities and programmes of an employer's organisation. [1080] Every trade union and every employer's organisation has the right to determine its own administration, programmes and activities, [1081] to organise, [1082] and to form and join a federation. [1083] Every trade union, employers' organisation and employer has the right to engage in collective bargaining. National legislation may be enacted to regulate collective bargaining. [1084]

These provisions are by nature general, but *reinforce* the provisions in the current *Labour Relations Act*. It also has a wider purview than the workplace forum provisions under the *Labour Relations Act*. For example, it will be recalled that section 78(a) of the LRA defined an employee as

> any person who is employed in a workplace, except a senior managerial employee. … [1085]

Section 78(b) went on to say that a

> 'representative trade union' means a registered trade union, or two or more registered trade unions acting jointly, that have as members the majority of the employees employed by an employer in a workplace. [1086]

Under the *Basic Conditions of Employment Act*, a 'senior managerial employee' is defined as an employee who has the authority to hire, discipline and to dismiss employees and to represent the employer internally and externally. [1087] From section 78 of the LRA with section 23(1) and (2) of the Constitution it can be deduced that *all* employees, *including senior managerial employees*, will have the

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[1078] 1996 Constitution section 23(2)(c). See also Currie et al, above n 1075, chapter 23, 3 and 20. See also *South African National Defence Union v Minister of Defence* (CCT27/98) 1999 (4) SA 469, paragraphs 24 and 48 (CC)(SANDU).

[1079] 1996 Constitution section 23(3)(a).

[1080] 1996 Constitution section 23(3)(b).

[1081] 1996 Constitution section 23(4)(a).

[1082] 1996 Constitution section 23(4)(b).

[1083] 1996 Constitution section 23(4)(c).

[1084] 1996 Constitution section 23(5).

[1085] *Labour Relations Act* 66 (1995), section 78(a).

[1086] LRA section 78(b).

[1087] *Basic Conditions of Employment Act* 75, 1997.

right to fair labour practices, to form and join a trade union and to participate in its activities and programmes and to strike, except where this involves dealings with workplace forums. It is only in this situation that the rights of these employees are reduced or curtailed in this way.

The Constitution also entrenches the rights to collective bargaining. These sentiments were expressed to a significant degree in the LRA. For example, regarding the establishment of workplace forums, the LRA provides for the appointment of a commissioner to assist the parties in establishing a workplace forum by collective agreement. [1088] Additionally, the LRA refers to

> … a collective agreement by an employer for the purposes of collective bargaining in respect of all employees in a workplace. … [1089]

This is for the purposes of establishing a trade union based workplace forum. Furthermore, regarding the specific matters for consultation, the LRA provides,

> a bargaining council may confer on a workplace forum the right to be consulted about additional matters in workplaces that fall within the registered scope of the bargaining council, [1090]

and that,

> (f)or the purposes of workplace forums in the public service, the collective agreement … is (one) concluded in a bargaining council. [1091]

Individual employers also have the right under the Constitution to *individually* engage in collective bargaining. Moreover, both in the Constitution and under the LRA, employees, through their various trade unions, have the right to bargain collectively. This is further strengthened by section 23(2)(c) of the Constitution, which provides for an unqualified right for *individual* employees to strike. [1092] The LRA, however, does *not* expressly provide for such a right in this way. Section 213 of the LRA *only* protects strike action brought by a number of employees. Brassey *et al* note,

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[1088] *Labour Relations Act* 66 (1995), section 80(6)-(10).

[1089] LRA section 81(1).

[1090] LRA section 84(2).

[1091] LRA section 84(6).

[1092] 1996 Constitution, above n 734, section 23(2)(c).

> … the most noteworthy aspect of the strike protection in (the constitution) is that (the) subject is not the union but the striker. … Making the right to strike the prerogative and privilege of the union … enhances the power of the collective and promotes trade unionism, but the result can be unfortunate when … the union is the employer's stooge or otherwise becomes co-opted or emasculated. Locating the right in the individual may make collective bargaining less manageable, but it certainly makes it more vital. [1093]

Very often, individual employee demands are made during *individual* negotiations. If an agreement cannot be reached between the individual employee and employer and a deadlock arises, the individual employee may be left with no other alternative other than to engage in *individual* strike action. This would obviously not involve collective bargaining or the need to engage in collective strike action. Therefore, the Constitution makes it possible now for individual employees to engage in individual strike action *for whatever reason* through the provisions contained in section 23(2).

Additionally, the LRA places a number of restrictions upon the right to strike, which are not present in the 1996 Constitution. These restrictions include not being able to strike in situations involving essential services, [1094] or not striking when it breaches a collective agreement, [1095] or not striking when it deals with an issue, which can be arbitrated under the LRA or in terms of an agreement. [1096] The LRA also does not protect strike action actuated by political motivations.

Moreover, a point that should be noted is that in terms of the Interim Constitution,

> (w)orkers and employers shall have the right to organise and bargain collectively. [1097]

This means that individual workers or employers have the right to negotiate on an individual basis and come to individual agreements on a collective bargaining basis. Under the 1996 Constitution, section 23(5) removes this right in the individual worker. This was a deliberate change by the Legislature, which was designed to enhance collective bargaining amongst trade unions and employers' organisations. Section 23(5), however, retained an individualistic approach on the

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[1093] Brassey et al, above n 747, C3, 11.

[1094] *Labour Relations Act* 66 (1995), section 65(1)(d).

[1095] LRA section 65(1)(a).

[1096] LRA section 65(1)(b) and (c).

[1097] *Interim Constitution of the Republic of South Africa Act* 200, 1993 (Interim Constitution), section 27(3).

part of the employer. This was arguably not a progressive step made by the Constitutional Assembly. It is reasonable to assume that if employers can enter into collective bargaining practices, so should employees be able to. There may, however, be situations where a worker *alone* wants to enter into a process of collective bargaining with the employer and therefore not wish to participate in collective bargaining in concert with a trade union.

Furthermore, the decision of *SANDU 2* noted that although section 23(5) of the Constitution grants trade unions the rights to engage in collective bargaining, it does not impose an obligation to bargain on the other side. However, in this regard the court dissented in *SANDU 3*. The court *in casu* determined that section 23(5) of the Constitution did in fact impose a duty to bargain on the other side (the minister) as the employer. The court took the view that collective bargaining was central to a proper exercise of the rights conferred by the provisions of section 23 of the Constitution. Thus, the court said that one's right to engage in collective bargaining might impose a correlative obligation on another to engage in this process. The dissenting decisions of the *SANDU* cases will need to be resolved as soon as possible by a Constitutional Court as to whether section 23(5) allows trade unions, employers' organisations and employers *only* the freedom to engage in collective bargaining or whether a positive right exists to bargain collectively. [1098]

Additionally, the Interim Constitution provided that the

> employers' recourse to the lock-out for the purpose of collective bargaining shall not be impaired, subject to section 33(1). [1099]

Under the present Constitution, the employer's right to engage in lockouts has been removed. The matter was brought before the Constitutional Court in the case of *Ex parte Chairperson of the Constitutional Assembly: In re Certification of the Constitution of the Republic of South Africa*. The objections were

> … that in order to engage effectively in collective bargaining, bargaining parties must have the right to exercise economic power against each other [795]. …(B) y including the right to strike but omitting the right to lock out, the employers' rights to engage in collective bargaining is accorded

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[1098] 1996 Constitution, above n 734, section 23(5). See also Currie et al, above n 1075, chapter 23, 20-21. See also *South African National Defence Union v Minister of Defence* (2003) 24 *ILJ* 1495, 1510J-1511A (T) and *2003 SACLR LEXIS 38*, paragraph 33, page 10 (SANDU 2). See, however, *South African National Defence Union v Minister of Defence* (2003) 24 *ILJ* 2101, 2111G-H and 2113F (T) and *2003 SACLR LEXIS 38*, paragraphs 29 and 35, pages 9-10 (SANDU 3).

[1099] Interim Constitution, above n 1097, section 5.

> less status than the rights of workers to engage in collective bargaining [65]. … (T)he principle of equality requires that, if the right to strike is included in the (New Text), so should the right to lock out be included [66]. [1100]

In discussing these arguments and rejecting the application the Constitutional Court noted that

> (w)orkers … need to act in concert to provide them collectively with sufficient power to bargain effectively with employers. Workers exercise collective power primarily through the mechanism of strike action. … (E)mployers … may exercise power against workers through a range of weapons, such as dismissal, the employment of alternative or replacement labour, the unilateral implementation of new terms and conditions of employment, and the exclusion of workers from the workplace (through lockouts). … The argument that it is necessary in order to maintain equality to entrench the right to lock out once the right to strike has been included, cannot be sustained, because the right to strike and the right to lock out are not always and necessarily equivalent [66]. [1101]

The Constitutional Court's decision not to entrench the lock out provisions under the 1996 Constitution is, arguably, correct. It is unnecessary to entrench lock out provisions because employers could, in any event, decide to exclude employees from the workplace. Employers also have many others means whereby they could stifle or repress the interests of their employees. Although the current LRA has gone some way in attempting to redress the imbalance of rights endured by employees through past unfair labour practices, for example, by developing legislation to establish workplace forums, employers still have greater economic power and can consequently, in many cases, treat employees as they deem fit. Many employees are aware that employers may be committing unfair labour practices but may feel intimidated and therefore do nothing about it. An interesting question is *why* the legislature decided to retreat from its decision to enact legislation entrenching the right to lock out under the Interim Constitution. This retreat may be due to the fact that the Legislature had decided that by entrenching the lock out provision, as it had done previously, it would be doing more harm than good to establish what it refers to as "fair labour practices". It had probably also decided that it was not necessary to entrench a right clearly in favour of the employer. This would sway the balance to an even greater extent and would thus directly repress the rights of employees. Hence, this would ultimately not achieve the "fair labour practices" that it had hoped for. The Legislature may also have deduced that the workplace forum provisions under the

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[1100] *Ex parte Chairperson of the Constitutional Assembly: In re Certification of the Constitution of the Republic of South Africa*, 1996 (4) SA 744 (CC), 65, 66.

[1101] Ibid 68.

LRA had not gone far enough in establishing the rights of employees. It is to be recalled that the joint decision-making roles of workplace forums established under section 79 of the LRA are rather limited in its purview.

The right to collective bargaining has been entrenched under the 1996 Constitution. The State, of course, has the overriding power to "regulate" this when it becomes necessary for it to intervene. Until then, trade unions, employers' organisations and the individual employer may enter into negotiations and come to agreements. The Legislature probably decided to give the State overriding power to regulate collective bargaining so that it could intervene in deadlock situations, which could bring about a severe threat to the economy or financial instability to the Republic. The Legislature was very wise to have done this.

Section 18 of the 1996 Constitution also has a freedom of association clause, which reads, "every person has the right to freedom of association". [1102] This gives employees the right to join organisations, even political parties. In this sense, it goes further than section 4 of the LRA, which provides that every employee has the right to participate in forming only a trade union or federation of trade unions and to join a trade union, subject to its constitution. [1103]

Section 18 provides, for the *first* time under South African labour law, the possibility of employees being *free to join* any movements they wish other than trade unions.[1104] This does mean, however, that any movement other than a registered trade union will not have the right to establish workplace forums under the LRA. That is, it will be recalled that section 78(b) of the LRA provides that a

> 'representative trade union' means a registered trade union, or two or more registered trade unions acting jointly, that have as members the majority of the employees employed by an employer in a workplace. [1105]

Furthermore, subsection 1 of section 80 of the LRA states that a workplace forum may be established in any workplace in which an employer employs more than 100 employees. [1106] Subsection 2 states that any representative union may apply

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[1102] 1996 Constitution, above n 734, section 18.

[1103] *Labour Relations Act* 66 (1995), section 4.

[1104] 1996 Constitution, above n 734, section 18.

[1105] *Labour Relations Act* 66 (1995), section 78(b).

[1106] LRA section 80(1).

to the Commission in the prescribed form for the establishment of a workplace forum. [1107] Therefore, only a registered (representative) trade union having more than 100 employees may apply to have a workplace forum established. The LRA is, however, subject to section 36 of the 1996 Constitution. Section 36 authorises derogation from the rights provided only that it is embodied in a law of general application and is reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom. [1108] Brassey *et al* note,

> this provision, whose importance cannot be underestimated, allows the court to strike a balance between the interests of the individual and the broader interests of society. So much is clear; what is less clear is precisely how the section operates and, in particular, how it articulates with the substantive rights in this chapter. [1109]

This is a very broad provision and it remains to be seen whether, and to what extent, it may be used to override any provisions in the LRA in circumstances, which are deemed to be neither "reasonable nor justifiable in an open and democratic society" nor based on "human dignity, equality and freedom".

However, section 8(1) of the 1996 Constitution noted,

> the Bill of Rights applies to all laws, and binds the legislature, the executive, the judiciary and all organs of State. [1110]

There can be no doubt that this is a very *powerful* provision. It overrides all laws and makes the legislature, the executive, the judiciary and all organs of State subject to it. However, as Brassey *et al* note,

> a litigant should, where possible, rest the claim on the (Labour Relations) Act rather than the Constitution since it is through the Act that the democratically elected representatives of the people have expressed their will. … The statutory rights float on top of the Constitution and, when they are deficient, the constitutional rights can still be relied on. [1111]

It should be noted that rule 17(1) of the 1996 Constitution provides direct access to the Constitutional Court in certain circumstances. That is, it provides that the court is to allow direct access to it only in exceptional circumstances and when

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[1107] LRA section 80(2).

[1108] Brassey et al, above n 747, C3, 18.

[1109] Ibid.

[1110] 1996 Constitution, above n 734, section 8.1.

[1111] Brassey et al, above n 747, C3, 25.

the matter is of such urgency, or otherwise of such political significance, that the delay caused by using the ordinary procedures, would prejudice the interest of the public or prejudice the ends of justice and good government. The constitutional court is, therefore, to be approached in the first instance only in highly exceptional circumstances. The 1996 Constitution makes the Constitutional Court the final court of appeal from the Labour Appeal Court (LAC) on constitutional issues. It is not an automatic right of appeal. The 1996 Constitution gives the Constitutional Court exclusive jurisdiction with respect to those issues dealing with the validity of parliamentary or provincial Bills and the distribution of State power. Thus, a constitutional matter includes the interpretation of the constitutionality of labour legislation or where an individual believes that their constitutional rights had been infringed. [1112]

However, on labour law matters, the other superior courts can decide such matters as the constitutional validity of a bargaining council agreement. It is doubtful whether the Labour Court has the power to invalidate legislative acts. The court does, however, have the power to apply the *Labour Relations Act* in accordance with the Constitution. [1113]

Labour Courts will, therefore, give effect to the *Labour Relations Act* in accordance with the 1996 Constitution. The courts cannot strike down a provision in the LRA that offends against the Constitution, but it can ignore it to the extent of not complying with it. In most cases, the Constitutional Court is beyond the reach of the labour force as a court of first instance. It may also be very difficult to distinguish a situation when a matter is so urgent, or otherwise of such political significance, that the delay caused by using the ordinary procedures, would prejudice the interest of the public or prejudice the ends of justice and good government. In this way, many urgent matters may *not* reach the Constitutional Court at all. Alternatively, using these criteria it is possible that some matters that reach the Constitutional Court could easily be disposed of in the lower courts.

(6.11.3) Conclusion

[1112] 1996 Constitution, above n 734, rule 17(1). See also Currie et al, above n 1075, chapter 23, 11. See also *National Union of Metalworkers of South Africa v Bader Bop (Pty) Ltd and another* (CCT14/02) 2003 (2) BCLR 182, paragraphs 15, 20 and 51 (CC).

[1113] Brassey et al, above n 747, C3, 27-28.

The Bill of Rights under the 1996 Constitution provides another means under which labour could ensure the rights to fair labour practices. Section 23 promotes collective bargaining. [1114] However, it is very different to section 27 of the Interim Constitution, which stated that both workers and employers had the right to bargain collectively.[1115] In effect, section 23 removed the previous reference to 'workers' and substituted it with 'trade unions, employers' organisations and employers'. [1116] Thus, whilst 'employers' retained the right under the 1996 Constitution to engage in collective bargaining, individual workers did not. This leads to an *imbalance* of rights and the Constitutional Assembly and Constitutional Court should consider reinserting the word 'workers' into the provision dealing with labour relations. It is possible for individual employees to be part of the collective bargaining process. Thus, requiring them only to act in concert as part of the collective bargaining process is unnecessary and restrictive.

Section 23(2)(c) of the 1996 Constitution provides that "every worker has the right to strike". This is an unqualified right that includes both political and socio-economic strikes. The right to strike under the 1996 Constitution is located with individuals, not the union. [1117] Section 213 of the *Labour Relations Act*, on the other hand, does not provide this right on an individual basis, but confers it only upon a number of employees acting in concert. [1118] Furthermore, the LRA does not protect strike action based upon political motives. Additionally, the *Labour Relations Act* places a number of restrictions on strike action, such as with essential services, [1119] or in situations involving a breach of a collective agreement, [1120] or when dealing with an issue that can be arbitrated under the Act or under an agreement. [1121] Thus, it is the 1996 Constitution that must provide the relief for employees who strike in this way. It is evident that the 1996 Constitution does go *much further* than the LRA in protecting individual strike action for whatever reason that may be.

Section 27(5) of the Interim Constitution provides that the

[1114] 1996 Constitution, above n 734, section 23.

[1115] Interim Constitution, above n 1097, section 27.

[1116] 1996 Constitution, above n 734, section 23.

[1117] 1996 Constitution, section 23(2)(c).

[1118] *Labour Relations Act* 66 (1995), section 213.

[1119] LRA section 65(1)(d).

[1120] LRA section 65(1)(a).

[1121] LRA section 65(1)(b) and (c).

> employer's recourse to the lock-out for the purposes of collective bargaining shall not be impaired. …[1122]

Section 23 of the 1996 Constitution, however, removes this provision in its entirety. The removal of this provision was brought before the Constitutional Court in the certification case in 1996, but the arguments in favour of entrenching the rights to lock out were dismissed by the Court. The court was of the view that employers had already sufficient means at their disposal to use against its workers, and therefore did not need to have the lock out provision entrenched under the 1996 Constitution. This right to lock out was already *implied* in the employer's right to bargain collectively. Thus, the Constitutional Court noted,

> … it suffices that the right to bargain collectively is specifically protected. Once a right to bargain collectively is recognised, implicit within it will be the right to exercise some economic power against partners in collective bargaining. [1123]

Section 18 of the 1996 Constitution also has a freedom of association clause, which reads, "every person has the right to freedom of association". [1124] This clause is wider in scope than section 4 of the *Labour Relations Act*, which restricts the right to freedom of association to trade unions or to a federation of trade unions. [1125] Thus, section 18 provides that employees may freely join any movements, even political ones. [1126]

The Constitutional Court only provides direct access to it as the court of first instance in very limited circumstances. These circumstances involve those matters that are usually so urgent that ordinary procedures should be dispensed with. Matters of this kind usually threaten and prejudice the interest of the public or the ends of justice and good government.

Generally speaking, the 1996 Constitution entrenches in part constitutionally sound principles of labour law. However, it does not go far enough in formulating and entrenching certain principles that would achieve greater industrial democracy in South African labour and company law. In addition to the

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[1122] Interim Constitution, above n 1097, section 27(5).

[1123] *Ex parte Chairperson of the Constitutional Assembly: In re Certification of the Constitution of the Republic of South Africa*, 1996 (4) SA 744(CC), 795B-C, paragraph 64.

[1124] 1996 Constitution, above n 734, section 18.

[1125] *Labour Relations Act* 66 (1995), section 4.

[1126] 1996 Constitution, above n 734, section 18.

shortcomings and restrictions already discussed, the 1996 Constitution does *not* mention the extent to which employees should have a joint decision-making role in the running of the organisation. South Africa would move forward in establishing a dual board structure and consequently in achieving greater industrial democracy if the Constitutional Assembly and/or the Constitutional Court take an active role in supporting this. This issue is general and can therefore be readily incorporated into any new amendments made to the Constitution. It is also important enough to be taken very seriously by the highest bodies in the land.

As discussed previously, greater job satisfaction is achieved, as a result of greater industrial democracy. This, in turn, would yield greater customer satisfaction and improved company profits, which would place South Africa on a sounder economic platform. Thus,

> (f)or even the most alienated worker, work is never totally unpleasant, never completely rejected by the worker. … The need for sheer activity, for social intercourse, and for some status and identity in the larger society keeps even unskilled workers on the job after they are economically free to retire. … (A) skilled man takes pride in his work. He does not do it merely to earn money. He does it to make his contribution to the well being of all. He does it so as to keep himself busy, and not idle. To use his skill, and to improve it. To have the satisfaction that comes of a task well done. … Something attempted, something done, has earned a night's repose. [1127]

Thus, both the Constitution and the *Labour Relations Act* should enact provisions, which require management to recognise the needs of employees in order to achieve job satisfaction in their workplace. In so doing, employers must maintain and operate the workplace in such a way, which clearly maximises the possibility of attaining these results. This promotes a sense of goodwill and confidence amongst the parties and creates an environment, which is conducive to achieving greater job satisfaction and enhanced economic productivity. The Appellate Division in the decision of *Council for Scientific and Industrial Research v Fijen* noted,

> … that in every contract of employment there is an implied term that the employer will not, without reasonable and probable cause, conduct itself in a manner calculated or likely to destroy or seriously damage the relationship of confidence and trust between the parties. … It is well established that the relationship between employer and employee is in essence one of trust and

[1127] Brassey et al, above n 747, E2, 22-23.

> confidence and that, at common law, conduct clearly inconsistent therewith entitles the 'innocent' party to cancel the agreement. … [1128]

In this way, employers are required to treat the employees reasonably. However, in the labour provisions and 1996 Constitution there is

> no general duty that an employer must treat the employee in a reasonable manner. … It is, of course plain that there are some obligations in a contract of employment, which the employer must comply with reasonably. … [1129]

Consequently, both the 1996 Constitution and the current *Labour Relations Act* still have a long way to go in attaining an acceptable balance in labour between the rights of employees and those of the employers. At this time, employers still have very much the upper hand in South African labour law.

[1128] *Council for Scientific and Industrial Research v Fijen* 1996 (2) SA 1 (A), 9.

[1129] Brassey et al, above n 747, E4, 66.

CHAPTER 7:

(7.0) THE THIRD STEP OR BUILDING BLOCK: PROPONENTS IN FAVOUR OF OR AGAINST EMPLOYEES HAVING GREATER RIGHTS IN THE DECISION-MAKING PROCESSES OF THE CORPORATION

To support the contention that employees should be allowed greater rights in the running of organisations, it is necessary to discuss the views of academic and other writers who have expressed their ideas on this issue. There are still writers who believe that the traditional shareholder maximisation theory should be retained and it is therefore necessary to consider some of these views in order to establish whether there could be any advantages attached to this reasoning.

(7.1) COMMENTARIES ON THE RIGHTS OF EMPLOYEES WITHIN THE CORPORATION

Millon makes interesting observations. Firstly, he believes that corporate law is in

> the midst of crisis, because of the exhaustion of the shareholder primacy model [1373]. [1130]

That is, although historically speaking corporate law supported the model of shareholder wealth maximisation, policy and society today are eroding this traditionalist approach. Whereas the shareholder primacy model ignored the rights of non-shareholder constituencies, corporate law in business today is obliged to take into account the rights of others, including the employees. Thus, the crisis exists because there are two camps labelled the 'contractarians' and the 'communitarians'. On the one hand, the contractarians wish to re-establish and firmly entrench the traditional shareholder primacy approach, whereas, on the other hand, the communitarians are pressing for the recognition by the organisation of non-shareholder rights (also referred to as the stakeholder view). Millon notes,

> the rift is deep and likely to persist. [1131]

Similarly, it is evident that the erosion of the shareholder primacy model is not a superficial or temporary phenomenon. It is so profound that today the rights and interests of non-shareholder constituencies are being modified and supported in South African labour legislation, suggesting that there can be now no turning back to the traditionalist shareholder approach. Society and business would act quickly against any attempt to restore the traditionalist approach. Continued changes have to occur. Society and business are dictating further policies to achieve greater recognition of non-shareholder rights. Thus, directors are more accountable today for their actions than ever before in the past.

Secondly, Millon draws a distinction between the approaches of the contractarians and the communitarians. The contractarians, he says, support the shareholder primacy model. Contract is the means in terms of which the rights are determined and defined. The main aim of these rights would be to maximise shareholder wealth.

[1130] David Millon, "New directions in corporate law: communitarians, contractarians, and the crisis in corporate law", (1993) *Washington and Lee Law Review*, Vol. 50, 1373.

[1131] Ibid 1377.

Non-shareholders, including employees, may negotiate with shareholders for their rights. In this way, contracts are to be established between the respective parties with legislation playing a *limited* role in regulating, determining and defining the rights of shareholder and non-shareholder interests. Thus, a trend in the nature and function of the corporation is to view it as a 'nexus of contracts' between the shareholders and management, between the shareholders themselves, between the corporation and the suppliers or between the corporation and consumers. [1132]

Communitarians, on the other hand, embrace legislation to determine these rights. They do not have much faith in contracts protecting the rights of non-shareholder interests. Communitarians regard the *social values* of corporations as being highly significant and can have a deep impact on the public and community.

What differentiates the communitarians from the contractarians is the communitarians' belief that contract alone should *not* specify the terms of corporate governance relationships. [1133] The contractarian theory describes the company as a network of contracts, which emphasises shareholder value, whilst the communitarian theory emphasises broader community and societal issues. Preference for one approach over the other is often indicative of a preference for either a 'private' or 'public' perception of the company. Although this dichotomy between contractarian and communitarian theories is commonly adopted, it is arguably an inapt distinction because contractarian theory is capable of supporting communitarian values. Thus, the contractarian/communitarian division arguably fails to properly delimit any underlying theoretical differences. [1134] However, because of the very different approaches to how, and to what extent, rights are to be determined amongst the various stakeholders, these two camps have caused, according to Millon, "the current corporate law crisis". [1135]

Contractarians believe that people should be free to make their own decisions. Legislation that forces people to make decisions about how they should conduct their business is "objectionable". [1136] Communitarians believe that people owe each other something more than just that which could ever be placed in a contract. That is, one

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[1132] V Brudney, "Corporate governance, agency costs, and the rhetoric of contract", (1986-87) *Corporate Practice Commentator*, 28, 229.

[1133] Ibid 1381.

[1134] S Worthington, "Shares and shareholders: property, power and entitlement (Part 1)", (2001) *The Company Lawyer*, 22 (10), 263-4.

[1135] Brudney, above n 1132, 1382.

[1136] Ibid.

must have respect for one another and therefore treat one another with the kind of dignity and integrity that society expects and demands. In this way, society dictates that people are to be responsible for the quality of life of all those who live in the community. The communitarians advocate that social expectations *cannot* become a possibility if based solely upon contractual mechanisms.

Additionally, contractarians abhor rules that impose restrictions upon shareholders in order to benefit the non-shareholder constituencies. They believe that this amounts to nothing more than a simple redistribution of wealth from shareholders to non-shareholders. Shareholders are not expected to have to take into account the interests of the non-shareholder constituencies.

However, Millon notes, "… that it is the contractarians who ought to justify their insistence on a relentless commitment to market-defined outcomes". [1137] These 'market-defined outcomes' would be considerably improved if greater job satisfaction had been first achieved in the workplace. This would, in turn, lead to better customer service. Happier customers mean a greater turnover for the business. Many people believe that "cash is king". Arguably, the expression should be that the "customer is king".

Communitarians, however, proceed from a different vantage point to that of contractarians. They seek instead to reform corporate law in order to foster individual dignity and promote societal welfare. [1138] To a certain extent, these sentiments have been captured in the South African labour legislation and also in the 1996 Constitution. For example, it will be recalled that the current *Labour Relations Act* provided for the establishment of workplace forums on a very limited basis, and the 1996 Constitution expanded the concept and application of the right to freedom of association. However, the communitarian principles could be endorsed even more rigorously in both company and labour law. For example, Millon notes,

> as it does in Europe, corporate law might facilitate participation in decision-making by those most directly affected by particular kinds of decisions. Employee ownership structures are yet a further possibility. [1139]

However, Brudney believes that the communitarians will need to explain why traditional corporate law doctrines, which enshrine shareholder wealth maximisation,

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[1137] Ibid 1386.

[1138] Ibid.

[1139] Ibid 1388.

should not be preserved under modern law. In this way, the protection of non-shareholder interests could be *exclusively* considered by, for example, labour and employment law. [1140] However, this is not the question that communitarians should be asking. Different legislation within a country is inextricably intertwined. It often happens that legislation in one area refers to legislation in another. South Africa also has overriding legislation in the form of a Bill of Rights under a Constitution. Because labour law provides the rules relating to employment, this should not mean that corporate or company law should ignore the rights of the non-shareholder constituencies. The view that corporate or company law is regarded as separate from the other legal regimes makes little sense. This dilemma would potentially also lead to conflict situations arising in terms of which corporate or company law would be focusing on and providing for shareholder wealth maximisation, whilst the other legal regimes, such as labour law, would be providing for the inclusion of the rights of non-shareholders. *Both* company and labour law need to provide suitable and appropriate mechanisms in terms of which the rights of both shareholder and non-shareholder constituencies are considered. This understanding is not only necessary, but also vital to achieving greater corporate success and industrial democracy. Both labour and company law need, therefore, to be complementary for this goal to be achieved.

Since the commencement of the current *Labour Relations Act* and the 1996 Constitution, both directors in a company and the rest of management itself have had to consider, to a much greater extent than ever before, the interests of the other stakeholders associated with the organisation. This "multifiduciary model" is embraced in the communitarian camp. [1141] It is multifiduciary in the sense that the directors of the company and therefore management are now fiduciaries not only of the shareholders, but *also* of the employees and of the other non-shareholder constituencies. The South African legislature has also moved away from the traditionalist approaches of company law, which emphasises the maximisation of shareholder growth. Moreover, it has, moved closer towards the doctrinal ideology of the communitarians by allowing legislation to have a greater part in the determination of stakeholders' rights. Thus, company directors "should be entitled, and perhaps even obliged" to take other public interests into account. Consequently, the aim of the board can longer be based simply upon "immediate profitability". [1142]

[1140] Ibid 1386.

[1141] Ibid 1388.

[1142] Havenga (1997), above n 36, 314.

The legislation does have, however, features, which are also characteristic of the contractarian model. However, the contractarian approach is arguably too narrow and restrictive. Ideologically, it would not be sufficient to establish the rights of employees simply by way of contractual means. South Africa has started on the long road to achieving greater industrial democracy in the workplace, but the country has still a long way to go in establishing adequate rights for its employees. This is especially so where rights of employees involved in the decision-making processes of the organisation at board level must be established.

Green argues for non-shareholder constituency rights. He notes that managers and directors are permitted, in the reasonable exercise of 'business judgment,' to take longer-term shareholder interests into account and sometimes to defer immediate shareholder gain. [1143] Green points out that in the United States of America a few states have passed legislation expanding the business judgment rule and therefore permitting, but usually not requiring, directors and their management to take into account the impact of their decisions on and the interests of non-shareholder constituencies, including employees. It is arguable, however, that legislation, which generally does not oblige management to take into account non-shareholder interests, may reinforce the supremacy of the traditionalist approach in company law, which seeks to maximise the profits of shareholders. However, on the other hand, Green suggests that the non-shareholder constituency statutes adopted by over half the states indicate a firm erosion of the shareholder wealth maximisation doctrine. [1144]

In South Africa, the traditional company law approaches supporting the maximisation of shareholder wealth to the detriment of other non-shareholder constituencies, have been eroded, but *not* eliminated. The South African *Companies Act* itself *should be amended* to include provisions, which expressly support and advance the recognition of the rights of other non-shareholder constituencies. This would be in keeping with current South African social and business practices and expectations.

However, Bainbridge notes that he is

[1143] Ronald M Green, "Shareholders as stakeholders: changing metaphors of corporate governance", (1993) *Washington and Lee Law Review*, Vol. 50, 1409, 1411.

[1144] Ibid 1412.

> … not persuaded … that the shareholder wealth maximisation norm is both descriptively and normatively deficient. … (The) shareholder wealth maximisation long has been the fundamental norm, which guides U.S. corporate decision makers. [1145]

Furthermore, according to Milton Friedman, who supports the traditionalist notion favouring shareholder wealth maximisation,

> (i)n a free enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society. … Insofar as his actions in accord with his "social responsibility" reduce returns to stockholders, he is spending their money. [1146]

In this, Milton Friedman contends that executives have a direct responsibility to make as much money for the company as possible. They are specifically employed in the capacity to accomplish this. If they place other interests ahead of this, such as non-shareholder interests, and this causes loss to the company, this becomes a loss to the shareholders. In his view, this would be similar to stealing money from the shareholders. Friedman's views are, however, very anachronistic. It is not conceivable today that the executives in a company should devote all of their time increasing the returns to the shareholders. The shareholders are only but one constituent body making up the organisation or requiring attention from the executives and management.

One salient point that Bainbridge makes, however, is that he believes that the entities, comprising the non-shareholder constituency, are better able to negotiate their terms of their relationship in the organisation than the shareholders. He believes that non-shareholders have a variety of remedies that shareholders lack. For example, shareholders generally have no meaningful voice in the decision-making processes of the organisation. The directors themselves generally make the decisions. However, employees under the current *Labour Relations Act* have a very limited role in the joint decision-making processes of the organisation in regard to those matters to be dealt with by workplace forums. However, the shareholders could decide not to invest in the organisation if they are dissatisfied with the way in which the company is being managed or with the returns that they are receiving. This is their greatest weapon. On the other hand, dissatisfied employees could

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[1145] Stephen M Bainbridge, "In defense of the shareholder wealth maximisation norm: a reply to Professor Green", (1993) *Washington and Lee Law Review*, Vol. 50, 1423.

[1146] Ibid 1428, referring to Milton Friedman, "The social responsibility of business is to increase its profits", *New York Times*, 13 September 1970, 6 (magazine), 32-33.

embark upon strike action or institute dispute procedures for any alleged unfair labour practices under the Act. In addition, non-shareholders have other means to influence management that shareholders do not possess. Creditors, for example, can refuse to supply the organisation with further products until such time that previous debts have been settled. Employees have the right under the Act and in terms of the 1996 Constitution to enter into collective bargaining procedures in accordance with set legislative provisions. A community forum can enter into negotiations with an organisation for sponsorship in return for free advertisements.

It is in the interests of the organisation to take into account the interests of the non-shareholder constituencies as well. The traditionalist theory favouring the maximisation of shareholders' wealth to the exclusion of everything else is inappropriate today. Businesses have become too dependent upon the non-shareholder constituencies for it to be any other way.

Although non-shareholder constituencies are better able to negotiate the terms of their relationship with the organisation than the shareholders for the reasons discussed, this does not mean that the directors and management should only be concerned with the rights of shareholders. In other words, the traditionalist approach supporting the maximisation of shareholder wealth cannot be supported simply because the non-shareholder constituencies have other means at their disposal to influence management decisions.

In this regard, Bainbridge is arguably incorrect when he notes,

> … non-shareholder constituencies have adequate mechanisms to protect themselves (from) management misconduct. [1147] … Shareholders are more vulnerable to management misconduct than are non-shareholder constituencies, because shareholders lack meaningful access to many of the protective mechanisms of which non-shareholder constituencies may avail themselves. … I regard them as a compelling set of reasons for retaining the shareholder wealth maximisation norm. [1148] … For many years, the basic rule that shareholder interests come first has governed public corporations. That rule has helped to produce an economy that is dominated by public corporations, which in turn has produced the highest standard of living of any society in the history of the world. A system with that record of success cannot be all bad. Nor should it be replaced without a much stronger showing.[1149]

[1147] Ibid 1444.

[1148] Ibid 1446.

[1149] Ibid 1447.

(7.2) THE STAKEHOLDER VIEW: A NEW DIMENSION IN THOUGHT?

> "Corporations are what we do". [1150]

The stakeholder theory was first used in 1963 at the Stanford Research Institute. [1151] The theory maintained that the objectives of the company would be achieved "by balancing the conflicting claims of the various "stakeholders" in the firm, managers, workers, stockholders, suppliers (and) vendors". [1152]

Thus, the corporation is composed of "multiple constituents" referred to in figure 1.1. It provides wealth and other benefits to these constituents. Most of these constituents are essential to the corporation because they "contribute inputs, receive outputs … actively or passively … and provide its "license to operate" as an institution within the economy and society". These constituents are the stakeholders because they have a stake in the successful operation of the firm. [1153] Viewing the firm from the inside, the wealth of the corporation can be built through the development of favourable relationships with all the stakeholders. From the outside, the wealth of the corporation can be built through the development of its status within the economy and society. [1154] Thus, it is imperative to recognise the participation and interests of the different groups, which "are vital to the success of the corporation". Therefore, the concerns of all of the relevant stakeholders must be considered. This commitment must be implemented, either directly or indirectly, through appropriate "structures, strategies and practices over the long term". [1155] Thus,

> (r)elationships with investors, employees, customers, suppliers, communities, governments and other stakeholders are part of the history of every corporation. [1156]

Thus, relevant stakeholders "have had distinct impacts on the firms". These impacts are the stakeholders' journeys within each corporation. [1157]

[1150] JE Post, LE Preston and S Sachs (2002), *Redefining the Corporation: Stakeholder management and organisational wealth*, Stanford University Press, Stanford, California, US, 23.

[1151] T Clarke (ed) (2004), *Theories of Corporate Governance: The philosophical foundations of corporate governance*, Routledge, London, 194.

[1152] Ibid.

[1153] Post et al, above n 1150, 229.

[1154] Ibid 230.

[1155] Ibid.

[1156] Ibid.

[1157] Ibid 232.

> The stakeholder view places the firm and its core of strategy, structure and culture at the center of a web of stakeholder relationships, and shows how organisational wealth can be enhanced by favourable relations (and reduced by unfavourable relations) between the corporation and the stakeholders. [1158]

Thus, the stakeholder view attaches great significance to "humanistic values and ethical practices as a basis for "organisational morality"". "It is not competitive with other perspectives, but complementary and integrative". [1159] Trust is an important part of the stakeholder approach. [1160] This view therefore "offers a broader and more comprehensive perspective on the source of business success, as well as greater insight into potential problems and failure". [1161] Consequently, corporations are recognising the importance of favourable stakeholder relationships by "increasing their public commitment to broad societal objectives". They are doing this by adopting a "triple bottom line" commitment to economic, environmental and community factors. [1162] Stakeholder management allows the corporation to develop relationships on those whom it depends for "its license to operate and for its ultimate success". [1163] Although not every stakeholder wish can be granted, corporate managers must consider "the legitimate concerns of all stakeholders". [1164]

Adoption of the stakeholder view "increases the ability of managers to … implement combinations of strategy, structure and culture that enhance organisational wealth".[1165]

> To maintain its status, … the corporation must earn its "license to operate", both locally and globally, by demonstrating its respect for people and its contribution to building a better world. The wealth of the corporation is not merely the property it owns, the financial resources it accumulates, or even the intellectual property it develops. The corporation's most important asset – and the only one it cannot create or replace on its own – is its acceptance within society as a legitimate institution. [1166] (Thus), (a) smart company is a good investment, employer, customer, supplier and neighbour. [1167]

[1158] Ibid 239.

[1159] Ibid.

[1160] Ibid 240.

[1161] Ibid 241.

[1162] Ibid 242.

[1163] Ibid 243.

[1164] Ibid 245.

[1165] Ibid 255.

[1166] Ibid 256.

[1167] Ibid 243.

Thus, the stakeholder view "may be not just a moral imperative, but a commercial necessity" where "competitive advantage" is being created "more and more" from "values embodied in human and social capital". [1168]

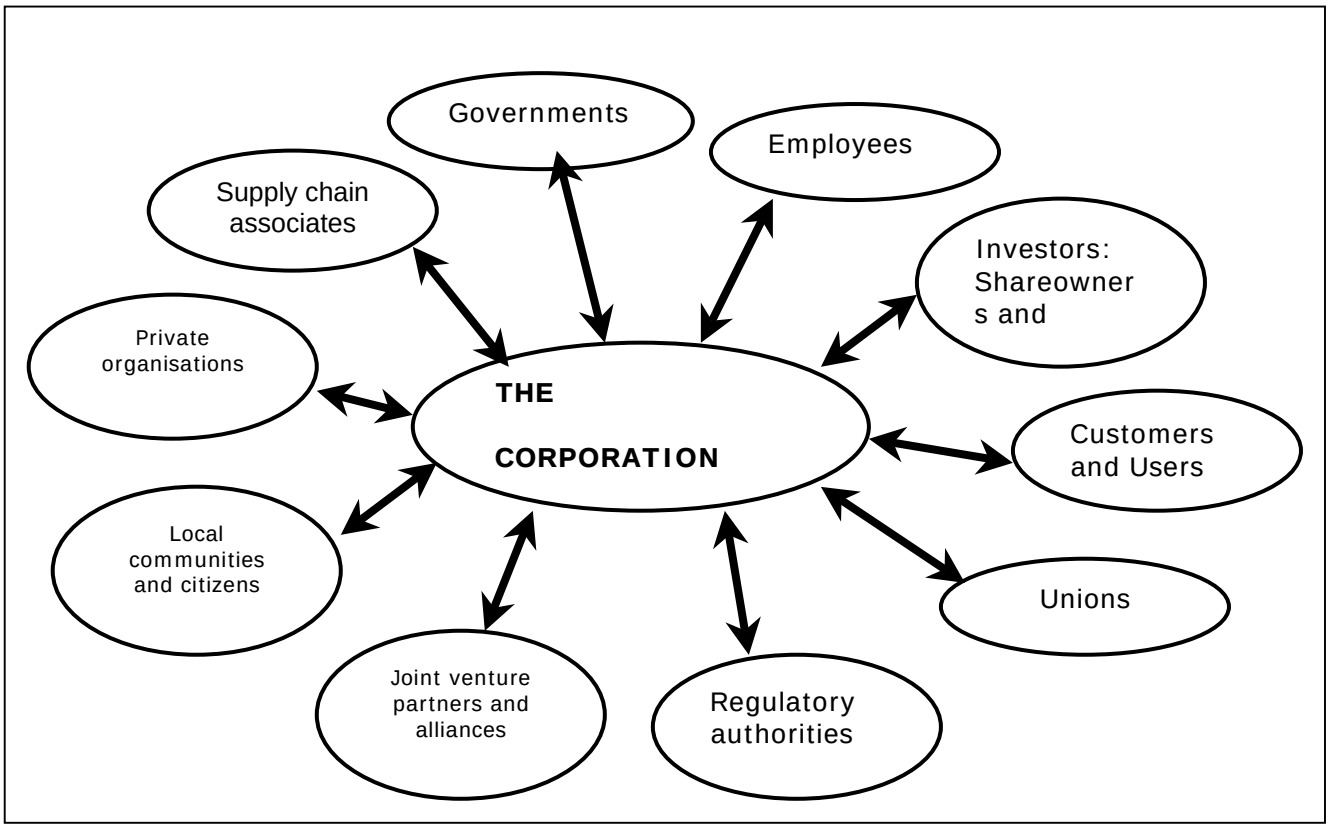

Figure 1.1: The corporation and its stakeholders [1169]

(7.3) CONCLUSION

The world has moved forward since the formulation of the shareholder wealth maximisation doctrine and so has South Africa. It is difficult to endorse a doctrine that does not take into account the rights of the non-shareholder constituencies. It is not possible to endorse a doctrine that is so antiquated that Milton Friedman believed that if the executive "… reduce(s) returns to stockholders, he is spending their money". The current *Labour Relations Act* has rejected the 'traditionalist' approach. Although the Act has still a long way to go, it has commenced the process

[1168] Clarke, above n 1151, 200.

[1169] Post et al, above n 1150, 22.

of turning away from the ideology that organisations exist to maximise shareholder wealth. It has begun to recognise the rights of non-shareholders. Workplace forums now exist and employees, through their trade unions, now have a joint decision-making role at line management level in limited situations. South Africa has now moved beyond the traditional doctrine in company law and there is now no returning to it. South Africa must now enact legislation that extends these rights to greater and more meaningful dimensions for labour. It needs to do this by establishing dual board structures. Rules and provisions regulating the establishment, functioning and membership of these structures should be provided for in *both* labour and company legislation. Labour law has progressed to a limited degree in recognising non-shareholder rights in decision-making processes. It is time that a new South African company act reflects these rights as well.

CHAPTER 8:

(8.0) THE FOURTH STEP OR BUILDING BLOCK: INTERNATIONAL MODELS OF CORPORATE GOVERNANCE

In this chapter of the thesis the German, Japanese and French models of corporate governance will be discussed in detail and compared. We will also consider the role that the banks play in each country in administering corporate governance policies.

(8.1) INTRODUCTION

Corporate governance is classified into two broad categories: *the outsider-based and insider-based systems*. In the first category, we find *Anglo-American models* such as that existing in Australia, New Zealand and South Africa. In the second category, we find the Japanese, German and Western European systems. The first model category depends upon the external markets for shares. The second model category does not depend on markets, but has more stable long-term *shareholder relationships* with other companies. Here banks play a main part in corporate relationships. [1170]

In this part of the thesis some of the most important characteristics of *models* of corporate governance of other countries will be discussed and evaluated. These models *support* the contention that employees should be permitted to have a greater say in the running of the corporation and in the decision-making processes. The way that corporations are governed is important to all stakeholders. In this regard, particular attention to those structures, which endorse a *two-tier board* or similar system, will be discussed. It will be indicated how international features of corporate governance could become workable in South Africa.

(8.2) WHY IS THIS IMPORTANT?

Poor corporate governance will create *weaknesses* in the links between the managers, directors, shareholders, employees, suppliers, the community and environment, the economy and the country. Because it is essential that businesses operate efficiently and effectively, the *effectiveness* of corporate governance practices is a vital factor, which contributes to the success or failure of the corporation. Moreover, it is vital that *all* of the stakeholders in the corporation feel satisfied with their returns, while it is healthy for all businesses to *continually* consider the progress that other businesses are making in regards to corporate governance practices. No business can afford to say that it has the perfect corporate governance model and leave it that. Continued research and developments of corporate governance models are necessary in order for corporations to remain competitive in this our ever-changing world. It is important to examine the features

[1170] J Farrar (2001), *Corporate Governance in Australia and New Zealand*, Oxford University Press, Australia, 417.

of corporate governance models, which are successful and consequently achieve a healthy competitive edge (or have come close to achieving it). Eventually, it is hoped that these features could be adopted in South Africa as part of the South African corporate governance model for the future on employee participation schemes.

(8.2.1) Germany

Charkham refers to the fact that German attitudes attach much significance to the concept of "co-operation" rather than that of "confrontation". [1171] He states that Germans have an overwhelming sense of commitment to the community and "… seem to think in the long term and not to expect too much too soon". He believes that the German educational system works closely with industry. [1172] In this way, Germans have great respect for and pride in their industry. German companies place their employees and customers *before* the shareholders. [1173] He notes that shareholders are but one group of stakeholders and that, although important, making a profit is *not* the only thing that counts. Charkham refers to a quotation from Ellen Schneider-Lenne, a member of the management board of Deutsche Bank, in her 1992 Stockton Lecture, which is interesting to mention. She notes,

> profit is as necessary as the air we breathe but it would be terrible if we worked only to make a profit, just as it would be terrible if we lived only to breathe. [1174]

In Germany, good industrial relations are paramount to achieving economic success. These industrial relations are comprised of three parts - the unions, work councils and company boards. The German co-determination system provides for the participation of employees in the corporation through works councils and on the supervisory board. Co-determination has developed because of "social governance", rather than corporate governance. It also reduces the alienation of employees through their involvement in the decision-making processes of the corporation. [1175]

The concepts of co-determination and corporate governance have been distinguished. Hence, although both concepts "control economic power associated with large corporate enterprises" they "diverge in other respects". Thus,

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[1171] Charkham, above n 87, 7-8.

[1172] Ibid 9.

[1173] Ibid 10.

[1174] Ibid 11, referring to Ellen Schneider-Lenne, 1992 Stockton Lecture.

[1175] Farrar (2001), above n 1170, 423.

> codetermination gives economic power to those who control the means of production and uses employee participation as a tool to counter the interests of capital. The prevailing corporate governance paradigm, by contrast, places major control in the hands of capital owners and uses management as their agents. … In essence, the main difference between the two concepts is that codetermination offers social governance, whereas corporate governance provides firm-level governance. [1176]

Thus, some believe that co-determination has established "not only social governance but also social peace (*Sozialfrieden*)". Any attempt to remove co-determination from the corporate governance structure existing in Germany, would endanger social peace. [1177]

"Social co-determination" is used to describe employee participation at shop-floor level through works councils or other committees (such as safety or job classification committees). [1178] "Supervisory co-determination", however, describes employee participation at supervisory board level in the German two-tier board system. [1179] Thus, in Germany today, co-determination exists on two levels. Firstly, co-determination exists through workers' councils at shop floor level. This provides employees with the rights and opportunities to participate in the decision-making processes that affect them at their workplace. Secondly, co-determination also exists at the corporate or supervisory board level (through union and employee representation). [1180]

The German Chancellor, Gerhard Schroder, has indicated that it was due to the German system of co-determination that Germany evolved into a stronger country.[1181]

Charkham reports that Germany has a simple union system, which is "based on industry not craft". [1182] The unions are inspired today by economic rather than political objectives.

[1176] MM Blair & MJ Roe (eds) (1999), *Employees and Corporate Governance*, The Brookings Institution, Washington, DC, 163.

[1177] Ibid 165.

[1178] Cordova, above n 65, 127.

[1179] JJ du Plessis and O Sandrock, "The rise and fall of supervisory codetermination in Germany", (2005) 16 *International and Commercial Law Review*, 68.

[1180] Blair & Roe, above n 1176, 165-6.

[1181] Du Plessis & Sandrock, above n 1179, 77.

[1182] Charkham, above n 87, 12.

Work councils encourage employees to participate in the decision-making process. They achieve this by promoting trust, co-operation and harmony, which improves the relationships between the employer and employee. Thus, the right to be consulted ensures that informal discussions occur. Employers believe that informed and trusted employees are more loyal and would have a greater understanding of the problems of the company. [1183] However, participation in the decision-making processes needs to be applicable in *all* matters pertaining to the working conditions of employees. Unfortunately, participation in decision-making in South Africa only takes place on a *limited* basis regarding *specific* matters. Furthermore, workplace forums in South Africa are required only in those corporations whose employees exceed one hundred in number. Thus, since most corporations (including close corporations) in South Africa have arguably less than this number of employees, most corporations will not have workplace forums. There is, therefore, very limited employee participation in the decision-making processes of most corporations. This, coupled to the definition of "affected corporations" in the King I Report (and "affected companies" in the King II Report), means that employees in most South African businesses still remain without a solid foundation upon which they could legally claim that they have a right to participate in the decision-making processes of the corporation. This is unquestionably inadequate.

The main features of German work councils are: [1184]

1. The *Works Constitution Act* of 15 January 1972 provides the rights for work councils of private companies (which covers almost all of German businesses, except very small businesses).

2. The size of the works council depends upon the size of the business.

3. The members are elected for four years by their peers (this is so despite the fact that an employee might not belong to a union).

4. The works councils must meet on a quarterly basis during which time its members are entitled to receive full pay.

[1183] Ibid 12-14.

[1184] Ibid.

5. The works councils are entrusted with the duties to deal with all matters that may pertain to the conditions of employment, including such matters as hours, overtime, leave, safety at work and the like.

6. In this way, work councils enter into agreements with the employers (with a procedure for conciliation if there is a deadlock).

7. They also have rights to participate in decisions (rights of co-determination), which pertain to dismissals or employee grievances.

8. In those companies with more than 100 employees, an economic committee must be formed. These committees only have rights to information regarding those matters dealing with "the economic and financial situation … the production and sales situation, the investment programme, rationalisation projects and closures, organisational changes, including mergers (and) proposed changes in method". [1185]

9. Although the unions have sole bargaining rights with respect to basic pay and conditions and also have the right to strike, work councils do not have the right to strike.

10. Workplace councils, therefore, handle disagreements through the applicable conciliation procedures and labour courts.

It should be emphasised that these days works councils have "a very considerable say" in those matters that concern the shop floor, such as daily working hours, overtime, holidays, appointments, promotions, dismissals and social amenities. [1186] Additionally, the work council and its chairperson, which represents the interests of the employees, are very much kept informed about the affairs of the company and its business development as is the management board. Thus,

> (i)t is obvious that the council, and … its chairman, not only has a finger on the company's pulse but is conversant with the workers and their problems. Many of the worker representatives on the supervisory board … are also influential members of the works council. [1187] … If we consider all these things together … it is not difficult to see that employees in fact participate through the works council. Co-determination on the supervisory board only rounds that participation off, and in some respects

[1185] Ibid 13.

[1186] Lutter, above n 108, 156.

[1187] Ibid 158.

> even leads to duplication. [1188] … It is the two together – works council "below" and co-determination (worker participation) on the supervisory board "above"… which are *de facto* and *de jure* the essence of German entrepreneurial organisation. [1189]

Germany, having one of the strongest economies in the world, features the following *operating* mechanisms for its corporate boards: [1190]

1. Since the late 1800's, Germany has had a system of corporate governance for all companies, except the very smallest. As time went by, the general meetings of many companies became too large. Hence, a system was developed of placing matters of supervision into the hands of shareholder committees. Therefore, this type of system identified the need for *supervision* and placed this function into the hands of a group of people. It also identified the need for *direction and management* and placed this function into the hands of another group of people. In this way, large German companies today have a supervisory board, termed the "Aufsichtsrat", and a management board, termed the "Vorstand".

2. The division of functions between the supervisory and management boards is based upon the belief that the stronger management is the less likely it is that its interests coincide with those of the owners of the business.

   Generally, the main functions of the supervisory board are to compare financial statements from year to year, oversee and consult over the manner in which the management board runs the corporation, ensure that the management board acts lawfully and appropriately, scrutinize the information that it receives from the management board and respond promptly when it believes that the management board is acting inappropriately. When a corporation goes through a difficult period, the duties of the supervisory board are extended to change the board members' duties or to appoint or remove members of the management board. Furthermore, in order for the supervisory board to supervise the management of the corporation, German law provides for the free flow of information between the managing and supervisory boards. The management board must report to it periodically. [1191]

[1188] Ibid 159.

[1189] Ibid 160-61.

[1190] Charkham, above n 87, 14-26.

[1191] Du Plessis (1996), above n 104, 28-29.

However, it should be noted that the exact scope of duties of the supervisory board are uncertain. This is because it is uncertain whether and how the duties are defined in terms of the "interests of the corporation". [1192]

Although the worker representatives on the supervisory board influence the composition of the management board and decisions regarding governance of the company, the supervisory board does not influence

> the company's day-to-day life, the social climate, and especially the everyday problems of the workforce (including) appointments and dismissals, working hours and organisation, breaks, holidays, equipment and safety precautions, further training and promotion. All these questions … have nothing to do with the supervisory board; in these matters it has no powers at all. … These matters are the responsibility of the management who do not have to comply with the wishes of the supervisory board and its worker representatives. [1193]

3. The *Co-determination Act* of May 1976 provides for the *proportions of employee and shareholder representatives on the supervisory board*. It also requires that one director sitting on the management board shall be entrusted with labour matters.

   Du Plessis notes that there are four different systems in Germany, which appoint the members to the supervisory board. Firstly, in public companies, through the *Satzung*, all members of the supervisory board are appointed through the general meeting or in accordance with the provisions in the articles of association. In this case, employee participation is not mandatory. Secondly, through the *Das Statut*, one-third of the employees or their representatives are appointed to the supervisory board, whilst two-thirds are appointed by the general meeting or in accordance with the articles of incorporation. Thirdly, in other types of corporations, half of the members are appointed by employees or their representatives and the other half by the shareholders. The two groups appoint one neutral member jointly. Fourthly, in some companies, the employees or their representatives and the shareholders appoint an equal number of representatives. The chairperson must be elected from the group of persons appointed by the general meeting, whilst the employee representative must include a manager or executive employee. [1194]

[1192] Ibid 32-33.

[1193] Lutter, above n 108, 155.

[1194] Du Plessis (1996), above n 104, 23.

Thus, although the institutional basis for worker participation in German companies was only created in 1952 with the enactment of corporate co-determination legislation in the coal and steel industries (with the board reserving one-third of the seats for employees), by 1976, through the *Co-determination Act*, the law extended "equal employee representatives on the supervisory board to all of the largest companies in Germany irrespective of the industry sector". These companies have more than 500 workers. [1195] However, a new 2004 German Act on One Third Co-determination of the Employees on the Supervisory Board now prescribes that in some companies only one third of employee representatives can occupy the seats of supervisory boards. Shareholder representatives occupy two-thirds of the seats. [1196]

4. Shareholder and employee representatives on the supervisory board proceed with management by co-operation rather than by confrontation.

   In this way, the supervisory board has a duty to provide the management board with advice (*Beratung)*. Also, the supervisory board provides a good discussion forum for business issues because the board consists of employees and other people with considerable business experience. Therefore, the decisions of management can be tested against a group of individuals who come from very diverse and varied backgrounds. [1197]

5. There is a formal obligation to inform and consult and a system of extensive prior consultations. Employees have routine access to confidential information and, as members of the supervisory board, they must approve the accounts.

6. Trade unions have a high regard for the two-tier board structure and believe that representative employees are better informed.

7. A two-tier board system is to be preferred *"on grounds both of principle and of pragmatism"*. [1198] In principle, it provides a "clear division of function".

[1195] Blair & Roe, above n 1176, 167-8.

[1196] Du Plessis & Sandrock, above n 1179, 70.

[1197] Du Plessis (1996), above n 104, 31.

[1198] Charkham, above n 87, 15.

Pragmatically, the principle of co-determination would not work well in a unitary board system.

8. Most German industries are carried out by one of two types of incorporated companies, which are those companies with limited liability (GmbH or *Gesellschaft mit beschrankte Haftung*) and the share companies (AG or *Aktiengelleschaft*). The remaining companies, which do not fall into either of these two categories, are hybrids and families usually control them.

9. All AG's must have a management board. Additionally, all AG's must have a supervisory board whatever their size, but co-determination is not mandatory if the company has fewer than fifty employees. However, in smaller GmbH companies (with less than 500 employees) a managing director (*Geschaftsfuhrer*) is appointed, who may, regardless of the contractual rights therein, be dismissed at any time. Therefore, these companies are not required to have supervisory boards. In larger GmbH companies, the principle of co-determination applies and a supervisory tier must be established. This is so even in the case where there is only one shareholder. In this way, the number of employees would determine whether a supervisory board has to be formed or not. Shareholders would hold two-thirds of the available seats on the supervisory board, whilst the employees or unions would hold one-third of the seats. This would also apply to AG companies that have less than 2000 employees. In the case where an AG company has more than 2000 employees, half of the available seats would be held by employees/unions. The chairman of the supervisory committee is always a representative shareholder (except in the coal, iron and steel industries where the chairman is neutral) who has the right of two votes, which he or she cannot delegate, in the event of a deadlock. Both employees and the unions usually choose representative employees. One employee representative must be selected in each case from the salaried staff and from the executive staff.

10. Regarding the *Vorstand*,

> … it is a real decision-making body" (and) "… it is by law the engine of management and no one may instruct it to act in a way that is injurious to the business. [1199]

[1199] Ibid 19.

The functions of this board depend upon the nature and size of its business. The *Vorstand* is tasked with ensuring that the company finds business and promotes it. The managerial board and CEO are responsible for making the day-to-day decisions and must report to the supervisory board, which the CEO may neither join nor dominate. [1200]

Consequently, the management board is responsible for managing and directing the business of the corporation and for representing the corporation towards third parties. It must act in good faith towards the corporation.[1201] Statutory duties of care, skill and diligence are expected from the management board. These duties require the management board to manage "as decent and conscientious business leaders". Members of the management board who breach these statutory duties are liable as joint debtors towards the corporation for any damages or losses incurred. [1202]

Within the *Vorstand* the members may themselves elect their chairman or speaker (*Sprecher*), although there is no obligation upon them to do so. In the legislation, the chairman is not given any specific powers. Members of the *Vorstand* are expected to act as a team, rather than individually trying to achieve success. In this way, principles enshrining consensual approaches are widely endorsed within this type of framework. The success or failure of the company results, to a large extent, from the drive or lack of it of the *Sprecher*. It is therefore essential for a *Sprecher* to be elected to this position that will have enough stamina and drive to ensure success. However, when it comes to voting, "one person one vote" is applicable.

Appointment to the management board itself is the responsibility of the supervisory board and requires a two-thirds majority (except where a decision has not been reached in the first round of voting upon which time a simple majority of votes will suffice). Both the *Vorstand* and the *Aufsichtsrat* may bring about nominations. If the supervisory board does bring in external nominations and appoints them, the management board may not veto this. Additionally, a major shareholder on the supervisory board may exert such influence that power is shifted away from the management board. Members

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1200 MJ Roe, "Some differences in corporate structure in Germany, Japan and the United States", (1993) 102 *Yale Law Journal*, 1941.

1201 Du Plessis (1996), above n 104, 35.

1202 Ibid 36.

of the management board may be appointed on the board for a period of up to five years, which is the maximum period permitted by legislation. The supervisory board typically reviews management performance two to four times per year. [1203]

A member of the management board can be dismissed for reasons including "… gross breach of duty, inability to exercise proper management, or after the passing of a vote of no confidence by the general meeting. …" [1204] The contract to sit on the management board may be renewed provided only that this renewal takes place within six months before it expires. Only the supervisory board (and neither the management board itself nor the shareholders in a general meeting) can dismiss a member from the management board. Generally, however, if a member's performance is shaky or questionable, a deputy will be appointed by the management board to assist that member so that his or her contract over the time period in question can be fulfilled.

Thus, the supervisory board's right to appoint or remove members of the management board, is an exceptionally significant feature of the two-tier board system. This is regarded as one of the most important duties of the supervisory board. [1205]

The general meeting is the organ of the company where the members or shareholders can enforce their rights. It is also responsible for appointing the supervisory board members where the statutory provisions do not provide for their appointment by the employees. Thus, the number of supervisory members to be appointed by the general meeting will vary in accordance with the size of the corporation, the type and business operations of the corporation and in accordance with the provisions in the articles of incorporation. Sometimes, the general meeting may appoint all of the supervisory board members (referred to as the shareholders' representatives) where employee participation is not obligatory. In other cases, the general meeting may appoint one-third or half the number of supervisory board members. Generally, these members can be removed by a three-quarters

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[1203] Roe, above n 1200, 1941.

[1204] Charkham, above n 87, 21.

[1205] Du Plessis (1996), above n 104, 25.

majority of the general meeting. [1206] Furthermore, it has been the subject of much debate as to whether there should be a "tightening up of the legal consequences" for members of the supervisory board, especially where they have breached or have failed to carry out their duties properly. Currently, supervisory board members do not become personally liable where they perform their duties in a careful manner and to the best of their abilities. This general duty of care requires that each supervisory board member must have "the minimum standard of knowledge and competence" in order to understand matters arising in the normal course of business. [1207]

11. Board remuneration is not as important to Germans as it is in other countries, such as the US or UK. Germans see profit as being important, but not the only aspect to consider when making decisions. Thus, there are virtually no stock options for tax reasons and pay is not tied to profits. Directors would receive about 65 percent of their income as a basic salary. The balance would be comprised of annual bonuses and other company benefits. The "Sprecher" receives about 30-50 percent more than his colleagues, whilst the chairman receives about 200 percent and the vice-chairman about 150 percent of their colleagues' remuneration.

    The supervisory board is responsible for determining the total sum of remuneration of the members of the management board. The supervisory board needs to ensure that the remuneration is reasonable and proportionate in regard to the functions of each of the members, the position of the company and of the undertaking involved. This is aimed at protecting the shareholders, the creditors and the corporation from excessive remuneration. If excessive remuneration has been made to the management board, members of the supervisory board will be liable on the basis of a breach of fiduciary duty. [1208]

12. The functions of the *Aufsichtsrat* are covered by legislation. Charkham notes on page 22 that this includes overseeing "the company's accounts (annual profit and loss and balance sheet statements) for a specified period (usually quarterly), major capital expenditure and strategic acquisitions; closures;

[1206] Ibid 39.

[1207] Shearman, above n 453, 124.

[1208] Du Plessis (1996), above n 104, 27.

appointments to the Vorstand; approving the dividend". [1209] Its functions are therefore strategic in nature. The articles of the company usually extend this list further. The supervisory boards ensure that the standards in the corporation are not only established, but maintained as well. In this way, *"(t)he Vorstand proposes, the Aufsichtsrat disposes".* [1210] Consequently, the main function of the supervisory board is to ensure that the management board acts competently through a framework of consensus. The supervisory board may also establish committees to deal with matters requiring "a technical understanding", which have been put forward to it by the management board. [1211] Additionally, the supervisory board may appoint inspectors, who would report back directly to it.

13. The question of employee representation on the supervisory board is highly significant. Although their power is somewhat limited by the casting vote of the chairman and the general meeting of shareholders, employee members can use their position to bargain. In this way, employees may threaten not to vote for a particular member to be elected onto the management board (which usually spells out an end to that management nomination).

    Thus, if a dispute divides the board equally between labour and the shareholders, the chairperson of the supervisory board, who is always elected by the shareholders, would have the casting vote to cast a second vote to break the deadlock. In practice, this means that the decisions of the shareholder representatives would prevail over those of the labour representatives. [1212]

14. The works councils play an interesting and important part in the decision-making processes of the supervisory boards. In many cases, the works councils first discuss complex matters before they reach the supervisory boards. In this way, many of the types of difficulties, which may arise in a situation, are ironed out before they reach the supervisory boards. This facilitates the easier conclusion of agreements, although this may not always be necessarily assured.

[1209] Charkham, above n 87, 22.

[1210] Ibid.

[1211] Ibid.

[1212] Andre, above n 94, 1827.

15. The supervisory board may delegate some matters, which are given to it by the management board, to appointed committees to investigate matters of concern on a more thorough basis. The reasons for them deciding to take a closer view of some matters are threefold. Firstly, their personal reputation may be at stake. Secondly, in terms of the legislation, if they neglect their duties, they may be held personally liable for any losses or damages suffered. Thirdly, the members of the supervisory board may have an interest in the company, through shareholdings or loans or something else, and, therefore, the survival of the business would be of cardinal importance to them.

16. In practice, the members of the supervisory board ratify the chairman's proposals. Such proposals should have been formed usually after consultation with members of the supervisory board and with the *Sprecher* of the management board. Sometimes, the chairman may also consult with interested outsiders.

17. Members of the supervisory board (except the employee representatives) are appointed by the general meeting of shareholders. They are appointed for four years, but generally serve for five. Casted votes, in the amount of seventy five per cent, are required to remove a member from the supervisory board before the period of appointment has been completed.

18. Many companies are very large and are run by the founding families, who sit on both boards. Very often the most influential members sit on the supervisory boards, although German law expressly disallows an *Aufsichtsrat* to run a company. Thus, the supervisory board, in this way, would give orders either to the *Vorstand* or the *Geschaftsfuhrer*, despite the fact that in law the *Vorstand* is obliged to act independently. With such a power over the members, the *Vorstand* is in a "weak position". [1213]

19. Many of the top 100 German companies have sent members of the management boards to sit on the supervisory boards, and visa versa. This indicates the personal connections between the two boards that large companies support. These companies usually have link-ups with outsiders as well. The whole aim is to promote a consensual, rather than a confrontational approach, to business relations and management.

[1213] Charkham, above n 87, 25.

20. In addition to the supervisory and management boards, the supervisory boards may set up other relationships by establishing small committees, or *Praesidial* committees, which may or may not consist of employee representatives. It usually consists of the chairman and vice-chairman of the supervisory board and the chairman of the works council together with about three other people. This committee considers difficult issues and attempts to iron out problems before formally reaching the supervisory board members for deliberations. The *Praesidial* committee may oblige members of the management board to appear before it. Thus, links exist, not only between the two boards, but also between the supervisory board, the works councils and the established *Praesidial* committees.

21. Regarding the question of partnerships, legislation governing work councils do apply, but not legislation, which govern the boards. As such, there is no formal supervisory tier and therefore no employee representatives.

German legislation enshrines the principle of "commercial prudence" in accounting procedures, rather than the principle of having to show a "true and fair view", which is found in other accounting systems. [1214] In this way, accounting reserves for risks are made. Consequently, profits are reduced, but reserves are maintained in case the company experiences financial difficulties at some stage. Employees have a direct role in approving the reserves, as they sit on supervisory boards and work councils in the process of assuring their continued employment. This has a positive effect on all stakeholders. Although the profits are reduced, "commercial prudence" ensures that the business survives. This principle is more important to German companies than any of the reasons attempting to maximise shareholder wealth and company profits.

Thus, as Charkham notes,

> the whole atmosphere … is one in which the stock market is far less at the centre of the stage. [1215]

(8.2.1.1) What Role do the German Banks Play in Administering Corporate Governance Initiatives?

[1214] Ibid 31-32.

[1215] Ibid 35.

German banks have benefited from the success of the German two-tier board system of corporations. [1216]

1. Germany has approximately 4500 banks, 3000 of which are regional or people's banks. The balance is made up of public sector savings banks. Many of the banks are fairly small.

   Some German banks have very high "stakes" in German public companies. They are also represented on the board of most large German public companies.[1217] Historically, three powerful German banks, referred to the *Grossbanken*, have been more involved in the corporate governance processes of German companies than any other German banks. Each bank is an AG (*Aktiengelleschaft)* or share company and is a publicly traded "universal bank". The *Grossbanken* are the Deutsche Bank, Dresdner Bank and Commerzbank. The Deutsche Bank is the "godfather" of corporate Germany and is the dominant player in Germany. The other two *Grossbanken* together do not have the same amount of power as the Deutsche Bank. [1218] For example, in 1988, the nine largest German Banks held seats on the supervisory boards of 94% of the largest German firms. [1219] Furthermore, from a comparative perspective, the three largest German banks have assets amounting to 36% of the German gross national product (GNP), whilst the three largest US banks have assets equivalent to only 7% of the GNP. Thus, German banks are approximately "five times "stronger" than the largest American banks". Consequently, the largest German financial institutions have a much larger role in their economy than the largest institutions in the US economy. [1220]

2. The approach of banks towards its clients is based upon 'relationship' and not 'transaction' banking. Therefore, when a client decides upon a particular bank, there is an implied belief between the parties that the relationship will be a long and enduring one. Thus, *"what the banks provide is a cross between counselling and management consultancy".* [1221]

[1216] Ibid 35-55.

[1217] Andre, above n 94, 1834.

[1218] Ibid 1835.

[1219] Ibid 1837.

[1220] Roe, above n 1200, 1946.

[1221] Charkham, above n 87, 36.

3. German banks have become substantial shareholders in non-bank companies, although they do not, as a matter of policy, plan to acquire shares in its clients' companies. However, except in those few cases where a bank has attained a major shareholding, it is not likely that its own shareholding would significantly impact upon matters of corporate governance. Nonetheless, banks may acquire effective control of a large number of shares, which they do not own. This is through a system in Germany of deposited share voting rights or DSVR. More specifically, German shareholders lodge their share certificates with banks, which, by law, inform their clients on voting procedures. A proxy form, valid for a period of fifteen months, is sent with this information to clients. Since most issues are not controversial, most shareholders simply allow the banks to vote on their behalf, as the banks deem fit. In this way, banks may impact upon matters pertaining to corporate governance, as they would have sufficient votes to sustain this. Furthermore, if banks choose to act in concert, their cumulative voting power may become very effective on supervisory boards.

4. Banks in Germany are commonly represented on supervisory boards. In this way, companies acquire access to information, which they ordinarily may not have. In some cases, the banker may even become the chairman of the supervisory board. Therefore,

> (c)ompanies are glad to have them and they are generally glad to serve. The company benefits from their considerable personal skills and experience, the intelligence network they can tap, and their contacts. The banks gain by cementing the relationship with the company, by adding to their sources of information … (and) the money, which generally they keep. [1222]

5. German banks are in a strong position to provide the supervisory boards of companies with the latest and most up to date information. Many companies, having faced difficult times, depend on the support of banks on the supervisory boards for their survival. Consequently, "the banks very often have the knowledge, motivation and authority to exert influence on company management". [1223]

(8.2.1.2) Does the German Two-tier Board System, Consisting of Supervisory and Management Boards, Really Work in Practice?

Beuthin notes,

[1222] Ibid 42.

[1223] Ibid 43.

> Among those who favour some form of internal machinery to protect … employees, there are those who have pointed with approval to … the German, experience. The framework and structure of our company law, they maintain, has proved itself singularly ill-equipped to protect the interests even of the shareholders, and some fundamental changes will have to be made (in) protecting … those groups, which have never before in any way been the concern of company law. The solution … lies in the lessons to be learnt from the German system. … The division of responsibilities (between the management and supervisory boards) … is said to be the key factor, which avoids a danger, which is so inherent in the unified board system to which are accustomed, and in which active direction and control is vested in the board of directors. [1224]

This affirms that the German two-tier board structure does work very well in practice. Reasons for this are: [1225]

1. The *Vorstand* is accountable to the *Aufsichtsrat* legally. By having employee representatives and bankers on the supervisory boards improves the effectiveness of the system as a whole.

2. Whereas in the USA and UK the chairman or CEO is responsible for the flow of information, in Germany, however, works councils are responsible for this function. In this way, employee representatives receive information directly. Information from external sources will also be received via the bankers that sit as representative shareholders on the supervisory boards. Thus, where work councils are weak or where there are no bankers on the supervisory boards, the effectiveness or otherwise of the supervisory board will depend primarily upon its members, especially its chairperson.

3. Banks play a large part in the everyday running of the corporation in Germany. They do this not only by providing corporations with borrowing facilities, but also by sitting on supervisory boards, gaining additional proxy voting power and by being in a position where they are able to provide corporations with daily up to date information. In many situations, banks have influence rather than power. Consequently,

   > … the influence of the banks rests primarily on their relationship with individual companies, and partly on the interlocking relationships across the whole industrial financial spectrum which, taken together, produce a massive flow of intelligence. The power of banks rests on

[1224] RC Beuthin, above n 533, 155.

[1225] Charkham, above n 87, 44-56.

> DSVR and only secondarily on their shareholdings. And … influence is more important than power. [1226]

4. Many supervisory boards will receive information from various sources, including the management board. An effective supervisory board will ensure that the management board provides information to it regularly. It will also ensure that it provides its supervisory board with sufficient information to keep it well informed. In this way, information moves around the corporation in such a way that its boards remain fully informed. Therefore,

> … it is not true … to say that (the Aufsichtsrat) are only supervisors and do not contribute. In smaller companies the articles may prescribe a wider range of subjects in which the Aufsichtsrat must be consulted. [1227]

5. Primarily, the success or otherwise of a corporation will depend upon the strengths and effectiveness of the chairpersons in both the management and supervisory boards. Thus, *"if there is a poor Vorstand and a weak Aufsichtsrat a company will flounder"*; [1228]

6. In some situations the effectiveness of the two-tier system has been criticised. It is argued that employees on the supervisory board and the management board may sometimes work together through trade-offs and compromises, which may become disadvantageous to shareholders. Secondly, for political reasons, a supervisory board may not have any control over the management board. This is so where it is considered impolite for supervisory members to criticise management in front of works councillors (labour representatives sitting at the same table), as managers need to be seen to retain their full authority. Thirdly, it is argued that in some large companies, the management board may invite friends and colleagues to sit on the supervisory board. In this way, the managers are not controlled.

7. Supervisory boards have the power to appoint or dismiss. Generally, if the *Vorstand*, is not performing well, the *Aufsichtsrat* may give them another opportunity to improve. Sometimes, it may only be one or two members of the management board that are performing badly. The management board has the opportunity to remedy the situation by appointing a deputy to assist

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[1226] Ibid 54.

[1227] Ibid 45.

[1228] Ibid.

that member so that his or her contract over the time period in question can be completed. Thus, the *Aufsichtsrat* will generally only intervene if the management board is slow in acting in remedying its poor performance levels. In this way, supervisory boards may give members of the management boards the opportunity to renew their appointments even more than once until there is unequivocal evidence that the member's performance is no longer in the interests of the corporation.

8. It is not unusual for the *Sprecher*, on his or her retirement from the management board, to join the supervisory board as a member, or even as its chairman. At the same time, he or she may also have a role in recruiting the new chairman, his successor, to the management board. In this way, his or her control of the corporation will be further assured.

9. Banks and employee/unions have a significant role in making the supervisory tier function adequately. The system depends heavily on networks and only function effectively because co-operation is central to this concept. This factor has provided German industry with its success over the last forty years. The combination of factors, in particular, the availability of a well-motivated and trained workforce, technical competence, stable macro-economic climate and an effective governance system has enabled the German industry to prosper.

10. A two-tier board system has a clear division of functions, whereas some members of the unitary board system may be responsible for overseeing supervisory functions. This can give rise to conflicts of interest, as everyone in a unitary board has the same legal duties. Therefore, the Germans prefer their current two-tier board system. In this way,

> the test of any system is how good it is at accommodating individual idiosyncrasies: … (B)ecause of the basic German approach … the country has … managed to live with a rising currency. … (T)he German view of the purpose of companies gives shareholders an interest and a role, but not such a pronounced one as in the UK and USA. They are important, but further down the pecking order. [1229]

11. Over the years, supervisory boards have shifted towards the ideology that they should be advising and counselling the management boards rather than confronting them. In this monitoring manner, the focus is on mistakes being prevented rather than being detected. Thus, in Germany, co-operation rather

[1229] Ibid 49.

than confrontation, is significant. This is demonstrated in the relationships between sections of the German economy, including proprietors, management, employees, the financial sector, government and academia.

12. Germany has long been supportive of the EC (European Communion) Fifth Directive, which seeks to harmonise company structure within Europe and to introduce the principle of co-determination, which they believe is socially desirable and economically beneficial.

13. Certain changes to the German law of corporate governance came into effect on 19 July 2002 upon the recommendations of the Cromme Commission. These reforms related to public corporations and to aspects pertaining to accounting, transparency and disclosure. The rights and responsibilities of supervisory boards were expanded. The supervisory board can now request that the management board reports it in the event that deviations exist in the agreed business plans during the financial year. [1230]

A Code of Best Practice, the official German Code, came into effect on 26 February 2002. [1231] The Code states that it aims are to make German corporate governance more "transparent and understandable" and to promote trust amongst investors (national and international), customers, employees and the public regarding the management and supervision of listed companies. [1232] The Code has three functions, which include giving companies suggestions for good and responsible corporate governance, providing recommendations reflecting nationally and internationally recognised standards and summarising the main statutory requirements governing publicly listed companies. [1233]

The main aims of the Code were to improve corporate governance practices with respect to the management and direction of listed corporations. This code was only applicable to listed corporations and was not mandatory. However, listed companies still needed to explain if they decided not to follow certain recommendations of the Code. This is referred to as the "comply or explain" principle, which was previously adopted in the UK, and was statutorily introduced through section 161 of the *Aktiengesetz (AktG)*. Thus, supervisory boards are now under a new statutory duty

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[1230] Du Plessis (2003), above n 158, 388.

[1231] H-C Hirt, "The German corporate governance code: Co-determination and corporate governance reforms" (2002) 23 *The Company Lawyer*, 349.

[1232] Ibid 350.

[1233] Ibid 351.

to either comply with the German Code or to explain why they are not doing so. [1234] This duty applies to three main groups of people: the supervisory and management boards (including individual members) and the corporation's auditors. [1235] Most of the provisions in the Code deal with the role of the supervisory board and the relationship governing their relationship with the management board.[1236]

There are three types of provisions in the code. The first provision uses the word "shall" or *soll*. These provisions apply the principles of "comply or explain". The second provision uses the word "should" or *sollte* or "can" or *kann*. These provisions are not the main ones, but are considered to be good corporate governance principles to follow. No explanations are required in this case if corporations decide not to follow them. All the rest of the provisions in the Code simply confirm in a "general and user-friendly way" the existing legal requirements under the current German law, which relate to public corporations. [1237]

The advantages of this model include the provision of a quick and effective response to the changing needs of business, which could not be achieved if corporate governance was formalised through legislation. [1238]

Hirt, however, submits that the wording of section 161 suggests that, where a company has not complied with the recommendations of the Code, it need only state which recommendations were not complied with. Thus, it need not give any reasons for such non-compliance. This is because such explanation is usually contained within the annual report. However, because of public pressure and the expectations of the capital markets, in practice, the management and supervisory boards will be required to explain any such non-compliance. [1239]

The Code also deals with employee representation. Thus, as explained above, companies with more than 500 employees must have employee representation on the supervisory board. If a company has more than 500 employees, the supervisory board must be composed of one-third employee representatives. If a company has more than 2000 employees, the supervisory board must consist of 50% employee

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[1234] Du Plessis (2003), above n 158, 390. See also du Plessis, "The German two-tier board and the German corporate governance code", (2004) 15 *European Business Law Review*, 1142.

[1235] Du Plessis (2003), above n 158, 393.

[1236] Du Plessis (2004), above n 1234, 1145.

[1237] Ibid 1144. See also du Plessis (2003), above n 158, 392; and Hirt (2002), above n 1231, 351.

[1238] Du Plessis (2004), above n 1234, 1143.

[1239] Hirt (2002), above n 1231, 350.

representatives. Thus, if half the members of the supervisory board are employee representatives, this is called quasi-parity co-determination. [1240] Recently, however,

> (a) new 2004 German Act on One Third Co-determination of the Employees on the Supervisory Board now prescribes that only one third of employee representatives can occupy the seats of supervisory boards. Shareholder representatives occupy two-thirds of the seats. Thus, there is no parity-co-determination in these corporations. [1241]

Thus, supervisory co-determination is complicated, as different forms exist, namely quasi-parity and one-third co-determination. To determine which system of supervisory co-determination applies it is necessary to consider *inter alia* the type of corporation and the requisite industry it is involved in and also the stated share capital and number of employees. [1242] Codetermination has not been portrayed as a significant issue under the German Code. [1243]

> On 21 May 2003, the Cromme Commission amended the original Code with respect to the remuneration of the members of the management board, particularly in so far as to ensure that the supervisory board conducts a regular review of this remuneration. [1244]

The legal nature of the German Code is uncertain. It has been suggested that the Code is neither an Act of Parliament nor a contractual agreement binding the various parties to it. [1245] However, both the UK and German Codes are mandatory in the sense that they both require compliance with the principles or recommendations of the respective corporate governance codes. As mentioned previously, in the UK, corporate governance codes are well established. The Combined Code, which is annexed to the Listing Rules issued by the UK Listing Authority and based on the recommendations of the Cadbury, Greenbury, Hampel and Higgs Committees, sets out the current principles of good governance (see heading 2.5). [1246] In Germany there is a statutory duty on both the supervisory and management boards to state that that there was compliance with the Code or to explain non-compliance. [1247]

1240 Ibid 352.

1241 Du Plessis and Sandrock, above n 1179, 70.

1242 Ibid 71.

1243 Du Plessis (2004), above n 1234, 1160.

1244 Du Plessis (2003), above n 158, 391.

1245 Du Plessis (2004), above n 1234, 1159.

1246 Hirt (2002), above n 1231, 353.

1247 Du Plessis (2004), above n 1234, 1163.

Thus, these changes to the German law, relating to public corporations, extended the rights and duties of the supervisory board and strengthened its role in fulfilling its functions to the shareholders, creditors and employees. It also ensured that good corporate practices operated within Germany and introduced into legislation modern corporate governance practices. It also allows the German Code to respond speedily to changing business needs. [1248]

Consequently, because of these "remarkable developments" any "criticism aimed at the German two-tier board system as recently as 1997 could nowadays be discarded". [1249]

A further discussion of the major features of the German corporate governance system will be given when a new model of corporate governance for South Africa is proposed later in this thesis. However, du Plessis sums up the position when he notes,

> (i)t should … always be kept in mind that there are many checks and balances built into the German two-tier system. Viewed in its entirety, the two-tier system has proved to be meaningful in Germany.[1250] … Even those who criticise the effectiveness of these institutions, do acknowledge the merits of the two-tier system. They do indeed emphasise the very important advisory role of the supervisory boards in many medium-and small-sized corporations. It is also stressed that supervisory boards play a useful role when competent people are elected to serve on them and when they are dealing with their task in an efficient way. [1251]

Furthermore, there are three "practical" reasons why Germany would find it difficult to move away from co-determination and the two-tier board system. Firstly, employee representatives serving on supervisory boards and the employees themselves would most likely counter any move towards this type of change. Secondly, trade unions would most likely be unwilling to lose their rights of determination and therefore their ability to nominate representatives to the supervisory board. Thirdly, it would be "political suicide" for a government to abolish co-determination or the two-tier board system. [1252] Consequently, it is most likely that the two-tier board system and co-determination will remain fixed in German law and culture. Thus,

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[1248] Du Plessis (2003), above n 158, 393-4.

[1249] Ibid 394.

[1250] Du Plessis (1996), above n 104, 41.

[1251] Ibid 44.

[1252] Du Plessis and Sandrock (2005), above n 1179, 76-77.

> … there is little or no chance that Germany … would forfeit … the two-tier board system … in favour of a unitary board system. There is still too much evidence, even from academic circles, that the two-tier board system is considered to be the preferred corporate governance model for Germany. It is also unlikely that German corporations will readily agree to substitute their two-tier board structure … for a one-tier board structure. … [1253]

It is also well established in the European Union that if a company is incorporated in one country, but conducts its business affairs in that of another, this other country in which the company is conducting its business affairs, cannot enforce its own law relating to codetermination. Thus, it would be possible for a German corporation to avoid codetermination by incorporating in another country, but still conducting its business affairs in Germany. [1254] This may provide some serious challenges to the German two-tier board and co-determination system in the future. [1255] However, the German two-tier board and co-determination system has developed remarkably well due to the recent amendments to the legislation and the creation of the German Corporate Governance Code. Thus, commentators believe

> that the German legislature's dedication to improving the way in which German corporations are directed and supervised has, at least for the moment, come to an end. [1256]

(8.2.2) Japan

Key features of the Japanese corporate governance system will be discussed, which would be advantageous in contributing to the formation of a new model of corporate governance for South Africa. A new model of corporate governance for South Africa would improve the unitary board system currently in existence.

There are very important cultural differences in Japan compared to many other countries. This factor markedly affects the manner in which corporate governance is applied in Japan. [1257] The unique features of this system are significant and are useful in contributing to the formulation of an improved system of corporate governance in South Africa. The unique Japanese features include: [1258]

[1253] Ibid 78.

[1254] O Sandrock & JJ du Plessis, "The German corporate governance model in the wake of company law harmonisation in the European Union", (2005) 26(3) *Company Lawyer*, 90.

[1255] Ibid 91.

[1256] Ibid 93.

[1257] Charkham, above n 87, 70-118.

[1258] Ibid.

1. The three concepts of *obligation, family and consensus* affect the application of corporate governance principles in Japan. Obligation arises from "specific causes", including the obligation to do one's duties and to offer service where this may be appropriate. As part of a family, one is obligated to serve in the family company, which "… envelopes one's life to an unusual degree". [1259] Consensus is very important to the Japanese and hence they would rather conduct their affairs by way of agreements between the parties than in an authoritarian and dictatorial manner. Arguably, to some extent, all organisations have to work in a collegiate manner. However, it is much more the norm in Japan and thus much more emphasised. Thus, Japanese corporations prefer a collegial approach based upon the principles of consensus rather than a confrontational approach.

2. Because Japan bases its market economy upon the *family* concept, the Japanese system has been described as one of "community logic" rather than the US/UK system of "market logic". [1260] That is, whereas in the US the markets generally operate freely and the state has been responsible for handling the social consequences thereof, in Japan, it is preferable for the corporation itself to prevent any tears in the social fabric. Thus, in Japan, the government will generally *only* intervene to mitigate the effects of any unavoidable changes.

3. The UK/US "market logic" system is geared around the stock market and the maximisation of profits for investors and for the corporation itself. The Japanese system, however, recognises that the business family is *not* there simply to make a profit. Profit is important to Japanese companies otherwise they would not survive, invest and grow. However, the goals are *"often expressed in terms of market share rather than profit".* [1261] Therefore, for Japanese companies, having greater power is more important than making greater profits. Japanese companies attach, in this way, a greater amount of emphasis on their *ranking* in the Japanese corporate world, as a measure of their corporate success. Thus, for the Japanese, although profit is important, the *long-term preservation and prosperity of the family* are the main goals rather than the maximisation of profits for shareholder.

[1259] Ibid 71.

[1260] Ibid 72.

[1261] Ibid 73.

4. There are *three* types of companies in Japan - the commercial partnerships, limited partnerships and limited companies (termed the "Kabushiki Kaisha").[1262] Those businesses in Japan that wish to have the benefit of limited liability with a public subscription for their shares, must register as *Kabushiki Kaisha*. These companies must have a minimum of three directors, who are elected by the shareholders. Most Japanese companies have more directors than the minimum required. The "symbolic role" of the bank is significant in providing "vision and values in leadership to the members of the organisation". [1263]

   These limited companies often form groups of companies, which consist of two types (termed "Keiretsu" or "association"). [1264] The term "keiretsu" (or kairetsu) describes the "grouping or cross-shareholdings into which the company fits". Many of the shareholding institutions are the banks, which provide substantial loans to the company. The company is also a "social unit", which unifies management and labour. The managers, having risen through the ranks, are also (together with the shareholders) representatives of the employees. [1265]

   These groups are either classified as vertical or horizontal "Keiretsu". With horizontal "Keiretsu" groups, companies with dissimilar industries, which are in different markets, usually group together, often with banks at the centre that have encouraged the formation of groups of this kind. On the other hand, companies in a vertical "Keiretsu" group "… produce a more efficient production-distribution change for a particular range … of products". [1266] In this way, subcontractors supply the main manufacturer, which develops into a long-term relationship. Consequently, "… the purchaser nurtures the supplier".

   It can be said that the ownership of Japanese large firms is almost "analogous" to that of German corporations. Hence, the "Keiretsu" may even aggregate in order to own 50% of each other's stock. Japanese corporations have had, over the last twenty-five years, a "persistent pattern of

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[1262] Ibid.

[1263] Kendall & Kendall, above n 102, 59-60.

[1264] Charkham, above n 87, 73.

[1265] Kendall & Kendall, above n 102, 60.

[1266] Charkham, above n 87, 77.

concentrated ownership". Furthermore, the largest Japanese banks own large stocks in the Keiretsu's industrial firms, which, in turn, own stocks in these banks. [1267] Thus, an important "difference in corporate ownership structure" is the existence of "concentrated voting blocks" in German and Japanese corporations and the absence of these in American corporations. [1268]

5. Japanese Annual General Meetings have *two* essential functions - the appointment of directors to the board and the approval of dividends. Company directors need not be shareholders and there must be at least three directors who cannot be appointed for a period of more than two years, irrespective of their level in the corporation. Reappointment is, however, possible, and, in some cases, occurs until the age of retirement. Presidents and chairpersons very often decide their own retiring ages. Directors must be appointed at the general meeting of shareholders and require the support of one third of the shareholders to be elected onto the board. The board of directors decide the manner in which the affairs of the company will be administered and also supervise the actual execution of the duties of directors. Boards must meet at least quarterly, but many meet on a monthly basis. The board of directors consists almost exclusively of insiders, that is, full-time employees of the company. However, sometimes, part-time executives sit on the board of directors as well.

6. In smaller companies, the boards of directors are often involved in the decision-making processes of the corporation. Thus, they act as the board of directors *and* also as the top management committee of the corporation. In larger companies, however, there is a split between the board and the top management committee (termed the "Jomukai"), each facet of which holds separate and distinguishable roles in the administration of the corporation. The top management committee, which controls the company, will consist of the president and the main directors. Therefore, the duties of the lower board are mainly ceremonial, except in emergency situations or in those situations where the board is specifically requested to take part in those matters, which concern questions of legal liability. Otherwise, the board simply places a rubber stamp on those proposals that they were consulted on earlier.

[1267] Roe, above n 1200, 1939.

[1268] Ibid 1941.

7. Promotion from the lowest rank of director to the highest rank of president (or chairman) of the corporation usually occurs from within the company. Thus, many members of the board may be in a direct line relationship to others for promotion. Promotion depends, therefore, to a large extent, upon the president of the corporation who selects the directors through a process of nomination or after consultation with other colleagues. The president of a Japanese corporation is usually the 'representative' director. He or she is the most significant person in the determination of strategy and in ensuring that the corporation is being run well. It is very difficult to have an incompetent president of a corporation removed from office if he or she does not wish to stand down. The president will usually be left to complete the term of office, as *"only God removes a president"* of a corporation in Japan. [1269] Alternatively, a chairperson may resign so that the president may take up this position. Notwithstanding this and in any event, the chairperson appointed is usually a former president of the corporation and the president will be seen as "stepping down to the chairmanship". [1270] In this way, the selection of the board and of the top management team is regarded as a purely internal matter. Hence, no outsiders are consulted, although a select few may be advised as a matter of courtesy on the outcome of those directors appointed to the board or to the top management team. Sometimes, the roles of the chairperson and president may be combined. If not, the role of the chairperson is usually that of an elder statesman who is the face of the company performing ceremonial duties at official functions. In some corporations, however, the chairperson may have more power than this, especially if he or she is slow to hand over the presidential reigns. Additionally, the president remains the official nominee of the chairperson, the removal of whom can always be orchestrated by the chairperson. Advisers may also be appointed. They may have purely honorarium roles or may be appointed to give advice to directors on specific issues. They may be insiders of the corporation or outsiders usually from the government or from the banks.

8. In many large Japanese companies, the general rule is "lifetime employment". It is evident the importance, which Japanese companies attach to their personnel. One slogan read, *"(b)efore we build products we build people".* [1271] In this way, Japanese chief executives believe that it is their *responsibility* to

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[1269] Charkham, above n 87, 90.

[1270] Ibid 91.

[1271] Ibid 89.

look after and to take under their wings the junior members of the board. This is regarded by Japanese society as an honourable thing to do.

9. The processes of decision-making within Japanese corporations vary in accordance with the subject matter, structure of the company and management systems. Thus, matters that are important to warrant formal board approval will be subject to consultation with all relevant parties of the business to allow senior management to be "in touch with the mood of the company". [1272] Thus, decision-making in Japanese companies usually consist of a powerful chief executive (the president), the chairman, the executive management of the board and the rest of the company's executive management who are not on the board.

10. Presidents of corporations in Japan do not receive remuneration in excess of sixteen times that of an average industrial worker. This is *markedly different* from the remuneration that a UK or US CEO earns, which can sometimes be in the order of 125 to 160 times more than the earnings of an average employee of the company. Additionally, Japanese directors do not receive share options and the top rate of personal taxes in 1992 was pegged at 65 percent.

11. The shareholders appoint statutory auditors or "Kansayaku". These auditors should be differentiated from the external auditors (accountants) and the internal auditors (appointed by management) who are also appointed. Statutory auditors have a very interesting and useful role. They keep the activities of the directors in check to ensure that they act legally and in accordance with the regulations of the company. They also ensure that directors act "… in the best interest of the shareholders". [1273] Thus, the statutory auditors continually monitor the activities of the corporation and will timely advise the directors of any problems they encounter. The main purpose of the statutory auditors is to prevent the company from being sued by any activities that may cause this. The Kansayakus' office is for a period of two years.

12. Banks in Japan are relationship rather than transaction driven towards clients. Usually, companies have a "main" bank, which has the greater portion of the corporation's business. "Main" banks usually have to take the lead by reducing

[1272] Ibid 94.

[1273] Ibid 92.

its lending rates and bank charges to its clients. This relationship with corporation clients is viewed as a long-term initiative. In this way, the Japanese banks are a ready and useful source of up to date information to corporations. A newly established company may well have frequent visits from the banking officials to encourage the success of the corporation. Thus, the *role* of the banks depends upon on a particular customer. With an established and prosperous major company the bank's role will be minimal. Generally, the "main" banks would try everything possible to ensure the success of the corporations, which are their clients. If the corporations fail, this may severely tarnish the reputation of the "main" banks concerned. Additionally, in times of trouble, banks may assume great responsibility for a company and its employees. In this way, unlike in the case with the German banks, Japanese banks intentionally acquire shareholdings to secure their relationships with their clients and to be able to "strengthen" their influence if the corporation fell on difficult times.

13. Compared to the USA, the UK, France and Germany, it is thought that Japanese banks have the greatest ownership of shareholdings in corporations. Charkham indicates that, during the period 1988 to 1990, ownership of "common stock", which is reflected as a percentage of the total outstanding common shares, differed markedly between these five countries. [1274] These percentages are 0.5 (USA), 0.0 (UK), 3.5 (France), 8.1 (Germany) and 25.2 (Japan). 'Common stock' is defined by each country as:

    A USA and UK: total market values of the securities quoted on the Stock Exchange.

    B Germany: total par values of listed and unlisted companies.

    C France: total market values of the securities of listed and unlisted companies.

    D Japan: total par values of the securities quoted on the Stock Exchange.

However, since the definition of "common stock" is *not* standard in meaning amongst the five countries, it would have been preferable to have compared the market/par values of *only* the *listed* companies on the one hand, and of *only* the *unlisted* companies on the other. In this way, the percentages of shares held by the banks in listed and unlisted companies for each country would have been separately reflected and analysed. This would have been

[1274] Ibid 105.

more meaningful in determining the extent to which Japanese banks had a greater ownership of shareholdings than in the other countries in regard to listed and unlisted corporations. In any event, the issue is that the "main" banks take responsibility with the other banks in ensuring the survival of corporations. This may even occur when the "main" bank negotiates a merger with another Japanese, or sometimes foreign company to prevent the demise of a company, which may be ailing.

14. Shareholders in Japanese companies seldom interfere or are confrontational with management. These shareholders are stable. They are inclined towards assessing the performance of management on a long-term basis. This is so unless management makes a serious mistake or is negligent in their management of the corporation. If there is clear evidence of a problem, which management is unable or unwilling to consider, the 'stable' shareholders may then play their part in remedial action, as this would raise questions about the management of the company. Japanese management always considers its employees and customers before its shareholders. Furthermore,

> (a)s the shareholders have handcuffed themselves, this seems quite logical … the shareholders have to be very roughly treated before they assert themselves. [1275]

Japanese companies have tended to place the 'family' first. The Japanese believe, and are arguably correct, that since employees may devote practically their whole life to a particular corporation, it makes sense morally to give them a bigger stake in the business than that of the shareholders. Therefore, what has made Japan so different is the fact that, outside the company, the interested parties, banks and shareholders, share the company's view that the shareholders' interest does not have to be satisfied by a growing dividend stream. Thus,

> … (s)hareholders' interests, in other words, may be pushed to the back of the queue, but cannot be wholly neglected. … (Thus) (t)he Japanese feeling about the company as a family (is one) … in which shareholders are 'poor relations'. [1276]

15. Unions in Japan form not around trade delineations, but around the enterprise itself. That is, each corporation may have its union. Confrontations between unions and management are infrequent. Both sides contribute towards better

[1275] Ibid 109.

[1276] Ibid 116.

communication. Thus, in this way, with labour receiving better education and training and understanding the needs of management, management simultaneously co-operates in ensuring that its employees adequately comprehend its policies. Furthermore,

> (t)here is as a result greater unity of purpose … leaders of unions sometimes find themselves appointed to the board on retirement. [1277]

Consequently, although unions have their members' interests at heart, they are also concerned with the *survival* of the corporation.

Thus, in summary, the most notable features of the Japanese corporate governance system include: [1278]

1. Powerful government intervention, which is dominated by the Japanese Ministry of Finance;
2. Systemic patterns of cross-shareholdings of corporations, which include customers and suppliers. Often, a dominant shareholder, such as a main bank (or *keiretsu*) is present. The *keiretsu* system can be defined as "relationship investing";
3. The existence of close relationships between corporations and the government; and
4. A non-existent market for corporate control with minimal takeover activity.

Consequently, although the traditional (or Western model) is based upon a belief that managers and directors should direct their concerns to maximising profits for "the providers of capital", in Japan, however, the interests of the company and of its employees are considered before those of the "outside directors". In this way, "pay is tied to growth, not profits". [1279] Thus,

> (s)hareholders are passive; they have very few rights if they are not happy with management, and what rights they do have are seldom exercised. An extensive system of cross-holdings provides stability, but it does not provide much by way of market pressure to respond to poor performance.[1280]

[1277] Ibid 109.

[1278] Monks and Minow, above n 37, 313.

[1279] Ibid.

[1280] Ibid 314.

In May 1998, Japan produced a corporate governance code. The Code accepted the fact that Japanese corporate culture takes “a more holistic view than the West”. The Forum comprised executives, academics, lawyers and shareholder representatives. The Forum recommended some major changes to the corporate governance system operating in Japan. For example, it suggested that more outside directors should be appointed (as they had only accounted for 4 percent of board seats). Furthermore, the Forum recommended that board committees, which were non-existent in Japanese corporations, be formed. These committees could include independent audit, pay and nomination board committees. This Forum “monitors progress and has urged the Tokyo Stock exchange to incorporate the Code into its Listing Rules”.[1281]

The main features of the Japanese corporate governance system will be considered when constructing a new corporate governance model for South Africa.

[1281] Ibid 318.

(8.2.3) France

France has unique features of corporate governance. The main features include: [1282]

1. The French government is inextricably tied to French business and consequently to corporate governance. Thus,

> 'stay close to government' is advice that seems often given and generally heeded. ...'(E)very subsidiary has central or local government as its main customer'. [1283]

Moreover, the French government supplies various services to businesses, which are the *Centrale des bilans.* This is an information exchange, which is run by the "Banque de France". Many large corporations in France, whether from the manufacturing, construction or retailing sectors, voluntarily furnish information about themselves to the bank. In return, these large companies can purchase reports produced by the bank on their performance.

Centrale des risques: The "Banque de France" operates an information exchange, which furnishes businesses with reports on any debts owed by companies.

Fichier bancaire des entreprises: Linked to the *Centrale des risques,* this system provides information on the ratings of companies to banks.

The Minister of Economy and Finance (*Tresor*) in France wields considerable power, especially in the financial sector. Over the years, the *Tresor* has been instrumental in saving many companies experiencing financial difficulties. Thus, the extent to which it becomes involved depends on how well the industry is doing. Consequently, the state has a protective role and its influence also extends to those situations, which do not "endanger public order, health or national defence". [1284] For example, the French government may use its influence to stop a merger for a "French solution". Furthermore, even the unions believe that the State has a significant role in ensuring that the market operates in the general interest of all stakeholders. Thus, only the

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[1282] Charkham, above n 87, 119-153.

[1283] Ibid 120.

[1284] Ibid 149.

State can establish the rules in areas such as competition, pollution and employment.

2. The French regard education as vital to success. In this way,

> (t)heir national attitude was that their role was to assist in the creation of a strong national economy, that quick money was immoral money, and that financial wizardry was less important than building up major industries. This thinking permeated the banking system too. … This means that there is an empathy between government and industry and excellent lines of communication. [1285]

3. Company structures in France consist of various types. The two main types will be mentioned. *Societés anonymes* (SAs) are public companies similar to the AG's in Germany. Any company in France with shareholders that exceed fifty in number must be incorporated as an SA company. These companies must have a capital base of at least FF 250,000. *Societés a responsibilité limitée* (SARLs) are limited liability companies similar to the GmbH in Germany. They must have shareholders not exceeding fifty in number and a capital base of at least FF 50,000.

4. Very uniquely in France there is a choice between two types of corporate governance systems. These are either the unitary board or two-tier board structures (which comprise the supervisory boards).

5. The unitary board structure, which houses the traditional French system of corporate governance, consists of two main components: the *président directeur-général* (PDG) and the board (*Conseil d'Administration*). The PDG is elected by the board, which, in turn, is elected by the shareholders. The PDG has the only right to represent the company, a right, which cannot be delegated. The PDG has *greater* power than the CEO in the USA or in the UK and may create an executive committee, which would be charged with administering various key functions. The board, however, has the power to dismiss the PDG, but, generally speaking, the PDG remains in office until retirement at the age of 65 or until a later date in those circumstances where the board and general meeting have granted a renewal of term of office. The personality of the PDG may vary considerably. In this way, the PDG may

[1285] Ibid 122.

either decide to work as a team member with the board and to consult with them widely, or may decide not to. PDG's may either be appointed internally within the corporation, or may be an outside recruitment. Boards meet fairly regularly (usually every two months). They must have between three and twelve members (except holding companies) of which two-thirds of the board must be non-executive. The board members, in practice, are selected by the board itself and elected to office by the shareholders at a general meeting. The PDG, however, may play a significant part in the election process. The board does not take part in the day-to-day operations of the corporation. Its functions are usually confined to the hiring or firing of the PDG and the authorisation of new capital or mergers. If the corporation remains financially sound, the board generally takes on passive roles and allows the PDG to run things. If not, the board may intervene and, if the situation warrants this, may even dismiss the PDG from office. However, French boards over the last decade have, on the whole, become more active than previously. This has provided the major shareholders with a greater voice during the consultation period with the PDG. In addition to these two components, and because of the statutory limitations placed upon board numbers, "censors" may be appointed. They may participate in board discussions, but they have no voting powers. Their main roles (for which they are usually paid) are to ensure that the corporation follows the correct procedures, especially during those times when it might matter most.

6. The other option for companies is to have a system of corporate governance based upon the two-tier approach, which incorporates the additional supervisory board structure. This system, introduced by the French government in 1966, is similar to the two-tier approach found in Germany comprising the *Vorstand* and *Aufsichtsrat*. In this way, the French two-tier board structure comprises the directorate (*directoire*) and the supervisory board (*conseil de surveillance*). The directorate consists of two to five members, who have been appointed for a two to six year term of office. A supervisory board of three to twelve members appoints them with members of the supervisory board having been elected at ordinary general meetings of shareholders. A quorum is established where at least 25 per cent of the capital has voted. If not, the meeting is reconvened and, in this situation, a quorum is not required but only a simple majority. Membership of these two bodies is kept separate. A member of the directorate becomes the leader of the directorate (*président de directoire*). The supervisory board, however,

cannot dismiss members of the directorate. This is the function of the shareholders in a general meeting, consensus of which must be based upon a simple majority. This is markedly different from the supervisory boards in the German corporate model where only the supervisory board (and not the management board itself nor the shareholders in a general meeting) can dismiss a member from the management board. Additionally, the French directorate has the executive authority and decisions are taken by a majority vote. In Germany, however, it would appear as if the supervisory board has executive functions as well. This is because, the German supervisory boards ensure that the standards in the corporation are not only established, but maintained as well. In this way, "(t) he Vorstand proposes, the Aufsichsrat disposes". [1286] Consequently, the main function of the German supervisory board is to ensure that the management board acts competently through a framework of consensus. The German supervisory boards have shifted more towards the ideology that they should be advising and counselling the management boards than confronting them. It appears that German supervisory boards take a more proactive role than the French supervisory boards in ensuring that the management board performs competently. Consequently, it would appear as though the supervisory boards of French Companies have less authority and power than the supervisory boards of German companies.

7. In France, one or more members of the directorate are appointed by the supervisory board to act as the representatives of the corporation. Whereas members of the French directorate do not have to hold any qualifying shares to sit on the board, members of the supervisory boards do. The French directorate must furnish the supervisory board with its quarterly report.

8. In both the unitary and two-tier French board models, members receive remuneration in the form of attendance payments (*jetons de présence*), which is determined by the shareholders. The board determines the remuneration for the PDG. Regarding the shareholders themselves, French shareholders feel that large payments are never justified. If a company is not doing well, it cannot afford them. If it is, it should maintain its resources. "The model preferred is for steady unspectacular growth, which produces commensurate capital appreciation. …" [1287] This would then provide attractive

[1286] Ibid 22.

[1287] Ibid 142.

tax advantages. Therefore, the stock-market in France "… is *not* in any way as important as it is in the UK or USA". [1288]

9. Regarding the roles of the unions and of the workforce in corporate governance processes, it is to be noted that all companies (over a certain size) must have a *comité d'entreprise*, which is a committee on which labour and the unions are represented.

   The process of representation consists of three stages, being those of information, consultation and participation. However, this process of representation is not nearly as powerful as the representative system (work councils and supervisory boards) practiced in Germany. Thus, the French do not have much regard for the German co-determination ideology "… because they feel it leads to a confusion of roles". [1289] Hence, problems arise with the three-stage process because of the confidentiality of the information, the scope of consultation and the difficulties with power sharing, which is part and parcel of the process of participation. The French are, in many cases, content to leave the decision with the PDG, except where the boards of nationalised industries exist, as they have employee representatives on them. Notwithstanding this, members of the *comité d'entreprise* do attend board meetings, even though they do not possess any rights of voting. The influence of the members of the committee is therefore limited. The committee can, however, appoint its financial adviser to examine the accounts. In addition, the unions and management do believe that the committee has some value. Consequently, through the committee, there is consultation on some fundamental issues, including

   > … structure, closures, expansion and diversification. … The comité d'entreprise and the presence of employees at board meetings cannot stop a PDG but can give him pause – and the very existence of the formal structure opens useful informal channels of communication. [1290]

10. Most companies prefer to have banks as shareholders because this provides them with protection against take-over. It also provides them with general support should the need for this arise. The advantage for the banks is that a banking relationship is established rather than simply a source of short-term

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[1288] Ibid 147.

[1289] Ibid 144.

[1290] Ibid 153.

profit. However, a conflict of interest may then be created for the banks. They would have to wear two hats when dealing with the corporation, those of managers and those of suppliers of credit. Thus, the question arises *whether* a banker, as a board member of an industrial company, is to give preference to the interests of the company or to his or her bank?

11. A corporation may, at any time, *change* from the unitary board structure to the dual board structure and visa versa, provided that it calls an extraordinary general meeting and, at such meeting, acquires a two-thirds majority of votes in favour of the change called for.

12. The main reason why another model of corporate governance was introduced into France was *primarily* due to the differing personalities of people. It was thought that the personalities that could not fit within the traditional, older structure would fit within the newer, more modern version. Thus,

> … in the end personalities matter more than structure, and … it is logical therefore to offer alternatives to fit people rather than force people to fit a single type of structure. [1291]

13. It is interesting to note the variety of circumstances in which corporations *preferred* the dual board system. This has usually been: [1292]

    (1) At the stage when the nature of the corporation has dramatically changed, for example, after a merger;

    (2) To limit or reduce the power of the PDG;

    (3) To solve problems that are associated with having problematic personalities in control with executive powers. In this way, the PDG with executive powers in a unitary board structure could become the chairman of the supervisory committee of the dual board structure. A new *président de directoire* can then be appointed;

    (4) To find directorships for more than twelve people when this is required (this is the upper limit for the number of board members allowed on a

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[1291] Ibid 151.

[1292] Ibid 135-152.

unitary board structure, whilst the legal upper limit in a dual board structure is seventeen);

(5) To divide power equally on the two boards, for example, where two families have equal shares;

(6) To upgrade managers or family members to the directorate, whilst still retaining a power of supervision over them;

(7) To allow five directors in family businesses to qualify for tax advantages for employees, instead of only up to four under the unitary board system;

(8) To allow for a better transition from a partnership to an SA, members are either appointed to the directorate or the supervisory board;

(9) To allow for a greater security of tenure of the directorate. The *conseil d'administration* can summarily dismiss the PDG (and without compensation), whilst shareholders at a general meeting can only dismiss the directorate. This is so except in those cases where the *conseil de surveillance* controls the shares and therefore the company. Then, the directorate would not enjoy security of tenure in this case, especially since they do not need to hold any shares;

(10) To facilitate the decision-making process, as it is easier to get the directorate together than the *conseil d'administration*;

(11) To satisfy German holding companies, which, due to their own two-tier board system, prefer to have also the two-tier board system in their French subsidiaries;

(12) To satisfy foreign owners who, by and large, prefer the distinction between management and supervision;

(13) To prevent legal liability. That is, members of the *conseil d'administration* can be sued for fault, whereas members of the *conseil de surveillance* cannot be.

(14) To allow for greater accountability. Very often boards in the traditional model of corporate governance did not

> … hold the PDG accountable in any consistent way. They were often aged; they met seldom; were little consulted; and were quite content to cruise along passively unless and until the ship was nearly on the rocks. Even when it was clear they should throw the captain overboard, they did so with great reluctance, usually after the vessel was badly holed. [1293]

(8.3) AN OVERVIEW AND CONCLUSION ON CORPORATE GOVERNANCE IN GERMANY, JAPAN AND FRANCE

In discussing whether a model of corporate governance is *effective* or not, Charkham refers to what he calls the 'two criteria' - *dynamism and accountability*. [1294] With the question of dynamism, it should be asked whether the corporation could conduct its affairs in such a way that *governmental interference*, litigation or displacement does not significantly impede it. The German government generally interferes on a very limited basis, whereas governmental intervention is still rather visible in Japan and France. Litigation, unlike in the USA, does not make a large impact on corporate governance in any of these three countries. In Germany and Japan, company take-overs are rare and there is limited pressure, which the share market can exert on companies. In this way, displacement of an existing management structure through a takeover bid does not occur. The threat of take-overs, however, may still exist in some French companies, which may obviously yield competitive disadvantages for them. With the question of accountability, formal mechanisms need to operate, which allow a board to control management, such board having been appointed by the shareholders. This is evident to a greater or lesser degree in Germany, France and Japan. In addition, in order to have a system of accountability that is credible, Charkham reports that certain elements are essential. That is,

> (t)here must be an adequate and timely flow of relevant information from management. … Those who receive it must be able to understand it. … These people, be they bankers, fellow members of the board, or shareholders, must be in a position and willing to exert influence. [1295]

[1293] Ibid 152.

[1294] Ibid 354-66.

[1295] Ibid 360.

The two criteria, which have been suggested to test the effectiveness of a corporate governance model, relate *only* to the company's economic performance. Some say that a third criterion should be taken into account. This is based upon a corporation's *social performance*. [1296] In this way, the corporation should be seen as doing its share for society, either positively by contributing to society's well being, or, at the very least, by not damaging it. Thus, economic and social policies are inextricably tied together. Economically successful corporations will often have socially desirable programmes in place for its employee on the basis that happier employees are more productive and that more productive companies generate greater returns. This factor, in turn, allows these companies to be more appealing to do business with, whilst, at the same time, impressing the customers who continue to support the business.

Charkham does not believe it to be necessary to list the social performance criterion as a separate factor. He believes that this is automatically taken into account when discussing the economic performance criterion. [1297] However, this argument is arguably flawed. It *is* necessary to establish social performance as a *separate* category in evaluating corporate governance models. This is to *ensure* that this criterion *is* emphasised and taken into account when the effectiveness of such system is evaluated.

Consequently (and not surprisingly), of the three systems studied, Charkham contends that the German model of corporate governance is the *most* favourable. That is,

> … with its tendency towards rigidity, the Germans make their system work more consistently. … And most of those outside Germany, who criticise it, do so from positions of relative weakness. My judgment is not based on Germany's phenomenal rise since 1945 but on its development for more than a century. The two terrible conflicts into which its leaders drew the country conceal the probability that continuous peace might well have shown the relative superiority of their corporate governance system much sooner. … To praise the apparent effectiveness of a particular system is not to advocate that others should seek to emulate it. There are many paths to the top of the mountain. … (T)he distinctive nature of each country's culture, history, and institutions means that it would be impossible for one nation to copy another's arrangements in their entirety. … (Other countries) will gradually decide what bests suits their own history and culture. It would be a vast task to chronicle each and the changes occurring within them. It would, moreover, not seem to be necessary, since the basic principles appear to be universal, however they are applied. … We must never ever forget that what is here discussed is power, and that in every country someone already enjoys it however well the

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[1296] Ibid 354.

[1297] Ibid 354.

> corporate governance system works as a whole. … It must be remembered there is nothing more difficult to plan, more doubtful of success, nor more dangerous to manage than the creation of a new system. … It is, nevertheless, vital to keep a system of corporate governance under review. It is as important to a nation as any other crucial part of its institutional framework, because on it depends a good portion of the nation's prosperity; it contributes to its social cohesion in a way too little recognised. A proper framework for the exercise of power is an economic necessity, a political requirement, and a moral imperative. … [1298]

Finally, these sentiments are reiterated in a very interesting and recent paper. Firstly, du Plessis notes that corporate governance needs to be considered specifically in terms of a "country's own tradition, history, culture and … corporate law system".[1299] Secondly, in comparing the various features of the unitary and two board structures, du Plessis notes,

> (i)n a corporation where the business of the corporation is not managed by the board, but "under the direction of directors", with a majority (of) independent non-executive directors … and several subcommittees, it can hardly be said that such a corporation has a "unitary board" comparable to the "unitary board" that was the focus of attention of many studies over many years. … If one looks at the modern unitary board it does not look so single dimensional, as some would believe. … Because of the way the traditional unitary board was reinvented, we will probably have a score slightly in favour of the two-tier board system if we really must select a winner in "the unitary board" versus "the two-tier board" contest, but at the end of the day it is perhaps best simply to realise that the so- called "fit-all board structure" does not exist and will probably never exist. [1300]

We will now progress to consider in chapters 9 and 10 the manner in which and the extent to which the four building blocks or steps discussed in chapters 5 to 8 – being organisational development, legislative changes, corporate attitudes and international models of corporate governance – would contribute towards the development of an improved model of corporate governance for South Africa. This is especially significant in so far as it pertains to a more meaningful participatory role of corporate stakeholders (especially those of the employees) in the affairs of the corporation.

[1298] Ibid 363-6.

[1299] Du Plessis (2003), above n 158, 382.

[1300] Ibid 383.

CHAPTER 9:

(9.0) THE BIRTH OF AN IMPROVED MODEL OF CORPORATE GOVERNANCE FOR SOUTH AFRICA

A pivotal point in this thesis has now been reached where an *improved* model of corporate governance in South Africa is to be developed. We saw in chapters 2 to 8 that an increased level of worker participation in the governance of corporations is highly desirable for both the corporation itself and for the other stakeholders of the corporation. In this chapter these various strands will be tied together in a general model of corporate governance for South Africa. These strands constitute the four main building blocks or steps in the formulation of a new and improved model of corporate governance. They consist of the introduction and maintenance of a system of organisational development within the corporation, the enactment of new company and labour legislation, changes in traditional corporate attitudes and the extraction and implementation of favourable features comprising successful international governance models.

(9.1) INTRODUCTION

An improved model of corporate governance can work in South Africa provided that there is a *desire* by those that use it to make it work. There needs also to be a desire to change. Unfortunately, for many people, making any change at all, moving away from the known to the unknown, is probably the most difficult thing in life to do. Yet, this is what life requires of us and this is what must be done if society is to adapt successfully to and cope with the new burdens and problems that are thrust upon it. In this way, the business world is no different. Even with the technological advances occurring today, which very few people can keep up with, it is still very important to modify and adapt the business world so that all of its stakeholders might feel satisfied. The proposed model of corporate governance for South Africa does this. Focus has been placed primarily on the rights of employees. Arguments are made, which have been based primarily upon a review of the literature. More specifically, it is argued that it is fundamentally important for employees to be afforded the rights to participate in corporate governance decisions that are taken at board level. This is presently not legally acknowledged in South Africa and therefore not implemented. It is hoped that this new model will be viewed as a refreshing beginning to a new order of corporate governance practice in South Africa.

(9.2) METHODOLOGY

Through an extensive review of the literature on corporate governance over the years, those writings have been selected that could be used to develop an improved and workable model of corporate governance for South Africa. These writings fall into four main categories and form the four main steps, which are used in the design of the building blocks of a new model on corporate governance. In turn, each one of these steps or building blocks is composed of sub-blocks or factors, all of which cemented together, form the composite whole. In this way, this proposed model of corporate governance could be likened to any building, which has been structurally engineered. That is, each building consists of four walls and each wall is made up of a number of bricks, which fit tightly together. Therefore, if any one or more of the bricks are missing it is possible that the wall will be weakened or not stand at all.

Similarly, if any of the factors constituting the four steps of this proposed corporate governance model are missing, the model will weaken and, depending upon which factor is missing, may even collapse. If any one of the *four steps* in this corporate governance model is disregarded, the model will not succeed. The four steps are therefore the fundamental building blocks of this corporate governance model and are just as important as four walls, which are required to keep most building structures standing. Another way of looking at this and hence emphasising the importance of all of the constituent parts or factors, which make up this corporate governance model, is to compare it to a jigsaw puzzle. If even one piece of a jigsaw puzzle is missing, it will markedly change the overall effect of the work. In this way, a model of corporate governance in South Africa will be formulated, which is built upon the four main steps or building blocks. Each one of these steps is built upon a variety of factors. To ensure a good understanding of this proposed model of corporate governance, there will be a consideration of the significance and value of, and the manner in which, each step *separately* has a role in constituting a new corporate governance model for South Africa. Each step will be labelled either A, B, C or D and each factor, constituting each step, will, in addition, be labelled numerically. A full discussion of each step, or factor constituting each step, has been referred to in previous chapters of this thesis. This model is also illustrated, step-by-step, in Table 6, which follows after its detailed discussion.

(9.3) THE SIGNIFICANCE AND VALUE OF, AND THE MANNER IN WHICH, THE FOUR STEPS CONSTITUTE A NEW CORPORATE GOVERNANCE MODEL FOR SOUTH AFRICA

(9.3.1) The Building Blocks That Form the First Step (A)

The aim of step A is to introduce and maintain a system of organisational development within the corporation. The empowerment of employees in the corporation is cardinal to their job satisfaction, which positively affects the performance of the business and greatly improves customer service. Organisational development is a long-term, planned process, which ultimately seeks to enhance the well being of employees. The success or failure of a business is primarily in the hands of its employees. Employees will respond positively to changes surrounding them in the corporation provided that they had a role in the decision-making

processes affecting them. This step *de-emphasises* hierarchical authority and control. It *emphasises* improved employee productivity, greater job satisfaction, better customer service and greater productivity for the corporation and for South Africa as a whole through the implementation of systems and programmes designed to achieve improvements in the workplace.

(A1) To achieve effective organisational development patterns in the corporation, *changes in the behaviour* of its participants must occur. Behavioural changes are managed through *change agents*, who are the catalysts in this process. Change agents can be recruited from within the corporation or can be outside recruits. They can be managers or even the employees. Their roles are to change any stagnant and undesirable attitudes in the workplace through the introduction of uplifting and encouraging systems and processes.

(A2) *Seven processes* are required to achieve effective and successful changes in the workplace. All seven processes *must* be complied with before there can be any successful and meaningful change in the corporation. These seven processes are:

(A2 (1)) *Pressure for change*: Without pressure, any suggested changes in the workplace would either be slow or non-existent. Any pressures thrust upon the participants in a corporation must be done in a carefully planned and meaningful manner.

(A2 (2)) *A cleared shared vision*: Employees need to be able to understand clearly why changes are required and why pressures are being brought to bear upon them. Employees must participate in this process by being permitted to express their views to management.

(A2 (3)) *Capacity for change*: The corporation must ensure that it has enough resources and funding to introduce any changes that are being advocated. The introduction of changes, which are inadequately funded, could impose further stresses and disadvantages upon the workplace.

(A2 (4)) *Actionable first steps*: It is vital for managers to encourage small wins. Once employees feel positive about their achievement, however small, this will encourage them to achieve greater goals in the future. There is nothing more discouraging than employees receiving negative feedback from their managers, or no feedback at all, after having made a real and determined effort to get something right.

(A2 (5)) *Model the way*: It is essential that, in the first instance, managers make, or are seen to be making, a sterling effort towards the vision that the corporation is trying to achieve. If managers do not act as exemplars in this way, it is hardly likely that the employees are going to share in the vision.

(A2 (6)) *Reinforcement of change*: Any changes introduced into the workplace must be reinforced through a system of active encouragement and participation. In this way, the efforts of employees in their attempts at participation could be rewarded in some form or another.

(A2 (7)) *Evaluate and adapt*: It is necessary to evaluate the success or otherwise of any introduced changes in the workplace. This must happen on a regular basis. It is of no use to any party concerned to continue to flog a dead horse.

(A3) Various *means* must be integrated into the workplace to achieve the desired changes, and, through this process, employee empowerment. These means can comprise a variety of different forms, such as, group feedback sessions, feedback questionnaires, process consultation, team-building exercises, inter-group development systems, organisational restructuring and total quality management programmes.

(9.3.2) The Building Blocks That Form the Second Step (B)

The aim of step B is to suggest changes for South Africa of a *legal* nature, which would promote an improved and more meaningful system of worker participation in the corporation. In this regard, modifications will be suggested that should be made to the major South African legislative enactments and to the King Reports, which have thus far attempted to provide employees with some rights of participation in the decision-making processes of the corporation.

(9.3.2.1) Workplace Forums Established in Terms of the Labour Relations Act 66 of 1995 (B1)

The chapter on workplace forums in the *Labour Relations Act* is inadequate in protecting and equalising the rights of employees as against the employer. This is due to the fact that there are provisions in the legislation that are ambiguous, restrictive, vague and in conflict with one another. Another shortcoming of the

legislation is that it only provides for the participation of employees in the joint-decision-making processes at *line-management level on specific matters* on a limited basis. It does not advocate the participation of employees in decision-making matters at board level. The establishment of workplace forums is *not* a mandatory requirement under the Act.

(B1 (1)) Section 78(a) of the LRA excludes a *senior managerial employee* from the definition of 'employee'.

The provision should be amended to remove such restriction and should therefore read,

> 'employee' means any person who is employed in a workplace whose contract of employment or status confers authority to do any of the following in the workplace. …

(B1 (2)) Section 78(b) of the LRA defines a representative trade union as one or more trade unions that is/are *registered* and that have as members the *majority* of the employees employed by an employer.

The provision should be amended to remove such restrictions and should therefore read,

> 'representative trade union' means any trade union, or two or more registered trade unions acting jointly, that have as members employees employed by an employer in a workplace.

(B1 (3)) Section 79(d) notes that a workplace forum is entitled to participate in joint decision-making regarding those *matters referred to in section 86*.

The provision should be amended to remove such restrictions and should read,

> a workplace forum established in terms of this Chapter is entitled to participate at all levels in the company, including at board level, in joint decision-making processes on any matters affecting the interests of all employees in the workplace.

(B1 (4)) Section 80(1) states that a workplace forum *may* be established in any workplace where *more than one hundred employees* are employed.

The provision should be amended to read,

> a workplace forum must be established in any workplace in which an employer employs more than ten people. In the event that ten or less people are employed in the workplace, the employees are entitled to participate at all levels in the company, including at board level, through a nominated and elected employee representative, in joint decision-making processes on any matters affecting their interests, either directly or indirectly, in the workplace.

(B1 (5)) Section 80(5)(b)(iii) states that there must not be any *functioning* workplace forum already established at the workplace.

This provision should be amended to read,

> there must be no workplace forum already established at the workplace.

(B1 (6)) Section 83(1) states that there must be *regular* meetings of the workplace forum.

This provision should be amended to read,

> there must be monthly meetings of the workplace forum.

(B1 (7)) Section 83(2)(a to b) states that there must be *regular* meetings between the workplace forum and the employer at which the employer must present a report on its financial and employment situation, its performance since the last report and its anticipated performance in the long and short terms. The employer must also consult the workplace forum on any matter arising from the report that may affect its employees.

This provision should be amended to read,

> there must be monthly meetings between the workplace forum and the employer. …

(B1 (8)) Section 83(3)(a) states that at *regular and appropriate intervals*, there must be meetings between the workplace forum and the employees where the workplace forum must report on its activities generally on matters in respect of which it has been consulted by the employer and on matters in terms of which it has participated in joint decision-making with the employer.

This provision should be amended to read,

> there must be meetings between members of the workplace forum and the employees employed in the workplace on a monthly basis. …

(B1 (9)) Section 83(3)(b) states that each calendar year, *at one of the meetings* with the employees, the employer must present an annual report of its financial and employment situation, its performance and on its future prospects and plans.

This provision should be amended to read,

> each calendar year, at one of the various scheduled meetings to take place with the employees.

(B1 (10)) Section 84 states, "(u)nless the matters for consultation are regulated by a collective agreement with the representative trade union, a workplace forum is entitled to be consulted by the employer on those *proposals* (my italics) relating to any of the following matters - restructuring the workplace, including the introduction of new technology and work methods, changes in the organisation of work, partial or total plant closures, mergers and transfers of ownership in so far as they have an impact on the employees, the dismissal of employees for reasons based on operational requirements, job grading, criteria for merit increases or the payment of discretionary bonuses, education and training. …"

This provision should be amended to read,

> unless the matters for consultation are regulated by a collective agreement with the representative trade union, a workplace forum is entitled to be consulted by the employer on any of the following matters. …

(B1 (11)) To section 84 an additional deeming provision, section 84(1A), should be added, which would provide,

> the workplace forum must also be consulted by the employer on employee-related matters if (1) such matters are of such an urgent nature that to postpone the disclosure thereof would most likely cause severe hardship to the employees, the employer or the company, or (2) the workplace forum deems the disclosure of any matter to be in the best interests of the company.

(B1 (12)) Regarding section 85, which expands upon the duty to consult in terms of section 84, a further provision, section 85(5), should be added.

This provision should read,

> in the event that any agreed procedure cannot be reached between the employer and the workplace forum, this dispute should, in the first instance, be resolved by the Commission through conciliation. If the dispute remains unresolved, the matter must be resolved through arbitration.

(B1 (13)) Section 86(1) states that unless the matters for joint decision-making are regulated by a collective agreement with the representative trade union, the employer must consult and reach consensus with a workplace forum before implementing any *proposal* concerning disciplinary codes and procedures, rules relating to the proper regulation of the workplace in so far as they apply to *conduct not related to the work performance of employees*, measures to protect and advance persons who are disadvantaged by unfair discrimination and changes by the employer or its appointed representatives on trusts or boards of employer-controlled schemes to the rules regulating social benefit schemes.

This section should be amended to read,

> unless the matters for joint decision-making are regulated by a collective agreement with the representative trade union, the employer must consult and reach consensus with a workplace forum before implementing any matter concerning disciplinary codes and procedures, rules relating to the proper regulation of the workplace in so far as they apply to the conduct of its employees. …

(B1 (14)) Section 86(4) reads, “if the employer does not reach consensus with the workplace forum, the employer *may* - …”.

This section should be amended to read,

> if the employer does not reach consensus with the workplace forum, the employer must - … .

(B1 (15)) To section 86 an additional provision, section 86(1)(e), should be added, which would provide,

> any other matters, including board-related matters, affecting the interests of the employees, either directly or indirectly, in the workplace.

(B1 (16)) Section 86(7) reads, “If the dispute remains unresolved, the employer *may* (my italics) request that the dispute be resolved through arbitration”.

This section should be amended to read,

> if the dispute remains unresolved, the employer must request that the dispute be resolved through arbitration.

(B1 (17)) To section 86 an additional provision, section 86(4A), should be added, which would provide,

> if the employer does not reach consensus with the workplace forum, the workplace forum may – (a) refer the dispute to arbitration in terms of any agreed procedure; or (b) if there is no agreed procedure, refer the dispute to the Commission.

(B1 (18)) To section 86 an additional provision, section 86(7A), should be added, which would provide,

> if the dispute remains unresolved, the workplace forum may request that the dispute be resolved through arbitration.

(B1 (19)) To section 87 an additional provision, section 87(1)(d), should be added, which would provide,

> any other matters, including board-related matters, affecting the interests of the employees, either directly or indirectly, in the workplace.

(B1 (20)) Section 87(4) reads, "*A review of the disciplinary codes and procedures, and rules, must be conducted in accordance with the provisions of section 86(2) to (7) except that, in applying section 86(4)* (my italics), either the employer or the workplace forum may refer a dispute between them to arbitration or to the Commission".

This provision should be amended to read,

> either the employer or the workplace forum may refer a dispute between them in subsection 1 to arbitration or to the Commission.

(B1 (21)) Section 87(3) should be deleted.

(B1 (22)) The short title of section 87 reads, "Review at request of *newly established* (my italics) workplace forums".

This short title should be amended to read,

review at request of workplace forums.

(B1 (23)) Section 92 has the short title “(f)ull-time members of workplace forum”. Section 92(1) reads, “In a workplace in which *1000 or more* employees are employed, the members of the workplace forum *may* designate from their number *one full-time member* (my italics)”.

This provision should read,

in any workplace in which more 10 or more employees are employed, the members of the workplace forum may designate from their number one or more full-time members.

(B1 (24)) Section 82 has a short title “(r)equirements for constitution of workplace forum” Section 82(1)(s) reads, “The constitution of every workplace forum *must* provide for the designation of *full-time members* of the workplace forum if there are *more than 1000* employees in a workplace (my italics)”.

This section should be deleted.

(B1 (25)) Section 93(1 to 4) reads, “a representative trade union in a workplace *may* request a ballot to dissolve a workplace forum. If a ballot to dissolve a workplace forum has been requested, an election officer must be appointed in terms of the constitution of the workplace forum. Within 30 days of the request for a ballot to dissolve the workplace forum, the election officer must prepare and conduct the ballot. If *more than 50 per cent* of the employees who have voted in the ballot support the dissolution of the workplace forum, the workplace forum must be dissolved (my italics)”.

Section 93 should be amended to read,

a representative trade union in a workplace must request a ballot to dissolve a workplace forum when such workplace forum becomes a non-viable or non-functional body. If a ballot to dissolve a workplace forum has been requested, an election officer must be appointed in terms of the constitution of the workplace forum. Within 30 days of the request for a ballot to dissolve the workplace forum, the election officer must prepare and conduct the ballot. If a significantly large number of the employees who have voted in the ballot support the dissolution of the workplace forum, the workplace forum must be dissolved.

(9.3.2.2) The King Reports (B2)

The King Reports do not provide adequate recommendations to protect and equalise the rights of employees as against the employer. Both King Reports *dismiss* the ideology that a two-tier board structure is preferable in South Africa. Consequently, both King Reports recommend that a unitary board structure be retained in South Africa despite overwhelming evidence in a country, such as Germany, that the two-tier board structure has, over many years, been a *significant* factor, which has greatly contributed towards achieving a very strong market economy.

(B2 (1)) The *recommendations* of the King Committee are primarily directed towards "the affected corporations" (King I Report) or "the affected companies" (King II Report). The ideology that "large" entities are those that have *shareholder' equity of R50 million* or more is unsound and restrictive. The recommendations need to be transformed into *mandatory rules*, which should be applied right across the board to all corporations, whatever their nature or size, being both public and private, including close corporations. It is inadequate for the King Report to merely "encourage" all companies to adopt the recommendations and the Code. The next King Report should *require* all corporations, whatever their nature or size, to engage in corporate governance processes, especially regarding those issues that relate to worker participation matters. This is because participative management relies on the building of employee partnerships at every level to encourage employees to do their best. After all, the employees are the ones who will make a difference in the business performance of the corporation.

(B2 (2)) The King Reports write in favour of retaining a *unitary board system* of corporate governance. The next King Report, however, should recommend that employees become part of the decision-making processes *of the board* through the introduction and development of either, or a combination of, the following structures (noted below in a particular order from the least to the most preferable option):

(B2 (2)(1)) The *unitary board structure is retained*, whilst making provision for the participation of employees, through employee representatives, in the decision-making processes of the corporation at board level. Additionally, a new and improved workplace forum is developed, which has extended powers as suggested under building block B1.

(B2 (2)(2)) An *employee sub-committee of the board* (or employee board committee) in a unitary board system is created. The board itself would delegate some of its functions that deal with employee issues to the employee sub-committee of the board. Which issues would be delegated to the employee sub-committee would have to be agreed upon by management and the employee representatives in the various corporations. This sub-committee would be composed of only employee representatives, who have been nominated and elected to this office by interested stakeholders, including their peers, the shareholders and management. The authority of such sub-committee would be in writing from the board, which would set out the parameters and context within which such powers are conferred. This authority would also be incorporated in the Articles of Association of the corporation. The sub-committee of the board would be chaired by one of the employee representatives who have been nominated and elected to this office by interested stakeholders, including their peers, the shareholders and management. Additionally, a new and improved workplace forum could be developed, which has extended powers as suggested under building block B1.

(B2 (2)(3)) A *supervisory board* is created. The supervisory board would, together with a management board, constitute the two-tier or dual board system. This system would co-exist with the unitary board system. This would mean that corporations would have the *option* of selecting the unitary or dual structured corporate governance model that suits them best. Additionally, a new and improved workplace forum could be developed, which has extended powers as suggested under building block B1.

(B2 (2)(4)) A *two-tier board system* is created in South Africa, which consists of a supervisory and management board structure. Additionally, a new and improved workplace forum could be developed, which has extended powers as suggested under building block B1.

(B2 (3)) Regarding the questions of disclosure and consultation, the King Reports have, by way of varying recommendations, *inconsistently* attempted to define how, when and what type of information needs to be disclosed to the stakeholders of the corporation during stakeholder communication. Future King Reports should consider formulating one statement, which clearly defines the issues pertaining to the questions of disclosure and consultation. A workable statement would be,

> it is the duty of the board to present a report to all stakeholders of the corporation on those matters that affect their interests or rights either directly or indirectly. Such report would be couched in easily

> understandable language and would be transparent, fair, true, accurate and complete. Such report would be disclosed to the stakeholders as soon as management knows of an issue or issues, which may affect their interests or rights in this way. Consultation must take place between management and labour on any other matters, including board-related matters, which affect the interests of the employees in the workplace. Such consultation would also be couched in easily understandable language and would be transparent, fair, true, accurate and complete. Such consultation would take place with labour as soon as management knows of an issue or issues, which may affect their interests or rights in this way. During such consultation, management and labour would resolve any disputes, if not immediately, as expeditiously as possible.

(B2 (4)) The King Committee should *not* incorporate both enabling and mandatory terms in its Report or in its Code of Corporate Practices and Conduct. The next King Report should compose its Report in a form of rules, rather than recommendations, which should be *mandatory*. These rules should then be incorporated into legislation and be applicable to all corporations *whatever* their size, nature or type.

(B2 (5)) The King II Report recommends that a board committee should be established to assist the board in reviewing risk management procedures. The next King Report should expressly include a statement to the effect that at least one employee representative of the corporation should take part in any of the decision-making processes, which are associated with the risk management procedures.

(B2 (6)) The next King Report ought to include a statement, which notes,

> corporations must establish participative management for its employees at all operating company levels. This will achieve exemplary employer/employee relations and will encourage its employees to reach their maximum potential.

(B2 (7)) The next King Committee should engage in discussions with EthicSA on matters dealing with ethical considerations. This would encourage companies to understand the reasons why ethical issues have to be woven into the fabric of the corporation.

(9.3.2.3) The Bill of Rights (B3)

The Bill of Rights reinforces and expands some of the provisions in the current *Labour Relations Act*. It entrenches the rights to collective bargaining, expands the rights of freedom of association, provides that everyone has the right to fair labour practices, widens the definition of the concept of employee and provides an unqualified right for individual employees to strike.

However, the Constitution does *not* go far enough in formulating and entrenching certain principles that would achieve greater industrial democracy in South African labour law. For example, the 1996 Constitution does not mention the extent to which employees should have a joint decision-making role in the running of the organisation. South Africa would move forward on the issue of having a dual board structure and, in this way, achieve greater industrial democracy if the Constitutional Assembly and/or the Constitutional Court take an active role in supporting this. This issue is general enough and can therefore be incorporated quite easily into any new amendments that are made to the Constitution. It is also important enough to be taken very seriously by the highest bodies in the land.

(B3 (1)) Section 23(5) reads, “every trade union, employers’ organisation and employer has the right to engage in collective bargaining. National legislation may be enacted to regulate collective bargaining”.

Section 23(5) should be amended to read,

> workers and employers shall have the right to organise and bargain collectively.

(B3 (2)) To section 23 an additional provision, section 23(1)(A), should be added. The contents of such provision would ultimately depend upon which model of corporate governance is selected.

(B3 (2)(1)) Should the current unitary board system be retained as is, the provision should read,

> every workplace forum is entitled to participate in joint decision-making on any matters, including board-related matters, affecting the interests of the employees, either directly or indirectly, in the workplace.

(B3 (2)(2)) Should the unitary board system be retained with the introduction of employee representatives on the board, the provision should read,

> every workplace forum and employee representative(s) of the board are entitled to participate in joint decision-making on any matters, including board-related matters, affecting the interests of the employees, either directly or indirectly, in the workplace.

(B3 (2)(3)) Should a unitary board system be retained with the development of employee sub-committees of the board, the provision should read,

> every workplace forum and employee sub-committee of the board are entitled to participate in joint decision-making on any matters, including board-related matters, affecting the interests of the employees, either directly or indirectly, in the workplace.

(B3 (2)(4)) Should a unitary board system be retained alongside the introduction of a two-tier board structure, the provision should read,

> every workplace forum, employee sub-committee of the board and supervisory board are entitled to participate in joint decision-making on any matters, including board-related matters, affecting the interests of the employees, either directly or indirectly, in the workplace.

(B3 (2)(5)) Should a two-tier board system be introduced alone, the provision should read,

> every workplace forum and supervisory board are entitled to participate in joint decision-making on any matters, including board-related matters, affecting the interests of the employees, either directly or indirectly, in the workplace.

(B4) To section 23 an additional provision, section 23(1)(C), should be added. This should read,

> every employer has a duty to treat every employee in a reasonable manner.

(9.3.3) The Building Blocks That Form the Third Step (C)

The aim of step C is to suggest changes in the patterns of traditional corporate thinking and attitudes by continuing to reject the anachronistic principles of company law. It is necessary to seriously consider the ideology that employees should have greater rights in the decision-making processes of the corporation at all levels. This establishes greater insight into the reasons why this has become necessary in order to achieve an improved market economy.

(C1) The traditional shareholder primacy model, which firmly entrenches the shareholder maximisation theories, should be rejected and abandoned. Corporate law in business today must take into account the rights of *all* stakeholders in the corporation. Society and business require greater recognition of the rights of non-shareholders.

A provision should be inserted into the *Companies Act* 61 of 1973 that reads,

> the directors of a company must recognise and pay sufficient regard to the rights of all of the stakeholders of the corporation, which include, but are not limited to, the employees, shareholders, suppliers, creditors, community and environment.

(C2) Both company law and labour law are inextricably interdependent. It makes good sense for each branch of law, through its respective legislation, to recognise the rights of all stakeholders in the corporation. In this way, the rights of employees in the decision-making processes of the corporation at all levels would be widely recognised. Company law should therefore formulate a *multi-fiduciary* model, which would oblige the directors to become fiduciaries for all of the stakeholders.

A simple and clear provision should be inserted into the *Companies Act* 61 of 1973 that reads,

> the directors act as the fiduciaries for all of the stakeholders in the corporation.

(C3) Both the contractarian and communitarian (stakeholder) models have features that could be advantageous in corporate governance. It is preferable, therefore, to draw on these features rather than to force legislation or recommendations around one or other of the models. In this way, a new model could be created, which recognises the need for the existence of a framework based upon the typical social, moral and ethical values of a country. For example, contract could be the means in terms of which the rights of the parties are determined, defined and recognised. At the same time, however, legislation could play a significant role in regulating, determining and defining the rights of shareholder and non-shareholder interests where the contract is silent, or where the contact is ambiguous, vague or unconscionable. Legislation, in this regard, could take into account any social values that may typify a culture or a community. In this way, legislation could take into account any social expectations that are not necessarily covered in a contract. This would foster individual dignity and promote societal welfare.

(9.3.4) The Building Blocks That Form the Fourth Step (D)

The aim of step D is to extract the most favourable features from successful international corporate governance models and use them, as building blocks, in the

design of a new and improved model of corporate governance for South Africa. The features apply primarily to the issue of stakeholder participation in the decision-making processes of the corporation. In this regard, focus will be placed upon the participation of the employees. For this, it is proposed that there are unique and advantageous features in the corporate governance models of Germany, Japan and France.

(D1) To attain economic success, it is imperative that all of the stakeholders in the corporation feel *satisfied* with their returns.

(D1 (1)) Stakeholders would then consider any *obligations* they have as their *duties* to offer their services where required.

(D1 (2)) No business can afford to assume that it has the perfect corporate governance model and leave it at that. Therefore, *continued research* into and the upgrading of corporate governance models are necessary for corporations to remain economically competitive and to be able to achieve a healthy competitive edge.

(D2) Businesses need to be able to think in the *long term* and therefore must not expect too much too soon.

(D2 (1)) It is preferable for corporations to proceed by way of *co-operation* than by confrontation. It is therefore preferable for a business to conduct its affairs through *consensus* and by agreements between the parties than in an authoritarian and dictatorial manner.

(D3) Shareholders are but only one group of stakeholders that need to be considered. Making a profit should *not* be the *only* thing that counts.

(D3 (1)) Informed and trusted employees are more likely to have the welfare of the business at heart, to be sympathetic to its aims and understanding of its problems.

(D3 (2)) If employees are treated as members of a *family*, rather than simply as workers, employees will offer an improved service to the corporation. In this way, the ideology of *lifetime employment* ought to develop and manifest within the corporation.

(D3 (3)) Promotion of employees through the ranks should be greatly encouraged.

(D3 (4)) Education and training programmes for employees should be introduced more rigorously into South African corporations. Such programmes foster an intelligent and disciplined labour force, which, in turn, creates a strong national economy.

(D3 (5)) The principle of 'commercial prudence' in accounting practice is preferred to the principle of showing 'a true and fair view'. In this way, profits may be reduced, but accounting reserves for risk are made, which promote the survival of the corporation.

(D4) A unitary board system, in any form, is *not* the preferred option. A two-tier board system, based upon co-determination, is recommended on grounds both of *principle and of pragmatism*. In principle, it provides a clear division of function. Pragmatically, the principle of co-determination would not work well in a unitary board system.

(D4 (1)) The principles of co-determination consist of *three* phases, which are the information, the consultation and the participation stages.

(D4 (2)) Since South Africa has not yet endorsed the two-tier board structure, a choice between this model and the unitary board structure might be created. Thus, in the *transition phase* until the two-tier board structure is widely accepted and adopted, corporations could be given the option of choosing between the unitary board and the two-tier corporate governance models.

(D4 (2)(1)) A corporation may, at any time, change from the unitary board structure to the dual board structure and visa versa, provided that it calls an extraordinary general meeting and, at such meeting, acquires a two-thirds majority of votes in favour of the change called for.

(D5) A two-tier board structure would consist of a supervisory board and a management board.

(D5 (1)) The supervisory board would consist of shareholder and employee representatives.

(D5 (1)(1)) All corporations, which have more than ten employees, whatever their nature or type, would have a supervisory and management board. In those companies having ten or less employees, a managing director would be appointed, with or without a management board consisting of no more than three members. These corporations, therefore, do not have supervisory boards, but at least one employee representative must be nominated and appointed to this office by the employees.

(D5 (1)(2)) Both shareholder and employee representatives would hold an equal number of seats on the supervisory board.

(D5 (1)(2)(1)) The shareholder representatives would be nominated and elected to the supervisory board by a majority vote of the shareholders themselves in the general meeting.

(D5 (1)(2)(2)) The employee representatives would be nominated and elected to the supervisory board by a majority vote of the employees themselves, including the members of the workplace forum.

(D5 (1)(2)(3)) The chairperson of the supervisory board committee would always be a representative employee appointed to that position by a majority vote of the employees themselves, including the members of the workplace forum. The chairperson of the supervisory board would always hold the casting vote, which he or she cannot delegate in the event of a deadlock situation arising. In this case, the casting vote would have a value of two votes.

(D5 (1)(2)(4)) Members of the supervisory board would be appointed to the board for a period of five years, after which time re-election must take place.

(D5 (1)(2)(5)) Seventy-five percent of votes of the employees and of members of the workplace forum would be required to remove an employee representative, including the chairperson, from the supervisory board before the expiration of the five-year term of office.

(D5 (1)(2)(6)) Seventy-five percent of votes of the shareholders in a general meeting would be required to remove a shareholder representative from the supervisory board before the expiration of the five-year term of office.

(D5 (1)(2)(7)) A member of the supervisory board may be dismissed on grounds of any one of, or a combination of, a gross breach of duty, an inability to exercise proper supervisory management, a passing of a vote of no confidence, or for any other reason, which is determined by the board to be in the best interests of the corporation.

(D5 (1)(3)) The number of seats available on the supervisory board would depend upon the number of employees employed in the workplace. This would be determined on a sliding scale basis.

(D5 (1)(3)(1)) If a corporation employs between eleven to one hundred employees (inclusive), up to six seats would be available on the supervisory board.

(D5 (1)(3)(2)) If a corporation employs between one hundred and one employees and five hundred employees (inclusive), up to twelve seats would be available on the supervisory board.

(D5 (1)(3)(3)) If a corporation employs more than five hundred employees, up to eighteen seats would be available on the supervisory board.

(D5 (1)(4)) The main function of the supervisory board is strategic in nature. The function would be to supervise, advise and counsel the management board and to ensure that it acts competently through consensus. It ensures that the standards in the corporation are not only established, but maintained as well. The management board would, therefore, be *legally accountable* to the supervisory board.

(D5 (1)(5)) The main functions of the supervisory board are to be covered by *legislation*, although there can be an extension of these functions as agreed upon by the supervisory board and the management board. Such extension of functions would be clearly tabled in the articles of association or constitution of the corporation.

(D5 (1)(6)) The main functions of the supervisory board would be to *oversee* the accounts of the corporation, which the management board prepares. Additionally, the supervisory board would *supervise* any major capital expenditure, mergers, acquisitions and closures, which the management board is involved in. It would also *approve* the dividend and *make* appointments to the management board.

(D5 (1)(7)) Members of the supervisory board would have routine access to confidential information of the corporation.

(D5 (1)(8)) The supervisory board may also establish any sub-committees, or appoint inspectors, whose task would be to thoroughly examine matters of a technical or complex nature.

(D6) Workplace forums would be involved in the decision-making processes of the supervisory boards. In many cases, workplace forums would first follow the processes to discuss matters with the management board, which affect the interests of all of its employees in the workplace, before formally placing them before the supervisory board. The supervisory board is to be kept advised of any developments during the consultations between the workplace forum and the management board. Should no agreement be reached between the workplace forum and the management board, the supervisory board would step in and take an active role in attempting to reach an agreement with the management board. In this way, many of the difficulties of a situation are ironed out before reaching the supervisory boards. This does not affect the main functions of the supervisory board in (D5 (1)(6)), which it alone must consider. Workplace forums must also be in a position to receive information directly, which they must then pass on to the supervisory boards.

(D7) The main function of the management board would be to ensure that the company finds business and promotes it. It would also decide the administration of affairs of the corporation.

(D7 (1)) Members of the supervisory board would nominate and elect to office members of the management board. This would require a two-thirds majority vote in favour of the nominated member or members.

(D7 (2)) The members of the management board would appoint, by majority vote, a chairperson to the management board.

(D7 (2)(1)) If the members of the management board cannot or will not appoint a chairperson to the management board, members of the supervisory board will do so by majority vote.

(D7 (2)(2)) The chairperson of the management board would always hold the casting vote in the event of a deadlock situation arising, which he or she cannot delegate. In this case, the casting vote would have a value of two votes.

(D7 (3)) Members of the management board would be appointed to the board for a period of five years, after which time re-election must take place.

(D7 (4)) Both the supervisory and management boards may dismiss a member or members from the management board. Seventy-five percent of votes of the members of the management or supervisory board would be required to remove a member from the management board, including the chairperson, before the expiration of the five-year term of office.

(D7 (4)(1)) A member of the management board may be dismissed on grounds of any one of, or a combination of, a gross breach of duty, an inability to exercise proper management, a passing of a vote of no confidence, or for any other reason, which is determined by the board to be in the best interests of the corporation.

(D7 (4)(2)) The management board may, with a seventy-five percent voting majority of supervisory board members, appoint a deputy to assist a member who has committed a breach on any grounds stated in (D7 (4)(1)), in order that such member may complete his or her term of office with the corporation.

(D7 (5)) The number of seats available on the management board would depend upon the number of employees employed in the workplace. This would be determined on a sliding scale.

(D7 (5)(1)) If a corporation employs between eleven to one hundred employees (inclusive), up to six seats would be available on the management board.

(D7 (5)(2)) If a corporation employs between one hundred and one employees and five hundred employees (inclusive), up to twelve seats would be available on the management board.

(D7 (5)(3)) If a corporation employs more than five hundred employees, up to eighteen seats would be available on the management board.

(D7 (6)) Members of the management board would have routine access to confidential information of the corporation.

(D7 (7)) The management board may also establish any sub-committees, or appoint inspectors, whose task would be to thoroughly examine matters of a technical or complex nature.

(D8) Banks, as shareholders, should be encouraged to sit on supervisory boards. A corporation would greatly benefit from their considerable personal skills, knowledge, motivation and experience. Corporations would also benefit by having access to the latest and most up to date information, which banks can bring along with them.

(D9) Management boards and supervisory boards must operate in such a way so as to ensure that each one of them provides information to the other on a regular basis. In this way, both boards remain fully informed.

(D10) Former members of the supervisory board may be elected as members of the management board of the same corporation, and visa versa, provided only that no member shall hold membership of both boards simultaneously.

(D11) Members of both the supervisory and management boards must meet regularly. At the start of the calendar year, a schedule of meetings for the year must be devised where the two boards agree to meet at least on a monthly basis. In this way, the supervisory and management boards would work together in the best interests of the corporation. Individual boards would also devise a schedule of meetings, which would allow its members to meet regularly.

(D12) A top management sub-committee of the management board *may* be established, which consists of no more than four members of the management board.

(D12 (1)) The top management sub-committee would consist of the chairperson of the management board together with up to three other members of the management board who have been nominated and appointed by majority vote to this position by the management board members themselves.

(D12 (2)) The functions of the top management sub-committee will be mainly ceremonial in nature, which would give a face to the corporation in matters of

importance. It would also be empowered to deal with matters that are so urgent in nature that, if delayed, would seriously affect the interests of the corporation.

(D12 (2)(1)) In the event that a matter is so urgent, the top management sub-committee does not have to confer with the supervisory board.

(D12 (2)(2)) The supervisory board cannot overturn the decision taken by the top management sub-committee.

(D12 (2)(3)) The top management sub-committee would not be legally accountable to the supervisory board for such decision taken.

(D12 (3)) The members of the supervisory board may, by majority vote, demand that the top management sub-committee disband on grounds of any one of, or a combination of, a gross breach of duty, an inability to exercise proper management, a passing of a vote of no confidence, or for any other reason, which is determined by the board to be in the best interests of the corporation.

(D13) In addition to the internal and external auditors and accountants appointed, all corporations, employing more than ten employees, must also appoint *statutory auditors*.

(D13 (1)) The members of the supervisory board would appoint statutory auditors for a period of three years.

(D13 (2)) The main purpose of the statutory auditors would be to monitor the activities of the corporation, to timely advise the management board of any problems that they encounter and to prevent the corporation from being sued for breaching any legislative regulations and rules.

(D14) Shareholders, who are elected to the membership of the supervisory board, must hold qualifying shares to sit on the board. However, employee representatives, elected to the membership of the supervisory board, do not need to hold qualifying shares to sit on the board.

(D14 (1)) Members of the management board do not need to hold qualifying shares to sit on the board.

(D14 (2)) Qualifying shares are to be determined by the management board and the supervisory board from time to time.

Table 6: A Schematic Diagram of the Major Building Blocks or Steps and Sub-blocks/steps of the Proposed Corporate Governance Model for South Africa

STEP A	STEP B	STEP C	STEP D
(A1) Change agents	(B1) Workplace forums (wpf)	(C1) Abandon traditional shareholder model	(D1) Satisfaction of all shareholders
(A2) Seven processes	(B1 (1)) Section 78(a) Senior managerial employees	(C2) Company/labour law linked/ multi-fiduciary model	(D1 (1)) Obligations seen as duties
(A2 (1)) Pressure for change	(B1 (2)) Section 78(b) Representative trade unions	(C3) Contractarian/ communitarian models	(D1 (2)) Continued research
(A2 (2)) Clear shared vision	(B1 (3)) Section 79(d) Joint decision-making matters		(D2) Long-term planning
(A2 (3)) Capacity for change	(B1 (4)) Section 80(1) Number of employees		(D2 (1)) Co-operation and consensus
(A2 (4)) Actionable first steps	(B1 (5)) Section 80(5)(b)(iii) Functioning wpf		(D3) Profit does not only count
(A2 (5)) Model the way	(B1 (6)) Section 83(1) Monthly meetings of wpf		(D3 (1)) Informed and trusted employees
(A2 (6)) Reinforcement of change	(B1 (7)) Section 83(2)(a)(b) Monthly meetings between wpf and employer		(D3 (2)) Family/ life-time employees
(A2 (7)) Evaluate and adapt	(B1 (8)) Section 83(3)(a) Monthly meetings between wpf and employees		(D3 (3)) Promotion through the ranks
(A3) Means	(B1 (9)) Section 83(3)(b) Annual Report		(D3 (4)) Education and training programmes
	(B1 (10)) Section 84 Proposals/ matters		(D3 (5)) 'Commercial prudence' principle
	(B1 (11)) Insert new deeming section 84(1A)		(D4)) Two-tier board: principle and pragmatism
	(B1 (12)) Insert new section 85(5)		(D4 (1)) Principles of co-determination

	(B1 (13)) Section 86(1) proposal/ conduct of employees		(D4 (2)) A choice between unitary/dual boards
	(B1 (14)) Section 86(4) Consensus between employer and wpf		(D4 (2)(1)) Revocable choices
	(B1 (15)) Insert new section 86(1)(e)		(D5) Two-tier board structure
	(B1 (16)) Section 86(7) Unresolved disputes		(D5 (1)) Constituents of the supervisory board
	(B1 (17)) Insert new section 86(4A)		(D5 (1)(1) Number of employees
	(B1 (18)) Insert new section 86(7A)		(D5 (1)(2)) Number of seats available
	(B1 (19)) Insert new section 87(1)(d)		(D5 (1)(2)(1)) Shareholder representatives
	(B1 (20)) Section 87(4) disputes to arbitration or Commission		(D5 (1)(2)(2)) Employee representatives
	(B1 (21)) Delete section 87(3)		(D5 (1)(2)(3)) Chairperson/ casting vote
	(B1 (22)) Short tile of section 87		(D5 (1)(2)(4)) Term of office
	(B1 (23)) Section 92(1) full-time members of wpf		(D5 (1)(2)(5)) Removal of employee representatives
	(B1 (24)) Delete section 82(1)(s)		(D5 (1)(2)(6)) Removal of shareholder representatives
	(B1 (25)) Section 93(1-4) Ballots		(D5 (1)(2)(7)) Grounds of dismissal
	(B2) The King Reports		(D5 (1)(3)) Available seats
	(B2 (1)) Nature/ size of corporations/ mandatory rules		(D5 (1)(3)(1)) Eleven to one hundred employees
	(B2 (2)) Development of other structures		(D5 (1)(3)(2)) One hundred and one to five hundred employees
	(B2 (2)(1)) Unitary board/ employee representatives/ wpf		(D5 (1)(3)(3)) More than five hundred employees
	(B2 (2)(2)) Unitary board/		(D5 (1)(4)) Strategic functions/

	employee sub-committees/wpf		legal accountability
	(B2 (2)(3)) Supervisory board/ unitary board/ wpf		(D5 (1)(5)) Stated functions in legislation/ extension in articles
	(B2 (2)(4)) Supervisory board/ wpf		(D5 (1)(6)) Functions to oversee/ supervise/ approve and appoint
	(B2 (3)) Disclosure and consultation		(D5 (1)(7)) Access to confidential information
	(B2 (4)) Mandatory rules		(D5 (1)(8)) Establish sub-committees/ inspectors
	(B2 (5)) Risk Management: employee representative		(D6) Involvement of wpf
	(B2 (6)) Participative management at all levels		(D7) Functions of management board
	(B2 (7)) Engaging with EthicSA		(D7 (1)) Election of management board members
	(B3) Bill of Rights in the Constitution		(D7 (2)) Appointment of chairperson by management board
	(B3 (1)) Section 23(5) Collective bargaining		(D7 (2)(1)) Appointment of chairperson by supervisory board
	(B3 (2)) Insert new section 23(1)(A)		(D7 (2)(2)) Casting vote of chairperson
	(B3 (2)(1)) Section 23(1)(A) unitary board		(D7 (3)) Term of office
	(B3 (2)(2)) Section 23(1)(A) unitary board/ employee representatives		(D7 (4)) Dismissal of members
	(B3 (2)(3)) Section 23(1)(A) unitary board/ employee subcommittees		(D7 (4)(1)) Grounds of dismissal
	(B3 (2)(4)) Section 23(1)(A) unitary board/ dual board		(D7 (4)(2)) Appointment of a deputy to assist members
	(B3 (2)(5)) Section 23(1)(A) dual board		(D7 (5)) Available seats
			(D7 (5)(1)) Eleven to one hundred employees
			(D7 (5)(2)) One hundred and

			one to five hundred employees
			(D7 (5)(3)) More than five hundred employees
			(D7 (6)) Access to confidential information
			(D7 (7)) Establish sub-committees/ inspectors
			(D8) Involvement of banks
			(D9) Information sharing between boards
			(D10) Switching to alternate boards
			(D11) Board meetings
			(D12) Top management sub-committee
			(D12 (1)) Composition
			(D12 (2)) Functions
			(D12 (2)(1)) Overriding powers in urgent matters
			(D12 (2)(2)) Decision cannot be overturned
			(D12 (2)(3)) No legal accountability
			(D12 (3)) Grounds to disband top management sub-committee
			(D13) Appointing statutory auditors
			(D13 (1)) Term of office
			(D13 (2)) Functions
			(D14) Qualifying shares for shareholder supervisory board members/ not required for employees
			(D14 (1)) Not required for management board members
			(D14 (2)) Determination of qualifying shares

CHAPTER 10:

(10.0) CONCLUDING REMARKS REGARDING THE PROPOSED CORPORATE GOVERNANCE MODEL

The approach taken in this study was premised upon three key research theses:

Research thesis 1: Corporate governance systems and legislation in South Africa have become anachronistic, especially in regard to employee participation.

This enquiry has been addressed by considering *inter alia* the two King Reports on corporate governance, South African company and labour legislation and the constitution. The problems associated with the traditional doctrine of company law enshrining the principles of wealth maximisation for shareholders were fully discussed. The significance of corporate stakeholders' rights and interests were considered in detail.

More specifically, in chapter 6, part 6.2, it was concluded from the analysis and discussion of the provisions relating to the establishment, functions and operating mechanisms of workplace forums, that they are inadequate in protecting and equalising the rights of employees for three main reasons.

Firstly, in the legislation there are provisions that are ambiguous, vague or in conflict with one another. Various provisions in the legislation should therefore be modified, amended or deleted to allow consistency and greater understanding and clarity for all the parties concerned.

Secondly, it is important that the establishment of workplace forums is made a mandatory requirement under the Act for those corporations that have more than

ten employees. In those corporations with ten or less employees, an employee representative must be nominated and elected to office by the employees. As it currently stands, only those workplaces with one hundred or more employees may establish workplace forums.

Thirdly, the legislation only allows for joint decision-making between the workplace forum and employer at line management level and, then, in only very limited and defined circumstances. Thus, the legislation needs to expand in such a way that it opens the doors for workplace forums to be involved in many more matters as part of the joint decision-making processes. This would mean allowing the workplace forum and its employees a joint decision-making role in those matters decided even at board level. If the employees were happy and satisfied, this would most likely lead to improved customer satisfaction, and, through this, improved profitability of the organisation.

A critical analysis and detailed discussion of the King Reports I (1994) and II (2002) in parts 6.3 to 6.5 of chapter 6 revealed that the guidelines referred to in each Report were inadequate in ensuring that worker participation exists in the corporation for the following reasons.

Firstly, the King Reports cannot be construed as enforceable legal documents. They have to rely on other factors to encourage compliance therewith. Some of these factors may be viewed as unreliable, especially those that encourage compliance with the Code through peer pressure. Although many recommendations and principles of the King Reports are encouraging, they are vague. It may thus be rather difficult in practice to persuade or encourage companies to implement the recommendations.

Secondly, the King Reports have made recommendations that ought to be applied to only “affected corporations” (King Report I) or “affected companies” (King Report II). Hence, the majority of corporations in South Africa, whatever their nature, size or type, are generally not expected to comply with the recommendations contained within the King Reports, although they may if they wish to. Since the King Reports only formulated recommendations, they are not mandatory and, therefore, even affected corporations/companies need not apply them if they do not wish to.

Thirdly, the King Reports do not support the development and implementation of the two-tier board system. Although the Reports acknowledge the success of this type of system in Germany, they encourage the unitary board system to be retained in South Africa. The reasons the Reports provide for this conclusion are based upon affirmative action policies and greater personal interaction for new board members and are therefore unsound. As discussed in this thesis, however, to dismiss the two-tier board structure is unconvincing and anachronistic. At the very least, the King II Committee should have seriously considered the proposals for organisations to establish 'employee board committees'. This would commence the process of achieving a system in terms of which employees would have participatory roles in joint decision-making at board level. This could develop into a system where the employees could be invited to sit on the board itself. This governance system does not necessarily advocate that employees need to be directors. There is no reason why employees need to be directors to sit on the board. Although this is a traditional approach enshrined in deep-seated company law principles, there is no reason to assume permanency. By allowing employees a say in decisions taken at board level would be advantageous to all parties. It would also help to strengthen the processes of industrial democracy in South Africa, which, at times, may seem rather fragile.

Fourthly, the King Reports repeat various points throughout the text with variations in content and application, which can cause much confusion to the reader. A more succinct and concise text would have been preferred in each Report. Therefore, the King Reports suffer from too much disorganisation in structure and content to be entirely useful to corporations.

Fifthly, the rights of workplace forums under the South African *Labour Relations Act* to be involved in the joint decision-making processes of the corporation have not been increased or improved in any significant manner as a result of the recommendations of the King II Report. The King II Report focuses its proposals to a large extent on issues such as accounting and auditing practices and the like. It does not pay sufficient attention to the advantages of workplace forums and of employees participating in the decision-making roles of the organisation.

In part 6.11 of chapter 6, it was indicated that the Bill of Rights under the 1996 Constitution provides another means under which labour could ensure the rights to fair labour practices. Section 23 promotes collective bargaining. However, section 23 removed the previous reference to 'workers' and substituted it with 'trade unions,

employers' organisations and employers'. Thus, whilst 'employers' retained the right under the 1996 Constitution to engage in collective bargaining, individual workers did not. This leads to an imbalance of rights and the Constitutional Assembly and Constitutional Court should consider reinserting the word 'workers' into the provision dealing with labour relations. It is possible for individual employees to be part of the collective bargaining process. Thus, requiring them only to act in concert as part of the collective bargaining process is unnecessary and restrictive.

Generally speaking, the 1996 Constitution entrenches in part constitutionally sound principles of labour law. However, it does not go far enough in formulating and entrenching certain principles that would achieve greater industrial democracy in South African labour and company law. In addition, the 1996 Constitution does not mention the extent to which employees should have a joint decision-making role in the running of the organisation. South Africa would move forward in establishing a dual board structure and consequently in achieving greater industrial democracy if the Constitutional Assembly and/or the Constitutional Court take an active role in supporting this. This issue is general and can therefore be readily incorporated into any new amendments made to the Constitution. It is also important enough to be taken very seriously by the highest bodies in the land. Thus, both the Constitution and the *Labour Relations Act* should enact provisions, which require management to recognise the needs of employees in order to achieve job satisfaction in their workplace. In so doing, employers must maintain and operate the workplace in such a way, which clearly maximises the possibility of attaining these results. This promotes a sense of goodwill and confidence amongst the parties and creates an environment, which is conducive to achieving greater job satisfaction and enhanced economic productivity. Consequently, both the 1996 Constitution and the current *Labour Relations Act* still have a long way to go in attaining an acceptable balance in labour between the rights of employees and those of the employers. At this time, employers still have very much the upper hand in South African labour law.

Research thesis 2: In order to achieve higher levels of corporate performance and to become more competitive on the global market, South Africa needs, amongst other things, to update its corporate governance systems, structures and legislation.

This enquiry has been addressed by proposing in chapter 9, parts 9.3.2.1 to 9.3.2.3, numerous recommendations for change to *inter alia* company and labour legislation,

the Constitution and future King or similar Reports. Thus, the aim is to suggest changes for South Africa of a *legal* nature, which would promote an improved and more meaningful system of worker participation in the corporation. In this regard, modifications were suggested that should be made to the major South African legislative enactments and to the King Reports, which have thus far attempted to provide employees with some rights of participation in the decision-making processes of the corporation.

Additionally, chapter 9, part 9.3.1, revealed that seven steps needed to be complied with in order to ensure successful changes in the workplace. These steps focus on what managers need to do to show the various stakeholders of the organisation that they are flexible enough to introduce progressive changes to the workplace and to adapt to a changing environment. These steps are critical in establishing not only effective employee participation in the workplace, but also in enhancing a system of improved employee satisfaction in their jobs. It is to be noted that all of these seven steps need to be complied with in order for any successful change to be implemented. Different adverse symptoms result in each case if one of the seven steps is not present.

Furthermore, various organisational development means were discussed to bring about the changes resulting in greater employee empowerment. Thus, by empowering employees and allowing them to participate in the decision-making processes of the corporation, this would lead to changes in their working environment and thereby promote their sense of well-being. As a result, organisations would generate greater job satisfaction, improved customer service and enhanced profitability.

Changes in the patterns of traditional corporate thinking and attitudes were suggested in chapter 9, part 9.3.3, by continuing to reject the anachronistic principles of company law. It is necessary to seriously consider the ideology that employees should have greater rights in the decision-making processes of the corporation at all levels. This establishes greater insight into the reasons why this has become necessary in order to achieve an improved market economy. Thus, The world has moved forward since the formulation of the shareholder wealth maximisation doctrine and so has South Africa. It is difficult to endorse a doctrine that does not take into account the rights of the other non-shareholder

constituencies. The current *Labour Relations Act* has rejected the 'traditionalist' approach. Although the Act has still a long way to go, it has commenced the process of turning away from the ideology that organisations exist to maximise shareholder wealth. It has begun to recognise the rights of non-shareholders. Workplace forums now exist and employees, through their trade unions, now have a joint decision-making role at line management level in limited situations. South Africa has now moved beyond the traditional doctrine in company law and there is now no returning to it. South Africa must now enact legislation that extends these rights to greater and more meaningful dimensions for labour. It needs to do this by establishing dual board structures. Rules and provisions regulating the establishment, functioning and membership of these structures should be provided for in *both* labour and company legislation. Labour law has progressed to a limited degree in recognising non-shareholder rights in decision-making processes. It is time that a new South African company act reflects these rights as well.

Research thesis 3: Corporate governance models based on those systems, which have proven successful elsewhere and can be adapted to South Africa's specific needs and cultural dimensions, will provide a strategic platform to facilitate substantial improvements in corporate performance and productivity.

Substantial improvements to South Africa's corporate governance structures were recommended through its implementation of certain features of governance models used in Germany, France and Japan. As a result, if implemented, corporate performance and productivity will substantially improve. In chapter 9, part 9.3.4, the most favourable features from successful international corporate governance models were extracted as the building blocks in the design of a new and improved model of corporate governance for South Africa. The features extracted apply primarily to the issue of stakeholder participation in the decision-making processes of the corporation. In this regard, focus was placed upon the participation of the employees.

Finally, based on the arguments and discussions in this thesis, the proposed corporate governance model will offer an improved system of corporate governance to organisations in South Africa. This is particularly apposite in so far as the participation of the employees in the decision-making processes of the corporation at

board level is concerned. The King Reports have been reluctant to recommend a change from the current unitary board structure to the two-tier board structure. However, the two-tier board structure is, for reasons provided, the preferred option. In the proposed corporate governance model, it is recommended that certain features of other systems be adopted, which further the interests and the rights of employees in the decision-making processes at board level. These systems could be introduced into the unitary board structure whilst the development of the dual board structure is underway. Ultimately, however, if South Africa is firmly intent on turning its economy into one that is stronger and better, corporations will have to introduce the two-tier board model of corporate governance into their business practices.

The proposed corporate governance model consists of four main steps, which are also the four main building blocks, or pillars that keep it upright. These four building blocks consist of:

The introduction and maintenance of a system of organisational development within the corporation;

The introduction of new legislation in South Africa, which promotes an improved and more meaningful system of worker participation in the corporation;

The introduction of changed patterns of corporate thinking and a rejection of antiquated principles of company law; and

The introduction in South Africa of some of the favourable features of successful international corporate governance models.

Each of the four main building blocks is made up of sub-blocks or factors, all of which cemented together, form the composite whole. Each factor, as mentioned previously, can be likened to a brick in a wall of any building. If one or more of the bricks are missing, the wall or, in this case, the corporate governance model, will be weakened.

The proposed corporate governance model is presented as a potentially new and refreshing start to effective corporate governance practices in South Africa. Changes are always viewed with great skepticism, but are nevertheless vital to progress and

it is therefore recommended that this model be seriously considered. It is an economic necessity and a moral imperative and will contribute to a wealthier and happier South Africa.

APPENDIX:

A discussion of the recommendations and proposals of the Department of Trade and Industry highlights the fact that corporate reform will commence in 2006 with the introduction of a new South African Companies Act. This discussion is also significant because it sets the scene for the commencement and implementation of a new corporate governance structure for South Africa in 2006 through legislative changes in the South African Companies Act.

(A.1) The Department of Trade and Industry (DTI) South Africa

In May 2004 the DTI issued for public comment a policy document. [1301]

According to Mandisi Mpahlwa, the South African Minister of Trade and Industry, the main purpose of this policy paper is to establish the approach that government intends taking to review company law in South Africa. The report also establishes a

> … framework for detailed technical consultation to ensure that we have company law, which is up-to-date, competitive and designed for a modern corporation that is not only a domestic institution operating in a new environment but also an international competitor. [1302]

This will involve a review of the *Companies Act 1973*, the *Close Corporations Act*, 1984 and the common law. [1303] The Minister also acknowledges the fact that since the introduction of the 1926 *Companies Act* there has only been *one* significant review of South African company law and that was through the introduction of the 1973 *Companies Act*.

[1301] Department of Trade and Industry, above n 159.

[1302] Ibid 5.

[1303] Ibid 10.

Havenga also believes that the South African *Companies Act* is "in need of comprehensive review". [1304]

Although the 1973 Act was a major review of South African company law, it left the traditional framework and principles of English law firmly entrenched in our company law. [1305] This policy document will be used as the foundation to draft a new *Companies Act* to be considered by cabinet for publication in September 2005. It will then be published for public comment during the period September to December 2005. The State President will proclaim the Bill in June 2006. [1306]

The broad areas of review will focus upon issues of company formation, finance, corporate governance, mergers and takeovers, liquidation and corporate rescues and non-profit corporate entities.

The DTI policy document has recommended certain changes in the areas of company formation and corporate governance, some of which are relevant to the discussions and arguments in this thesis. Many of the changes, which have been outlined in the DTI review paper, are identical or very similar to the amendments, modifications and suggestions that have been proposed in this thesis. There are, however, various principles outlined in the DTI Report, which are arguably incorrect or unconvincing.

(A.2) Major reform proposals of the Department of Trade and Industry

In this thesis, the significance and application of key principles have been discussed in an attempt to formulate, design and construct a new and workable model of corporate governance for South Africa. The proposals set out in the DTI public discussion document have highlighted some of the key principles and issues argued in this thesis. These issues will be divided into two categories depending upon whether the proposals set out in this thesis concur with the views of the DTI or not.

1304 Havenga (1997), above n 36, 323.

1305 Department of Trade and Industry, above n 159, 4.

1306 Ibid 53.

Firstly, based upon the arguments in this thesis, the following ten major proposals and concerns of the DTI are sound:

1. Any regulatory policy must recognise the unique South African context and therefore promote equity in such a manner, which is consistent with the South African Constitution. [1307]

2. Company law should encourage principles of transparency and high standards of corporate governance and therefore recognise the broader social functions of corporations. [1308]

3. The review will also consider the relationship between company law and any other rules, which protect the interests of shareholders, employees, the State, the environment, consumers and suppliers. [1309]

4. From an international perspective, company law review is a continuous process, which ensures that the laws are reflective of market practices and societal needs. Because we now live in a world of greater globalisation, increased electronic communication and greater sensitivity to social and ethical concerns, South Africa must review its legislative policies or be left behind. There is a growing recognition by companies and governments that higher standards of corporate governance are required. There is a need for further interdependence between corporations and communities. Corporate failures in South Africa have revealed serious defects in the current standard of corporate governance, which have resulted in extensive losses to investors.[1310]

5. The most significant change was the adoption of the Constitution in 1996. No area of South African law can be evaluated without a consideration of the Constitution, which is the supreme law of the country. Chapter 2 of the Constitution provides for the Bill of Rights, which “constitutes a cornerstone of democracy in South Africa”. It enshrines the “democratic values of human dignity, equality and freedom”. It regulates the relationship between economic citizens and has fundamental implications for company law. “…

1307 Ibid 9.

1308 Ibid 10.

1309 Ibid 11.

1310 Ibid 14.

Legislative and other measures, which reflect these constitutional principles, include the attempt to balance the interests of employees and employers and to enhance equity in employment, as captured in labour legislation, particularly the *Labour Relations Act* of 1995". Furthermore, new company law should be consistent with the Constitution of South Africa and with the principles of equality and fairness and with other legislation as well. [1311]

6. Current company law does not contain clear rules regarding corporate governance issues and the duties and liabilities of directors. These matters have been left to the common law and Codes of Corporate Practice. Thus, there is no extensive statutory scheme, which covers the duties, obligations and accountability of directors. Thus, directors and senior management of large companies are generally "immune from legal control", except in more serious criminal cases. Another significant weakness is the "absence of a public institution" charged with the powers to "enforce the rights of shareholders and other stakeholders". [1312]

   Havenga is of the opinion that South African company law would benefit "from a general statement of directors' fiduciary duties in the Act". This duty "should confirm" that fiduciary duties are to be owed to the company and also consider "other stakeholders' interests". [1313] This would allow directors to be accountable in the way that they exercise their powers. [1314]

7. The economic success of a company will bring about social benefits to many stakeholder constituencies. This will not happen if the company is a financial failure. The issue of obliging directors to act primarily for the benefit of shareholders alone was questioned. Corporate governance reforms were undertaken in many parts of the world in the late 1980's and early 1990's. This reform process questioned whether the interests of the company should be managed for the shareholders alone or for the other corporate stakeholders as well. There are many views that strongly support the idea that corporate governance should be seen as a system by which corporations are to be governed for the benefits of all stakeholders, including shareholders, employees, creditors, suppliers and the community. In this

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1311 Ibid 15.

1312 Ibid 18.

1313 Havenga (1997), above n 36, 323.

1314 Ibid.

way, “companies should be run as communities in partnerships with all their stakeholders”. Thus, the success of a company is inextricably intertwined with a consideration of the rights and interests of its employees and other stakeholders. [1315]

8. In South Africa, company law must consider the rights and interests of the other corporate stakeholders such as the community, customers, employees, suppliers and the environment. Thus, consideration must be given to both the economic factors and also to the social and environmental factors. In this regard, a review of company law in South Africa would follow world trends and also consider the country’s unique social and legislative environment. Hence, ‘a company should have as its objective the conduct of business activities with a view to enhancing the economic success of the corporation, taking into account, as appropriate, the legitimate interests of other stakeholder constituencies’. Consequently, directors should consider the policies and principles, which are reflected in the Constitution and other legislation for the benefit of other stakeholders. [1316]

9. Company law needs to recognise that companies affect society and therefore many stakeholders. However, some of the relationships, such as those with employees, are best regulated through specific laws. Furthermore, codes of best practice ensure that stakeholder interests are considered. Thus, there is a need to promote corporate citizenship. [1317] Company law must protect investors in companies, including the equity investors, employees and creditors. This is so notwithstanding the fact that the rights of employees are generally protected in labour law. Furthermore, many creditors rely on contract in order to protect their investments. [1318]

10. The categorisation of business entities between close corporations, private companies and public companies is artificial and hence no longer economically viable for South Africa. Thus, it is necessary to move away from this separation of different business forms and to recognise only one business structure in order to provide simpler company practices and legislation. [1319]

[1315] Department of Trade and Industry, above n 159, 22-23.

[1316] Ibid 26.

[1317] Ibid 27–28.

[1318] Ibid 37.

[1319] Ibid 32.

In light of the arguments in the thesis, the following proposal of the DTI is arguably incorrect and unconvincing:

> There has been a question in South Africa for some time whether we should follow the example of continental Europe in establishing a two-tier board or whether a unitary board structure should be required. While a two-tier board provides for the opportunity for stakeholder representation, the European experience has shown that this type of Board structure is often inefficient, may deter investment and is not necessarily desirable for stakeholders. Furthermore, South Africa has largely adopted a unitary board structure to date and imposing a legal requirement for a two-tier structure may be costly. For this reason, the position of this policy document is that a unitary board structure be retained, but that stakeholder representation on that board should be optional. [1320]

Arguments refuting the contentions of the DTI with regard to the two-tier board structure of corporate governance are set out below. [1321]

A Regarding the issue of *efficiency*, the two-tier board structure identifies the need for supervision and places this function into the hands of a group of people. It also identifies the need for direction and management and places this function into the hands of another group of people. In this way, large German companies today have a supervisory board and a management board.

A key reason for the division of functions between the supervisory and management boards is based upon the belief that if management is stronger, it then becomes less safe to assume that its interests coincide with those of the owners of the business. Shareholder and employee representatives on the supervisory board proceed with management by co-operation rather than by confrontation. Thus, trade unions have a preference for the two-tier board structure and believe that representative employees are better informed.

A two-tier board system is, therefore, to be preferred “on grounds both of principle and of pragmatism”. In principle, it provides a “clear division of function”. Pragmatically, the principle of co-determination would not work well in a unitary board system. Based upon these features, the two-tier board structure certainly appears to be a far more *efficient* system of corporate governance than the unitary board system.

[1320] Ibid 39.

[1321] Charkham, above n 87, 14-56.

B Regarding the question of the *desirability* of the two-tier board structure for stakeholders, shareholders would hold two-thirds of the available seats on the supervisory board, whilst the employees or unions would hold one-third of the seats. This would apply to AG companies that have less than 2000 employees. In the case where an AG company has more than 2000 employees, half of the available seats would be held by employees/unions. Both employees and the unions usually choose representative employees. One employee representative must be selected in each case from the salaried staff and from the executive staff. Based upon these features, the two-tier structure would certainly be one, which would allow a greater amount of stakeholder representations in having created its supervisory boards. Furthermore, banks in Germany also commonly sit on supervisory boards. In this way, companies may have access to information, which they ordinarily may not have. This would be a far more *desirable* system for corporate stakeholders.

C Regarding the question of attracting *investment*, the two-tier board structure, through the German legislation, enshrines the principle of “commercial prudence” in accounting procedures, rather than the principle of having to show a “true and fair view”, which is found in other accounting systems. In this way, accounting reserves for risks are made. Consequently, profits are reduced, but reserves are maintained in case the company experiences financial difficulties at some stage. This has an overall positive effect on stakeholders, a factor, which German corporations tend to value highly. Therefore, although the profits are reduced, “commercial prudence” ensures that the business survives. This principle is more important to German companies than any of the reasons, which attempt to maximise shareholder wealth and company profits. This, in effect, removes the stock market from the centre of the stage. Furthermore, banks and employees and unions have a very important role, which has enabled the supervisory board to function adequately. This success has largely depended upon the establishment of networks, which only function effectively because co-operation rather than confrontation is regarded as the way forward. This system has given rise to the success of German industry over the last forty years. In particular, the German industry has prospered due to the creation of a well-motivated and trained workforce, a relatively stable macro-economic climate and an effective two-tier board governance system. In this way, Germany has consistently had a rising currency. This success may be due to the fact that there is a

genuine belief that co-determination is socially desirable and economically beneficial. Therefore, on the whole, the two-tier board system in Germany has not deterred, but very much *enhanced*, German *investment*. Thus, the "general consensus … of German commentary" is that the German two-tier board system would not benefit if replaced by a single board structure. Thus, there is no need to change the current system in Germany, "which would bring about changes and upheaval to a legal culture … evolved over many years".[1322] Finally, du Plessis believes

> that the German two-tier system provides answers to many of the compelling problems associated with the unitary system: Through such a system a broader spectrum of interests in the corporation are formally recognised and it ensures that exclusive shareholder control is not the norm anymore. [1323]

D It is not clear what the DTI means when it submits that "a two-tier structure may be costly". Although it may be *costly* (from a monetary point of view) for South Africa to convert from a unitary to a two-tier board structure of corporate governance, the advantages of having a two-tier board system would easily outweigh the financial costs involved. In any event, it would appear (from the wording "(f)or this reason") as if the DTI has placed *primary emphasis* on the question of costs. The DTI ought not to rely on the questions of costs as its prime reason to reject the two-tier board system. If the DTI is referring to costs of a non-pecuniary nature, it needs to spell out exactly what it intends in its proposals in this regard.

(A.3) Conclusion

Regarding the aforementioned discussions, the DTI policy report has made a number of sound proposals concerning corporate law reformation. I have held many of these views ever since work was started on this thesis in 1995. Thus, many of the sentiments, which have been expressed in this thesis regarding stakeholder interests in corporate governance, have finally been recommended as a way forward for South African corporate governance. The DTI is, unfortunately, arguably incorrect in its recommendation to retain the unitary board system of corporate governance in

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[1322] Shearman, above n 453, 24.

[1323] Du Plessis (1996), above n 104, 45.

South Africa. Hopefully, this thesis will prompt the DTI to place greater value on the effects and advantages of the two-tier board structure of corporate governance for South Africa.

Finally, it is arguable that the view set out below may have some general significance for South African corporate governance. In a recent Australian corporate governance research report, it was noted that

> (t)here is a wide gap between the maximum possible and the minimum excusable, and the whole spectrum is observable in Australian corporate governance; the best of our boards are performing well, but there is a long tail of boards in which little thought is given to governance, and in which more attention is given to personal gain than fiduciary duty. [1324]

Thus, some business entities would have very good corporate governance structures in place, whilst others would have governance structures, which were poor or deficient in some way or another. Company and labour legislation (and bodies such as the King Committee and the Department of Trade and Industry) must ensure that corporate governance processes are considered significant and put into practice in the most workable and efficient manner possible by all business entities in South Africa.

[1324] H Bosch (2001), *Collapse Incorporated*, CCH, Australia, 5, quoted in Horwath (2002), "Corporate Governance Report", <http://www. newcastle.edu.au/school/newc-business/horwath/index.html>.

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