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CORPORATE GOVERNANCE LAW REFORM IN SOUTH AFRICA

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I. CHAPTER ONE: INTRODUCTION

(a) Introduction and background

Achieving good corporate governance has proved to be a complex and difficult task in practice. The implementation of sound governance practices is therefore fundamental for the healthy functioning of corporate entities. The objective of this mini dissertation is to, amongst others, examine the evolution of corporate governance in South Africa. Good and proper corporate governance practices is essential in preventing corporate scandals, fraud, as well as potential civil and criminal liability of corporate entities. Further to this, sound corporate governance practices are paramount to capital investment, particularly for developing countries like South Africa where there is a greater need to attract direct foreign investment and strengthen the economy.[1] According to the ninth president of the Word Bank, Jim Wolfensohn, proper governance of companies will become as crucial to the world economy as the proper governing of countries.[2]

Corporate governance essentially deals with the structures and processes associated with management, decision making and control in organisations.[3] It thus relates to the way in which companies are directed and controlled and the principles and practices that are regarded as appropriate conduct by the company's directors.[4] It can therefore be adduced that responsible leadership is key for healthy corporate governance. Responsible leadership can be broken up to reveal a number of values which should underpin a good corporate governance system. On this note, the court held in the case of *South African Broadcasting Corporation Ltd v Mpofu*[5] as follows:

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[1] In the case of *Minister of Water Affair and Forestry v Stilfontein Gold Mining Co Ltd* 2006 (5) SA 333 (W) Para 16.7 it was held ' *Practicing sound corporate governance is essential for the well-being of a company and is in the best interest of the growth of South Africa's economy, particularly in attracting new investments and potential investors*'.
[2] Wolfensohn, *World Bank,* http://www.ifc.org/ifcext, accessed: 22 April 2016.
[3] Wixley and Everingham*, Corporate Governance* 2 ed (Cape Town: Siber Ink 2005) 1.
[4] King '*The synergies and interaction between King III and the Companies Act 71 of 2008*' 2010 447.
[5] [2009] 4 All SA 169 (GSJ).

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> 'Integrity is a key principle underpinning good corporate governance. Put clearly, good corporate governance is based on a clear code of ethical behaviour and personal integrity exercised by the board, where communications are shared openly…'[6]

In 1994, the King Report on Corporate Governance (King I) was published by the King Committee on Corporate Governance. King I, which incorporated a Code of Corporate Practices and Conduct, was the first of its kind in South Africa and was considered as ground-breaking. King I intended to promote the highest values and standards of corporate governance in South Africa. However, as time progressed, the amendments to legislation coupled with rapid global economic development, necessitated the updating and modernising of King 1. In light of such, the King Committee on Corporate Governance developed the King Report on Corporate Governance for South Africa, 2002 (King II). King II acknowledged that there needs to be a transition from the 'single bottom line' approach, which was focussed only on profit making for the shareholders, towards a 'triple bottom line' approach, which embraces three main aspects, namely the economic, environmental and social characteristics of a company's activities. The King Report on Corporate Governance for South Africa 2009 (King III) and the King Code of Governance for South Africa 2009 (the Code) came into effect on 1 March 2010, and have thus replaced the King II Report.

Once again, the reforms in legislation, and more specifically, the enactment of the Companies Act, 2008 (Act No. 71 of 2008) (Herein interchangeably referred to as "The Act or The Companies Act") together with changes in the international governance trends sparked the need for King III. Amongst others, King III focuses on the importance of reporting on the positive and negative economic effect that a company has on the community which it operates in on an annual basis. Furthermore, emphasis is placed on how the company will enhance positive effects and work towards eradicating the negative financial impacts on the community it operates in.

While it may be true that achieving good corporate governance is difficult in practice, the positive spin from the recent 'Gupta saga' in South Africa is that corporate governance in South Africa is working as it indeed should. This is according to Rhodes University Professor Matthew Lester, a member of the Davis Tax Committee, who reacted to financial services companies breaking ties with the Gupta-owned Oakbay Investments (Pty) Ltd.[7] The King III

[6] At paragraph 64.
[7] Fadia Salie, *Gupta saga shows corporate governance working in SA*, http://www.fin24.com/Economy/gupta-saga-shows-corporate-governance-working-in-sa-20160410, accessed 13 April 2016.

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report starts off with the observations that stakeholders cannot be ignored. The consequence of such proved itself in the March 2016 'Gupta saga', when Oakbay's auditor KPMG as well as its financial institutions, namely FNB and Absa and also its sponsor Sasfin Capital all cut ties with the Gupta-owned Oakbay Investments (Pty) Ltd, which indirectly had a negative effect on the reputation and public standing of Oakbay Investments (Pty) Ltd.

(b) Problem statement

This mini-dissertation seeks to address the question of whether our current legislation, specifically the Companies Act, adequately addresses corporate governance issues.[8] In the early 2000s, government found that it was a crucial to improve South Africa's company laws. The then Minister of Trade and Industry stated as follows:

> 'The new horizons in the commercial world, developed in a short period of 25 years resulting from a generation change, has undoubtedly made the present Companies Act somewhat archaic in many respects and certainly cumbersome in operation.'[9]

The above statement by the Minister of Trade and Industry sparked the commencement of the Act which replaced almost the whole of the 1973 Companies Act.[10] The Act brought about momentous amendments to South African Company law, with corporate governance being one of them.

The question now is whether the corporate governance reforms in South Africa are adequate to meet internationally recognised standards. Furthermore, an insinuation is being made by academics that certain components of King III stand good ground to become law. This study will thus further analyse whether any of the corporate governance principles in King III should ideally be legislated as the best approach for South Africa in terms of corporate governance going forward.

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[8] The Act which was approved by parliament in in November 2008 contained multitude of errors which had to be remedied. This led to a staggering 60 page Companies Amendment Act No. 3 of 2010. Perhaps this reveals that government as the drafters of the bill, failed to consider key factors when drafting the Companies Bill.

[9] Bowman Gilfillan Attorneys, *The Most Significant Changes to South Africa's Company Laws brought about by the Companies Act*, page 6.

[10] With exception to Chapter 14, sections 337 to 426, which governs the winding up and liquidation of insolvent companies, and which remains in force and unaltered.

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(c) Literature review

Professor Mervyn King, says

> ‘Good corporate governance is about 'intellectual honesty' and not just sticking to rules and regulations, capital flowed towards companies that practiced this type of good governance, and it is clear that good corporate governance makes good sense. The name of the game for a company in the 21st Century will be conforming while it performs.’

The code of King III applies to all entities, regardless of the manner and form of their incorporation or establishment. Organizations are encouraged to disclose principles and practices and to provide explanations for non-compliance. King III identifies that there is no ‘one size fits all’ answer. The governance framework of King III is based on the ‘apply or explain’ approach. This method provides that the board may practice governance in a manner that is different from that recommended by King III, as long as the Board provides satisfactory reasons for the diversion.

The Act brought about a wholesale overhaul of South African company law and it seeks to introduce best practice and promote transparency and accountability in the South African corporate sector. As mentioned above, corporate governance was institutionalised in South Africa through the King Reports on corporate governance. Many of the recommendations contained in the King Codes have been included in the Companies Act. The King Commission provides that corporate governance is ‘*the process by which organizations are directed and controlled’*. The U.K. committee on corporate governance, on the other hand, defines corporate governance as *‘a system by which companies are directed and controlled*’.

The codes of corporate governance, offers a suitable guide on how a company should be governed and controlled, in order to meet the set company goals. Upholding and following the corporate governance codes will thus be beneficial to all stakeholder because it adds value to a company’s integrity and sustainability.

This study will examine the Act, as well as King I, King II, King III and the Code. This study will further look at King III and compare it with the Act in order to determine if there are still King principles that need to be incorporated into law rather than in the codes in order to promote a healthier and fruitful South African corporate governance system. Importantly, this study focusses on King III rather than King IV, because at the time of conducting the research for this study, King III was in effect and King IV had not yet been released.

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(d) Aims and objectives of the study

The aim of this study is to examine corporate governance reform and to furthermore conduct an investigation into the King III principles in order to determine to what extent the King III principles should be legislated.

As mentioned above, proper corporate governance is important for investment, especially in South Africa, where it is essential to attract foreign direct investment. One of the most fundamental forces for corporate governance reform in South Africa has been government.[11] Government has been tasked with the drafting of legislation in accordance with their respective portfolios and mandates. The Department of Trade and Industry (DTI) is responsible for drafting South African corporate laws. It goes without saying that corporate governance failures can have detrimental effects on stakeholders, especially on the shareholders of a company. This was evident from examples of prominent corporate collapses like Saambou Bank and Fidentia in South Africa. In addition to this, South Africa's largest steel producer, ArcelorMittal, was under severe financial strain in 2016, which forced the company to retrench approximately 2200 employees without retrenchment packages. ArcelorMittal narrowly escaped corporate failure due to the successful completion of a fundraising drive with a 3-billion dollar rights issue, in which shareholders were offered the first option to buy additional company shares in order to cut its debt and shore up its balance sheet.[12]

The protection mechanism against corporate collapses is infallibly, national legislation and appropriate industry regulation. In light of such, government is entrusted with the fundamental responsibility of ensuring that it applies its mind adequately to the past, present and future corporate issues when drafting legislation. Surely not all corporate governance failures can be prevented, however national legislation is a key factor in limiting corporate governance failures. Considering that directors will have a greater information advantage over other stakeholders, including the shareholders, the need for proper and effective corporate governance is more paramount now than ever before.

The question is whether our statutory laws are sufficient and appropriately aligned with corporate governance codes and set international standards in order to effectively prevent the

[11] It is imperative to note that the market, regulatory agencies, the accountants' profession and the JSE have, in addition to government, also been forces for change in corporate governance which is motivated largely by the desire to apply international standards in South Africa.

[12] Lisa Steyn: SA's steel industry on brink of collapse http://mg.co.za/article/2016-04-07-sas-steel-industry-on-brink-of-collapse , accessed on 13 May 2016

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abuse of power and ultimately corporate collapse. On this note, this study will seek to obtain information from government on how it views the reforms of corporate law to be. In assessing corporate governance reforms, the study will aim to determine whether such is in harmony with reforms of other international jurisdictions. A comparison with United Kingdom (UK) company laws will be drawn. The Act and corporate governance principles in King III will be examined, with the aim of determining whether any of such principles should ideally be legislated as the best approach for South Africa going forward.

(e) Research methodology

The Companies Act, 2008 (Act No. 71 of 2008) and King III are the primary sources of literature used in this study. Reviewing the development of the King Reports and corporate governance forms a fundamental part of this study and thus chapter two will discuss the King III principles in order to determine which principles should ideally be legislated. Research for this study was conducted in two phases. The first part was based on a literature study of the subject of corporate governance, which covers the historical development of corporate governance and the current corporate governance practices in South Africa. The literature study was library based and internet based, drawing information mainly from textbooks, reports, legislation case laws, articles and websites.

The second part of this study was based on the practical evidence gathered by means of interviewing the Director: Legislation within the DTI, Mr Johan Strydom. Mr Strydom has been working for the DTI for the past twenty five years and was involved with the drafting and review of the Act. Mr Strydom was also actively involved with the review of the Act from a legal and technical perspective and indicated that Mr Phil Knight, a Canadian, in conjunction with externally sourced expertise by the DTI were primarily tasked with the drafting of the Act. The externally sourced expertise formed a panel called the 'Companies Act Drafting Team' which comprised for four panel members. Specific questions were posed to Mr Strydom as the representative of DTI in order to gain an improved understanding of the intentions of the legislature regarding the approach taken toward corporate governance[13] and in order to gain an understanding of the future plans for corporate governance reform.

[13] Although parliament is legislature, the Bill was drawn up by the government Department of Trade and Industry under direction of the Minister or Deputy Minister of Trade and Industry. Following the South African law making process, the Bill was then approved by the Cabinet before being submitted to Parliament.

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(f) The structure of the mini-dissertation

This mini-dissertation consists of five inter-related chapters. Chapter one is the introductory chapter laying down the basis for the study. Chapter two discusses the principles of corporate governance provided in the King III Report and the code. Notably, the intention of Chapter two is not to provide a summary of King III and the code but rather to briefly discuss all nine principles of corporate governance, in order to determine which should be ideally legislated. Chapter three will focus on Corporate Governance Reform in South Africa. Furthermore, Chapter 3 will cover the possibility of the incorporation of King III principles into law. Chapter four discusses a comparative perspective on corporative governance between South Africa and the UK. This chapter will examine the role played by the UK in influencing South African company law specifically on the corporate governance. Lastly, chapter five is the summary of conclusions drawn from the whole study and makes some recommendations.

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II. CHAPTER TWO: PRINCIPLES OF CORPORATE GOVERNANCE

(a) Introduction

As a result of certain corporate failures in the United Kingdom (UK) and in the United States of America (US), the Treadway Commission and the Cadbury Commission were both set up in the US and the UK, respectively, with the Cadbury Report[14] being published in 1992. This sparked many corporate governance codifications all over the world, including South Africa when the Institute of Directors of Southern Africa (IoDSA), together with the support of several businesses and professional organisations, commissioned the drafting of a code of corporate governance, namely King I.[15] The transition of South Africa from an apartheid era to a democratic state created an added challenge in drafting appropriate governance codes and principles. However, as a new democratic country, the need for South Africa to acquaint itself with international corporate governance practices was greater than ever before. Loubser provides that the King Report I, was envisaged to be a living document which would be reviewed and adapted to changing circumstances.[16] King I created awareness on good governance and advocated an integrated approach towards good governance.

It is difficult to find a single definition of corporate governance in the South African context. Corporate governance is subject to both broad and narrow definitions, with the narrow definition referring to governance of companies from within the company and the broad definition referring to control of a company from the outside of the company. Notably, most definitions in corporate governance refer to a form of control, management and conduct of a company. Thus, corporate governance is generally understood to mean the manner in which companies are directed and controlled,[17] implying that the emphasis is on those that play a vital role of the companies 'brain' with respect to corporative decision making as agents for the entity.

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[14] Report of the Committee on the financial Aspect of Corporate Governance. December 1992

[15] Esser 'The protection of stakeholder interests in terms of the South African King III Report on corporate governance: an improvement on King II? SA Merc LJ (2009) 188

[16] Loubser, 'The King Reports on corporate governance', Esser (ed) et al, *Corporate Governance Annual Review 2012* (LexisNexis 2012) 22

[17] Report of the Cadbury Committee on the financial Aspect of Corporate Governance. December 1992, para 2.5.

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Notably, the governance of companies can be on a statutory basis or as a code of principles and practices, or of a combination of the two.[18]

(b) Comparison between King II, King III and King IV

The Draft Code of Governance Principles for South Africa was released for public comment in March 2009 by the King Committee on Governance. As mentioned in Chapter 1, King III was necessitated as a result of the 2008 Companies Act and international corporate governance transformations. Some of the international corporate governance, which King III picked up on are notably as follows: - alternate dispute resolution, risk-based internal audit, IT governance, and remuneration.[19]

Undoubtedly, King III has proved its success as it is regularly quoted by our courts and has been held out as exemplary, both nationally and internationally. King III is thus arguably one of the world's leading corporate governance standards, which relates to all entities irrespective of the way and form of incorporation or establishment and irrespective of whether the company falls under the public, private or non-profit sectors.[20]

King III, in comparison with King II, dealt commonly with the same concerns but did however differ in that the King III principles apply on a 'apply or explain' basis whereas King II revolved around a 'comply or explain' basis. King III did not favour the 'comply or explain' approach because it could lead to a 'mindless response' to the recommendations of the code.[21] With the 'apply or explain' approach, companies and their boards of directors will have to explain why King III was not followed, in the event that they did not. It is however imperative to note that some of the King III principles have been incorporated into the Act, and therefore legal sanctions could potentially become a reality.

Further to the distinctions mentioned above, the King II Report only applied to certain categories of business enterprises, such as those listed on the JSE and therefore companies falling outside of the defined categories merely had to consider the principles enshrined in King II in so far as it was applicable to it. However, even though King III clearly stipulates that it

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[18] King III Report preface 6.
[19] See principle 8.6 for alternative dispute resolutions, principle 3.5 for internal auditing, and principle 2.25 regarding remuneration
[20] King III Report 16.
[21] Loubser, (LexisNexis 2012) 24

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applies to all entities,[22] the IoDSA has indicated that non-profit organisations, private companies and entities in the public sector have all experienced challenges with the interpreting and adapting of King III to their particular circumstances.[23] As a result thereof, the difficulties experienced with the application of King III is one of the reasons behind updating King III with King IV.

The fourth iteration of the King Reports, namely King IV became effective in November 2016. According to Professor Mervyn King,

> "The overarching objective of King IV is to make corporate governance more accessible and relevant to a wider range of organisations, and to be the catalyst for a shift from a compliance-based mindset to one that sees corporate governance as a lever for value creation"[24]

Important corporate governance reforms, both nationally and internationally, have also been cited as a factor necessitating the updating of King III with King IV. King IV builds on the content of King III and thus the fundamental viewpoint and notions as promoted by King III will not be changed by King IV. However, as stated by Professor King, King IV is aimed at making corporate governance more accessible and applicable to a wider range of organisations, inclusive of government. This seems needed and appropriate, considering that the former Public Protector, Thuli Madonsela's State of Capture Report[25] raised serious questions about shortcomings in governance practices at the state owned entity (SoE), Eskom. In the said State Capture Report, Madonsela states that it appeared that the board of Eskom was improperly appointed and was not in line with the spirit of King III. King IV now includes a specific sector supplement for SOEs, so as to make it simpler to implement in the environment SoEs operate in. The behaviour of SOEs, State Owned Companies and Chapter 9 institutions were previously governed by the protocol on corporate governance issued by Cabinet in 2003, which summarises the King II Report. The said protocol is obviously outdated for many reasons and

[22] King III, Para 13 of the Introduction and Background in King III Report stipulates that the King III report applies to all entities regardless of the manner and form of incorporation or establishment and whether in the public, private or non-profit sectors
[23] IoDSA, King IV: Questions and Answers, available at http://c.ymcdn.com/sites/www.iodsa.co.za/resource/resmgr/King_IV/Guide_to_questions_and_answe.pdf , accessed on 13 April 2016.
[24] IoDSA, Governance in SA gets major update, available at http://www.iodsa.co.za/news/315704/Governance-in-SA-gets-major-update.htm , accessed on 20 November 2016
[25] Report No.: 6 of 2016/17

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the intention is thus to change the protocol from a King II basis to that of the newly launched King IV.

Notably, King IV has moved the regimen of 'apply or explain' to 'apply and explain'. This essentially entails that the board will have greater flexibility in respect of how to implement the recommendations, so as to reach the goals articulated in the King IV principles. However the board must now become more accountable and transparent about how they did so, which will ultimately assist stakeholders to make an informed decision about whether the organisation has or has not achieved the principles. Importantly, it is reiterated that this study focusses on King III rather than King IV, because at the time of conducting the research for this study, King III was in effect and King IV had not yet been released.

(c) *The main principles of corporate governance provided in King III Report and the code*

The King III Report comprises of nine principles of corporate governance, together with the recommended practices relating to each principle. It is not the aim of this dissertation to discuss the King III principles in great detail or to replicate the said principles herein. However, in order to achieve a basic comprehension of the King III principles, so as to determine whether or not there is scope to legislate such, a brief discussion of each principle is essential. The nine King III principles are as follows:

(i) Ethical leadership and corporate citizenship

Ethics, over the decades, became an important aspect in the success and revival of the country's capital markets. It is common knowledge that a company, being a juristic person has, apart from its rights, a moral obligation towards the society it operates in. Professor Mervyn King notes that good governance will not result from mindless quantitative compliance with governance codes or rules but rather that good governance encompasses fairness, accountability and responsibility based on a foundation of intellectual honesty.[26]

Notably ethical behaviour was already introduced in King I and further modified in King II. King III gives companies a more concrete expression, as it further requires the board to observe the impacts or likely effects of a company's operations on the society in which it operates in. This is linked to sustainability, which is highlighted throughout King III and referred to in the 'triple bottom line approach'.[27] It was once stated that corporate citizenship and social

[26] King, 'The corporate citizen', 2006 (Johannesburg: Penguin Books) 15
[27] King III Report 15

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responsibility is about the integration of social and environmental strategies into the core business of a company so that the existence of those companies will be sustainable in more than just financial terms.[28]

Principle 1.1 of the King III report requires that boards should provide effective leadership based on an ethical foundation. In addition, the Act also highlights the importance of maintaining an ethical manner in corporate governance in that it stipulates that the Minister may pass regulations requiring that certain companies put social and ethics committees in place.[29] The King III Report specifically recommends that the assessment, monitoring, reporting and disclosure of an organisation's ethical performance is necessary to provide the board and management with relevant and reliable information.[30] On this note, every board should maintain a code of conduct or ethics in order to ensure that the company is portrayed as an ethical corporate citizen. The board should further ensure that the company's ethical performance is assessed, monitored, reported and disclosed.[31]

Notable, when it comes to ethical behaviour, King III and King IV are broadly similar, with King IV requiring that the board ensures that ethics is monitored and assessed so as to determine its success in establishing ethical standards and to further make the required public disclosures in this regard.[32]

(ii) Boards and directors

Without going into the finer details of the administration by the board and the board operations, it is clear that corporate governance is the responsibility of the board. According to Naidoo, a company can act only through its 'human agents', namely its directors.[33] King III emphasises that boards should be informing and directing the company's strategy and moreover acknowledge that strategy, performance sustainability and risk are all interlinked and inseparable.

[28] Naidoo, *'Corporate governance: an essential guide for South African* companies' (Cape Town: Double Storey Books 2002)
[29] Section 72(4).
[30] King III Report, 27.
[31] Principle 1.3.8 of the King III Report.
[32] Deloitte, 'King IV Ethical leadership and the governance of ethics', available at https://www2.deloitte.com/content/dam/Deloitte/za/Documents/governance-risk-compliance/King_Ethical_Lead.pdf , accessed 22 November 2016
[33] Naidoo, (Cape Town: Double Storey Books 2002) 55

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The King III Report further provides that 'the board should comprise of a balance of power, with majority of non-executive directors'[34] and recommends further that a third of the non-executive directors should rotate each year.[35] Perhaps the rationale behind this is to ensure the objectivity of the non-executive directors is constantly maintained. Notably, King III does not however provide a particular criteria to which directors are to be classified as executive or non-executive, however regardless of such classification, directors must possess an independent state of mind and maintain objective judgment. This is supported by King IV, which proposes the appointment of independent non-executive directors.

In order to avoid an abuse of control situation, the chairman of the board should ideally be a non-executive director and King III[36] recommends that the functions of the chairman should be independent from that of chief executive.[37] This is considered to be global best practice and aids in promoting an all-round balance of authority, thus avoiding a situation where one individual has unconstrained control of an entity. In the case of *Fisheries Development Corporation of SA Ltd v Jorgenses, Fisheries Development Corporation of SA Ltd v AWJ Investment (Pty) Ltd*[38] the court stated that non-executive directors are not bound to give continuous attention to the affairs of the company and furthermore their duties are of an intermittent nature, to be performed at periodical board meetings or at any other meetings that may require their attention. Perhaps the reasoning behind this is to ensure that a form of independence and objectiveness is maintained.

An interesting observation is that King III recommends that the board be permitted by the companies Memorandum of Incorporation (MoI) to remove any director with shareholder approval. Notably, section 71 of the Act not only provides for the removal of a director by ordinary resolution of the shareholders, but goes further to make provision for the removal of a director by his fellow directors where the director to be removed is unable to perform his or her duties. Such resolution can, however, be subjected to judicial review by the court.[39]

Turning to board committees, King III provides that the board should delegate certain of its responsibilities to structured committees such as audit, risk nomination and remuneration

[34] Principle 2.18.
[35] Recommendation 2.18.6
[36] Principle 2.3.3. see further Principle 2.16
[37] The consequence of concentration of power in the hands on one person was illustrated by the collapse of Regal Treasury Bank when absolute power vested in Jeff Levenstein who was the CEO and chairman at the same time
[38] 1980 (4) SA156 (W) 165.
[39] S71(5) and (6) of the Act

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committees.[40] King III however further indicates that, with exception to risk committees, all board committees should consist only of directors.[41] Notably, this recommendation by King III differs from the Act which allows a company, under section 72(2) to include persons who are not directors in board committees unless the company's MoI provides otherwise. According to Loubser, 'this seems to be a rather precarious position to be in for a person who does not have access to full board meetings or the information that directors would have'.[42]

The last three principles of chapter 2 of the King III Report is dedicated to the subject of remuneration of the board members. It is often said that remuneration is the driving factor behind the attitude and performance of the board. Remuneration should thus be just, equitable, responsible, and disclosed for all to see. Section 66(9) of the Act attempts to prevent the situation of directors being 'over remunerated' in that it stipulates remuneration may only be paid to directors for their services in accordance with the special resolution approved by the shareholders every two years. King IV, sees the concept of remuneration receiving far greater prominence, in line with international developments. While King III stipulates that entities should adopt a remuneration policy, which is voted on by the shareholders, King IV goes further to provide minimum requirements for the remuneration policy. This highlights that the issue of director remuneration is a growing concern calling for further prominence.

Considering another aspect falling under 'boards and directors', King III, unlike King II, speaks to business rescue due to business rescue proceedings being introduced by chapter 6 of the Act. King III suggests that the company's solvency and liquidity should be continuously monitored and financial distress[43] is avoided.[44] Interestingly, should the company find itself in a situation where it has to stop trading and apply for liquidation, then it is the board that is tasked with the obligation of applying for such liquidation. On this note, there is uncertainty as to whether the power to apply for such liquidation is part and parcel of the duties of the board. In the case of *Ex parte Graaff-Reinet Rollermeule (Edms) Bpk*[45] it was held that the board had the power to apply for liquidation without approval by the general meeting. However, in conflict to this finding, the case of *Ex parte New Seasons Auto Holdings (Pty) Ltd*[46] found that the application for liquidation did not fall within the ambit of the boards management duties and thus approval

[40] Recommendations 2.23.1 to 2.23.3
[41] Ch 2, para 57
[42] Loubser, (LexisNexis 2012) 43
[43] Financially distressed is defined under section 128(1)(f) of the Act
[44] Principle 2.1.13.
[45] 2000 (4) SA 670 (E)
[46] 2008 (4) SA 341 (W)

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was required. Interestingly, should business recue proceedings commence, King III provides that a business rescue practitioner should be appointed and that such practitioner should be required to furnish security for the value of the company's assets.[47] In comparison with the Act, no such security requirement on the part of the practitioner occurs.[48]

(iii) Audit committees

The audit committee was the first committee to gain board acceptance and has been referred to as the 'watchdog' of governance. Principle 3.1 of the King III report requires the board of directors to ensure that the company has an effective and independent audit committee. According to King III, both listed and state-owned companies should establish an audit committee,[49] whereas private companies, non-profit companies and personal liability companies may voluntarily appoint an audit committee and define its composition, purpose and responsibilities in the MoI.[50] Looking at legislation, section 94 of the Companies Act 2008 now provides that audit committees of listed and state-owned entities must be a separate statutory committee as opposed to a sub-committee of the board. The audit committee should be appointed by the shareholders, reporting to the shareholders, while still acting in partnership with the board. In respect of audit committees, it appears that the Act and King III have 'married' because most of the duties of the audit committee as set out under section 94 (7) of the Act are found in the recommendations of King III. Further to this, it is mentionable that Regulation 42 of the Company Regulations 2011 provides that:

> 'at least one-third of the members of a company's audit committee at any particular time must have academic qualifications, or experience, in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource management.'

(iv) The governance of risk

Risk is a very significant aspect - if not managed and controlled, it can lead to financial distress and possibly even dreaded corporate failure. Loubser provides that risk is an unavoidable part of any business enterprise and if a company is too risk averse, it will stifle growth'.[51] The King

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[47] Recommendations 2.15.4 and 2.15.4
[48] However s 130(1)(c) of the Act provides '…an affected person may apply to a court for an order-… requiring the practitioner to provide security in an amount and on terms and conditions that the court considers necessary to secure the interests of the company and any affected persons.'
[49] Para 3 p56
[50] Para 4 p56. See also See s 94(2) read with s 34(2) of the Act.
[51] Loubser (LexisNexis 2012) 50

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III Report[52] requires that the board of directors be responsible for the governance of risk and determines the levels of risk tolerance that the company is able to bear in the pursuit of its aims and objectives. In addition to determining the levels of risk tolerance on a yearly basis, the board of directors should review the risk limits during periods of increased uncertainty or any adverse changes in the business environment.[53]. A risk committee and Chief Risk Officer may be appointed by the board to assist with the governance of risk. It is notable that King IV does not refer to the role of the Chief Risk Officer in the risk and opportunity management process. King IV does, however, place emphasis on the board's role in overseeing the adequacy and effectiveness of risk management and focussing on the organisation's resilience to withstand susceptibilities.

Turning to the Act, section 159 makes statutory provision for protection of 'whistle-blowers'. This seem to be aligned with Principle 3.1.8 of the King II Report which recommended that, for the purposes of managing risk, a company should consider adopting a confidential reporting process such as 'whistle-blowing' in order to curb risks such as fraud and corruption.

(v) *The governance of information technology (IT)*

IT governance is said to be a framework that supports the effective and efficient management of IT resources to facilitate the achievement of a company's strategic objectives.[54] IT has become an integral[55] part of doing business and is fundamental to support, sustain and grow the business.[56] The governance of IT has therefore been dealt with for the first time in the King III Report and recommends that companies understand and manage the risks, benefits and constraints of IT.[57] Deloitte and Touche provides:

> 'IT Governance is no longer some stand-alone function, but is an integral part of any organisation's overall corporate governance. If an (your) organisation cannot survive as a competitive player without IT, then the (your) Board cannot apply acceptable corporate governance without overt IT Governance.'[58]

[52] Principles 4.1 and 4.2.
[53] King III Report Para 11 p 74.
[54] King III Report Para 6 82.
[55] Ibid Para 6 82 also provides that IT governance is not an isolated discipline, but an integral part of overall corporate governance.
[56] King III Report ch 5, Para 1 82.
[57] King III Report Para 1 p 82.
[58] Delloitte annual 2010 review.

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The above quote highlights the importance of the use of IT in the corporate world. IT could be effectively used as a tool to assist the board with monitoring the solvency and liquidity of the company it manages. Importantly, appropriate and proper IT can very well assist with the avoidance of financial distress. Notably, King IV recognises information as being separate from technology and furthermore as a part of the company's intellectual capital and thus a company asset. What is interesting is the fact that King IV requires the board to periodically formally review the adequacy an effectiveness of the organisation's technology and information function.

Looking at the Act in its current form, there are many provisions in the Act which allows and even compels the use of IT. For example section 6(10) of the Act provides that

> 'If, in terms of this Act, a notice is required or permitted to be given or published to any person, it is sufficient if the notice is transmitted electronically directly to that person in a manner and form such that the notice can conveniently be printed by the recipient within a reasonable time and at a reasonable cost'.

Proper governance of IT is thus a crucial ingredient for a healthy functioning corporate entity. However, although the Act incorporates provisions compelling the use of IT, it lacks when it comes to the regulation of IT governance. This will be further discussed in the next chapter.

(vi) Compliance with laws, rules, codes and standards

Without going into too much of detail, Principle 6.1 of the King III Report is absolute, in that it requires the board of directors to ensure that the company complies with all applicable and relevant laws and that it considers compliance with non-binding rules, codes and standards. It is interesting to note that Principle 6.2 of the King III Report goes further, in that it requires the board as a whole, as well as each individual director, to have a working understanding of the effect of the applicable laws, rules, codes and standards on the company and its business.

(vii) Internal audit

The importance of internal audit has previously been acknowledged by the former Public Protector, who indicated that it is the back bone of good governance.[59] The King I Report acknowledged the importance of establishing the internal audit function but its duties seemed

[59] Khuswayo, 'Internal audit is bedrock of god governance' *Business Report* 14 August 2012 at 17

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limited only to financial aspects.[60] King II however saw the internal audit function being given more emphasis and one of the important roles was to provide objective information to the board,[61] which could be especially beneficial to non-executive directors.[62]

King III moved away from the compliance-based approach to internal auditing towards a risk-based approach. This transition was reasoned because with the risk-based approach, the internal audit would then determine if controls which were in place are indeed effective in managing the risk of the company.[63] Principle 7.1 of the King III Report requires the board of directors to ensure that there is an effective risk based internal audit, however it is the audit committee that should be responsible for overseeing the internal audit.[64]

The Act seems to properly cover the governing of internal audit.[65] Section 203 of the Act provides for the establishment of the Financial Reporting Standards Council. Section 204 of the Act further stipulates the role and responsibility of the council, which, amongst others, is to receive and consider any relevant information relating to the reliability of, and compliance with financial reporting standards and advising the Minister of Trade and Industry on matters relating to financial reporting standards.

(viii) Governing stakeholder relationships

There is no doubt that stakeholder activism is on the rise and the importance of stakeholder communication can be traced back to King I.[66] The King III Report adheres to the 'triple context' which acknowledges that companies should act with economic, social, and environmental responsibility.[67] Directors must thus consider and balance the interests of all stakeholders of the company. The King III Report observes that stakeholders cannot be ignored and the newly released King IV echoes this as well. Furthermore, sections 26 and 31(3) of the Act are two notable provisions which acknowledge the rights of stakeholders.

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[60] King I, Recommendation 21 and Ch 14 par 7
[61] King II, Ch 2, par 3
[62] Non-executive directors, because of not being involved in the companies daily business, was dependant on information from the executive directors. Independent information from the internal audit function could thus provide reassurance to the non-executive directors that information received is indeed reliable
[63] Loubser (LexisNexis 2012) 56
[64] King III Report, Principle 7.4
[65] S 28 provides that a company must keep accurate and complete records and declares it an offence if a company fails to do so. Further to this s 29 of the Act contains extensive requirements concerning the accuracy, reliability and standards for financial statements.
[66] King I, Ch 12
[67] Paragraph 18 p 22.

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A typical example of the importance of stakeholder engagement is found in the recent incident involving Oakbay Investments (Pty) Ltd. Oakbay Investments (Pty) Ltd, which is owned and managed by the Gupta family, is a shareholder in a number of private equity investments and joint ventures, such as Sahara Computers, JIC Mining Services, Shiva Uranium, The New Age newspaper, ANN7 TV and Clifftop Lodge. Stakeholders of Oakbay Investments (Pty) Ltd, such as KPMG, FNB, Absa and sponsor Sasfin Capital had major concerns with regard to the involvement of Gupta directors in the business of the company. In the past, not much could be done about this. However in present day, stakeholders concerns relating to their own reputation should be considered by the company and therefore those that manage and control the affairs of the company should always strive to maintain the confidence and trust of the company's stakeholders. The product of failing to do so was witnessed when KPMG, FNB, Absa and sponsor Sasfin Capital 'cut ties' with Oakbay Investments (Pty) Ltd.

(ix) Integrated reporting and disclosure

Integrated report can be described as a holistic and integrated representation of the company's performance in terms of both its finances and its sustainability.[68] The King III Report emphasises that companies should recognise that the principle of transparency in reporting sustainability information is a critical element of effective reporting.[69] It is mentionable that King IV also focusses on greater accountability and transparency and aims to achieve disclosures in all areas.

(d) Conclusion

Corporate governance has existed from the separation of ownership and control of entities. It was therefore essential to have a board of directors to manage the relationship between the company, shareholders, management and all other stakeholders. In South Africa, the changeover from the apartheid era to a democratic state further supported the need for good and proper corporate governance principles. This was vital in order for South African companies to contest for investor funding on an international level. The corporate governance codes have continually aimed to hold the board more answerable and to recommend governance systems which support transparency and accountability, and this is also true for the newly released King IV.

[68] Para 1 p 108.
[69] Para 13 p 109.

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Notably, the principles of the King III report links well with the purpose of the Act, specifically that embodied under section 7(b) (iii), which states that one such purposes of the Act is to:

> 'promote the development of the South African economy by… - encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation'.

The King III report does indeed provide useful guidance on how directors should manage and control the company in order to ensure its sustainability and continued economic viability. It is imperative bear in mind that without consistent and reliable corporate governance rules, South Africa will run the unaffordable risk of watching investor funds surge somewhere else. It is thus the board of directors which is accountable for the application of company legislation and relevant governance standards.

The King Codes ultimately have done us proud - however South Africa still has a long way to go in order to cultivate a healthier culture of corporate governance. King III is read in conjunction with the Act, but it may be more beneficial to have some of the above-discussed principles incorporated into the Act, thus making it binding on the board of directors. The next chapter will explore this avenue further.

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III CHAPTER THREE: CORPORATE GOVERNANCE LAW REFORM

(a) Introduction

The 1980s saw some dramatic corporate failures in the US, such as Drysdale Government Securities, Washington Public Power Supply System, Baldwin-United Corp and ESM Government Securities.[70] This resulted in the US Congress questioning whether or not the failures could have been avoided by utilising better auditing practice measures. The Treadway Commission had three objectives, one of which was to identify aspects that may lead to fraudulent financial reporting and steps to limit and reduce such.

It has been said that modern corporate governance originated with the introduction of the UK Joint–Stock Companies Act of 1844, which established the manner that businesses were to be governed.[71] In the UK, there were also a number of corporate failures, such as Maxwell Communication Corporation, the Bank of Credit and Commerce International and Polly Peck International Plc to name a few. This in turn led to the production of the Financial Aspects of Corporate Governance Report, chaired by Sir Cadbury (Cadbury Report). The Cadbury Report sought to examine the UK corporate governance system and propose steps in order to restore investor confidence.

The above-mentioned international corporate governance reform sparked deliberation in South Africa, which led to the publication of King I in November 1994. It can be said that the task of the King committee was far more extensive than that of the Cadbury Report, as the King I Report also included a Code of Ethical Practice for business enterprises in South Africa and furthermore, circumstances that were unique to South Africa had be considered, such as previously disadvantaged communities for one. As a result thereof, five task groups were formulated[72] to examine, explore and develop corporate governance aspects in the respective focus fields.

International pressure again called for the updating of King I. Domestic pressure was also one of the driving factors behind the change, as the South African society was changing and an

[70] Grundfest, AJ and Berueffy M (1989), *The Treadway Commission Report: Two Years Later*, Sixteenth Annual Securities Regulation Institute, The University of California, San Diego
[71] Wiese, *Corporate Governance in South Africa with International Comparison* (JUTA 2014) 3
[72] Namely the director, audit, stakeholder links, ethics and compliance task groups

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African renaissance was underway.[73] Since the release of the King III, there have been significant global developments in corporate reporting, one of which being the release of the Integrated Reporting Framework by the International Integrated Reporting Council (IIRC) in 2013. The principles introduced by the said framework have now been reaffirmed in the King IV Code, which was released in November 2016.

From a legislative drafting perspective, the enactment of the Constitution of the Republic of South Africa led to a new political, social and economic environment post 1994. On this basis, the DTI embarked on a review of company law and subsequently published the Guideline for Corporate Governance Reform[74] in May 2004. According to the said Guideline, the objective of the review of company law was to ensure that the new legislation is appropriate to the legal, economic and social context of South Africa as a constitutional democracy and an open economy.[75] Three aspects of corporate governance reform were emphasised in the Guideline[76], namely shareholder and investor protection, the responsibilities of the board of directors and disclosure. The Act, which resulted from the guidelines, was published for comment after it received cabinet approval in early 2007. The published draft elicited well over 100 written submissions from stakeholders and interested and affected parties. These written submissions necessitated the reconsideration, reformulation and revision of the published draft of the Act by the DTI. Notably, in general the public comments did not suggest a rejection of the core principles of the Act but rather challenged many of the legal instruments and provisions that were proposed to give effect to those core principles.

As stated in the chapters above, the King III Code was in effect at the time when research was conducted for this study and thus this study will focus on the King III principles while making brief references to the newly released King IV.

(b) The incorporation of king principles into law

There is no doubt that the King codes have always influenced the development of legislation. A typical example of such is when the 1973 Companies Act was amended to make the appointment of a company secretary compulsory for all public companies[77] in response to the

[73] Rossouw et al, 'Corporate Governance in South Africa' (2002) 37(3) *Journal of Business Ethics* 289
[74] *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* GN 1183 in GG26493 23 June 2004
[75] *Guidelines for Corporate Law Reform* 7
[76] *Guidelines for Corporate Law Reform* 35
[77] S 268A-I was introduced by the Companies Amendment Act 37 of 1999

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emphasis placed by King I on the role of the company secretary. It is impossible for good governance to thrive without compliance with laws. King III ensures that compliance with it will result in compliance with the Act, however the opposite cannot be said to be true[78] King III, in comparison with the Act, supports a stakeholder-inclusive approach to corporate governance whereas the Act supports an enlightened shareholder approach.[79] It is mentionable that many of the voluntary governance principles enshrined in King III are currently legislated, such as the company secretary responsibilities[80], the role of the audit committee[81], financial statements[82], and alternative dispute resolution[83] to name a few. Nevertheless, there still remains voluntary principles in King III which perhaps would lead to improved corporate governance if it were to be legislated. The below serves as a discussion of the possibility of legislating some of the voluntary King III principles:

(i) The chairman responsibilities

The King I Report recommended that the chairman should be a non-executive director, existing separately from the chief executive officer.[84] The King II Report repeated this recommendation but on slightly stricter terms and provided that should the situation arise in which the position of the chairman and chief executive officer is combined, then there should be an independent non-executive director appointed as the deputy chairman.[85] The King III Report builds on the recommendations of both King I and King II in that it goes further to recommend that a retired chief executive officer should not occupy the position as chairman unless a period of three years has lapsed since his/her retirement.[86] King III seems to however contradict itself as it provides for a situation in which an executive director may be appointed as chairman - however King III does recommend that should the independence of the chairman be impaired or questioned, then a 'lead independent director' should be appointed to assist in matters of perceived conflict of interest, without undermining the independence of the chairman.[87]

The recommendations in all three King Reports, thus portrays the importance of maintaining a balance of power and authority so as to prevent a situation of abuse of power which could very

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[78] King, 'The synergies and interaction between King III and the Companies Act 61 of 2008' 2010 447
[79] Wiese (JUTA 2014) 26
[80] S 88 of the Act
[81] S 94 (7) of the Act
[82] S 30 of the Act
[83] Part C Ch 7 of the Act
[84] King I 33 para 3
[85] King II, Principle 2.3.4
[86] King III, Recommendation 2.16.7
[87] King III, Recommendation 2.16.3

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well lead to corporate collapse, as the case with the Regal Treasury Bank. In addition to this, the UK case of case of *Polly Peck International Plc v Asil Nadir*[88] demonstrated that there is a need for checks and balances, particularly where the posts of chief executive and chairman are combined.

Regardless of this, the Act lacks provision for the regulation of the position of chairman. The Act, furthermore, does not differentiate between the positions of chairman and chief executive officer. Corporate entities will thus have to use their respective MoIs to regulate the position of chairman but it is not mandatory to do so.

Perhaps the most significant argument for the legislation of the position of chairman is that it will ensure that abuse of control situations are avoided and ensure that there is more diligent decision making relating to the appointment of the chairman. As it stands, chairmanship will continue until a time when the chairman steps down. Considering the role played by the chairman, it will be difficult for the chairman to maintain a purely objective and independent role and the longer that the same person holds the position of chairman, the more likely that his/her independence will become compromised. Perhaps the Recommendation 2.16.1 in the King III Report, to appoint the chairman annually should be legislated, even if the same person is reappointed as chairman, it will allow for the reconsideration of factors that may impair independence.

The chairman's primary role is to lead the board and to maintain the confidence of each member of the board. In many companies, the role of the chairman is considerable as he/she is the contact person between senior management and the board and may even serve on a number of committees. Considering the chairman's vital role, it makes sense that the appointment, powers, functions and duration of office should be legislated.

(ii) Governance of risk

Recommendations 4.3.1 to 4.3.3 of the King III Report recommends that the board should appoint a risk committee consisting of at least three members, including executive and non-executive directors. The risk committee has the role of considering the risk management plan or policy and to manage the risk process. Although there are many companies in South Africa that have chosen to establish a risk committee, such companies are the larger and more complex companies, such as Tiger Brands for example. Smaller companies on the other hand, are more

[88] [1992] 2 Lloyd's Rep. 238

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likely to incorporate risk management functions with that of the functions of the company's CEO or other members of management. The reasons for this is primarily because risks associated with smaller companies can be easily assessed and sometimes even foreseen. Furthermore, smaller companies are often disadvantaged by constrained budget. According to Engelbrecht, when a large listed company applies the principle of governance of risk, it may require the risk committee or a Chief Risk Officer and to expect a smaller company to comply with the same principles would have significant cost implications and unintended consequences.[89] Notably, King IV does not refer to role of the Chief Risk Officer or CEO in risk management but rather recommends that there should be overlap in membership between the audit and risk committee and that the risk committee should constitute at least three directors, the majority of which being non-executives.

Turning to the Act, while section 159 does provide special protection for certain whistle-blowers that is as far as it goes with the regulation of risk management. It has been said that 'one of the dangers of implementing a complex risk management system is that the process of identifying and managing risk can become bureaucratic and unwieldy'.[90] It can thus be argued that making the establishment of a risk committee a statutory requirement may pose many problems in practice, and certainly would be neither sensible nor practical for smaller businesses.

Nevertheless, some of the risk management principles can be considered for legislative purposes, such as, for example, the establishment of internal controls to mitigate risks that have been identified. According to Naidoo, every company, regardless of size or structure, must at some level anticipate and plan for the business risk it faces in order to improve the prospects for its long term survival.[91] It is imperative to mention that internal controls can be of various forms and a possible avenue is the amendment of the Act to refer to 'internal controls' in general, thus leaving the discretion to the board to decide which form of internal control will work best for the particular company, considering, amongst others, the size, nature and characteristics of the company. Currently, the implementation of effective internal control lies with the commitment of the board and may be guided by policies of procedures of the company. However there is nothing in place which places a legal obligation on the board to implement

[89] Engelbrecht, 'King III code: comply vs. apply, what's the difference'. Occupational Risk Management. Vol5, Issue 6, June, 16.(2009) 16
[90] Wixley & Everingham, Corporate Governance 3 ed (Siber Ink CC 2010) 85
[91] Naidoo, (Cape Town: Double Storey Books 2002) 117

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effective internal risk management control. A counterargument to this is that the board must act in the best interest of the company[92] and there is thus an indirect obligation on the board to set up effective internal controls to monitor and mitigate risks to the company. Nevertheless, the Act should ideally clearly spell out that the board should establish an appropriate internal control model to mitigate risks that have been identified and furthermore, that the performance of internal control should be monitored to ensure accurate and timely reporting. The first two years after the establishment of a company is primarily when the company is faced with unanticipated risks, which impacts on the sustainability of the company. The notion is thus that if risks can be anticipated, then it can be managed.

(iii) Remuneration committee

The over imbursement of directors has always been prominent and problematic. The issue of director remuneration was first dealt with in the King I Report[93] and developed in both the King II, King III and King IV Reports. King III requires that companies provide full disclosure of each individual director's remuneration[94]and furthermore that such remuneration needs to be fair, responsible and in accordance with the remuneration policy approved by the shareholders.[95] King IV goes further to require more extensive executive remuneration disclosure which is aligned to global trends. Looking at the Act, section 66(9) of the Act has been enacted in an attempt to curb excessive payments to directors. The said section provides as follows: 'Remuneration contemplated in subsection (8) may be paid only in accordance with a special resolution approved by the shareholders within the previous two years'. Thus, at the very least, the requirement in King III that the remuneration policy be approved by the shareholders, is currently legislated. It is imperative to have good corporate governance in place to spell out how fair and responsible remuneration of directors can be achieved. With regard to this, the Act does confer the right to shareholders to be involved and have a say in the remuneration of directors. Although the Act does not stipulate that companies should establish a remuneration committee, we have yet to see how effective section 66 (9) is in deterring excessive remuneration of directors. There is thus currently no justification for the amendment of the Act in this respect. On this note, it must be remembered that it is important for companies to be allowed flexibility to decide whether or not to comply with the guidelines enshrined in

[92] S 76(3)(b)
[93] King I, ch 8
[94] King III, Principle 2.5.4.
[95] King III recommends that the shareholders pass a non-binding advisory vote on the companies remuneration policy yearly, however this situation is now regulated by the Act

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King III. Furthermore, although the underlying principles of having a remuneration committee is indeed relevant to any business, the actual use of the remuneration committee is more appropriate for larger entities.

(iv) Information Technology Governance

As stated in chapter two above, there are several sections in the Act which either allows or compels the use of IT technology, such as sections 6(10)[96], 6(11)[97], 61(10)[98], 63(2)[99] and 73(3)[100]. However, regardless of this, the Act does not make provision for the governance of IT. King III recommends that the board is responsible for the implementation of an IT governance framework and that such responsibility should be delegated to management to implement the necessary structures, processes and mechanisms to, amongst others, minimise IT risk and manage IT resources efficiently.[101] King III further recommends that the board may appoint an IT steering committee or Chief Information Officer, to assist it with IT governance. In addition to this, King III provides that the risk committee and audit committee should assist the board with its IT responsibilities.[102] King IV builds on the principles of King III and refers to the disruptive nature of technology and mentions the significant hazard this poses to companies. King IV thus recommends that the board governs both technology and information[103] so that these support the company in achieving its goals.

Considering that we currently live a technologically advanced world and that we are depending more and more on electronic means for communication, mainly because it is more rapid, flexible and convenient. From a corporate governance perspective, legislature should give thought to incorporating IT governance into the Act. The newly enacted King IV also confirms the need for governance structures to protect and enhance company information. It is vital that the board is obliged to ensure the protection and management of information, especially considering the various provisions in the Act which sanction the use of electronic means as a method of communication. Further to this, most business information is now being stored on electronic systems and bearing in mind that most electronic systems can be hacked into which

[96] Provision for electronic submission of any notice in terms of the Act
[97] Provision for the retaining, publishing, provisioning or delivering of documents in an electronic format
[98] Provision for the participation of shareholders in a meeting of a public company to be accessible via electronic means
[99] Provision for shareholder meetings to occur via electronic communication
[100] Provision for a board meeting or participation of a director in a board meeting using electronic communication
[101] King III, Principle 2.5.
[102] King III, Principle 5.7
[103] Because King IV recognises information and technology as separate aspects.

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may likely result in confidential information of a company and even sensitive information processed by the company being exposed. Three main risks associated with IT have been identified.[104] Firstly, significant expenditure to be up to date with technology trends, secondly the risk of failure and lastly, security and the lack thereof, remains a major concern. Thus, the move towards a more technologically advanced corporate world will certainly compel the legislature to consider the regulation of IT governance, perhaps not now, but certainly in the near future.

(c) Conclusion

South Africa has come a long way with corporate governance. Thriving enterprises contribute immensely to the economic growth of our country. The legislature acknowledges that the Act is not perfect and there is no guarantee against corporate collapse. Everyone, including the legislature, shareholders, directors and even the average citizen has an interest in how efficiently and honestly companies are managed. While it is indeed notable that King III does go further than the Act when it comes to corporate governance, it has been rightfully said that the Act and King III complement each other. It will be interesting to see how the newly released King IV works with the Act.

In conclusion, perhaps the safest avenue will be to allow companies the flexibility to decide to either comply or not with the guidelines, however as time changes, there becomes a need to review legislation and align our laws with international trends. There may be justification for the legislating of some corporate governance principles, such as the position of the chairman and IT governance, however the potential implications of such will have to be carefully studied before taking the decision to legislate.

[104] Nieman, 'Small business management: a South African approach' (Van Schaik 2006) 156

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IV. CHAPTER FOUR: COMPARATIVE ANALYSIS STUDY OF UK AND SOUTH AFRICA

(a) Short historical review of corporate governance in the United Kingdom

As mentioned in chapter 3 above, there were a number of corporate failures in the UK during the latter part of the 1980s, resulting from mainly the mismanagement or utilisation of company assets and corporate abuse by family controlled businesses. Corporate governance reforms in the UK have mainly been the work of six reports, namely the Cadbury Report, the Greenbury Report, the Hampel Report, the Turnbull Report, the Higgs Review and the Smith Report.

In the 1980s, the emphasis in the UK was on shareholder value, thus reinforcing accountability to shareholders. The case of *Guinness Plc v Saunders*[105] highlighted the need for corporate governance reform in the UK. In the mentioned case a sum of 5, 2 million pounds was paid to a director for his services in connection with a take-over bid. The said payment was approved by the committee of directors. A dispute later arose, when it became apparent that the director, to whom the said payment was made, had a financial interest in the take-over bid. In hearing the matter, the court found that the payment to the director infringed the company's articles of association, which stipulated that the 'board as a whole' must approve the said payment, yet despite this, only the committee of directors approved it. The court therefore found that there had been a breach of fiduciary obligation. This case exposed the risk that shareholders are susceptible to offensively large amounts of remuneration being transferred without proper guidelines.

Following the Guinness case came the collapse of Maxwell's empire of companies, which collapse was due to a number of factors, amongst which was fraudulent schemes and dishonest accounting methods. Another clear call for corporate governance reform was made when Polly Peck International Plc collapsed due to the domination of the board by the more powerful executive directors.[106]

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[105] [1990] 2 AC 663

[106] In the case of case of *Polly Peck International Plc v Asil Nadir* [1992] 2 Lloyd's Rep. 238, the CEO of a public company, which carried on business as the holding company of a group of over 200 subsidiaries, was a signatory of all the branch accounts of the company and was thus in a position to control and direct the

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The London Stock Exchange thereafter commissioned the establishment of a committee to be headed by Sir Adrian Cadbury. In December 1992, the Cadbury Report[107] was published. The recommendations of the Cadbury Report, together with its code of best practice, recommended the implementation of board committees and emphasized the importance of independent, non-executive directors on the board. Further to this, audit committees were also recommended in the Cadbury Report. The Greenbury Report[108] followed in the Cadbury Report in 1995 and was concerned with accounting for director's remuneration. Thereafter, the Hampel Committee, chaired by Sir Ronald Hampel was thereafter set up to review the recommendations of the Cadbury, as well as the Greenbury report. The Hampel Report[109] contributed to corporate governance by recommending the Combined Code on Corporate Governance. There were further reports by Turnbull (1999) on internal controls, Higgs, (2003) on the role of non-executive directors, and Smith (2003) on audit committees. Interestingly, in 2003, a new combined code was issued which drew on the guidelines by Turnbull, Higgs, and Smith.

(b) Recent corporate governance reforms in the United Kingdom

Today, corporate governance in the UK is regulated by the Companies Act of 2006 and the Corporate Governance Code (the UK code). The Financial Reporting Council (FRC) is an established independent regulator responsible for, amongst others, reviewing the UK code. The UK code consists of both main and supporting principles and follows a 'comply or explain' approach. Although the UK code is voluntary, companies are required to apply the main principles in the UK code and to explain to shareholders how such has been applied or alternatively why it was not. The clarification for any non-compliance is required to be detailed, which investors will carefully assess. The UK code covers a very wide range of areas, including board balance, independence and remuneration, relations with shareholders and the need to maintain a sound system of internal control, including effective risk management systems.[110]

Apart from the UK Code, there are other codes which contribute to corporate governance in the UK, such the Corporate Guidance and Principles for Unlisted Companies of 2010, which

company's funds to and from the various subsidiaries. The CEO allegedly misappropriated over $378 million of the company's funds.

[107] Report of the Committee on the Financial Aspect of Corporate Governance, 1992 (Cadbury Report)

[108] Directors' Remuneration, Report of a study Group chaired by Sir Richard Greenbury, 1995 (Greenbury Report)

[109] Committee on Corporate Governance, Final Report, 1998 (Hampel Report)

[110] United Kingdom Corporate Governance 2016, Published: 13 June 2016, http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2016/united-kingdom accessed 12 August 2016

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provides 14 voluntary corporate governance for unlisted companies.[111] The FRC has also published the UK Stewardship Code, with the second edition published in September 2012, which aims to promote better dialogue and engagement between shareholders and the board.

In 2013, amendments were made to the UK Companies Act 2006 in order to reform the director's remuneration regime of listed companies. Shareholders in listed companies have the right to a binding vote at least every three years on the company's remuneration policy, in addition to the existing annual advisory vote on the directors' remuneration. Another area of challenge in the UK is equity markets and how to better ensure that the equity markets support their core purpose of enhancing the performance of UK companies.

Some recent significant developments in UK corporate law include the promulgation of the Small Business, Enterprise and Employment Act, which was passed into law on 26 March 2016. The said Act makes some fundamental amendments to UK company law, which impacts companies of all sizes. Some of the said amendment, includes but is not limited to, measures aimed at increasing transparency on who is in control of a company. In order to promote transparency, the said Small Business, Enterprise and Employment Act requires that all directors of a company be natural persons and furthermore that a register of all persons having significant control of a company be maintained. Another notable recent change is the new audit regulations[112] which took effect on 17 June 2016 and brought about the compulsory rotation and rendering of audit engagements. The next strategic steps of corporate governance reform in the UK focuses significantly on investment culture, involving other parties in the investment chain, such as asset owners and managers.[113]

(c) The United Kingdom as a model for South Africa

UK company law is considered to be dynamic and influential. Across the globe, it has gained respect owing to its ability to adapt to the constant needs of modern society. When compared to King III, the UK code embodies similar principles. Nevertheless, there are some notable differences between the two codes. The main differences are as follows:

- The FRC in the UK is an established regulatory body whereas the IoDSA is a voluntary body.

[111] Wiese (JUTA 2014) 53
[112] The Statutory Auditors and Third Country Auditors Regulations 2016, can be found at: http://www.legislation.gov.uk/ufsi/2016/649/made , accessed 15 August 2016
[113] United Kingdom Corporate Governance 2016, Published: 13 June 2016, http://www.iclg.co.uk/practice-areas/corporate-governance/corporate-governance-2016/united-kingdom accessed 12 August 2016

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- The UK combined code follows a 'comply or explain' approach.
- Listed companies in the UK only have to apply the main principles incorporated in the UK Code.
- More emphasis on the regulation of remuneration of directors is placed in the UK Code than in King III.
- Other than shareholders, the UK contains no acknowledgement of other stakeholders.

The IoDSA is a voluntarily established body that has contributed to good corporate governance in South Africa by following an inclusive and consultative approach when drafting the King Reports. The making of the IoDSA as a regulatory body will necessitate the amendment of legislation and the risk of matters escaping legislation becomes a real risk which could create unintended consequences for government. The cost factor of amending legislation must also be taken into consideration. Therefore, the fundamental question is whether there are compelling reasons necessitating the IoDSA becoming a regulatory body? Currently the answer to this question is, in my view, 'no'.

The 'comply or explain' approach followed by the UK Combined Code is more rigid and allows for less flexibility compared to the King III 'apply or explain' approach. Notably, King IV requires an 'apply and explain" approach. This means that application of corporate governance principles is assumed, and that an explanation is required for the implementation of such and for the progress made. King IV is essentially a revised version of King III, aimed at aligning South African Corporate Governance with international corporate governance developments. King IV reinforces corporate governance as a holistic and integrated set of arrangements. Specific corporate governance developments, such as effective boards, increased compliance requirements, new governance structures such as Social and Ethics Committees, emerging risks and opportunities from new technologies such as Cyber-Crime and Social Media, and new reporting and disclosure requirements are now taken into account by the King IV Report.[114]

The UK Combined Code follows the traditional corporate governance model with the main focus being the shareholders. On this note, the approach followed by South Africa, namely that *all* stakeholders must be acknowledged should be preferred over the UK acknowledgement of shareholders only.

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[114] King IV says Apply & Explain, https://www.cover.co.za/kpmg-contributes-to-the-inclusive-and-consultative-drafting-process-of-king-iv/ , accessed 18 August 2016

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VI. CHAPTER FIVE: CONCLUSION AND RECCOMMENDATIONS

The primary objective of my study was to analyse whether our statutory laws are sufficient and appropriately aligned with corporate governance codes and set international standards in order to effectively prevent the abuse of power and dreaded corporate collapse.

South African corporate governance has come a long way, particularly in aiming to give confidence to investors and all other stakeholders. More importance is now placed not on if a company made a profit but rather on *how* profit was made.

Government, together with the sourced external expertise, when drafting the Act, had crafted a piece of legislation which contained multiple errors which needed to be remedied. However, when questioning Mr Strydom on the reasoning behind the staggering 60 page Companies Amendment Act, 2010[115], Mr Strydom explains that the said amendment was not regarded as being fundamental amendments which changed the essence, spirit and/or the character of the Act. Instead, the amendments were non-substantial, technical amendments

There have been many past and future drivers of corporate governance reform, such as international influences, environmental issues and increased expectations from stakeholders. Even though the Act currently stands as a commendable achievement for South Africa, there is and will always be room for improvement of corporate governance. As discussed above, certain King III principles such as the position of the chairman and IT governance should ideally be legislated. Considering the emergence of the digital and net generation era, as well as the provisions in the Act which allow for the use of electronic means, IT Governance will in the very near future have to be contemplated by the legislature. Further to this, the vital role played by the chairman and the importance of maintaining a balance of power and authority are perhaps good arguments for regulating the position of chairman of the board. However, it may be counter-argued that the role played by the chairman can be appropriately dealt with in a company's MoI and furthermore that there is no need to legislate the role of chairman. Chief economist, Iraj Abedian, when commenting on the newly appointed South African Airways board of directors, stated that:

[115] Act No 3 of 2010

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> 'If you have strong personalities around the table of the board, a chairperson then becomes much less relevant. The chairperson becomes dominating when surrounded by weak personalities who are unable to stand their ground or incapable of arguing. However, if the chairperson is put in the mix of a skilled people then he or she cannot necessarily rule the show'[116].

While the above quoted statement may be true to an extent, it does not take away from the fact that King III has placed much importance on the role of chairman of the board and makes some fundamental recommendations on the governance of such role. Nevertheless, the regulating of the chairman's role will have to be closely looked at in order to guard against over legislating which could lead to challenges in practice as well as wasted cost from a legislative reform perspective.

Turning to other areas of potential regulation, the issue of board remuneration which has notably received more emphasis in the UK, is currently regulated by section 66(9) of the Act. Section 66 (9) should be allowed more time to be tested in practice before considering if an expanded scope of regulation is required or furthermore if the establishment of remuneration committees are essential for certain entities.

Considering risk management, the regulation of risk management may in future need to be expanded further than section 159, however considering the diversity of entities operating in South Africa, there can be no 'one size fits all' approach to the regulation of risk management. If there is a compelling need for such regulation, then the scope to exercise discretion on which form of internal control will work best for the company should be afforded to the board of directors.

Although corporate governance schemes derived from the UK is certainly influential and closely observed worldwide, the unique political and social context which South African entities operate plays a vital role in the selection of which UK trends to pick up. The update of King III with King IV certainly indicates that South Africa is striving towards a world class corporate governance framework. It will be interesting to observe how the 'apply and explain' approach recommended by King IV will work in practice.

[116] SABC, *New SAA board competent and credible: analyst,* available at http://www.sabc.co.za/news/a/55c16e804e17ad588791a7ac4dc09bae/New-SAA-board-competent-and-credible, accessed 4 September 2016

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The Act in its current form and the code complement each other well and when read together is certainly commendable corporate governance for South Africa. King IV may live up to the legacy of its predecessors and have an influential impact on the future updating of Act, especially considering that King IV entrenches a more integrated manner of thinking within corporate structures.

It is fundamental to remember that the effectiveness of any corporate governance system is dependent, not only on legislation or the rules which promote healthy company management. Aspects of corporate character which cannot be legislated, has considerable influence on the effectiveness of corporate governance. Responsible decisions making and adherence to ethical standards comes from within the company and in particular from the board of directors. Perhaps this is why the Act gives greater responsibility to a 'body of persons'. During discussion with the DTI, section 66 of the Act, which shifts control of the company into the hands of the board of director, Mr Strydom, on behalf of the DTI, provides that the objective of section 66 was to give greater responsibility to a 'body of persons' namely the board of directors and to deter a situation in which power in concentrated in the hands of one person. On this note, Mr Strydom indicates that when interpreting the Act and the Codes, it must be borne in mind that shareholders are not isolated form the management of the affairs and business of the company.

The DTI holds the view that no piece of legislation is adequate to prevent corporate collapse because the implementation of the Act is directly linked to human nature and human beings are fallible creatures. Furthermore, the DTI affirms that there are no plans to draft a new Companies Act in the near feature as the current version of the Act is working reasonably well in practice. On this basis Mr Strydom, on behalf of the DTI provides that the promise enshrined in the Guidelines for Corporate Law Reform are still relevant, namely that 'it is not the aim of the DTI to write a new Act by unreasonably jettisoning the body of jurisprudence built up over more than a century'.

It is recommended that the legislating of certain King principles be considered, should future amendments to the Act be contemplated. It must however be remembered that good corporate governance does not begin or end in our statutes, it remains with not only the integrity and honesty of the board, but with society in general.

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