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Strengthening Domestic Corporate Activity in Global Capital Markets: A Canadian Perspective on South Africa's Corporate Governance

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Corporate governance is concerned with the enhancement or fortification of the rules and principles of company direction for the purpose of accommodating the modern environment within which companies operate, and the imposition of stricter checks and balances to curb or alleviate malpractice or wrongdoing by those engaged in corporate decision making.

Tshepo Mongalo, Durban, South Africa, 2003¹

Introduction

South African scholar Tshepo Mongalo has defined corporate governance as a dynamic process to maximize efficiency and generate wealth, but one grounded in the statutory and common law history of governance as the process of controlling managers and balancing the interests of all stakeholders affected by the corporation's conduct.² His definition reflects the fact that companies operate within a regulatory framework that facilitates their wealth generating activities and hence they have civil obligations to the home and host nations in which they operate. This approach to corporate governance seems particularly relevant for emerging economies such as those in Sub-Saharan Africa, where the risk of corporate malfeasance may be higher given the power imbalance between the host state and the multinational enterprises (MNEs) who engage in

productive activity in their countries. The tension between the need to attract global capital and
the need to address pressing social, economic and environmental issues in emerging economies
frames the governance debate in a direct and poignant way.

As a Canadian corporate law scholar who recently had the opportunity to visit South Africa and
meet with some of its scholars, practitioners and citizens, I was humbled by both the profound
challenges and the immutable positive spirit of the South African people when it comes to thinking
about their economic and social future. Hence while this paper is a reflective discussion on the
kinds of challenges that exist and the strategies that could be deployed to enhance corporate
governance in South Africa, it must be emphasized at the outset that it is for Sub-Saharan African
nations to develop their own governance models. They are best positioned to adopt strategies
that align with their social, economic and political goals, and it is not for the West to impose
Anglo-American conceptions of corporate and securities laws on developing nations. While there
are lessons, both positive and negative, from the North American governance experience, self-
determination of optimal governance strategies for emerging economies will allow them to take
account of both domestic needs and global capital markets.

This paper is divided into four parts. The first part sets a context for the discussion, including an
overview of the corporate law regime in South Africa and more generally, the challenges faced by
Sub-Saharan Africa in terms of economic development. Corporate governance cannot be
discussed without at least some appreciation of the challenges posed by foreign direct
investment, the level of debt of these nations and broader development concerns. Much of the
wealth of Sub-Saharan Africa has been mortgaged previously, creating enormous barriers to
becoming independent in their economic policy choices. Part II then sets out a framework for
thinking about corporate governance in Sub-Saharan Africa, briefly analyzing both shareholder
wealth maximization and stakeholder models of governance. Part III shifts into a more specific
discussion of corporate governance developments in South Africa. In this respect, South Africa
shares much in common with Canada in terms of its capital structure, corporate law and
challenges of being a host nation for many multinational enterprises (MNEs) headquartered
elsewhere. The King II Report on corporate governance is examined in terms of its influence on
shaping corporate governance policy in South Africa. A more fulsome conception of corporate
governance for South Africa includes empowerment, equity and the inclusion of African value
systems. Finally, Part IV looks forward, examining the possible benefits and limits of socially
responsible investing through the new Johannesburg Stock Exchange SRI Index. It also briefly
discusses areas of further research that may provide assistance in enhancing domestic corporate
activity in South Africa.
I. The Context

A. South Africa’s Corporate Law Regime

Several statutes govern corporate law in South Africa, the primary statute being the *Companies Act* which governs both public and private companies. Public companies must have a minimum of seven members (shareholders), and corporate entities can be members. Public companies must comply with the financial reporting and accounting requirements set out in the *Companies Act*, as well as listing requirements of the Johannesburg Stock Exchange (JSE) where the company is a listed company. Where the public company is not a wholly owned subsidiary, if the number of members falls below seven and the members have knowledge of this, the statute specifies that the members shall be jointly and severally liable for payment of all debts incurred by the company for the period in which the number of members is below the statutory minimum. The constating document for companies registered under the *Companies Act* is the memorandum of association, setting out the capital structure, the process for appointment of directors, specified duties of directors, and voting rights of members. The company is also required to have articles of association. The *Companies Act* allows for both par and non-par value shares, similar to the corporations statute in British Columbia, Canada.

Private companies are limited to a membership of 1-50 members. Membership can include both natural persons as well as corporate entities. The primary difference is that the right to transfer shares is restricted. The shares cannot be publicly traded, and they are subject to such other restrictions as specified, such as preemptive rights. Private companies must raise capital privately, failing which the company is treated as a public company. Members of a private company can determine their governance structure in shareholders’ agreements, which are not public documents. Private companies are held to slightly less rigorous accounting standards. State-owned enterprises, *parastatals*, are regulated in a manner similar to public companies.

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4 Section 32, South Africa *Companies Act*.
5 Sections 32-73, South Africa *Companies Act*.
6 Section 52, South Africa *Companies Act*.
7 Section 59, South Africa *Companies Act*.
8 Section 74, South Africa *Companies Act*. British Columbia *Business Corporations Act*. Until 2004, British Columbia was also a memorandum jurisdiction in terms of the structure of its corporate laws.
9 Section 20, South Africa *Companies Act*.
10 Whereas public companies must use “limited” as the end of the company name, private companies must use the designation “(proprietary) limited”.
11 Section 20, South Africa *Companies Act*.
The governance structure under the South Africa *Companies Act* resembles the statute’s British origins. The board of directors is responsible for oversight of the company. The structure and power of the board is drawn from the company’s articles of association. While the duties of care and loyalty by directors are not codified in the statute, the duty has been acknowledged at common law. The *Companies Act* does contain some specific duties, for example, directors and officers have a duty to disclose an interest in contracts.\(^{13}\) There is also some codification of directors’ obligations when a firm is financially distressed, where directors have an obligation to minimize losses to creditors and may be personally liable for fraudulent or reckless trading. Section 424 of the *Companies Act* specifies that in the course of winding-up or judicial management, if it appears that the business of the company was being carried on recklessly or with intent to defraud creditors, the court may declare that any person who was knowingly a party to such actions is personally liable for all or part of the company’s debts. “Reckless” in this context has been defined by the court as conduct that evinces a lack of genuine concern for the company’s prosperity, including failure to regularly attend meetings and carrying on business where in the eyes of a reasonable business person, there was no reasonable prospect of creditors being paid for the transactions.\(^ {14}\)

The *Companies Act* requires a “company secretary” for a public company, with such an appointment optional for private companies.\(^ {15}\) The company secretary is appointed by the board and has some of the characteristics of the role of “lead director” that is increasingly common in Canadian corporations. The company secretary is the principal administrative officer of the company. The secretary is responsible for ensuring that board procedures are regularly reviewed and followed in practice, and that all legal and regulatory requirements are complied with. The secretary also works with the board chair and CEO to determine strategic administrative issues; and provides directors and the board with guidance on the discharge of their responsibilities in the best interests of the company.\(^ {16}\) The role is often filled by the financial director, the auditor (independent of its audit function) or by professional companies offering this specific service.\(^ {17}\)

The South Africa *Companies Act* allows for fundamental changes by special resolution, requiring 21 days clear notice, a quorum being 25% present and voting, and a majority of 75% present and by proxy required to carry the vote.\(^ {18}\) The board of directors approves the Annual Financial

\(^{13}\) Sections 234-237, South Africa *Companies Act*.

\(^{14}\) See for example, *Ozinsky NO v. Lloyd* 1992(3) SA 396 (c).

\(^{15}\) Section 268A-268I, South Africa *Companies Act*.

\(^{16}\) King II Report on Corporate Governance, published 26 March 2002, at 2.10 (hereafter “King II”).


\(^{18}\) Section 199, South Africa *Companies Act*. For urgent matters, shareholders holding 95% of shares can agree to abridge the notice period, s. 199(3).
Statements, although they are presented to the annual general meeting for the members’ receipt, with 21 days notice. Members elect the directors and formally appoint the auditor. Members have remedies under the Companies Act, including: relief from oppression; the ability to seek an appointment of inspectors to investigate financial interest in and control of the company; the power to impose some restriction on shares or debentures; and some power of investigation of the company’s affairs. The oppression remedy is similar to that in Canadian statutes. Section 252 of the Companies Act specifies that a member may complain that an act or omission of the company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner that is unfairly prejudicial, unjust or inequitable. The court has broad powers to remedy the oppression, including making orders for regulating the future conduct of the company.

The Companies Act also provides the mechanism to allow companies to offer shares publicly. Chapter VI of the Companies Act sets out requirements for offering of shares and issuing a prospectus. Companies must also comply with the JSE listing requirements, which include a requirement that companies comply with Statements of Generally Accepted Accounting Practice (GAAP) as advocated by the South African Institute of Chartered Accountants and international standard setting bodies. The introduction of the STRATE (share transfers totally electronic) allows for the administration of share transfers by electronic means.

The appointment, removal and duties of auditors are regulated under the Companies Act, as well as other applicable legislation. The Companies Act does not require that an audit committee be struck, although companies listed on the JSE are required to have an audit committee.

The Companies Act also makes provision for a special type of private company which uses “incorporated” after its name, in which the memorandum and articles specify that the liability of directors is unlimited in respect of contractual obligations incurred by the company for the period they are directors. Another statute in the South African system is the Close Corporations Act, which allows for limited liability companies with a maximum of ten members who must be natural persons. This statute has streamlined reporting requirements.

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19 Section 302, South Africa Companies Act.
20 Sections 252-268, South Africa Companies Act.
21 Sections 142-169, South Africa Companies Act.
23 This form is frequently used by attorney, auditor and professional firms.
Other legislation also has a direct impact on corporate governance. For example, the Employment Equity Act, 1998 requires that companies above a specified size develop employment equity plans and undertake regular periodic reporting on progress in achieving the plan’s objectives. The Promotion of Access to Information Act, 2002, requires that private companies, including registered close corporations, produce specified operational data. The Constitution of the Republic of South Africa, as well as environmental legislation, defines environmental rights of South Africans. Section 24 of the Constitution specifies that everyone has the right to an environment that is not harmful to their health or well-being; and to have the environment protected for the benefit of present and future generations, through reasonable legislative measures that prevent pollution and ecological degradation; promotion of conservation and ecologically sustainable development and use of natural resources while promoting justifiable economic and social development. Depending on the outcome of these suits, constitutionally enshrined environmental protection rights may have a profound impact on corporate governance standards. These provisions impose a duty of care on any party that directly or indirectly contributes to transgression of these rights. Recently, there have been some class action type suits brought against corporate polluters under these provisions. A recent court judgment also held that companies may not be able to be ISO certified for particular activities where they have, previously violated standards under environmental legislation. These developments may sufficiently affect a corporation’s ability to engage in economic activity that greater attention is paid to environmental compliance.

The King I and King II reports on corporate governance have also shaped governance practices in South Africa, considered at length in Part III. Aimed at issuing companies, the King II recommendations offer a comprehensive approach to governance and in 2003, the JSE revised its listing requirements based on King II’s recommendations.

**B. Recent Governance Failures in South Africa**

Notwithstanding comprehensive legislation for the governance of companies, South Africa has experienced several major governance failures in recent years. In 1999, the holding company of

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26 For example, the National Environmental Management Act, No. 107 of 1998; the Insider Trading Act, No. 135 of 1998; the Public Finance Management Act, No. 1 of 1999.
28 Naidoo, supra, note 13 at 14.
29 Chapter 2, section 24, Constitution of the Republic of South Africa.
30 Naidoo, supra, note 13; citing as example the Thor Chemicals mercury poisoning case; the asbestos related claims against Cape plc and anti-pollution suits against Iscor for discharge of toxic effluent into unlined seepage outs and dams on the outskirts of Vanderbijlpark steel plant, at 7-9.
healthcare group Macmed was the largest corporate failure in the history of South Africa, entering liquidation owing 16 banks R1 billion in unsecured loans.\textsuperscript{32} There was a serious governance failure at Macmed. Profitable operations were diverted to expansion of hospitals, with directors and auditors failing to flag the incredible drain on cash flow of this expansion campaign. Financial statements failed to fairly disclose the financial status of the company. There were also allegations of insider trading. The liquidators brought a civil suit against four directors with a claim of R900 million, which was proceeding in 2004.\textsuperscript{33} There was also an issue of the former auditors not reporting the irregularities in Macmed’s financial statements when they were forced to resign as auditors three years prior to the collapse; reporting that would likely have prevented losses of millions of Rand.\textsuperscript{34}

In October 2000, the collapse of LeisureNet affected 5,400 full time employees and almost one million South Africans, many of whom had paid for lifetime or long-term contracts.\textsuperscript{35} LeisureNet operated 85 health and racket clubs in South Africa and through its various corporate structures had 17 subsidiaries throughout Europe and Australia. It was placed under a winding-up order and a commission of inquiry was appointed to examine the dealings and affairs of corporate officers.\textsuperscript{36} At the time of its collapse, LeisureNet had debts totaling R681 million and its previous financial statements had failed to disclose R900 million in contingent liabilities.\textsuperscript{37} The two senior executives had also failed to disclose their interest in companies that LeisureNet had acquired, where they pocketed gains both from the acquisition and associated management fees. The officers were charged with fraud and theft and with contravening section 234 of the \textit{Companies Act}.\textsuperscript{38} LeisureNet’s governance failure is particularly significant because it had many governance mechanisms in place. The audit committee had six chartered accountants on it, however the board as a whole had left the integrity of the financial reporting to the audit committee, without engaging in oversight itself.\textsuperscript{39} This illustrates the need to have the entire board remain responsible for the integrity of the financial reporting.

A series of legal actions in connection with LeisureNet’s collapse are still working their way through the court system, including litigation regarding the scope of examination of corporate

\begin{itemize}
\item 31 \textit{Ibid.} at 134.
\item 32 One billion Rand. Naidoo, \textit{supra}, note 13 at 94.
\item 33 Wiseman Khuzwayo, \textit{Macmed Civil Case will Begin Next Week}, (23 January 2004), Business Report.
\item 34 Chantelle Benjamin, “Auditors turned blind eye to Macmed cover-up”, (08 May 2004).
\item 35 Naidoo, \textit{supra}, note 13 at 34-35.
\item 36 \textit{Mitchell and Another v. Hodes NO and Others}, 2003 (3) BCLR 253 (C) at para. 12.
\item 37 Naidoo, \textit{supra}, note 13 at 34.
\item 38 \textit{Mitchell and Another v. Hodes NO and Others}, \textit{supra}, note 36.
\item 39 Naidoo, \textit{supra}, note 13 at 50.
\end{itemize}
officers when those disclosures may influence criminal proceedings against the officers. In the proceedings to date, the Court has held that there is an inevitable tension between the right to a fair trial for corporate officers and the public interest in the proper investigation of corporate collapses. The Court held that a general immunity from use of derivative evidence would furnish wrongdoers with "immunity baths" contrary to the public interest. The Court found that a balance is achieved by direct use immunity and by leaving use of any derivative evidence a matter for the discretion of the trial judge.

Another example of corporate malfeasance was the collapse of Regal Treasury Bank in June 2001. An inquiry into the collapse of Regal found that the CEO and Board Chair Jeff Levenstein failed to act in good faith and with integrity in the best interests of the bank. It found that he acted fraudulently and dishonestly, carried on the business in a reckless manner and that he had "confused corporate governance with thuggery". The Chair/CEO engaged in self-dealing transactions, securing excessive cash bonuses, stock options and other benefits. On the day before the bank was placed under curatorship, he had ordered R22 million of debts owed by him and his brother in law, Jack Lurie the former Chair, to be paid by the bank. Levenstein chaired 5 of the 8 board committees, and he fired staff and removed directors who questioned his actions. The inquiry also found that the directors of Regal had failed to act diligently and to exercise the care and skill which is reasonably expected of persons of their expertise; that the directors had failed to ensure that the audit committee operated in accordance with the Banks Act; and that they had failed to challenge the Chair and CEO in his decisions.

The findings of the Regal Treasury Bank Inquiry resonate with the kind of super-egos involved in the Enron scandal in the United States, where the failure to challenge a powerful corporate actor meant that the usual oversight and supervisory role of the board was completely ineffectual. The Regal Inquiry also criticized the company auditors for failing to act in the bank's best interests. The inquiry report led to 90 pages of recommended criminal charges, including 18 recommended counts of fraud against Levenstein and Lurie. The South African Institute of Chartered Accountants pursued investigations into the chartered accountants of both LeisureNet and Regal

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40 Mitchell and Another v. Hodes NO and Others, supra, note 36. The High Court Cape of Good Hope Provincial Division held that the purpose of an inquiry under section 417 of the Companies Act was to assist liquidators in discharging their duties and in their primary objective of ascertaining the assets and liabilities and recovering the assets and that the problem of the admissibility of derivative evidence was to be dealt with on a flexible basis by the trial court.
41 Ibid. at 84.
43 Naidoo, supra, note 13.
44 Myburgh, supra, note 42.
Treasury Bank. There have also been several other bank failures, notably Saambou Bank Limited in 2002. These failures have resulted in less capital available to smaller South African businesses.

A further inquiry into the corporate governance aspects of South African banks, named the Myburgh Commission after its chair John Myburgh, reported in 2003. The Myburgh Report advocated substance over form in corporate governance, but it emphasized that banks have an obligation to comply with the law, balancing economic performance with legal constraints on their activities. In 1999, the South African Reserve Bank established a Financial Stability Committee. Part of its mandate is to monitor the capitalization and governance of its domestic banks and other financial institutions.

The Nel Commission of Inquiry into the Affairs of Masterbond Group and Investor Protection in South Africa made a series of recommendations to enhance confidence in the securities law system in South Africa. It observed that public confidence in the accounting profession has been shaken, in part because of the failure of the auditing profession to acknowledge its role in detecting fraud, the perception of loss of independence, and the demise of several companies shortly after external auditors had signed unqualified audit reports. It recommended changes to regulation of the profession that would protect the quality of the external audit function, including an independent oversight function to encourage high professional standards.

There are also challenges for enforcement of corporate and listing standards. For example, the JSE fined steel producer Iscor for failing to disclose share dealings by its director Lakshmi Mittal on a timely basis. Mittal is director and owner of a company, LNM Group, with 35% interest in Iscor. The director engaged in self-dealing by purchasing close to R400 million in Iscor shares in the closed period leading up to announcement of the company’s financial results, without disclosing this purchase to the board. The company, not the director, paid the fine. If insider trading penalties are paid by the company, and as in this case, involve a controlling shareholder

49 Ibid. at 328.
50 Ibid. at 343.
52 Ibid.
53 Naidoo, supra, note 13.
who is unlikely to be ousted through the annual general meeting, the system sets up inappropriate incentives to reduce self-dealing transactions.

These governance failures in South Africa are particularly significant. They illustrate the gap between governance standards under a comprehensive corporate law regime and compliance with those standards. A recurring pattern in the collapse of these South African companies is weak boards that failed to engage in effective oversight of the business and affairs of the company, and in particular, failed to ensure that senior officers did not engage in self-dealing. The inability of boards to act independently to discharge their oversight function is the result of numerous factors. They create what scholar Marleen O’Connor has called “group think”, where key actors in the corporation create a board culture that rewards unquestioning agreement with executive decisions and discourages any independent role for directors to question decisions or actions.54 As with other governance systems, the challenge is how to create a culture of good governance that is principles-based and at the same time create effective enforcement mechanisms that act as a deterrent to misconduct and hold directors and officers accountable for any breach of their fiduciary obligations.

The corporate failures of recent years have led to some reforms of South African corporate and securities law. The JSE revised its corporate governance listing requirements following the King II recommendations. The JSE has been creating new avenues to encourage venture capital investments.55 The JSE has also started to de-list companies that no longer meet the filing requirements, in order to maintain public confidence in the capital markets.56 As with the colossal failures in the United States in the past three years, these initiatives raise the question of whether the corporate law system creates the appropriate incentives for corporate actors in their pursuit of wealth generating activity, a subject discussed at length in Parts II and III.

C. Development Potential and Barriers to Effective Governance in Sub-Saharan Africa

In thinking about corporate governance in South Africa, part of the context that informs the discussion is the much broader issue of development in this region of Africa. The economic and social situation of Sub-Saharan African states is a critical consideration in thinking about domestic

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55 One question is how to support small and mid-market companies in South Africa, in terms of dual challenges of size and location in a developing country. South Africa continues to need access to capital, particularly in terms of venture capital. The JSE has reported that it recognizes that the Venture Capital Market (VCM) and the Development Capital Market (DCM) have not been successful in providing this access and so it has launched a new initiative Alt6 in a joint venture with the Department of Trade and Industry. Http://www.jse.co.za.
56 It de-listed 57 companies in 2003, ibid.
corporate activity and governance challenges in global markets, particularly given the serious poverty and the economic imbalance in power for these nations as they seek to strengthen domestic activity. Amartya Sen has suggested that development must be seen in terms of substantial freedom of people. Yet people who are economically, politically and socially disenfranchised are unlikely to experience this fulsome meaning of development.

i. The Plight of Developing Nations

The World Development Report 2000 on Human Poverty provides a snapshot into the challenges. 78.4% of people in Ghana; 70.2% in Nigeria; 36% in Uganda and 11.5% in South Africa live on less than US$1 per day. The percentages of citizens that are not expected to live to over 40 years of age are: 21% in Ghana; 33% in Nigeria; 46% in Uganda and 30% in South Africa. Lack of safe drinking water and extremely poor sanitation conditions are major contributors to the mortality and morbidity rates in Sub-Saharan Africa. Even where there has been a reduction in infant and adult morbidity and mortality, the infrastructure necessary to support the resulting growth in population, including access to safe drinking water, adequate healthcare services, decent education, skills building and jobs has not been put in place. The HIV/AIDS epidemic is taking a devastating toll on the citizens of Sub-Saharan Africa and the lack of an effective prophylactic as well as the more general lack of access to health care services is a serious barrier to development. The pressure on Sub-Saharan African nations to address these urgent challenges competes with their ability to pay off international loans, creating irregular and uncertain public policy priorities and growing problems for both aspects of states’ commitments.

Sub-Saharan Africa is facing complex pressures internationally. The shift in the post-colonial era to global markets is a shift that has a complex impact on different African nations because of their different size, history, political structure, social and economic base, natural resource base and a host of factors that make the challenges for each of these nations quite unique. Sub-Saharan Africa has emerged in recent years from a prolonged period of colonization, in which colonizing individuals or their descendants directed not only its economic base, but also political traditions and structure, and a host of other social and economic activities. This unique history, and in particular, the distribution of property and other economic wealth, informs current capital and governance structures of corporations.

57 Amartya Sen, *Development as Freedom*.
58 World Development Report.
59 *Ibid*.
60 *Ibid*.
Sub-Saharan Africa’s debt grew from $84.1 billion in 1980 to $227.1 billion in 1996, representing three times the value of the region’s exports of goods and services. Africa still receives a disproportionately small share of foreign direct investment as compared with other developing and transition nations. Foreign direct investment (FDI) usually involves a foreign investor making a direct equity investment in assets in the host nation, frequently with intent to manage the asset and with a view to medium to long term investment. An example would be registering a subsidiary of a large multi-national enterprise, to undertake activity in the host nation and take advantage of the limited liability regime to limit any downside risk of operating in the country. Of FDI flows to emerging markets from 1990-2000, Africa received 4% compared with Asia, which received ten times that amount. Globally, FDI to Africa is only 1%. The principal amount of FDI in Africa is investment in extractive industries in those countries that are oil and resource endowed. For example, Nigeria, Lesotho and Angola account for more than 60% of FDI inflow into Sub-Saharan Africa. The G-8 Nations have recently pledged billions of dollars to promote FDI in Africa, yet FDI continues to be limited. Development aid to Africa fell 40% from 1999 to 2001, from $17.2 billion to $12.3 billion. The combination of reduced aid and limited FDI has exacerbated the difficulty these nations face in moving toward economic self-sufficiency.

Many problems in Sub-Saharan Africa are exacerbated by the weak financial sector. In the search for capital to engage in productive economic activity, the financial system is an important component because it facilitates the exchange of goods and services, creates capital on a scale sufficient to meet the needs of the economy and provides markets for the transfer of financial assets. There is a need to have a well-functioning corporate and financial system in place, with appropriate monitoring and enforcement mechanisms, so that foreign investors are attracted to investment in the region. Currently, the heterogeneity of financial systems in Sub-Saharan Africa, the different stages of secondary market development, and the uneven distribution of currency and other markets, means that Africa continues to be considered high risk as a investment

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61 The World Development Report suggests that more than half of the Nigerian population have no access to safe drinking water or proper sanitation; the figures for the other countries are equally disturbing. Ibid.
64 Naidoo, supra, note 13 at 5.
66 World Bank, Africa Development Indicators Report.
67 Manesh, supra, note 63 at 2.
strategy. While foreign investors must be offered a system that allows for diversification of risk, Africa needs to encourage long-term investment, in order to raise capital to build more sustainable infrastructure for corporate and social activity. Equally important, Sub-Saharan African countries must devise a financial sector strategy that recognizes the incredible challenges posed by their status as developing nations, including distributions of wealth that are the result of long periods of colonization and discrimination. As with corporate law, there will not be a stable financial sector absent regulatory mechanisms in place that protect property rights; that allow for monitoring and enforcement; and that allow appeal to judicial bodies that are impartial and independent where disputes arise between financial market actors. Sub-Saharan African nations must also develop the infrastructure that will sustain a financial system, and provide skills training and jobs for those who will become the gatekeepers to the integrity of the system. Trent has observed that FDI can arguably enable Sub-Saharan African countries to add to capital formation and increase total savings, which in turn could be directed toward debt reduction and funding of social programs.

ii. The Contested Strategies to Overcome Economic Inequality

While a complete analysis of these challenges is beyond the scope of this paper, one must be cognizant of the connection between effective corporate governance and development concerns. There is a growing critique of development strategies in Sub-Saharan Africa, with strong normative disagreement about the appropriate course of action to relieve the poverty and underdevelopment. Any enterprise operating in Africa must take account of serious problems such as the incidence of HIV/AIDs, issues of access to water and housing, land redistribution problems, access to education, and access to credit or equity capital in growing businesses. More than 20% of the workforce in South Africa has AIDS or is HIV positive. Naidoo observes that with the current infection rate, the size and nature of regional markets in South Africa will change substantially in the near future. South African companies have an extremely low level of public disclosure on social, health and environmental issues, with only 1% of South Africa’s top

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68 Mongalo, supra, note 1 at 6.
69 Trent, supra, note 65 at 236.
70 Nduhukhire-Owa-Mataze observes that initial colonial administrations were the responsibility of mercantile companies, hence the close relationship between colonial expansion and the myth of Africa’s exploitable wealth. He argues that new initiatives aimed at strengthening of civil societies, democracy, support for small scale business and technology, rural finance and credit schemes, aimed at creating African capitalism or sustainable development are an attempt at creating conditions for sustaining global capitalism; Nduhukhire-Owa-Mataze, “Africa: A Continent Existing and Entering a Century in a ‘Sick-Bay’”, (1999) 3 Mafiti Mva frika (African Researcher) 56 at 60-63. See also, Pearce et al, Sustainable Development: Economics and Environment in the Third World (London, Gower, 1990).
100 companies producing separate reports on triple bottom line issues.\textsuperscript{72} One survey on corporate sustainability reporting ranked South Africa at the very bottom of 19 countries examined.\textsuperscript{73}

In terms of corporate activity and economic development, some scholars have suggested that the African managerial and bureaucratic class has been compromised by the direct economic benefits accruing to it from managers’ support and facilitation of global capital exploitation of resources, a form of “mal-development” in Africa.\textsuperscript{74} Hence there is a question about the capacity of state governments to effectively manage the development process. Structural adjustment programs (SAPs) formulated by the World Bank and International Monetary Fund (IMF) reflect the interests of global finance as opposed to the African people. SAPs have required Sub-Saharan African nations to sell state enterprises cheaply, liberalize markets, devalue currency, reduce budget deficits and cut jobs.\textsuperscript{75} However, international loans made on condition that the nation restructures its economy may not appropriately recognize the particular challenges of adopting a developed country market economy in a developing nation. Some of the normative underpinnings are not valid because of the education, information and property ownership asymmetries that exist for the bulk of the population. In some instances, because of the need to attract economic activity to the region, structural adjustment programs have created opportunities for MNEs to engage in environmentally harmful activities in relatively unchecked pursuit of profit-maximization.\textsuperscript{76}

A critical issue is whether the current international debt load carried by Sub-Saharan African nations is a major barrier to economically sustainable development, and in particular, how it acts to deter domestic corporate activity. The total debt of African countries rose from $6 billion in 1970 to $210.7 billion in 1994, representing 82.8% of Africa's GDP and 254% of its export earnings.\textsuperscript{77} The history of this debt load is complex, and different jurisdictions have different historical, political and social reasons for the volume, structure and repayment terms of the debt. There is evidence to suggest that much of the funding never went to development, but rather,
went to corrupt officials to enhance their own wealth.\textsuperscript{78} Hence states are required to repay debts for funds that were never beneficially directed to the country. While this is not unique to Africa,\textsuperscript{79} it is particularly exacerbated with the other economic, social and political challenges. That these challenges of corruption extend to jurisdictions beyond Africa raises the question of the responsibility that the World Bank and other international funds or lending institutions have to ensure that those who are the beneficiaries pay the debt.

In South Africa, the loans were made to apartheid governments, benefiting a small group of South Africans. Extremely little was ever directed toward development initiatives and toward ameliorating the lives of the socially and economically disadvantaged. Today, the South African government is saddled with onerous repayment terms for benefits that accrued to only a few. The onerous obligations mean that valuable resources are directed away from developing safe drinking water, health care facilities, education, and a range of other social and economic supports and basic infrastructure that is required if South Africa is to become a sustainable economy. This challenge is even greater in some other Sub-Saharan African countries. The difficulty with reliance on the World Bank and IMF loans is that the repayment and other conditions that were previously imposed have saddled current citizens with debt loads and repayment conditions that are almost impossible to meet.\textsuperscript{80} Massive international debt repayment obligations carry with them the inevitable consequence of poverty, famine and spiraling health care crises. Moreover, the sheer quantum of indebtedness creates a situation in which Africa’s resources, which are abundant but limited, are being extracted, while only a small proportion of the wealth generated from this economic activity accrues to the millions of people living in the Sub-Saharan African countries.

It is estimated that in order for African countries to make a dent in poverty alleviation, they need to raise annual GDP growth to 7-8\% annually, which in turn requires raising investment levels to 25-39\%.\textsuperscript{81} Yet Manesh observes that the capital required for development will not come from donors or from the banking sector in Africa because it traditionally specializes in lending on a short-term basis. He suggests that long term capital must be raised through capital markets specializing in long-term debt financing and equity investment, and that such markets will not develop absent liquidity which allows long-term investment holders of shares and bonds to sell

\begin{thebibliography}{99}
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\item\textsuperscript{78} Ibid.
\item\textsuperscript{79} Sharin Ebadi, 2003 Nobel Peace Prize Recipient, Remarks to UBC Faculty of Law, April 19, 2004, discussing similar problems in Iran.
\item\textsuperscript{80} The activities of the IMF and World Bank are highly contested, a debate that is beyond the scope of this paper. However, it is important to note that while their genesis was post-war (II) reconstruction of developed nations under the Bretton Woods agreement, almost from the outset, developing countries sought and received funds from these organizations under onerous repayment conditions.
\item\textsuperscript{81} Manesh, \textit{supra}, note 63 at 2.
\end{thebibliography}
with ease to maintain the appropriate diversity in their files. 82 Manesh observes that the relationship between liquidity of markets and economic growth through savings, investment and productivity, holds after controlling for other social, political and economic facts that may affect growth in Africa, such as political stability, inflation, education, fiscal policy, the legal system and openness to international trade. 83 Liquidity in the market can enhance investor confidence; however, liquidity can also cause uncertainty for the companies that heavily rely on equity markets because the value of equities traded on secondary exchanges influences the ability of the company to raise debt financing.

Dr. Peter John Opio has suggested that Africa lags behind in economic development for two fundamental reasons; that there has been an inability on the part of policy decision makers to establish a meaningful fit between economic progress, power politics and the common good of society; and that there is a lack of synergy between political and religious institutions. 84 He suggests that the failure of social market experiments led many African states to quickly embrace liberal capitalism in the hope of attracting capital from the World Bank and IMF. This form of capitalism includes freedom of enterprise, the right to private property and a democratic system. As a result of this shift, Opio observes that the priority of many African leaders shifted from promoting the well being of the most disadvantaged members of society to concern about credit ratings internationally. 85 Moreover, Opio argues that there is a disconnect between the assumptions of liberal policies on economic development in Africa and the political, social and economic experience on the ground. 86 He suggests that unless the debt is cancelled, the debt owed by Africa is likely to soon exceed $300 billion. This will mean that African countries can never develop or move out of extreme poverty because of the devastating consequence of debt servicing on society’s poorest and most vulnerable, who service the debt through their taxes. 87 Instead, new partnerships between all the economic, political and religious actors should be viewed as the means forward in development. Opio suggests that this includes coherence between the political representations and daily reality, and suspending conditionalities to embrace the needs of the poor and disenfranchised, giving substantive meaning to respect for human rights and democratic processes, especially for African women. 88

82 Ibid. at 2.
83 Ibid. at 3. He also suggests that stock markets have provided mechanisms for privatizing state owned enterprise.
84 Opio, supra, note 77.
85 Ibid. at 3.
86 Ibid. at 5.
87 Ibid. at 6.
88 Ibid. at 12.
iii. FDI and Trade Liberalization: Magic Bullets?

While few would argue that there is not a link between economic development and effective corporate governance, the nature of that link is highly contested. A number of scholars, primarily from Anglo-American jurisdictions, suggest that foreign direct investment is the means by which Sub-Saharan Africa will most rapidly develop. For example, the use of robotics and other advanced technology by General Motors and other MNEs in South Africa has allowed South Africa to sustain its market dominance within Sub-Saharan Africa. Others have observed that revised foreign aid and debt forgiveness as strategies are not sufficient and that Sub-Saharan African countries need to become viable participants in global capital markets. Bonaglia and Fukasaku have argued that there is a need for local business plans that improve local conditions for international business and create a strategy for export diversification. For example, the liberalization of Uganda’s economy resulted in an influx of foreign investment in the late 1990’s and a growth in GDP to 8% per annum from 1992-1995, although its overall debt continued to grow due to onerous servicing charges.

Initiatives outside of Sub-Saharan Africa, such as the U.S. Africa Growth Opportunity Act are aimed at increasing foreign investment and enhancing trade relations between the U.S. and African nations. The statute is aimed at eliminating barriers to free trade, increasing privatization and gaining market share in the African economy. However, Trent observes that one of the first eligibility requirements is that the host nation agrees to minimize government interference in the economy through reducing or eliminating measures such as price controls, subsidies and government ownership of enterprises. Hence there is some loss of state regulatory control that the U.S. is seeking as a prerequisite to providing funding. While the Africa Growth Opportunity Act may assist in bringing much needed capital to Africa, it is unclear at what price. Foreign investment does allow capital to flow into Sub-Saharan Africa, as well as contributing to the host nation some technological, labour skills development, managerial skills sharing and other advances. The control exercised by the foreign investor over the corporate entity means a loss of economic control by the host nation. This is exacerbated by the loss of regulatory control from

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90 Opio, supra, note 77 at 4.
91 Trent, supra, note 65 at 216, discussing the U.S. Africa Growth Opportunity Act, 2000, 106 PL 200, 114 Stat 251 to promote trade development and private sector interest in Africa.
93 Opio, supra, note 77 at 4.
94 Trent, supra, note 65 at 226-227.
95 Ibid. at 230.
the up-front conditions imposed on host nations in order that capital flows in. Host nations already face severe problems in terms of regulating the activities of MNEs within their jurisdiction, and the onerous access criteria under the *Africa Growth Opportunity Act* could exacerbate an already serious problem.

Access to global markets can be a positive factor. Domestic corporations can raise capital effectively, allowing expansion of their wealth generating activities. Investors get the upside value of wealth generated through dividends, and jobs and other economic benefits accrue to the community. However, the control issue remains unresolved. Domestic corporations face a loss of control because of dependence on global capital markets, or they are replaced in the market by subsidiaries that are registered in the host nation as a separate entity, but have the competitive advantage of having economies of scale and market access through large MNEs. Moreover, the capital flows out from productive activity may be highly problematic for future economic sustainability of the Sub-Saharan African nation, with the risk that any upside benefits from the activity accrue only to foreign investors. This creates a cycle in which poverty, serious health issues and environmental protection are not addressed, in addition to weakening domestic corporations and hence the potential for further economic development.

As Sub-Saharan African nations have moved, at least in principle, towards more mixed-market economies, they have embraced a number of Anglo-American strategies including price deregulation, privatization, freer international trade, and a dismantling of state enterprises and civil services. While these strategies are contested in developed countries, it is evident that they have been adopted or imposed in Africa without a closer consideration of whether or not they are development enhancing. Moreover, there is inadequate attention paid to the difference between development and self-sustainability. Development that is externally controlled may allow MNEs to extract excessive rents. Combined with co-operation or inability of host nations to secure any better bargain, benefits that should be directed to economic sustainability can exit the nation in the form of dividends to investors or in debt repayment.

Trade liberalization and aid tied to it can negatively affect development efforts. In Ghana, Opio has observed that the emphasis on cocoa production has exacerbated regional and local income disparities, with 18% of the farming sector receiving 46% of government funding support, resulting in a declining ability for food self-sufficiency in the nation.67 Liberalization policies and exchange rate adjustments resulted in farmers of food crops being hit by cheap imports of rice

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and other cash crops, making local farmers extremely vulnerable to private sector food monopolies.  

There is the further element of the complex political structure and history of Sub-Saharan Africa, with the result that these countries continue to be labeled as high risk for investment. This increases the cost of capital, in turn directly affecting the potential for self-sustaining development. A number of countries have made incredible advances in their democratic processes in the past decade, yet there is continued political and social strife. This uncertainty may bear directly on the development of models of corporate governance that will ultimately assist in generating wealth for the nation state.

iv. Sustainable Economic Development

Finally, a core issue for corporate governance is sustainability and in particular, the intersection between resource extraction, environmental protection and long-term economic sustainability. This is particularly critical in countries like South Africa, in which resource extraction is a main source of wealth creation and jobs. There are increasing environmental problems in Sub-Saharan Africa due to growing population and the pressures created by population shifts from rural to urban areas in search of jobs. There is need to ameliorate agricultural and other land use conditions due to extreme weather conditions, erosion of land, dilution of nutrients from the land and creation of further non-agricultural land through changing ecological conditions. These challenges are exacerbated with the shift to cash crop economies and the draining of wetlands by commercial agricultural enterprises. While long term sustainability of agricultural land is an urgent priority, the lack of energy alternatives and limited land supply have policy makers making difficult choices between feeding hungry populations and concern about long-term environmental sustainability. There is also a lack of empirical research regarding the very diverse types of environmental challenges in regions that encompass deserts to tropical rain forests. While developed nations also face the issue of long-term environmental sustainability with difficult public policy choices, the consequences of these choices are multiplied in nations where the population’s immediate basic needs for food and shelter are not being met, as exist in many parts of Sub-Saharan Africa. Often, Sub-Saharan host nations do not have the political will to prevent further environmental harms because of the economic activity brought to the region by the activities of an MNE. The World Summit on Sustainable Development in Johannesburg in 2002

98 Ibid.
concluded that the earth is held in trust for future generations. Yet there is not yet a systemic strategy for coming to grips with the sustainability challenges cited above.

These development challenges inform the corporate governance debate in Sub-Saharan Africa. What is the proper role of the corporation where host nations do not have the regulatory structure to require the corporation to engage in economic activity in a manner that reduces harms and increases the economic security of the people who are working to generate wealth for the company? What limits can or should be placed on the corporation and what is the appropriate vehicle for effective imposition and enforcement of any limits? What is the obligation of international lending agencies in assisting with the development of governance models that promote economic and social sustainability?

II. A Framework for Thinking about Corporate Governance in South Africa

Conceptually, most if not all jurisdictions have legally constructed the corporation as a separate legal personality aimed at the generation of wealth through its economic activities, with perpetual existence, the ability to contract and limited liability for investors. While viewed as largely engaged in private activity, the corporation, whether closely or widely held, private or an issuing corporation, is the beneficiary of a highly codified regime that enables it to operate in multiple jurisdictions. There is also special status granted the persons who participate in its activity through the corporate form in terms of the limitation of individual liability for corporate actors when corporate activity causes harms. Yet globally, there is strong normative disagreement as to the role and responsibility of the corporation, ranging from a single shareholder-wealth-maximizing objective that is the predominant paradigm of Anglo-American systems, to conception of the corporation as socially situated and constructed, more prevalent in continental Europe and Japan. In parts of Africa, this conception is overlaid with the notion of the corporation’s civic duties. Corporate law scholarship is grounded in different normative views of the corporation, which form the underpinning of current analysis. For example, some believe that corporate law involves observations about the effects of legislative intervention on the functioning of perfect markets, corrected for any outliers. Investors are viewed as rational actors, not socially situated individuals, with wealth maximization as their sole objective. Hence corporate law scholarship explores the law’s role as enabling and efficiency enhancing measured by returns to

99 Naidoo, supra, note 13 at 131.
101 Ibid.
shareholders, with all the attendant distributive effects. Yet the shareholder wealth maximization model appears incongruent with South Africa’s commitment to situating the corporation within civil society. Even Adam Smith recognized that the pursuit of profit could work against the public interest of wealth generation for the benefit of society and argued for scrupulous examination of any business legislative initiative that could be contrary to the public interest. This observation appears somewhat lost in the current Anglo-American governance debate.

A. Corporate Governance in a Domestic Context

Corporate governance, whether in Sub-Saharan Africa, Canada or elsewhere, involves creating the proper incentives for individuals in their management of the corporation, although the entire construct of this governance regime depends on what the incentives are aimed at. The vulnerability of the corporation’s assets to claims from legal liability serves as a constraint on decision-making by corporate managers, even under the strictest shareholder wealth maximization conception. If directors and officers subject the corporation’s assets to legal liability through reckless or negligent acts, they may face personal liability for breach of their fiduciary duty. However, corporate affairs in a multi-national operation can be arranged so that this risk is greatly reduced. The combination of the limited liability of the corporate form, and the general understanding of international law as inapplicable to MNEs’ operations dramatically reduce the constraints on their managers in regard to respecting the environment, human, political or social rights in their operations outside the “home” country.

Corporate law statutes assign directors oversight and control of the operations of the corporation. Shareholders can exercise episodic voice in corporate affairs, but only indirectly, through the election of directors, advisory shareholder resolutions, voting on management’s resolutions and super-majority votes on changes to capital structure that affect the existing shareholders. In terms of the limited liability regime, a key feature is that shareholder liability is limited to the

102 Ibid.
103 King II, supra, note 11.
104 Adam Smith, The Wealth of Nations, at 8-10, suggesting that by promoting self-interest in promoting self-wealth, one promotes the interests of society, without realizing it. However, he also observed that: “The interests of this third order [that is to say, of those who live for profit], has not the connection with the general interest of society as that of the other two [i.e. labourers and landlords]…The proposal of any new law and regulation of commerce which comes from this order [that is to say, from those who live for profit], ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions both deceived and oppressed it”.
105 For a full discussion of this, see Sarra, supra, note 100.
shareholder’s total investment. Managers control the corporation’s activity, but they have no general personal liability for harms caused by its activity. How we construct the economic incentives in the corporate governance system determines the outcomes, in this case, a narrowing of the corporate focus to short-term wealth maximization.

The second broad approach to corporate governance is that in acting in the best interest of the corporation, directors and officers should take account of the interests of all those with investments or interest in the corporation. While scholars differ on whether this should be a direct fiduciary obligation to corporate stakeholders or an obligation to balance multiple interests or prejudice, the idea is to take account of these interests. In taking into account stakeholder interests, the corporation should be concerned with negative externalities from its activities, including those that cause social and economic harms. This approach is also helpful in that it seeks to internalize all costs of productive activity, including long term sustainability costs, adjustment costs for labour shedding and harms from consumer torts. The premise is that if these costs were internalized, the corporation would be more likely to engage in decisions that foster long term job skills development instead of labour shedding; human rights practices instead of harms caused by discrimination; and environmentally sound practices to avoid the costs of harm and remediation that would be internalized to the corporation. The approach also has its challenges, one of which is how to ensure that corporate decision makers are accountable, given that they could justify any decision based on an expressed concern for the interests of a particular group. While the stakeholder conception of the corporation would formally recognize all those with an interest in the corporation, it leaves unresolved the larger issue of whether or not corporations should be allowed to determine social and economic policy through their activities. Of course, in the absence of any regulatory activity in a particular policy area, corporations are determining social and economic policy in that area through their unregulated activities.

Corporations engage in wealth generating activity because of public laws and policies that act as enabling devices in this activity. Yet corporations also have the ability to contribute to political parties and hence to influence the political process regarding not only corporate law, but also other laws that touch on their liabilities, such as labour or environmental law. Some of the current challenges to sovereign nations and protection of domestic human rights and

106 Ibid. There are some exceptions, such as statutory liability for wages, domestic environmental damage and some torts, as well as liability under oppression remedy and derivative suits.
108 Sarra, supra, note 100.
109 Ibid.
environmental norms are the result of political lobbying and consequent domestic adoption of policies of free trade, deregulation and dismantling of particular social safety nets.\textsuperscript{111} This trend is repeated internationally as MNEs exert considerable pressure in the international forum in terms of promoting trade, finance and capital markets policies that insulate their activities outside of the home state from liability.

B. Corporate Governance in the Context of Globalization and MNEs

Globalization poses particular challenges to the ability of domestic governments to enforce specific normative standards, particularly where corporations headquartered in the nation state have their economic activity elsewhere. It is increasingly evident that domestic law is incapable in itself of controlling the activities of MNEs, a concern where exportation of particular production activities creates harms in terms of human rights, health and safety or environmental standards. Moreover, the ability of domestic jurisdictions to tax corporations to generate revenue necessary to provide social services to ameliorate the harms is limited by the multinational nature of the corporate activity.\textsuperscript{112}

What will be the long term impact of “regulatory chill” in terms of both the willingness of MNEs to situate themselves in jurisdictions with few environmental or labour standards and the inability of host or home nations to devise laws that protect their citizens from the harmful effects of unregulated environmentally harmful or discriminatory activity?\textsuperscript{113} MNEs have been implicated in nations that engage in repressive human rights policies or police repression in order to engage in productive activity.\textsuperscript{114} MNEs have allegedly engaged in human rights violations, activities harmful

\textsuperscript{110} Ibid.
\textsuperscript{111} Ibid.
\textsuperscript{113} Sarra, \textit{supra}, note 100. The WTO has suggested that regulatory chill hinders the competition for capital globally, where some nations attempt to enact stronger domestic environmental protection policies. World Trade Organization, \textit{Trade and Environment} (1999).
\textsuperscript{114} Bennett Freeman, Deputy Assistant Secretary of State for Democracy, Human Rights and Labour, Speech to the Third Warwick Corporate Citizenship Conference (10 June 2000), \url{http://www.state.gov/www/policy_remarks/2000/00710_freeman_warwicku.html}. See also \textit{Wiwa v. Royal Dutch Petroleum Co.} 226 F.3d. 88 (2d Cir. 2000), that dealt with allegations that Shell Nigeria utilized police and military to quash opposition to its development activity; and \textit{Doe v. UNOCAL Corp.} 248 F. 3d 915 regarding alleged use of force to coerce residents to construct an oil pipeline.
to the environment, child labour, anti-unionization activity, slavery and dangerous health and safety conditions.\textsuperscript{115} This has occurred in parts of Africa and elsewhere, particularly where the host nation is desperate for the economic activity that MNEs offer.

Unlike developed countries, where there exists a framework for tempering the unchecked activities of corporations through employment standards, human rights and environmental law, many Sub-Saharan African countries do not have the infrastructure to develop or enforce laws to address the multinational enterprise. Moreover, initiatives such as the OECD corporate governance guidelines are aimed primarily at creating legal and enforcement structures in these nations for equity capital investors.\textsuperscript{116} Corporate codes of conduct are aimed at ensuring transparency of governance and financial reporting, and securities and credit enforcement regimes offer effective remedies for investors. The convergence pressure in respect of these property protections is facilitated by the importation of U.S. experts in the design of systems and considerable pressure to have transition and developing nations adopt Anglo-American norms and legal structures without consideration of the other types of remedial protections that exist as a counterbalance in Anglo-American jurisdictions. While these property protections are essential to fostering investor confidence and thus healthy capital markets, they ignore the need for a host of other public policy measures that are needed to provide the appropriate balance in wealth creation and protection of those with interests in the corporation. That interest might be a direct one, in terms of investments made in labour or local infrastructure, or it may be an interest in the environmental and social impact of corporate activities on the local community and the environment. The OECD corporate governance guidelines advocate respecting domestic law commitments to other stakeholder interests, but are silent on these issues where the domestic jurisdiction does not already have a developed notion of the corporation as socially situated.\textsuperscript{117}

The growth of MNE activity across multiple jurisdictions and international trade law that facilitates free trade and limits use of principles such as the national treatment principle has diminished the domestic regulatory capability of the nation-state, raising troubling social and distributional issues.\textsuperscript{118} It is important to examine the specifics of the regulatory diminution.

MNEs are organizations which, while created in one state, operate in several states through subsidiary corporate entities created in each country of operation, through contractual links in supply and delivery chains, and/or through licensing and franchise agreements. As private entities, MNEs are subject to the national law of the states in which they operate, and may also have been granted certain rights under treaties between states, rights that can be enforced in the

\textsuperscript{115} Sarra, \textit{supra}, note 100.

\textsuperscript{116} OECD Principles for Corporate Governance, \url{http://www.oecd.ca}.

\textsuperscript{117} Sarra, \textit{supra}, note 100.
courts of the applicable state. Certain treaties also provide for protection of investor rights against state action through binding international arbitration. Arbitration provides a dispute resolution mechanism for claims against the state by investors claiming the state regulatory or legislative actions harmed their investments. Thus a forum exists for private actors to hold public state actors accountable for decisions that harm equity investments. In contrast, however, there is no international forum in which these enterprises can be held accountable for their actions in breach of fundamental international law and conventions concerning human rights, the environment and social/political rights.\textsuperscript{119}  International law assigns this function to the courts of the various states, exercising their national jurisdiction over activities of the corporations that originate in or affect their territory.

There are two issues that arise when subsidiaries are involved. The first is that a subsidiary is provided with its own “legal personality”. Thus if a subsidiary is created to mine asbestos in South Africa, then that is the legal entity to which liability will attach in the first instance. If asbestos mining causes harm, then nothing automatically attaches liability on to the parent corporation for the acts of the subsidiary, irrespective of the ownership structure. Given this situation, the incentive on the parent is to leave as few assets in the subsidiary as possible.\textsuperscript{120} This leaves the miners with the unenviable task of establishing direct liability through a claim the parent failed to properly supervise the subsidiary or vicarious liability for the acts of one’s subsidiary.\textsuperscript{121} Thus, parent corporations may be encouraged to transfer all of the subsidiaries’ surplus assets to themselves in order to limit the loss to the MNE overall. If they are successful in doing so, they will have lessened constraints on decisions to breach international norms.

Second, the use of unlimited subsidiaries as the vehicle for corporate activities internationally means that directors and officers of controlling parent corporations are not directly liable for the actions of the subsidiary even where they are the controlling mind of the subsidiary. The construction of domestic liability regimes, judicial reluctance to draw aside the corporate veil and the practice of shifting corporate assets from the subsidiary to the parent to shield the assets from remedial claims in the host nation, create considerable barriers to MNE accountability for international activities.\textsuperscript{122}

There is frequently reluctance of home and/or host governments to take action against MNEs because of their importance to the country’s economy or because, as discussed on Part I, they

\textsuperscript{118} Ibid.
\textsuperscript{119} Ibid.
\textsuperscript{120} Ibid.
\textsuperscript{121} Lubbe v. Cape plc, [2000] 4 All England Reports 268 (H.L.) at 271.
are beneficiaries of the company’s activities. Hence while a separate legal entity has been formed for purposes of economic activity in the host nation, the host nation may be reluctant to enact legislation that may protect its citizens during the subsidiary’s value generating activity in the host nation. Those who may be harmed by its activities frequently do not have access to standards within their own nation or an enforcement mechanism in order to redress or prevent harms.123

The beneficiaries of these trends are the MNEs. The liberalization of labour markets has meant that in the home state, the MNE can exert consideration economic pressure to dismantle standards and make the home nation “more competitive” in a market in which the MNE has generated the competition. Failure to accede to these demands results in plant and industry closures and exportation of the economic activity elsewhere, where the host nation is so anxious for jobs and economic activity that it undertakes to allow the corporation to operate relatively unfettered. This undermines the effective power of nations to regulate domestic labour law and social policy.124 This trend is complicated enormously by the development history discussed in Part I and by the consequent inability of the host nation that has agreed to trade liberalization to provide some balance to stakeholder interests engaged in corporate value generating activity.

C. International Norms versus Corporate “Cultural Sensitivity”

Another issue is what corporations have called the political and cultural sensitivities of the host nation. An example would be nations where women or particular racial groups are not given access to employment, or if they are, their compensation reflects highly discriminatory practices. Respecting the cultural norms of the host jurisdiction in such a case runs contrary to international human rights and is offensive to Canadian and other law regarding equality rights. The MNE’s continued investment in the host nation that supports inequitable employment practices results in further dollars being invested to perpetuate gender and race discrimination. While developed nations must be careful not to press for wholesale importation of their normative conceptions of human rights or environmental sustainability into Sub-Saharan Africa and other emerging economies, it is appropriate to hold those nations to international norms set through democratic international efforts. The socio-cultural differences cannot be used, as they are now, to justify discriminatory and repressive labour practices and unaccountable environmental harms. International NGO communities have identified this problem for years, yet corporations continue

122 Sarra, supra, note 100.
123 Ibid.
to engage in global activity, relatively unchecked and unscathed by these debates.\textsuperscript{125} Hence the question is whether there ought to be internally generated norms that could potentially complement the public policy debates of international comparative law scholars.

Sub-Saharan Africa is comprised of a rich diversity of complex economic, social and political situations, hence there is not one prescription or strategy for effective corporate governance nor should there be. Similarly, while the current challenges facing these countries are shaped by their history, post-colonial economic controls, the politics of international developments such as the Cold War and post-Cold War periods, and the complex social, religious, tribal structure, there are commonalties.\textsuperscript{126} This includes long-periods in their development of external control, first through colonization, in which many domestic customs and economic activity were suppressed, and then through continued economic control, through both heavy interest on debt and through ownership structures of economic enterprises. This history and continued distribution of capital shapes not only corporate activity, but can determine state attitudes towards corporate governance. In turn, this can shape the nation’s prospects for economic sustainability, in terms of access to education, business and other skills, health care and the infrastructure that can lead to development. While there will be continued convergence pressure if emerging economies are to attract global capital, government initiatives must clarify the constraints that the emerging nation is willing to impose on corporate actors and determine in whose interest regulatory and economic activity is generated.

D. Importing Assumptions is Dangerous

In the Anglo-American conception of corporate activity, wealth is generated in part by the creation of externalities, those costs that the corporation does not have to bear and which are picked up by society in the form of unemployment, social welfare benefits and health care costs. The corporation is rewarded for its creation of externalities because it can shed many real costs associated with its activities and report greater profits, in turn paying out greater dividends to shareholders and extracting increased personal compensation for officers. Absent a requirement to account for all costs of corporate activity, the cycle continually repeats itself, causing a further distribution of wealth in favour of the corporation and its investors.

\textsuperscript{125} \textit{Ibid.}

\textsuperscript{126} In part, this was because there was a struggle for influence in Africa by the Cold War protagonists, leading to financial support for a variety of political structures that caused considerable long-term damage in the effort for nation states to become self-sustaining.
In Africa, these externalized costs are borne by millions of poor workers who act as a source of extremely cheap labour extracting already inexpensive resources. The African people thus lose both control over their natural resources and over any wealth they may generate, including the ability to ensure that the resources are preserved, sustained and regenerated for the future. They also bear the costs from this exploitation through the social and economic costs of poor wages, an inability to properly feed or shelter families, and injury and death on the job. The framework of wealth generation by reliance on externalizing costs imported into Sub-Saharan Africa carries with it some inappropriate assumptions. One glaring example of the outcome of corporate externalities in Sub-Saharan Africa are the townships and other conditions of extreme poverty for those who migrate to urban centres looking for work. These conditions are created by the MNEs ability to extract concessions in exchange for FDI, resulting in reduced taxes to pay for infrastructure and the availability of cheap labour in resource extraction. Such an approach does not allow communities to sustain themselves. While MNEs interesting in investing in Africa now should not have to bear the full costs of historical inequities, arguably neither should the host nation or its citizens who are disadvantaged by historical debt repayment obligations. Until one can break the pattern that currently exists, corporate governance reform in Sub-Saharan Africa will have little impact.

Amartya Sen has observed that business is both a competitive and a co-operative activity, and that societies flourish because of codes of conduct and the recognition of strategic interdependencies, involving the practical recognition of the goals of others, of the enterprise and of living in a situation of social interdependence.127 Hence, costs and benefits of development in Sub-Saharan Africa need to be assessed through a process of collective evaluation on the social value of corporate activity. This requires a determination of to whom the benefits of development are accruing and who is bearing the costs.128 Equally important, how can one construct a governance system that addresses the current inequitable distribution of wealth and creates the basis for more collective benefits that can accrue from successful corporate activity?

III. South Africa: Strategies for Enhancing Governance

South Africa has fared better economically than many other Sub-Saharan African Nations. Of global emerging equity portfolios, South Africa has captured about 8%, largely because of the stability of its Johannesburg Stock Exchange (JSE).129 In 1998, South Africa had a market

129 Manesh, supra, note 63 at 2.
capitalization of R170,252 million, with 668 companies listed, and a market capitalization to GDP ratio of 131.9%.  

Some of governance challenges faced by South African domestic markets bear a striking resemblance to issues faced by other markets globally. These include: executive compensation that is not appropriately tied to performance and is frequently excessive; a structure and role of the board of directors that leads to failure of oversight; the lack of independence of auditors and problems with transparency and adequacy of accounting standards; and questions about the appropriate role of outside directors in governance of the corporation. These challenges are evident in the recent failures of South African companies, discussed in Part I. Yet South Africa also faces unique challenges in thinking about the advancement of domestic corporate activity through effective governance.

Much of South African corporate law is based on the U.K. system, including its company law statutes and much of its common law. Hence governance issues, including the scope of decision making by corporate officers, prohibitions on self-dealing and the scope and limits of fiduciary obligation are heavily influenced by U.K. jurisprudence that has developed over the last century. In this respect, South Africa is similar to Canada, in that Canada’s company law is derived from the same sources. More recently, American corporate common law has impacted on Canada, but similarities still exist. As discussed in Part I, in South Africa longstanding companies’ legislation and other statutes, as well as the common law, were supplemented by a Code of Corporate Practices and Conduct in the 1990’s. Yet unlike the U.K. and Canada, the comprehensive corporate law regime is not matched by remedial legislation that tempers corporate activity by protecting human rights and enforcing environmental protection. Where such legislation does exist in South Africa, it is unclear that it is effectively enforced such that it tempers corporate malfeasance. Moreover, for the reasons cited in the last Part, the host nation may be unwilling or unable to enforce any remedial protections or standards because of the urgent need for capital and economic activity in a region.

There are also similarities in the capital structures of South Africa and Canada. South African companies are primarily financed by equity capital. Domestic corporations are large and constitute a sizable proportion of the Gross Domestic Product of South Africa.  Unlike the U.S., in which the operating governance paradigm is one of separation of ownership and control, Canada’s governance regime is one in which both publicly traded and privately held corporations are frequently closely controlled. Whereas the primary governance challenge for the U.S. system

130 Ibid. at 5, citing Stock Market Fact Book, 1999, IFC. In 1998, it had value traded of R58, 444 million and a 29.1% turnover rate, many times the volume of all the other Sub-Saharan African countries together
is to reduce agency costs of managerial self-dealing or shirking to the detriment of the interests of investors, the governance challenge in Canada is to reduce the possibility of collusion between corporate officers and controlling shareholders (represented also on the board of directors through nominee positions) to the detriment of minority investors and other stakeholders. While there has been a large growth in holdings by institutional shareholders in the past decade, there are still a large number of corporations that are closely held, even when publicly traded, as is the case in South Africa. In this respect, the governance challenges facing South Africa are somewhat akin to those faced in Canada.

The capital structure of South African domestic corporations arose as a result of the sanctions of the apartheid era and its devastating economic and social inequities. A few individuals, families and companies controlled many of the corporations in a series of complex cross-holdings. Apartheid also resulted in relatively little foreign investment or ownership, particularly as world condemnation of apartheid practices grew. With the end to apartheid and economic boycotts of South Africa, the capital markets began to open to the West, creating some shift in holdings. By 2000, there were 608 companies listed on the main board of the JSE and two-thirds of all listed companies had a shareholder with more than 30% shareholding. While this indicates a continuing high level of concentration of capital, it also indicates that the majority of South African companies no longer have legal control vested in a single shareholder. However, the levels of concentration may mean that these individuals or companies still have de facto control over governance of the corporation. Mongalo also observes that of 190 corporations listed on the JSE in December 2001 that had a single or small group of shareholders with 50% control, the majority were institutional shareholders. Hence, he argues that South African corporate governance must take account of situations in which corporations are widely held, as well as those cases in which they are closely held, if it is to be meaningful in the South African context. In this, he believes that the King II report on corporate governance, discussed below, only considered the governance mechanisms required for widely held corporations in its promulgation of a revised code of corporate practices and governance.

A. King Reports on Corporate Governance

131 Mongalo, supra, note 1.
132 Ibid. at 180.
134 Ibid. at 182.
Corporate governance in South Africa has focused primarily on listed companies. Governance policy has been shaped by two reports of Committees studying corporate governance in 1994 and 2002. The corporate governance principles enunciated by these reports are aimed at “affected companies”, a defined term. The first committee that studied corporate governance in South Africa was established in 1992, following closely on the heels of the Cadbury Committee Study in the U.K. Dubbed “King I” after its chair, Mervyn King S.C., the King Committee issued a report and a *Code of Corporate Practices and Conduct* in 1994. The JSE subsequently enshrined many of the recommendations as part of its listing requirements. A further review was conducted a decade later, resulting in the King II Report in 2002, including a revised *Code of Corporate Practices and Conduct*. While the *Code* applies to all companies listed on the JSE, banks, financial and insurance entities, and certain public sector enterprises, King II urged other companies to give consideration to implementing the provisions of the code as best governance practice. As with many corporate governance codes globally, the King II *Code* mandates principles, but does not prescribe a particular course of conduct or action. King II reflects very sophisticated thinking about the governance role of the board and implications for multiple stakeholders. In some respects, it is ahead of guidelines developed in many developed countries. This part examines the substance of recommendations for good governance and then the challenges for implementation.

The King II Report found that South Africa might arguably offer investment returns that are competitive globally, even when factoring in political, currency and other risks, and that corporate governance was an essential component if South Africa is to continue to compete. It referred to the June 2000 survey published by McKinsey & Co., which found that of 200 global institutional investors representing US $3 trillion in assets, 84% indicated a willingness to pay a premium on investment in well-governed companies over those poorly governed (where they had a comparable financial record). Hence, King II’s *Code* is aimed at providing a comprehensive set of principles for effective governance.

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135 Affected companies are all companies with securities listed on the Johannesburg Securities Exchange (JSE), as well as banks, financial and insurance entities defined by South African financial sector statutes, and specified public sector enterprises and agencies; *Code to Corporate Practice and Conduct* (2002), at para. 1.1.
137 *JSE Listing Requirements* (Durban, Buttersworth, 2001), Schedule 22.
139 King II at 1.1 and 1.2.
140 King II at 19.1.
King II sets out seven characteristics of good corporate governance. The first is transparency, the ease with which investors and others are able to meaningfully assess the financial and operational aspects of the company. The second is independence in terms of the mechanisms in place to ensure the avoidance of conflicts and minimizing potential conflicts of interest. The third principle is accountability by corporate decision makers for their decisions and actions. King II recommended that effective mechanisms must exist to allow investors to query and assess the actions of the board. The fourth principle is that the board must act in a manner that is accountable to the company, but also act responsively to and with responsibility towards all stakeholders. The fifth factor is one of corporate discipline; whereby corporate officers adhere to standards of behaviour that are widely viewed as correct and proper behaviour. Sixth, is fairness, in that governance systems and practices must take into account and balance the interests of all those with an interest in the corporation and its future. This principle is more progressive than principles enunciated by many developed countries, although as discussed below, its implementation faces considerable challenges. Finally, a well-managed company must be aware of and respond to social issues, placing priority on ethical standards of conduct. King II observed that good governance means that the company is non-discriminatory, non-exploitative, and responsible in respect of human rights and environmental protection.

i. Transparency

King II observed that a report by one institutional investor ranked South Africa among the top five of 25 emerging markets in terms of corporate governance, but that it ranked poorly in terms of disclosure and transparency. King II observed that the minimalist approach to corporate governance by a number of domestic companies must change.

King II recommends a number of measures to increase transparency of corporate decisions. It emphasized that directors must have unrestricted access to all company information, records and documents, and that the information needs of the board should be well defined and regularly monitored. There should also be transparency in the recruitment and nomination process for directors. Procedures for appointments should be formal and transparent, and final decisions on recruitment of directors made by the board as a whole, with the assistance of a nomination

141 King II at 18.1-18.7.
142 King II at 18.5.
143 King II at 18.1.
144 King II at 15.
145 King II at 2.1.7.
committee where appropriate. The nominating committee should be comprised entirely of non-executive directors. King II also recommends that companies provide full disclosure of director remuneration on an individual basis and that compensation should include performance-related elements. King II also recommends that membership of the remuneration committee must be disclosed in the annual report and that the chair of such committee should attend annual general meetings to respond to questions by shareholders. This would enhance transparency by enabling investors to assess director remuneration and whether it is sufficiently linked to performance.

The King II report had an immediate impact. The JSE reviewed its listing requirements and incorporated more rigorous requirements, effective November 2002, for directors in respect of their dealings in company shares and disclosure of director remuneration in the company’s financial statements. The revised listing requirements also require the nomination committee of public companies to be comprised of only of non-executive directors.

Disclosure must also encompass reporting that is broader than financial performance reporting. King II recommended that every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health and environmental management policies and practices. Disclosure of such information should be governed by the principles of reliability, relevance, clarity, comparability, timeliness and verifiability with reference to the Global Reporting Initiative Sustainability Reporting Guidelines on economic, environmental and social performance. King II also recommends disclosure as to efforts to reduce workplace accidents and injury; the nature and extent of strategies to address and manage the impact of HIV/AIDS; best environmental practices; disclosure of human capital development against equity targets.

These recommendations are directly relevant to South Africa’s potential for sustainability. In many developed countries, there are no similar required disclosures, although a number of corporations have voluntarily agreed to report on a triple bottom line basis. The difficulty for South Africa, as for voluntary initiatives in Canada, is that absent enforceable standards, there may not be sufficient incentive to comply with sustainability goals. Canadian corporations, even those supporting GRI reporting, have vigorously opposed any codification of standards that would provide rights and remedies. South Africa may not fare any better once it tries to move past general principles. Still, the requirement to report on these initiatives is a giant step forward and likely to have some positive impact on corporate activity, creating some normative pressure.
internationally for a “sustainability culture”. Moreover, reporting and failure to address harms may encourage NGOs and citizen groups to press for standards and measures to address harms.

ii. Directors’ Duties

The South Africa *Companies Act* does not codify the fiduciary obligations of directors, however, at common law, directors have been found to stand in a fiduciary relationship to the company. Fiduciary duty is not well defined, and the courts have held that principles of equity underlie fiduciary obligation and that the substance of the relationship and not the form must be examined to ascertain its nature and extent. The Nel Commission investigating the collapse of Masterbond Group recommended that the duties of directors be codified in the *Companies Act*, requiring directors to act honestly and in good faith, with such reasonable skill, diligence and care, including reasonable inquiry, as a reasonably prudent person would exercise under similar circumstances, in the best interests of the company.

King II emphasized that directors’ obligations are to the company, not its shareholders. It expressly rejects the “shareholder dominant theory”, finding that the company is a separate persona in law and that the relationship of the company and shareholders is contractual, arising out of the articles of association. It expressly rejected the notion that shareholders are the “owners” of the corporation. However, it also recognized that shareholders expect return on their investment and that this contractual relationship must be respected. This approach leaves some uncertainty as to how directors are to exercise their fiduciary obligations and how they may be held accountable. Express rejection of the “shareholder dominance theory” in favour of best interests of the corporate is a very positive aspect of the King II Report. Yet absent either statutory standards of conduct under company law and accompanying remedial statutes, and effective mechanisms for monitoring and enforcement of those standards, the only accountability mechanism is a reversion back to shareholder limited control mechanisms of exit and replacing directors at annual general meetings. King II leaves this critically important question unanswered.

Notwithstanding this unresolved issue, King II contains many important substantive governance recommendations. King II found that directors have an obligation to ensure that there are effective systems of internal control on accounting practices and standards, supported by reasonable, prudent and consistent judgment. It recommends that non-executive directors

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152 King II at 17.3-17.5.
should have skills, experience and credibility to bring independent judgment to bear on issues of strategy, performance, resources, transformation, diversity and employment equity and standards of conduct and evaluation of performance.\textsuperscript{153} King II called for an affirmation by directors that they accept responsibility for the preparation of financial statements in accordance with GAAP. Nomination committees should carefully check to ensure that potential nominees are qualified to be director, within the meaning of JSE guidelines. King II expressly calls for training for new directors with no or limited board experience. This should include a formal orientation programme to familiarize the director with the company’s operations, senior managers and the business environment. Such training is also essential to make directors appreciate the scope of their fiduciary obligations and the potential for personal liability where these obligations are not fulfilled.

As with many countries, there has been a problem with excessive executive compensation in South Africa, and insufficient connection between performance and compensation.\textsuperscript{154} Both director and officer compensation should be tied to performance, but in a manner that rewards long term sustainable development, not short term returns. The transparency measures discussed above may create some normative pressure on corporate boards for their decisions relating to executive compensation.

\subsection*{iii. Board Composition and Independence}

A survey of 73 major South African companies in 2002 found that corporate boards ranged from 5 to 30 directors, with the average board size being 12 directors.\textsuperscript{155} For South African banks, the average board size is 19 directors.\textsuperscript{156} The size of the board and the independence of directors can have a direct bearing on effective governance.

The revised \textit{Code} adopted by the JSE after King II emphasizes that corporations need an effective board as the focal point of the corporate governance system. The corporate board must

\begin{footnotesize}
\begin{enumerate}
\item King II at 2.4.2.
\item Naidoo, \textit{supra}, note 13 at 76-77, citing the R234 million in termination benefits to South African Airways officer Coleman Andrews; R100 million in termination pay and other benefits to BHP Billiton officer Paul Anderson and a pay hike of 70% to chief executive of BHP Billiton to R52 million per year at a time when the company had a 12% decline in attributable profits.
\item \textit{Ibid.} at 34.
\end{enumerate}
\end{footnotesize}
retain full and effective control over the company and monitor management in its implementation of board strategies.\textsuperscript{157} The board has an obligation to ensure that the company has complied with all relevant laws, regulations and codes of business practice, and that it communicates with shareholders and other stakeholders in a timely and transparent manner.\textsuperscript{158} King II also reinforces the notion that the board has a responsibility to engage in strategic planning and risk assessment for the company. In Canada, risk assessment includes both upside and downside risks to the company, an idea that is echoed in King II’s suggestion that the board should be monitoring key performance indicators, with particular attention to technology and systems. The King II report goes further than Canadian governance recommendations, however, in the sense of recommending that it is important that boards identify and monitor the non-financial aspects relevant to the business of the company.\textsuperscript{159}

King II calls for a balance between executive and non-executive directors, preferring that a majority of directors be independent of management. Its focus here is protection of minority investors.\textsuperscript{160} King II also advocates that boards analyze their existing composition to determine whether their size, diversity and demographic composition ensure that they are as effective as possible. The revised \textit{Code} also required a separation of the board chair and the CEO, in order to ensure a balance of power and authority. The chairperson should preferably be an independent non-executive director.\textsuperscript{161}

King II expanded on the discussion of independence from its first report. King II defines directors as executive, non-executive, independent and shadow directors.\textsuperscript{162} Executive directors are corporate officers involved in operating the business or in full-time employment of the company or its subsidiary. Non-executive directors are not involved in daily management of the business, but can be interested in the sense of being officers of the holding company. Independent directors are both non-executive and have no other relationship with the company other than the directorship. The independent director is not a shareholder nominee, does not have familial ties, is not a professional advisor to the company, has no significant contractual relationship with the company and is free from any business or other relationship that could be seen to materially affect the director’s capacity to act in an independent manner.\textsuperscript{163} A “shadow” director is considered to be a person (frequently a controlling shareholder) who is able to influence the

\begin{itemize}
  \item King II at 2.1.4.
  \item King II at 2.1.
  \item King II at 2.1.11-12.
  \item King II at 2.2.1.
  \item King II at 2.3. It found that where the roles are combined, there should be an independent non-executive directors serving as deputy chairperson (similar to what Canada refers to as a lead director).
  \item King II at 2.4.3.
  \item King II at 2.4.3.
\end{itemize}
activities of the corporation and decisions of the board, and whose directions or instructions determine the company’s decisions and actions. King II recommended that shadow directors should be discouraged.164

King II also recommends staggered terms for boards, formal briefings on developments in the law, and levels of remuneration that are sufficient to attract, retain and motivate directors.165 It called for regular board meetings, efficient and timely methods for informing and briefing members, and full access by directors to management. There should be regular review of processes and procedures to ensure the effectiveness of the company’s internal systems of control.166 King II advocated retention of the single board structure as appropriate to South Africa, primarily so that all directors would have the same information and hence engage in better decision making.

King II emphasized that the board's role is one of oversight, its guidelines closely aligning with the non-mandatory guidelines developed in Canada. Governance in both countries suggests that the board must give strategic direction to the company, must appoint the CEO, ensure that an effective succession planning strategy is in place, and that there is a mechanism to evaluate the performance of both board chair and the CEO. King II also recommends that companies adopt a charter setting out board responsibilities, and that the charter should be disclosed in the company’s annual report. Boards must develop codes of conduct addressing conflicts of interest. It also recommends that boards define levels of materiality, in terms of defining what powers are for the board to retain and what is more appropriately delegated to officers, with the board monitoring the exercise of that power.

The Myburgh Commission investigating governance of South African banks echoed many of these recommendations. It recommended that banks have smaller boards, that there be limits on the number of executive directors, and that the majority of directors should be independent directors.167 It observed that the independence of directors must be de facto as well as de jure, so that the director can bring impartiality, objectivity, fairness and flexibility to the exercise of judgment, and have the courage to challenge management’s current or projected future plans where they consider them not to be in the company’s best interests.168 Myburgh suggested that non-executive directors should meet at least twice annually without the executives.169 In South Africa, there are express regulations on the competency levels required of bank directors, aimed

164 King II at 2.4.4.
165 King II at 2.5.3.
166 King II at 2.6.4.
167 Myburgh Commission, supra, note 42 at 34.
168 Ibid. at 37.
at ensuring that directors have effective risk management skills. As with King II, the Myburgh Commission adopted a fulsome approach to directors’ duties, that they must have the necessary skill and experience to engage in oversight of strategy, resources, transformation, diversity and employment equity, standards of conduct and evaluation of performance. There should be clearly defined authority and roles for all board committees, including ongoing review of their mandate and effectiveness. The performance of both the board as a whole and the directors individually should be reviewed at least annually.

King II specifies that the Board should regularly review processes and procedures to ensure the effectiveness of its internal control systems, in order that both the accuracy of financial reporting and its decision-making capability are maintained. There should also be an established procedure whereby directors can seek independent professional advice, if necessary, at the company’s expense. The board should meet regularly, at least quarterly, and there should be annual disclosure of the frequency of meetings and directors’ attendance in the Annual Report. The Annual Report should also include a statement that the directors accept responsibility to prepare the financial statements and that they fairly present the state of affairs of the company; that the auditors are responsible for reporting on the financial statements; that adequate accounting records have been maintained and that there is an effective system of internal control and risk management; that appropriate accounting policies have consistently been used and that any departure is disclosed, explained and quantified. Directors should also attest that there is no reason to believe the business will not be a going concern in the year ahead, or provide an explanation of any reasons otherwise. The Annual Report should also disclose which directors are executive, non-executive and independent, so that investors and others can assess genuine independence. Finally, the Annual Report should confirm that the Code of Corporate Practices and Conduct has been adhered to, and report any instances where it has not.

King II also advocates a higher level of shareholder activism and suggests that the board has a role to play in encouraging investors to be actively engaged, through annual shareholder meetings, fulsome explanation of proposals and open and effective communication with investors. Interestingly, this is a departure from much of the Anglo-American approach, in which investor activism is discouraged; the view being that shareholders can exit if dissatisfied with the general direction of the corporation.

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169 Ibid at 43.
170 Ibid, citing Reg 38(1) and (2), Reg 39(1) and (3).
171 Ibid. at 45. It particularly stressed the need for this because of the universal financial services businesses, including credit risk, market risk, and the dynamics of technology with 6 million transactions a day.
Successful implementation of all these board practices would seriously reduce the incidence of corporate failures in South Africa. As noted in Part I, almost all the recent failures involved a weak and non-independent board as a contributing factor to the collapse. Strong, independent and dynamic boards are a critical component of corporate governance.

iv. Auditing and Accounting

Another aspect of recent corporate failures has been problems with a critical gatekeeping function, the internal and external audit processes. The corporate board is accountable for risk management and effective systems of internal control, including ongoing processes for identifying, evaluating and managing significant risks. Companies should have an effective internal audit function that provides independent, objective assurance that the management processes are adequate to identify and monitor significant risks; provide confirmation of the effective operation of internal controls; credible processes for feedback on risk management; and objective confirmation that the board is receiving reliable and accurate information. King II recommends a separate audit committee that has a majority of independent non-executive directors with the majority being financially literate. An independent non-executive director who is not board chair should chair the audit committee. The audit committee should have a written terms of reference for membership, duties and authority.

The focus on audit independence and financial reporting arises in part out of several corporate scandals in South Africa that are resonant with scandals in developed countries. The Masterbond Group financial collapse highlighted problems of corporate dishonesty and investor vulnerability. The Nel Commission investigating Masterbond Group and its affiliated companies found that inefficiency, lack of professional honesty, integrity and independence of corporate auditors resulting in staggering investor losses. The Commission found that accounting policies had been altered to change losses to profits without disclosure of the changes; that there was falsifying of financial statements, backdating of auditor reports and other malpractice. More than 90% of money borrowed on short term was used within associated companies for highly speculative projects, degenerating into a Ponzi scheme. The Masterbond scandal occurred in

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173 King II at 3.2.6.
174 King II at 4.2.
175 King II at 6.3.1.
the mid-1990’s. At the time, its occurrence was in part attributed to the fact that South Africa did not have as strong a governance climate as the United States. In the pre-Enron and WorldCom era, developed countries expressed some arrogance at their superior governance systems. Ultimately, the U.S. governance system revealed the same kinds of audit and accounting deficiencies, exacerbated by inappropriate incentives for corporate officers. The Nel Commission’s investigation into the Masterbond Group revealed serious deficiencies in the South African supervisory system and those sections of the Companies Act that were designed to protect investors. It found that the rights granted the investors were more illusory than real.178

Auditors and accountants are financial gatekeepers, particularly in respect of the accountability of issuing corporations. South Africa introduced draft legislation on the accountancy profession, to enhance standards of auditing and accounting and to establish a Representative Council of Accountants, a Regulatory Board for Auditors and an independent standard-setting board for ethics.179 However, the Nel Commission reported that the draft legislation had failed to deal with the need for independent regulation, failed to address increasing public distrust in the auditing profession by the public and observe that the draft legislation amounted to no more than window dressing.180 The Commission also recommended that significant interest groups should be allowed to appoint an auditor, including debenture holders, employees and their trade unions. It found that the debenture holders and bond investors in the failed Masterbond case would not have lost millions had an auditor acting on their behalf been able to access the audit files of the main auditor of the entity.181

A Ministerial Panel on Review of the Draft Legislation on the accountancy profession reported in September 2003.182 It recommended that the legislation require that auditors comprise only a minority of members on the board of the regulatory body controlling the profession. It found that the disciplinary arm of the regulatory body was a particular concern and recommended that a retired Judge or senior counsel chair it and that the legislation should provide for the enhanced investigatory powers. The Panel also recommended that auditors should be statutorily obligated to report to the regulatory body any false representations or material non-disclosures by executive management, and the regulatory body should be empowered to disclose such

178 Ibid. at 1.11.
180 Nel Commission of Inquiry into the Affairs of Masterbond Group and Investor Protection in South Africa, supra, note 176, Volume 3 at 344.
181 Ibid., Volume 2 at 3.2-3.4, suggesting that this access would reduce duplication of work and fees and have a salutary effect on the main audit.
information to relevant parties if it considers it in the public interest.\textsuperscript{183} However, the Panel rejected the notion of statutorily limiting non-audit services as proposed in the draft legislation. Rather, it would leave the nature and extent of such services to pre-approval of the audit committee.\textsuperscript{184} The Panel also rejected the idea of mandatory rotation of auditors, concluding that international experience indicates that this does not achieve the objective of independence and that there is no empirical data to suggest that a lengthy auditor/client relationship necessarily leads to compromise of independence. This recommendation goes in the opposite direction of current audit and accounting reform in the U.S., although such restrictions have not yet been imposed on Canadian auditors on the theory that Canada has a principles-based accounting system as opposed to the U.S. rules-based system that has caused such serious failures. The Panel also cited the limited skills and resource base in South Africa as not making such rotation practicable.\textsuperscript{185} It called for enhanced sanctions for negligent auditors.\textsuperscript{186} Significantly, the Panel recommended that the requirement of the audit committee be enshrined in legislation and that the membership be restricted to independent non-executive directors.\textsuperscript{187}

\subsection*{B. King II and the Stakeholder Debate}

As discussed in Part II, although there are numerous conceptions of corporate governance, the two principal approaches are the shareholder wealth maximization model and the stakeholder model. The first seeks to maximize either short term or long term investor returns, and while long-term investment return can frequently align with broader social and economic goals of a country, directors and officers are ultimately accountable only to shareholders. The stakeholder model also enjoys a range of approaches, from corporate directors and officers having to consider the interests of multiple stakeholders such as creditors, employees and consumers in acting in the best interests of the corporation, to a more direct fiduciary obligation to the stakeholders for their decisions and actions.

The King I Report in 1994 advocated an integrated approach to good governance in the interests of a wide range of stakeholders, having regard for the principles of good financial, social, ethical and environmental practices. It concluded that companies can no longer act independently from

\textsuperscript{183} Ibid. at 42. The World Bank also issued the report on the \textit{Observance of Standards and Codes for South Africa}, 15 April 2003, complaining that the legislative reform process was too slow and that high auditing and accounting standards lacked sufficient legal enforcement mechanisms. It called for immediate enactment of the \textit{Financial Reporting Bill}, amendments to the \textit{Companies Act} and enactment of the \textit{Accountancy Professions Act}, on file with author.
\textsuperscript{184} Ibid. at 19.
\textsuperscript{185} Ibid. at 24. It also concluded this would unnecessary raise costs as new auditors tried to gear up.
\textsuperscript{186} Ibid. at 22.
the societies in which they operate. However, the King II Report softens this approach. King II makes a distinction between accountability, where one is called on to render an account, and responsibility, where one is liable to be called to account. King II specifies:

The stakeholder concept of being accountable to all legitimate stakeholders must be rejected for the simple reason that to ask boards to be accountable to everyone would result in their being accountable to no one. The modern approach is for a board to identify the company’s stakeholders, including its shareowners, and to agree on policies as to how the relationship with those stakeholders should be advanced and maintained in the interests of the company.\(^{188}\)

Hence King II expressly rejects having corporate directors be accountable to all stakeholders on the premise that they would then be accountable to no one.\(^{189}\) The difficulty with this conclusion is that King II offers no accountability alternative, leaving shareholder remedies as the default accountability mechanism. Moreover, it fails to acknowledge that even under the shareholder wealth maximization model, corporate officers are accountable to a multiple investors with different investment priorities, timelines and risk capacity, and this has not posed a problem for determining the scope of fiduciary obligations to act to maximize their collective interests.

Even though King II enshrined some principles regarding sustainability and integrated sustainability reporting, the governance objectives, including sustainability, appear to be aimed at maximizing shareholder wealth. It is here that incoherence in various aspects of King II arise. King II emphasized that entrepreneurship and enterprise are what drive emerging economies, and hence the challenge for governance is to seek the appropriate balance between enterprise performance and constraints on corporate activity.\(^{190}\) The mechanism of who will be able to hold corporate officers accountable to this standard is unclear.

However, even with the softening of its position on stakeholder accountability, it is this set of recommendations that may distinguish South African corporate governance from that of the Anglo-American approach. King II recommended a move to triple-bottom line reporting, in which companies disclose not only their financial performance, but their performance on social, health, ethical and environmental practices. It recommended that the board of directors should define its stakeholder groups and direct its governance and reporting to meet their concerns. Stakeholders

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\(^{187}\) Ibid. at 30.

\(^{188}\) King II at 5.1.

\(^{189}\) King II at 5.1.

\(^{190}\) King II at 7.2.
are defined broadly to include workers, trade unions, consumers, suppliers and the community. King II also recommended that companies should engage their stakeholders in determining the company’s standards of ethical behaviour, and then demonstrate their commitment by codifying their ethics. There should also be transparency in disclosure of compliance with the code of ethics, measured against defined criteria that would include a statement by the board as to the extent that directors believe the ethical standards are being met. It also recommended consideration of transformation challenges such as development of human capital and black economic empowerment. King II’s revised Code also specifies that the board should ensure that it receives relevant non-financial information going beyond the financial performance of the company, and should look at other qualitative performance factors that involve broader stakeholder interests.191 These measures, if fully engaged, would advance corporate governance well beyond Anglo-American norms and truly situate the company in civil society. However, the enforcement mechanisms need to be clarified if the measures are to be truly effective.

One of the stakeholder interests identified by King II is diversity in employment, particularly for women and black people. In South Africa there has been considerable gender and race discrimination, with black women historically doubly disadvantaged. The South African Employment Equity Act has enabled some black people to gain access to jobs, but it has not yet been effective on a broad basis.192 Employment equity is aimed at rectifying the social and economic effects of historical discrimination that acted as barriers to millions accessing particular occupations. Enforcement of this kind of remedial legislation is a critical component of effective governance.

While black empowerment has created a class of successful individuals from previously disadvantaged communities, it has not addressed in any meaningful way the vast majority of black people in South Africa.193 As a result, there needs to be a more fulsome strategy for achieving basic economic and social security, and corporations that are extracting considerable wealth from the country should play a role in advancing these changes. King II recommended that black economic empowerment should be aimed at redressing the continued unequal distribution of ownership, management and control of South Africa’s financial and economic resources by ensuring broader participation in the formal economy.194 The King II Report observed that this is the only viable strategy for making sustained inroads in alleviating poverty and illiteracy.

191 King II at 2.6.5.
193 Naidoo, supra, note 13 at 144.
194 King II.
In respect of corporate governance, employment equity has resulted in a slightly increased number of black men on corporate boards, although the number of women continues to be very small. The King II Report recommended that companies proactively create the conditions and opportunities that will allow previously disadvantaged individuals equal opportunity to reach executive levels in companies. In order to facilitate access, including for women, King II recommended structural initiatives that will create real access. Scholar Lynne Dallas has written extensively on the need for Board diversity as an effective corporate governance mechanism, bringing diverse inputs into decision making and acting as a bridge between the board and the community.\(^{195}\)

Mongalo has observed that the King II report is modelled after international governance models aimed at reducing agency costs arising due to the separation of ownership and control, hence its focus on the role of non-executive directors, audit committees and the role of shareholders in holding managers accountable for their decision making.\(^{196}\) He observes that monitoring the conduct of directors and officers has become a critical issue in South Africa because of the importance of companies to the economic and social well being of the country.\(^{197}\) Hence, he suggests that it is inconceivable to ignore the manner in which companies are governed and the legal and other control on managerial power. In this, the stakeholder debate becomes a critical factor.

C. Including African Value Systems in Governance Strategies

King II emphasized the need to create a governance system that recognizes the African value system. That system emphasizes the collective good over individual realization.\(^{198}\) It recognizes principles of mutual interdependence and the inclination towards consensus rather than dissension. Co-existence with others is highly valued and *ubuntu*, the spirit of humanity, is key. The essence of *ubuntu* is that you can be respected only because of your cordial co-existence with others.\(^{199}\) King II noted that this is a value system that has an inherent trust and belief in the fairness of human beings. Finally, one must recognize the hierarchical nature of political structure and philosophy in South Africa, yet one based on a system of broad consultation and consideration of interests at all levels as “practiced by the chiefs since time immemorial”.\(^{200}\) King


\(^{196}\) Mongalo, *supra*, note 1 at 182.

\(^{197}\) Mongalo, *supra*, note 1 at 180.

\(^{198}\) King II at 38.1.

\(^{199}\) King II at 38.5.

\(^{200}\) King II at 38.8.
II observed that this should form the basis of modern labour relations and people management practice. Finally, King II observed that the perpetual optimism in South Africa is due to strong belief in the existence of an omniscient presence. Given this value system, King II defines corporate governance as leadership that will allow companies to compete effectively in the global economy and create jobs; that will act honestly and with integrity; that will address legitimate social concerns relating to the company’s activities and provide leadership that is transparent and accountable.201

Opio has observed that there is an Africa phenomenology of work, life and relationships, suggesting that African business requires more that the minimalist profit-maximization business ethic of the West.202 He observes that the Western approach divorces the business enterprise from the human person in his or her context. Rather, a business paradigm in Africa must achieve a dynamic balance between the integrity of business, which includes efficiency, and competitiveness, and integrity in business.203 In his view, competitiveness also needs a broader definition, one that encompasses freedom, fairness and equal opportunities for all; strategic vision concerning the nature of both local and global markets; and a commitment to the needs of society at large.204 Opio observes that while many of the business scandals in Africa mirror practices in the West, a challenge is that much fraud in Africa is viewed as normal and perhaps even necessary compensation for the expansion of the free-enterprise system.205 He observes that these practices, such as fraud in the banking and telecommunications sectors in Nigeria are sanctioned by a quasi-legal system of managers.206 Moreover, because of the strong traditions of family, tribe and community, African managers may place the interests of family members or tribes people before that of the enterprise, regardless of their skills or suitability. The African sense of time, where time is a composition of events, and means that there is a danger in the lack of balance between the procedure of project planning and the execution of the plan.207 Hence, Opio argues for a vision of business and ethics that integrates business imperatives with human values, those of life, physical and mental health, happiness, the community and the environment.208

203 Ibid. Opio defines business ethics as the need to integrate the demands of business (profit-making, efficiency and competitiveness), with the customs, values and norms upheld by a social group, at 3.
204 Ibid. at 4.
205 He gives as an example the Goldenberg fraud, which he suggests amounted to 12.5% of Kenya’s GDP, ibid. at 5.
207 Ibid. at 6.
Opio argues that economic development in Africa must be built on values of caring, in order to narrow the unjust gap between the few rich and the large number of poor people who live in sub-human conditions. He suggests that Africa will not ever be economically sustainable until African leaders break from their dependence on financial aid and development policies designed elsewhere, rather, Africa development must have its own unique set of values. Resources are bridges rather than ends in themselves and hence an African vision of economic relations includes pro-existing, sharing resources, viewing possessions in the context of relationship and the faith of human interconnection that allows people to give abundantly from what very little they possess. While he notes that Africa cannot act in isolation and must respond to competitive global markets, it needs enough distance to develop policies to promote the values of the people, and only then will it de-colonize itself. Opio argues that current U.S. versions of partnership are premised on opportunity windows for U.S. companies and as long as that is the only focus, there is no opportunity for partnership, growth and meaningful cooperation. Opio suggests that the partnership that development agencies need in Africa must be based on the following factors: a real shift in attitude; respect for humanity; that African nations should not acquiesce in the monetary benefits they receive from donor agencies; being explicit and respecting each others’ values; “allies on different terrain” with the same objectives; transparency of interest so that common ground can be found where interests diverge; clear contractual standards; and equality of capacity.

For the Canadian observer, this Afro-centric approach to corporate governance is very different than the Anglo-American system that recognizes or rewards few of these values. Investors and creditors are viewed as self-interested actors and models of governance are designed to temper the inevitable self-dealing or shirking that arises from this self-interest. African notions of collective good over self-realization could alter drastically the way in which corporate activity is conducted and its success measured. Given the incredible challenges of population growth, poverty and health issues, the notion of co-existence encapsulated by ubuntu, may present the only realistic way of developing in South Africa. Yet for all the reasons discussed above, the counter pressures of global capital and the imbalance in power and wealth may fail to acknowledge this unique paradigm for thinking about governance.

208 Ibid. at 16.
209 Ibid. at 7.
210 Opio suggests that the African world-view is phenomenological, i.e. that it is embedded in experience rather than in some rationalistic or rationalizable notion of the person and society; that Africans do not just co-exist, they pro-exist in that they engage in activity not primarily for their personal gain but for the good of the one and the many.
211 Ibid. at 10.
IV  Looking Forward

The generation of wealth through corporate activity must take account of whether or not it advances the social, political and economic welfare of South African people. In determining the scope and reach of corporate activity, what appropriately belongs to citizens and their state and what decision making power accrues to the MNE by virtue of its size? Can domestically registered corporations compete globally, if they do not conform to the largely Anglo-American single profit motive conception of the corporation? Is there a happy median or is accumulation of wealth incompatible with social justice?

There has been some debate as to whether the King II report provides strong enough recommendations and hence creates the appropriate deterrent effect to corporate misconduct. The South African Department of Trade and Industry has questioned the voluntary compliance nature of the Report and whether effective governance measures will be implemented and sustained absent some statutory enforcement mechanism.\textsuperscript{213} Naidoo has observed that new companies legislation, aimed to be in place in 2006, is likely to contain harsher penalties for governance transgressions.\textsuperscript{214} She observes that while one of the recommendations in King II was that a register should be kept of directors who have been found guilty of corporate governance transgressions, to be in place by mid-2004; that unless a register is linked to an absolute legal prohibition on directors to act again as directors, it is likely to be ineffectual in reducing such behaviour.\textsuperscript{215}

The King II recommendations on reporting annually on the ethical, social, health, safety and environmental practices are important, but unlikely to be effective absent serious commitment to this by legislators. This may require a commitment that is greater that reporting. A requirement that the company meet either its own declared goals or specified standards set by the democratic process, which would give real meaning to sustainability objectives. To date, legislators have not had the political will to link the corporation’s ability to extract resources and hence wealth to a requirement to achieve black empowerment, gender equality and environmental and economic sustainability.

\textsuperscript{212} He cites the Partnership Africa forum in Sweden as an alternative, where Africa and Sweden have an open forum to challenge their mutual assumptions about progress, developments and co-operation.
\textsuperscript{213} Naidoo, \textit{supra}, note 13 at 90.
\textsuperscript{214} \textit{Ibid.} at 90.
\textsuperscript{215} \textit{Ibid.} at 91.
Even where companies settle actions for harms caused by their activities, there appear to be inadequate enforcement mechanisms. Naidoo uses as an example the harms caused by asbestos by mining enterprise Cape plc. Under South African legislation, Cape was liable for rehabilitation costs of land contaminated by its operations. This liability was eliminated by the Government in exchange for the company paying millions to the 7,500 former employees and people living in the vicinity of its operation for asbestos-related illness. The government had concluded that its priority was compensation for those harmed and that remediation would likely have caused the bankruptcy of the company. However, Cape failed to make the first compensation payments and in 2002, the applicants had to pursue legal action to get the company to pay. Those harmed continue to die as the litigation moves through the legal process. Hence while settlements can reduce litigation costs and direct resources to those harmed by corporate occupational and environmental harm, they will be ineffectual absent mechanisms to ensure speedy compliance,

Capital is unlikely to flow into South Africa in greater amounts in the absence of effective measures to stem business corruption. The South African government has been working with the United Nations on elimination of all forms of corruption, including business corruption. A UN Report found that 63% of South African business believes that corruption has become a serious issue in business, although only 12% stated that they had refrained from making a major investment because of corruption. While the Report concluded that South Africa has a comprehensive and practical legislative framework in place with appropriate whistle blower protection, there are serious weaknesses in the capacity and will to enforce the legislation. The OECD has argued that bribery undermines good governance and its development of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (adopted in the U.S. in 1999) will allow companies to be prosecuted for bribery in both the home and host nations.

Corporate governance in South Africa and all of Sub-Saharan Africa must engage social, environmental and economic issues. It must tackle the incredible environmental and ecological challenges as a high priority. It must directly engage and begin to eradicate the extreme poverty

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216 Naidoo, supra, note 13 at 134.
217 Ibid.
218 For a discussion of corruption in the context of South Africa’s potential for sustainable development, see Patrick Bond, Unsustainable South Africa, Environment, Development and Social Protest, (South Africa, University of Natal Press, 2002).
219 For a discussion of these efforts, see United Nations and Department of Public Service and Administration, Country Corruption Assessment Report, South Africa, April 2003.
220 Ibid. at 3.
221 Ibid. at 45.
222 Naidoo, supra, note 13 at 146.
and poor living standards of the vast majority of people. Development of resources must look to
how it sustains and improves the lives of those in the country, and where this conflicts with the
priorities of those exporting the value generated, there may be need for a new paradigm in terms
of defining rights to profits generated by the resources and people of this region. While flight of
capital is always the risk when considering a reconception of the role of companies, investors will
respond if they receive transparency and certainty in terms of their investments and understand
the real costs of particular economic activity. One proposed solution is socially responsible
investing.

A. Socially Responsible Investing in South Africa

In 2004, the JSE launched the Socially Responsible Investment Index (SRI Index), following suit
to the Dow Jones Sustainable Group Index and the FTSE4Good index.223 The JSE launched the
SRI Index as a means of identifying those companies listed on the JSE that integrate principles of
SRI and sustainability into their business activities.224 The Dow Jones Sustainable Group Index
outperformed its regular world index 15.8% compared with 12.5% from 1997-2002, and JSE has
followed suit in an effort to simultaneously capture part of the market and to facilitate investment
in such companies.225 The JSE has publicly committed to rewarding companies for conducting
business in a socially responsible way, and the SRI Index will measure performance of
companies in relation to the triple bottom line. This includes fostering improved stakeholder
relations, promoting the Financial Services Charter, commitment to ethical and good corporate
governance practices, and ongoing focus on safety, health and environmental issues.226 Prior to
this initiative, the amount invested in SRIs in South Africa has been roughly 1.5% of total assets
under management, compared with 13% in the United States.227

Companies listed on the JSE SRI Index must report on environmental, economic and social
sustainability.228 This includes strategies to measure and monitor environmental impacts and the
implementation of systems that ensure that resources are used in a sustainable manner.
Economic sustainability objectives include decision-making that balances short term profits with
strategies aimed at long-term growth. Social sustainability is a recognition that companies are
required to develop and maintain positive relationships with a wide set of stakeholders, not only

223 JSE Annual Report, 2003, at 14. Http://www.jse.co.za. The JSE received funding of R5 million from the
Financial Deepening Challenge Fund, operated by the British government.
227 Ibid. at 18, 25.
228 JSE SRI Index, Background and Selection Criteria, supra, note 217 at 3.
shareholders. The JSE specifies that "companies need to demonstrate core business strategies that are linked to internal management systems and key performance indicators aimed at promoting the social upliftment, development and poverty reduction of its staff and the communities in which it operates". This includes a focus on employment equity, black empowerment, fair labour practices, employee health and safety, development of human capital and managing the impact of the HIV/AIDS pandemic on the companies activities. The Plan is to measure policy and strategy, management systems and performance and quality of reporting, having regard to standards set by internationally, such as the Global Reporting Initiative Sustainability Guidelines, 2002; the UN Declaration of Human Rights; the UN Global Compact, 1999; the Coalition for Environmentally Responsible Economies (CERES); Social Accountability 8000, 2001 and the New Partnership for Africa’s Development (NEPAD). The Social Venture Network has advocated principles of corporate social responsibility, including: ethical dealing with stakeholders; transparency and accountability to stakeholders; governance that seeks to balance conscientious management of resources with the interests of stakeholders; the objective of long-term growth and shareholder value; employment practices that support diversity, empowerment, fair labour practices, and a harassment free and family friendly work environment; fair and honest business dealings and quality products; an open, honest and transparent relationship with the community and environmental protection.

With the launch of the JSE SRI Index, there may be synergies in creating long-term shareholder wealth maximization and engaging in socially responsible behaviour, as the latter may produce value for shareholders in the long term from reduced liabilities, better consumer goodwill and fewer environmental remediation costs. SRI funds utilize particular social and economic benchmarks as signs of effective governance. In some cases, they have policy analysts sitting on the trading floor with the financial experts, making decisions on ethical investments against criteria of environmental compliance, compliance with labour, employment and human rights standards and local securities law, as measures of effective stewardship of corporations and

229 Ibid.
230 Ibid.
231 Ibid.
232 Ibid. at 5. The JSE is also committed to meeting SRI goals in-house, with HIV/AIDs anti-discrimination policies, training and counselling; employment diversity (50% of its employees are black and 56% are female); and training and education in accounting for disadvantaged students. It has also moved to more transparency in reporting board activities, including attendance records of board members, disclosure of risk management processes, and ensuring that non-executive directors are the majority on key committee. While it is difficult to measure these initiatives, the high profile commitment given by the JSE to these initiatives are likely to have its own positive normative effect in terms of companies dealing with the SRI Index, Annual Report, supra, note 226 at 28-36.
hence long term value maximization potential. In the U.S. alone, it is estimated that SRI funds hold $2 trillion in assets. Those advocating SRI and its ethical screening view SRI as the primary vehicle through which to achieve corporate social responsibility, by ultimately positively influencing stock prices. The premise is that shareholders will simultaneously profit and through their investments promote social objectives, the notion of doing well financially by “doing social good”. These are important developments, because they link effective stewardship of the corporation with norms such as long-term sustainability and human rights that arguably can be broadly supported as norms that we as a society want to support. It also indicates that there is a market for SRI funds, in terms of investor preferences. There are, however, a number of critiques regarding the efficacy of SRI. There are problems of transparency in terms of the information base on which these decisions are being made and different conceptions of what it means to be in compliance with such norms.

Scholars have also challenged the notion that SRI means that investors will “do well by doing good”. Knoll tracks SRI to turn of the century Quaker and other Christian initiatives screening investment for “sin” related activities, the shift through the 1960’s to avoiding investment in war related activities, the 1980’s in respect of screening for investment in the then repressive regime in South Africa to modern day screening which primarily screens for tobacco. Knoll suggests that whether or not ethical screening has a direct impact on targeted firms in terms of investors improving society by disciplining unethical corporations depends on the steepness of the demand curve for the corporation’s securities. He argues that there is a lack of empirical evidence that it has a substantial impact on targeted firms’ stock price and thus on their activities.

234 Sarra, supra, note 100.
236 Sarra, supra, note 100.
237 Michael Knoll, “Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment” (2002) 57 Bus. Law 681 at 695. See also, the Social Investment Forum, as of 2001, http://www.socialinvest.org/areas/research/trends/2001-trends.htm, (last accessed May 2002). He examines the claim that SRI is at least as profitable and prudent an investment strategy and hence not more risky than strategies without a socially conscious component. In respect of this claim, he suggests that it may be true where markets are efficient, although this does not indicate that all SRI programs are costless, referring to situations where market prices accurately reflect available information and prices are unbiased predictors of future prices. He also observes that one must adjust for risk and that the screened portfolio must produce a higher return that an unscreened one in order to compensate for the added risk of not having a fully diversified portfolio. Knoll argues that where markets are inefficient, there is a lack of empirical support for these claims; ibid. 694, 698.
238 Although in cases such as South Africa, he concedes that there was a correlation, but suggests that this is quite different from causation, i.e. causing South Africa to end its apartheid practices. Ibid. at 710.
According to the Social Investment Forum, as of 2001, 96% of all screened assets screened for tobacco, whereas less than 50% screen for human rights or labour standards.\textsuperscript{239} This indicates that there are different conceptions of what it means to socially screen. Investors may or may not be aware of the scope of the screens that their funds utilize. While a screen may be avoiding investment in one type of activity, it may be directing additional investment dollars to firms that engage in repressive labour or human rights practices. Since many of the social screening agencies sell the screening as a commodity, there is little transparency in the scope of the screening and in the weights given to particular corporate conduct.\textsuperscript{240}

There are also challenges unique to South Africa as an emerging economy. The African Institute of Corporate Citizenship has reported that many investors were “burned by the empowerment crash” of the late 1990’s and are now reluctant to invest in empowerment equity.\textsuperscript{241} It notes that the Black Empowerment Commission is advocating 10% of all assets under management, including those of government employees, be allocated towards areas of national priority via SRIs.\textsuperscript{242} The Institute argues that if enacted, this will have serious implications for SRI in South Africa because many funds are opposed to prescriptive allocation of assets.\textsuperscript{243} Instead, it recommends the approach of pension fund regulation, which requires trustees to disclose the extent to which, if any, social, environmental, ethical and in some cases labour issues are considered in making investment decisions. Its view is that disclosure will be the driver in changing investment practices to more socially responsible behaviour. The Institute suggests that in order for South Africa’s SRI sector to advance, the term SRI needs to be defined in the South African context, and that the definition of empowerment needs a broader interpretation.\textsuperscript{244} Standards and benchmarks in addition to the SRI index must be developed to provide the industry with measurable criteria with which to assess the merits of a particular investment and to measure its success in society. It argues that the merits of prescribed asset allocation versus disclosure must be debated. The Institute also recommends that the financial sector needs to start integrating the concepts of corporate governance, corporate citizenship and sustainability into its thinking and actions. Even with the limitations of the potential effectiveness of SRIs, it may prove an important vehicle to increase the funds flowing into SRIs, given the importance of South Africa’s transformation agenda.

\textsuperscript{239} Social Investment Forum, \textit{supra}, at 710.
\textsuperscript{240} Sarra, \textit{supra}, note 100.
\textsuperscript{242} \textit{Ibid.} at 7.
\textsuperscript{243} \textit{Ibid.} at 7.
\textsuperscript{244} That is in line with the principles of NEPAD and sustainable development. \textit{Ibid.} at 9.
Conclusion

South Africa, along with the rest of Sub-Saharan Africa faces daunting economic and social challenges over the next decades. However, it does have some advantages over its neighbors in having a much more active capital market, and tradition of corporate governance regulation (greatly distorted by apartheid and its economic and social inheritance). While internal initiatives such as the King Reports, the JSE initiatives and the proposed new corporation law provide the necessary evidence of the vast reservoir of willingness to progress in corporate governance in South Africa, it cannot progress on its own. Unless some international support is provided through debt reform, an international forum for control of MNEs' harmful activities, and support for other Sub-Saharan African countries’ development of capital markets and corporate governance initiatives, South Africa may drown in a race to the regulatory and economic bottom by short-sighted investors and corporate managers.

There are unlimited areas for further research, including: investigation into the recent suits for environmental harm under the Constitution and environmental laws and the impact of these suits both in terms of investor chill and in remediating the environment; study of reporting on HIV/AIDS in companies, including whether companies are reporting affirmative measures and whether there is any means to measure impact of such reporting; exploration of new ways to legislatively draw aside the corporate veil and give host nations access to assets of parent MNEs where there is corporate malfeasance or corporate harm from the activities of the MNE in the host nation; and further research on African value systems and their normative upside potential for developing an effective domestic corporate governance regime. There should also be further consideration of the proposal that a percentage of assets under management be directed to black empowerment and other remedial measures that would serve to rebalance the system before economic, social and environmental self-sustainability is possible.

This paper has explored more challenges than solutions, although it is meant to continue the conversation internationally about optimal governance systems grounded in the political, social and economic context in which corporations operate. The key question is whether governance initiatives will have any demonstrable impact on the problems highlighted here.