SMALL BUSINESSES AND THE SOUTH AFRICAN COMPANIES ACT:

DOES ONE SIZE REALLY FIT ALL?

BY

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ABSTRACT

This dissertation will provide a critical analysis on whether the South African Companies Act adequately serves the needs and interests of small formal businesses in South Africa. In this regard, the thesis will determine whether the Companies Act creates a more enabling environment for small business than the Close Corporations Act which was well known as being the ideal business legislation for small businesses. This will be done by determining whether it is indeed easy for an ordinary South African to open and run a small business in terms of the Companies Act or the Close Corporation Act (which no longer allows for new close corporations to be formed).

Furthermore, the dissertation will also look into how other foreign jurisdictions have governed small businesses and what constitutes an appropriate means for such jurisdictions in terms of regulating small businesses. Lastly, the dissertation will conclude by providing recommendations on the Companies Act and the Close Corporations Act, and by providing a proposed solution to the issue which pertains to regulating small businesses.

AUTHOR'S ACKNOWLEDGEMENT

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This dissertation is dedicated to the memory of my late father,

Desmond Vela Gumede.

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CHAPTER 1: INTRODUCTION

1.1 INTRODUCTION

The economically crucial development of small and medium business in South Africa is seen as vital to the stimulation of economic growth and thus the associated benefits.[1] South Africa has a proud and innovative history of facilitating such development, but key legislative events over the last decade may have undermined this enabling landscape.

The Close Corporations Act 69 of 1984 (the Close Corporations Act), hailed as a success and emulated elsewhere in the world has been consigned to a lingering death and has been replaced by an ostensible easier and more facilitating act. However, whether this is actually the case has been hotly debated. Further, additional legislative intervention in the name of black economic empowerment, while undeniably necessary, has also complicated small and medium business development. Now, almost a decade after the implementation of most of the aforementioned changes, we are in a position to assess whether these changes have had a positive and beneficial effect on small business development.

1.2 HISTORY

Before the introduction of the Close Corporations Act and the Companies Act 71 of 2008 (the Companies Act), all businesses which enjoyed the benefit of limited liability were regulated by one piece of legislation, namely the Companies Act 61 of 1973 (the 1973 Companies Act).[2] However, because of the complexity of the 1973 Companies Act, which largely

[1] Gordhan, P Budget speech: to parliament 27 February 2013 available at *http://www.daff.gov.za/docs/speeches/2013%20Budget%20Speech%20by%20Minister%20of%20Finance%20Pravin%20Gordhan.pdf*, accessed on 12 November 2019. 'Why SA businesses have a high failure rate' available at https://bizmag.co.za/sa-businesses-high-failure-rate/, accessed on 12 November 2019.

[2] JJ Henning 'Reforming business entity law to stimulate economic growth among marginalized: The modern South African experience', (2002-2003) 91 *Kentucky Law Journal* 773-828 at 781.

catered for the problems and issues of large companies, the 1973 Companies Act eventually outgrew the needs of small enterprises.[3]

In 1984 South Africa took a bold innovative step by introducing the Close Corporations Act, which provided for a 'simple, inexpensive, and flexible form of incorporation for the enterprise consisting of a single entrepreneur or small number of participants', without burdening these small business persons with unnecessary legal requirements.[4] The Close Corporations Act was praised and seen as a remarkable innovation in South African company law, as it combined some features of partnership law with the 'corporate attributes of legal personality and limited liability'.[5]

In the year 2004, before the birth of the Companies Act the Corporate Law Reform Guidelines (the Corporate Law Reform Guidelines) introduced by the Department of Trade and Industry (the DTI) in May 2004,[6] promised South Africans a single act that would provide maximum simplicity and flexibility with regards to corporate formation by minimising formalities, administrative burdens and categorisation.[7] The Companies Act was born as a result of the aforementioned promises by the DTI. In this regard, the Companies Act provides that its purposes are 'to promote the development of the South African economy by encouraging entrepreneurship and enterprise efficiency', and by 'creating flexibility and simplicity in the formation and maintenance of companies'.[8]

1.3 THE PROBLEM

According to the Corporate Law Reform Guidelines,[9] close corporations were seen to be very successful, and this was evidenced by the large number of close corporations that were already registered with the Companies and Intellectual Property Registration Office

[3] Ibid 781.
[4] JJ Henning 'Close corporation law reform in Southern Africa', (2001) 26 *Journal of Corporation Law* 917 – 950 at 918 to 919.
[5] Ibid 918.
[6] Department of Trade and Industry South African Company Law for the 21st century, Guidelines for Corporate Law Reform available at *www.pmg.org.za/bills/040715companydraftpolicy.pdf*, accessed on 24 March 2014.
[7] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42.
[8] S7(b)(i) and (ii) of the Companies Act.
[9] Department of Trade and Industry South African Company Law for the 21st century, Guidelines for Corporate Law Reform available at *www.pmg.org.za/bills/040715companydraftpolicy.pdf*, accessed on 24 March 2014.

(CIPRO).[10] For the period of the year 2010 to 2011, 283 371 close corporations had been registered compared to 86 343 companies.[11]

Some company law commentators are of the view that the legislature took a very bold stance by discontinuing the formation of new close corporations while permitting existing close corporations to continue indefinitely.[12] In addition, critics of the legislature's approach have declared that the legislature's policy on close corporations is debatable because of the success enjoyed by close corporations as business entities, and in particular the large number of active close corporations in South Africa and the relative simplicity, clarity and conciseness of the Close Corporations Act if compared with the Companies Act.[13]

Henning[14] has expressed the following concerns regarding the Companies Act and close corporations, namely that: (i) the Companies Act has placed more onerous administrative duties and arrangements on close corporations; (ii) 'the managerial and administrative requirements of close corporations are less formal than companies'; (iii) small entrepreneurs could complete the constitutional documents and register a corporation without expensive professional advice; (iv) the Companies Act provides additional onerous regulations which are in contrast with the philosophy of the Close Corporations Act; and (v) the Companies Act if compared to the Close Corporations Act creates a more intricate legal position with regards to capacity and representation.

However, the DTI through the Corporate Law Reform Guidelines, provided that even though a 'close corporation offers a viable alternative for smaller businesses, which have no need for the more onerous reporting requirements, the Close Corporations Act is still highly formalistic in nature, making it difficult for unsophisticated entrepreneurs to commence business and ensure its effective management'.[15]

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[10] In terms of s1 read with s185 of the Companies Act, CIPRO is now known as Companies Intellectual Property Commission (CIPC).

[11] 'Registration statistics March 2014' available at *http://www.cipc.co.za/Stats_files/March2014.pdf*, accessed on 21 May 2014. However, it should be noted that in the year 2011, 891 close corporations converted to companies compared to 622 companies which converted to close corporations. While in the year 2010, 1 766 companies were converted to close corporations compared to 1 174 close corporations converted to companies, see 'Registration statistics March 2014' available at *http://www.cipc.co.za/Stats_files/March2014.pdf*, accessed on 21 May 2014.

[12] FHI Cassim *et al Contemporary Company Law* 2nd Ed Cape Town: Juta, (2012) 100.

[13] Ibid 100-101.

[14] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 456-479.

[15] Department of Trade and Industry Guidelines for Corporate Law Reform: South African Company Law for the 21st century (2004) 17.

While in contrast to Henning's concern of small entrepreneurs having to seek expensive professional advice, the DTI stated that the Companies Act would make it 'possible for small businesses and their advisors to understand the administrative requirements without having to resort to expert advice'.[16]

According to Knight,[17] who was the principal drafter of the Companies Act, the critics seem to have missed that the key issue was not what was wrong with the Close Corporations Act as an instrument for incorporation, but rather what was wrong with providing two different, alternative and concurrent instruments for incorporation.[18] In Knight's view the answer to this question was 'a great deal', as this seemed to create a risk of regulatory arbitrage.[19]

Even though the Companies Act has attempted to create parity with the Close Corporations Act, Knight concedes that this has the effect of producing redundancy,[20] which implies that the Close Corporations Act is no longer needed.

The Close Corporations Act attracted attention from Australia because of its successful innovative idea. Australia, following the South African example, sought to introduce a similar act called the Close Corporations Act 1989 No.120 of 1989 (the Australian Close Corporations Act).[21] However, according to Professor Len Sealy of the University of Cambridge, the Australian Close Corporations Act was never promulgated into law because

> 'the Australians kept wanting to build more and more of the traditional company into it, so it became a fairly lengthy piece of legislation. If that were not enough, it then incorporated by reference, huge chunks of the main Corporations Act. So it was not a successful venture'.[22]

Based on the Australian experience, and considering that the Companies Act has amended the Close Corporations Act by incorporating the parts of the Companies Act in order to bring the Close Corporations Act in line with the Companies Act, one questions whether this could

[16] Department of Trade and Industry Guidelines for Corporate Law Reform: South African Company Law for the 21st century (2004) 28.
[17] Knight (note 7 above).
[18] Knight (note 7 above; 7).
[19] Ibid 7.
[20] Ibid 7.
[21] JJ Henning 'Close corporations without end. Two remarkable decades of simply "thinking small first"', (2007) 32(1) *Journal for Juridical Science* 187-194 at 189.
[22] JJ Henning 'Close corporations without end. Two remarkable decades of simply "thinking small first"' (2007) 32(1) *Journal for Juridical Science* 187-194 at 189, quoting Sealy, L.S., "Legislating for the small business", Keynote address, Symposium on Company Law, Institute of Directors, London, 7 Dec. 1993, reprinted 1994 in 1 CLDS (Corporate Law Development Series) 219.

possibly indicate that the Close Corporations Act is travelling on a disastrous road, because of the huge chunks of the Companies Act provisions which have been inserted into it. At this stage it seems only time will tell.

Initially consensus was reached with regards to recommending that close corporations be kept in place for at least a decade (10 years).[23] The idea was that close corporations would be replaced only if they were clearly outperformed during this decade grace period by an alternative, more effective corporate structure specifically designed for small businesses.[24]

> 'Clause 226(1)(b) of the Draft Companies Bill 2007 (Draft Companies Bill) made provision for the repeal of the Close Corporations Act. However, clause 2 of schedule 6 of the Draft [Companies Bill] stipulated that the President may not bring clause 226(1)(b) into operation before a date at least ten years after the general effective date of the new Companies Act; and the Minister has reported to Parliament, no earlier than eight years after the general effective date of the new Act, on the utility of continuing the dual system of incorporation of companies under this Act and the Close Corporations Act, and the advisability at that time of the repeal of the Close Corporations Act'.[25]

As a result, and according to Henning[26],

> 'the Draft [Companies Bill] envisaged that close corporations will continue to exist for an interim period in tandem with the "closely held company" after the new Companies Act eventually comes into operation.[27]
>
> This is not to say that the Close Corporations Act would inevitably be repealed at that stage. The Draft [Companies Bill] expressly created the possibility that the Close Corporations Act may continue in existence indefinitely. It did not envisage a

[23] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34.
[24] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 461.
[25] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 461-462.
[26] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 462.
[27] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 462.

> prohibition on the formation of new close corporations during the interim period. In the event the 'in tandem' arrangement did not survive the reform process'.[28]

As the Companies Act only came into effect in May 2011, according to the Draft Companies Bill, the Minister would have to report, only after May 2019 on the utility of retaining the dual system and, if it was decided not to do so, then the President would only be able to bring s226(1)(b) into effect after May 2021. However, clause 2 of schedule 6 did not survive the transition into the Companies Act.

1.4 THE ECONOMIC MILIEU

Just to highlight the importance of small businesses, the former South African Minister of Finance Trevor Manuel stated in the 2008 national budget speech that the support for small businesses was focused on encouraging job creation.[29] Mr Pravin Gordhan, another former South African Minister of Finance, also reiterated Mr Manuel's stance by stating in the 2010 national budget speech that government's approach to employment creation includes encouragement of small business development and entrepreneurship.[30]

In the 2011 national budget speech (the year in which the Companies Act came into effect),[31] Mr Gordhan spoke about economic development and industrial promotion. In this regard, Mr Gordhan stated that small businesses were an important source of jobs, and that businesses which employed fewer than 50 workers accounted for 68 per cent of private sector employment. Mr Gordhan then stated that South Africa needed to get the small business sector growing.[32]

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[28] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 462.
[29] Manuel, TA Budget speech: to parliament 20 February 2008 available at *http://www.treasury.gov.za/documents/national%20budget/2008/speech/speech.pdf*, accessed on 24 March 2014.
[30] Gordhan, P Budget speech: to parliament 17 February 2010 available at *http://www.treasury.gov.za/documents/national%20budget/2010/speech/speech2010.pdf*, accessed on 24 March 2014.
[31] Effective date of the Companies Act was 1 May 2011.
[32] Gordhan, P Budget speech: to parliament 23 February 2011 available at *http://www.treasury.gov.za/documents/national%20budget/2011/speech/speech2011.pdf*, accessed on 24 March 2014.

While singing the same small business tune in the 2013 national budget speech, Mr Gordhan stated that Small, Medium and Micro Enterprises (SMMEs) played a key role in economic development and that they were a significant generator of employment.[33]

Furthermore, former South African Minister of Finance Malusi Gigaba stated in the 2018 national budget speech that improving the ease of doing business in South Africa will support job creation.[34] In this regard, Mr Gigaba stated that the South African Government must create an enabling environment for small businesses to thrive, as small businesses are an important lever to create jobs and grow the economy inclusively.[35] In addition, Mr Gigaba stated that by enabling new businesses with new ideas to emerge and thrive, South Africa would be radically transforming patterns of production in the economy.[36]

In Australia Senator Hon Nick Sherry, Assistant Treasurer, in 2009 stated that small businesses are commonly referred to as the 'engine room' of the economy because of their potential to drive innovation and economic growth.[37]

In light of high unemployment rates which exist in South Africa, the Government is constantly encouraging people to form small businesses in order to eradicate unemployment. This is evident from the abovementioned national budget speeches to parliament by former Ministers of Finance, namely Mr Manuel, Mr Gordhan and Mr Gigaba. Consequently, this means that in order for small businesses to be able to thrive in South Africa, the law makers must ensure that they create laws which will produce a fertile environment for small businesses to be able to be easily formed. The Close Corporations Act created this fertile environment which proved to be an invaluable success as other countries began to adopt the Close Corporations Act for themselves. Consequently, one of the things that this dissertation will look into is whether the Companies Act has been able to catch the baton from the Close Corporations Act with regards to small businesses being easily formed.

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[33] Gordhan, P Budget speech: to parliament 27 February 2013 available at *http://www.daff.gov.za/docs/speeches/2013%20Budget%20Speech%20by%20Minister%20of%20Finance%20Pravin%20Gordhan.pdf*, accessed on 24 March 2014.

[34] Gigaba, M Budget speech: to parliament 21 February 2018 available at http://www.treasury.gov.za/documents/national%20budget/2018/speech/speech.pdf, accessed on 30 May 2018.

[35] Gigaba, M Budget speech: to parliament 21 February 2018 available at http://www.treasury.gov.za/documents/national%20budget/2018/speech/speech.pdf, accessed on 30 May 2018.

[36] Gigaba, M Budget speech: to parliament 21 February 2018 available at http://www.treasury.gov.za/documents/national%20budget/2018/speech/speech.pdf, accessed on 30 May 2018.

[37] K Heenetigala and A Armstrong 'Corporate governance issues facing small corporations in Australia', (2010) *Victoria University, Australia, paper submitted to the 2nd Finance and Corporate Governance Conference, Melbourne, Australia* 2.

Regardless of the fact that the commencement of the Companies Act made amendments to the Close Corporations Act in order to align the Close Corporations Act with the Companies Act,[38] the commencement of the Companies Act still assassinated the formation of new close corporations,[39] which was perplexing as close corporations had been performing very well if one considers the number of close corporations which were registered.[40]

Commentators have alleged that close corporations in the past have more effectively catered for the needs of small (and not so small) businesses than private companies, and that existing close corporations are still expected to take better care of the needs of small businesses than private companies under the Companies Act.[41]

Furthermore, some company law commentators have also alleged that it is more onerous to incorporate and maintain a company under the Companies Act than the Close Corporations Act.[42] In addition, it has been stated that close corporations have been subjected to increased 'onerous managerial and administrative duties and requirements, which are in direct conflict with the design philosophy' of closely held entities or small formal business entities.[43] These increased onerous managerial and administrative duties have been allegedly caused by the amendment of the Close Corporations Act with numerous sections which exists in the Companies Act.[44] This amendment of the Close Corporations Act is indeed ironic as one of the issues with the ill-fated Australian Close Corporations Act was the continuous incorporation of sections from the Australian Corporations Act.

Even though the Companies Act became effective on the 1st May 2011, the South African Government, after the May 2014 national elections, decided to create a new ministry for Small Business Development (SBD). According to minister Gwede Mantashe there was a need for a ministry to specifically address the issues faced by small medium enterprises, such

[38] Schedule 3 of the Companies Act.
[39] Item 1 and 2 of Schedule 3 of the Companies Act read with s2 and s13 of the Close Corporations Act.
[40] 'Registration Statistics March 2014' available at http://www.cipc.co.za/Stats_files/March2014.pdf, accessed on 21 May 2014.
[41] FHI Cassim *et al Contemporary Company Law* 2ed Cape Town: Juta, (2012) 10-11.
[42] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 26.
[43] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 26.
[44] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 26.

as regulation and development.[45] Lastly, Mr Mantashe added that the proposed ministry would review whatever rules which needed to be adapted to ease the burdens faced by small and medium enterprises.[46]

According to the Global Entrepreneurship Monitor's report, 2013 (the 2013 GEM report), the introduction of the ministry of SBD seems to be a welcomed step, as only twelve comma eight per cent of South Africans had entrepreneurial intentions of opening up a business, which was below the average of thirteen comma five per cent for countries with similar economies such as Malaysia, Brazil and Russia.[47]

Former SBD minister, Ms Lindiwe Zulu stated that the establishment and mandate of the department of SBD remains to be the promotion and development of entrepreneurship, small businesses and ensuring an enabling legislative and policy environment to support the growth of small businesses sustainability.[48]

The DTI believed[49] that there is no longer a need for close corporations in the current South African company law regime as the Companies Act reflects the characteristics of a close corporation.[50] As a result, the simplicity of forming and maintaining a company structure which previously existed as a close corporation, is now reflected in the Companies Act.[51]

1.5 RESEARCH AIM

According to business economics, before any business succeeds internationally, nationally or even provincially, it usually first needs to be successful locally.

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[45] B Ginindza 'ANC will add ministry for small business' Business Report Online 9 April 2014 at 1, available at *http://www.iol.co.za/business/news/anc-will-add-ministry-for-small-business-1.1673149*, accessed on 15 May 2014.
[46] B Ginindza 'ANC will add ministry for small business' Business Report Online 9 April 2014 at 1, available at *http://www.iol.co.za/business/news/anc-will-add-ministry-for-small-business-1.1673149*, accessed on 15 May 2014.
[47] 'Global Entrepreneurship Monitor 2013 Global Report' available at *http://www.gemconsortium.org/docs/download/3106*, accessed on 22 May 2014.
[48] L Zulu 'Address by the minister of small business development, Ms Lindiwe Zulu (MP), on the occasion of delivering budget vote 31 on small business development 17 May 2018 (national assembly)' available at http://www.dsbd.gov.za/wp-content/uploads/2018/05/2018-BUDGET-VOTE-31-SPEECH-FINAL-.pdf, accessed on 26 July 2019.
[49] NEDLAC Trade and Industry Chamber 2005: para 3.5; dti 2004:15‑16.
[50] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34.
[51] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34.

The purpose/goal of this research will be to determine if South African Company Law(s) are friendly towards small formal business enterprises (stated differently, whether they create an environment which enables small formal businesses to crawl). Therefore, the dissertation will aim to determine whether ordinary South Africans are effectively able to start and maintain small formal business enterprises after the commencement of the Companies Act, taking into account the impact of existing company laws and the removal of close corporations as an option for incorporation.

1.6 STATEMENT OF PURPOSE

The purpose of this study is to provide a critical evaluation of whether small formal business enterprises such as close corporations are effectively accommodated by South African company laws.

1,7 RESEARCH QUESTIONS

The dissertation will aim to answer the following research questions:

1.7.1 Is it easier and more efficient to incorporate and maintain a small formal business enterprise under the Companies Act as opposed to the Close Corporations Act?

1.7.2 Are the duties and responsibilities of shareholders and directors under the Companies Act more onerous than the duties and responsibilities of members under the Close Corporations Act?

1.7.3 Are the duties and responsibilities of a company under the Companies Act more onerous than the duties and responsibilities of a close corporation under the Close Corporations Act?

1.7.4 How do other foreign jurisdictions regulate small formal business enterprises such as close corporations?

1.8 RESEARCH METHODOLOGY

The research dissertation will be conducted by way of a qualitative desktop literature comparative methodology approach which will include a review and a comparison of primary sources such as the Close Corporations Act and the Companies Act. This research will also include a review of secondary sources which analyse close corporations, the Close Corporations Act and the relationship between small businesses and the Companies Act.

Furthermore, the qualitative desktop literature comparative methodology used to conduct the research will also include a review and a comparison between South African primary and secondary sources on small formal businesses; and primary and secondary sources on small formal businesses of other foreign jurisdictions which effectively regulate small formal businesses.

1.9 RESEARCH CHAPTERS:

The dissertation will consist of the following chapters:

Chapter 1 – Introduction;

Chapter 2 – How to incorporate and maintain a small formal business;

Chapter 3 – Duties of shareholders and directors versus duties of members;

Chapter 4 – Characteristics of a private company and close corporation;

Chapter 5 – Foreign Law; and

Chapter 6 – Conclusion.

1.10 CONCLUSION

It is submitted that South Africa should encourage entrepreneurship through small formal businesses as this will benefit the economy, the State, potential employees and potential employers. Potential employers will benefit as they will be generating an income, while potential employees will also benefit as they will obtain skills while earning an income.[52]

[52] Henning (note 2 above; 775).

The State will benefit as such entrepreneurship will increase economic growth and decrease unemployment which may also have a knock-on effect of decreasing crime[53] and other social benefits that go hand in hand with reduced unemployment.

[53] Ibid 775.

CHAPTER 2: HOW TO INCORPORATE AND MAINTAIN A SMALL FORMAL BUSINESS

2.1 INTRODUCTION

As already mentioned, in the Draft Companies Bill,[54] which was later passed as the Companies Act, the DTI expressed the intention to eventually repeal the Close Corporations Act, following a 10-year experimental period during which the Companies Act and the Close Corporations Act would concurrently be in force.[55] The DTI believed that the formation and maintenance of small companies under the Companies Act (which had attributes of the Close Corporations Act) was 'sufficiently streamlined and simplified' to such an extent that it was unnecessary to retain the option of forming new close corporations under the Close Corporations Act.[56]

The company law reform team which was tasked with formulating the Companies Act consisted of a project manager, Professor Tshepo Mongalo, who was assisted by the chief policy adviser, Judge Dennis Davis, and the chief drafter, Mr Philip Knight.[57] In addition to these three members, the team consisted of a working group labelled corporate formation.[58] The corporate formation group's main function was to 'recommend broad principles for the drafting of the relevant provisions' relating to corporate formation in terms of the Companies Act.[59]

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[54] Clause 226(1)(b) of the Draft Companies Bill. JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 461-462.

[55] Clause 2 of schedule 6 of the Draft Companies Bill. Department of Trade and Industry Companies Bill, Notice of intention to introduce a Bill into Parliament, General Notice 166 of 2007 of the Government Gazette (GN 166 of GG 29630 2007, 12/02/2007); 3. JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 461-462.

[56] Department of Trade and Industry Companies Bill, Notice of intention to introduce a Bill into Parliament, General Notice 166 of 2007 of the Government Gazette (GN 166 of GG 29630 2007, 12/02/2007) (GN 166 of GG 29630 2007, 12/02/2007); 6- 7.

[57] TH Mongalo 'An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) 32(1) *ACTA JURIDICA: Modern company law for a competitive South African economy* xiii-xxv at xvi.

[58] Ibid. It must be noted that the corporate formation working group was 1 of 6 working groups which were divided according to priority areas identified for consideration. The other 5 working groups were: (a) corporate finance; (b) corporate governance; (c) business rescue and mergers and takeovers; (d) not-for profit companies; and (e) administration and enforcement.

[59] TH Mongalo 'An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) 32(1) *ACTA JURIDICA: Modern company law for a competitive South African economy* xiii-xxv at xvi.

Consequently, as part of its broad principles, the corporate formation group identified simplification as a primary guiding principle as it stated that the corporate formation process provided for under the 1973 Companies Act was cumbersome and inflexible, and resulted in the discouragement of incorporation of new companies as well as low level business activity in the South African economy.[60] Change was indeed needed as it has been well recognised that company formation is healthy for the economy because it stimulates commercial activity and economic development.[61]

Since one can no longer incorporate close corporations,[62] and with of course the Companies Act promising a much more simple process of forming and incorporating companies,[63] this chapter will attempt to determine if it is indeed much easier to incorporate and maintain a small company under the Companies Act than it was to incorporate and maintain a close corporation under the Close Corporations Act.

This chapter will be approached from the point of view of a person who does not elect to purchase a close corporation as a 'shelf company' (or in other words, a shelf corporate entity). A 'shelf company' is a company or close corporation which has already been incorporated, in other words it is an 'already-made company'. For instance, even though a person may no longer be permitted to incorporate a close corporation, it is still logically possible for a person to acquire a close corporation if he or she purchases it in the form of a shelf close corporation (company) which was incorporated before the effective date of the Companies Act.[64]

The Companies Act only gives allowance for 4 different types of profit companies to be formed namely: (a) a state-owned company; (b) a private company; (c) a personal liability company; and (d) a public company.[65]

[60] TH Mongalo 'An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) 32(1) *ACTA JURIDICA: Modern company law for a competitive South African economy* xiii-xxv at xvii-xviii.
[61] FHI Cassim *et al Contemporary Company Law* 2nd ed Cape Town: Juta, (2012) 8.
[62] Item 1 and 2 of Schedule 3 of the Companies Act read with s2 and s13 of the Close Corporations Act.
[63] S 7(b)(i) and (ii) of the Companies Act.
[64] 11 May 2011.
[65] S 8(2) of the Companies Act.

These four profit companies are defined as follows:[66]

(a) A state-owned company is a company which is listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act 1 of 1999, or a company which is owned by a municipality in terms of the Local Government: Municipal Systems Act 32 of 2000;

(b) a private company is a company which is not a state-owned, personal liability or public company, and which its Memorandum of Incorporation (hereinafter the MOI)[67] prohibits the offering of its securities[68] to the public and restricts the transferability of its securities;

(c) a personal liability company is a company which meets the criteria of a private company and which its MOI expressly states that it is a personal liability company; and

(d) a public company is company that is not a state-owned, private or personal liability company.[69]

Consequently according to South African company law, if one wants to start a small formal business with the intention of making a profit and enjoying limited liability, the logical step seems to be for one to incorporate a private company in terms of the Companies Act.[70] The reason why the incorporation of a private company under the Companies Act will be contrasted against the incorporation of a close corporation under the Close Corporations Act is because close corporations were perceived to be the most appropriate corporate entity for someone who intended to start a small formal profit making business which enjoyed the benefits of limited liability.[71]

[66] S 1 of the Companies Act.
[67] S 1 of the Companies Act defines a MOI as document which sets out the rights, duties and responsibilities of shareholders, directors and others within and in relations to a company, and other matters contemplated in s 15 of the Companies Act.
[68] S 1 of the Companies Act defines securities as including shares, debentures or other instruments which are issued or authorised to be issued by the profit company.
[69] S 1 of the Companies Act.
[70] S 1 read with s 8(2) of the Companies Act.
[71] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science* 40 (1): 19-34.

The reason why close corporations were the preferred choice for small business entrepreneurs is because they catered for a small number of limited participants (up to 10 participants) who wanted to easily form a business without meaningless administrative issues or unnecessary regulatory red tape.[72]

2.2 FORMATION OF A PRIVATE COMPANY IN TERMS OF THE COMPANIES ACT

When a person decides to take the step of forming a private company, the first thing they need to do is ensure that they have a company name which is in line with section 11 (which deals with the criteria for company names) and section 12 (which deals with the reservation of company names and defensive company names) of the Companies Act.[73]

Interestingly the Companies Act allows a company to be registered with or without a company name.[74] If a private company that is being registered does not have a reserved company name, then it may be registered with its registration number and such registration number-name must be immediately followed by the expression '(South Africa)'.[75] It is submitted that this is a prudent step in the quest for a quick registration of a private company.

According to the Companies Act one or more persons may incorporate a private company by: (i) completing, and each signing in person or by proxy, the MOI in the standardised form or in a customized form; and (ii) by filing a Notice of Incorporation (hereinafter the NOI).[76]

In this regard, the NOI must be filed in the prescribed manner and form accompanied by the prescribed fee and a copy of the MOI.[77] Subject to a permitted fee reduction,[78] the prescribed

[72] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science* 40(1): 19-34.
[73] S 11 of the Companies Act deals with the criteria for names of companies while s12 deals with the reservation of name and defensive names.
[74] S 11(1)(b) of the Companies Act.
[75] S 11(3)(a) of the Companies Act.
[76] S 13(1) of the Companies Act. S 1 of the Companies Act defines a "NOI" as notice which is filed in terms of s 13(1), by which the incorporators of a private company inform CIPC of the incorporation of such company, for the purpose of having the private company registered.
[77] S 13(2) of the Companies Act.
[78] In terms of Regulation 14(2) of the Companies Act, the filing fee of a NOI must be reduced by an amount equal to the fee of an application for a name reservation, if the NOI stipulates that the private company must be known by its registration number, or by a name that has been reserved in advance.

fee for a NOI will vary between R175 and R475, depending on the form (short form or long form) of the private company's MOI.[79]

Furthermore, the NOI must include, amongst other things, a prominent statement drawing attention to any ring fencing provisions (MOI provisions which are more restrictive than the Companies Act) that are included in the MOI.[80] In addition, the NOI must include a list of initial directors of the private company,[81] and the date of the private company's financial year end.[82]

If the incorporators of a private company choose to use the standardised MOI form (as stipulated in s 13(1)(a)(i) of the Companies Act), then the private company's MOI may either be in the 'short form CoR 15.1A' or the 'long form CoR 15.1B'.[83] However, should the (incorporated) private company wish to change its MOI from the standardised short form to the standardised long form, it will cost the (incorporated) private company R250, unless a fee exemption has been granted.[84] This prescribed fee must be accompanied by a Notice of Amendment, a copy of the completed standardised long form MOI and a copy of a special resolution by the private company approving the new standardised long form MOI.[85]

Once formed, the private company will be required to prepare a financial statement each year, within 6 months of the company's financial year[86] or 'such shorter period which may be appropriate to provide the required notice of an annual general meeting'.[87]

Consequently a private company may then be required to audit its financial statements depending on: (i) the private company's annual turnover; or (ii) the size of the private company's workforce; or the nature and extent of the private company's activities.[88] Factors such as desirability of public interest and the economic and social significance of the private company will also play a role in the determination of compulsory auditing of the private

[79] Regulation 14(1)(a) of the Companies Act read with Annexure 2, item 2 of Table CR 2B (Commission Fee Schedule) of the Companies Act.
[80] S 13(3) of the Companies Act.
[81] S 13(4)(b) of the Companies Act.
[82] S 27(1) of the Companies Act.
[83] Regulation 15(1)(a) of the Companies Act read with s 13(1) and s 16 of the Companies Act.
[84] Table CR 2B (Commission Fee Schedule) of the Companies Act read with regulation 15(2) of the Companies Act.
[85] Regulation 15(2) of the Companies Act.
[86] According to regulation 25(1) of the Companies Act a private company is required to notify CIPC by filing Form CoR 25 if the private company decides to change its financial year.
[87] S 30(1) of the Companies Act.
[88] S 30(2)(b) of the Companies Act.

company.[89] Although at first glance one of the advantages of having audited financial statements may be that the company will have trustworthy financial statements which reflect the company's financial situation; on the converse the disadvantage of having audited financial statements is that a private company will incur the costs of hiring the services of accounting professionals should the private company be required to have its financial statements audited.[90]

However, a private company will be exempt from having its annual financial statements audited or independently reviewed if every shareholder is a director or if every person who has a beneficial interest in the private company's issued securities is a director.[91] Unfortunately, the Companies Act does not define what an 'independent review' is, however the Companies Act does make it clear that an independent review is not an audit which is defined in terms of the Auditing Profession Act.[92] In addition, the Companies Act does provide some guidance in the definition of an independent review as it states that an independent review must be conducted by 'a registered auditor or a member in good standing of a professional body that has been accredited in terms of s 33 of the Auditing Profession Act' or 'a person who is qualified to be appointed as an accounting officer of a close corporation'.[93] However, an independent accounting professional will not be permitted to independently review the private company's annual financial statements if such independent accounting professional was involved in the preparation of the private company's annual financial statements.[94]

Generally speaking, an independent review is seen as a watered-down audit as the scope of what is to be audited is narrower than that of a usual audit.[95] In this regard, an independent review is usually less burdensome and less rigorous than an audit.[96] Furthermore, regardless of the fact that a private company will have to incur the costs of hiring the services of an independent accounting professional, the benefit of an independent review is that it is usually

[89] S 30(2)(b)(i) of the Companies Act.
[90] Geldenhuys, C 'Audit vs. Independent Review' South African Institute of Tax Professionals available at https://www.thesait.org.za/news/116111/Audit-vs.-Independent-Review.htm, accessed on 9 July 2018.
[91] S 30(2A) of the Companies Act.
[92] See definition of "audit" in s 1 of the Companies Act.
[93] Regulation 29(4) of the Companies Act.
[94] Regulations 29(5) of the Companies Act.
[95] Geldenhuys, C 'Audit vs. Independent Review' South African Institute of Tax Professionals available at https://www.thesait.org.za/news/116111/Audit-vs.-Independent-Review.htm, accessed on 9 July 2018.
[96] Geldenhuys, C 'Audit vs. Independent Review' South African Institute of Tax Professionals available at https://www.thesait.org.za/news/116111/Audit-vs.-Independent-Review.htm, accessed on 9 July 2018.

less expense than the usual costs of an audit.[97] However, the disadvantage of an independent review is that because it is a watered-down audit is therefore also less reliable than an audit.[98]

What is clear in terms of the Companies Act is that a private company will be required to have its annual financial statements independently reviewed if the company's public interest score is 100 or less in that particular financial year.[99]

A private company will be mandatorily required to audit its annual financial statements if, such private company in its ordinary course of its primary activities, holds assets worth over R5 million in total value (at any time during its financial year) in a fiduciary capacity for persons who are not related to the private company.[100] In this regard it is important to note that a natural person will be considered to be related to a private company if the natural person directly or indirectly controls the juristic person.[101] Whilst on the other hand, a juristic person will be related to a private company if: (i) the juristic person or the private company directly or indirectly controls the other or the business of the other; or (ii) the juristic person or the private company is a subsidiary of the other; or (iii) a person directly or indirectly controls the juristic person and the private company or the business of each of them.[102]

Furthermore, a private company will also be mandatorily required to audit its annual financial statements if the private company has a public interest score of 350 or more in its financial year.[103] Alternatively, a private company will be mandatorily required to audit its annual financial statements if it has public interest score of at least 100, if its annual financial statements are internally compiled (for example, compiled by a director) for that financial year.[104] A public interest score is seen as a gauge of a company's social responsibility taking into account the company's social or economic impact on the public as a whole.[105] Consequently a private company's turnover, workforce size and/or the nature and extent of

[97] Geldenhuys, C 'Audit vs. Independent Review' South African Institute of Tax Professionals available at https://www.thesait.org.za/news/116111/Audit-vs.-Independent-Review.htm, accessed on 9 July 2018.
[98] Geldenhuys, C 'Audit vs. Independent Review' South African Institute of Tax Professionals available at https://www.thesait.org.za/news/116111/Audit-vs.-Independent-Review.htm, accessed on 9 July 2018.
[99] Regulation 29(4) of the Companies Act.
[100] Regulation 28(2)(a) of the Companies Act.
[101] S 1 read with s 2(1)(b) of the Companies Act.
[102] S 1 read with s 2(1)(c) of the Companies Act.
[103] Regulation 28(2)(c) of the Companies Act.
[104] Regulation 28(2)(c) of the Companies Act.
[105] FHI Cassim et al *Contemporary company law* 2nd ed Cape Town: Juta, (2012) 74.

the company's activities, will be used as factors in order to determine the private company's social or economic impact on the wider public.[106]

The calculation of a public interest score is determined in accordance with regulation 26(2) of the Companies Act which requires a private company to calculate its public interest score at the end of its financial year, as the sum of the following:

> '(a) number of points equal to the average number of employees of the private company during the financial year;
> (b) one point for every R1 million (or portion thereof) in third party liability of the private company at the end of the financial year;
> (c) one point for every R1 million (or portion thereof) in the turnover of the private company during the financial year; and
> (d) one point for every known individual who, at the end of the financial year, is known by the company—
> (i) in the case of a profit company, to directly or indirectly have a beneficial interest in any of the company's issued securities; or
> (ii) in the case of a non-profit company, to be a member of the company, or a member of an association that is a member of the company'.[107]

If a private company is not mandatorily required to audit its financial statements, but however still feels that it wants to audit its financial statements, then the private company may voluntarily audit its financial statements in terms of the Companies Act.[108] The material impact of a voluntarily audit by a private company is that a private company will be exempt from being required to independently review its financial statements if the private company undertakes to voluntarily audit its financial statements.[109]

Furthermore, a private company that is not mandatorily or voluntarily required to have its annual financial statements audited 'must file a financial accountability supplement to its annual return'.[110]

The Companies Act then requires every private company to file annual returns in a prescribed form with a prescribed fee, within 30 business days after the end of the anniversary of the

[106] FHI Cassim et al *Contemporary company law* 2nd ed Cape Town: Juta, (2012) 74.
[107] Regulation 26(2) of the Companies Act.
[108] According to s 30(2)(b)(ii) of the Companies Act voluntary auditing must be stipulated by the company's MOI or a shareholders' resolution or must be determined by the board.
[109] Regulation 29(2)(c) of the Companies Act.
[110] Regulation 30(4) of the Companies Act.

date of the private company's incorporation.[111] The prescribed fee for the annual return will vary according to the private company's turnover and time of filing.[112] For instance, if a private company has a turnover of less than R1 million then the filling fee will be either R100 (if filed within 30 business days after anniversary) or R150 (if filed after 30 business days after anniversary); if a private company has a turnover of at least R1 million but less than R10 million then the filing fee will either be R450 (if filed within 30 business days after anniversary) or R600 (if filed after 30 business days after anniversary); if a private company has a turnover of at least R10 million but less than R25 million then the filing fee will either be R2000 (if filed within 30 business days after anniversary) or R2500 (if filed after 30 business days after anniversary); and if a private company has a turnover of R25 million or more then the filing fee will either be R3000 (if filed within 30 business days after anniversary) or R4000 (if filed after 30 business days after anniversary).[113]

Furthermore, the Companies Act requires every private company to establish or cause to be established a register of the private company's issued securities[114] in the prescribed form.[115] Once the private company has established or caused to be established its securities register, then the private company must maintain its securities register in accordance with the prescribed standards.[116]

The Companies Act talks about certificated and uncertificated securities.[117] In this regard, certificated securities are securities which are evidenced by certificates, while uncertificated securities have the converse meaning.[118] Consequently, a private company is not required to issue certificates which show or purport to show title to uncertificated securities.[119] This certificated securities requirement is in line with the Close Corporations Act which also requires a Close Corporation to have certificated members' interest (securities).[120] As a result, the Companies Act is not less favourable than the Close Corporations Act in this

[111] S 33 of the Companies Act read with regulation 30(1)(a) of the Companies Act.
[112] Item 8 of Table CR 2B (Commission Fee Schedule) of the Companies Act.
[113] Item 8 Table CR 2B (Commission Fee Schedule) of the Companies Act read with regulation 30 of the Companies Act.
[114] See footnote 70 for the definition of securities.
[115] S 50(1)(a) of the Companies Act.
[116] S 50(1)(b) of the Companies Act.
[117] S 49 of the Companies Act.
[118] S 49(2)(a) and (b) of the Companies Act.
[119] S 49(2)(b) of the Companies Act.
[120] S 12(e) of the Close Corporations Act.

regard.[121] However, the Companies Act does allow for uncertificated securities which the Close Corporations Act does not allow.[122]

An argument may be made that based on the fact that certificated and uncertificated security holders have the same rights and obligations;[123] close corporations do not need to distinguish between certificated and uncertificated securities as members' contributions (and the changes thereof) are recorded in the founding statement.[124]

While on the subject of securities, once a securities register has been established, then all of the issued securities of a private company must be entered or caused to be entered, as soon as it is practicable to do so, in the private company's securities register.[125] In terms of certificated securities, a private company is required to enter the following details:

> '(i) the names and addresses of the persons to whom the securities were issued;
>
> (ii) the number of securities issued to each them;
>
> (iii) the number of, and the prescribed circumstances relating to any securities that have been placed in trust [as per a trust agreement] or whose transfer has been restricted;
>
> (iv) in the case of securities [other than shares], the number of those securities issued and outstanding, and the names and addresses of the registered owner of the registered owner and any holders of a beneficial interest in the security; and
>
> (v) any other prescribed information'.[126]

While in terms of uncertificated securities, a private company is only required to enter the total number of the uncertificated securities, and is resultantly not required to enter the in depth details which are required from certificated securities.[127] It is submitted that this lax requirement for uncertificated securities is perplexing as one is unable to know the identification details of the owners/holders of uncertificated securities.

[121] S 49(2)(a) of the Companies Act and s12(e) of the Close Corporations Act.
[122] S 49(2)(b) of the Companies Act.
[123] S 49(3) of the Companies Act.
[124] S 12(f) of the Close Corporations Act read with s24 of the Close Corporations Act.
[125] S 50(2) of the Companies Act.
[126] S 50(2)(b) of the Companies Act.
[127] S 50(2)(a) of the Companies Act.

2.3 FORMATION OF A CLOSE CORPORATION IN TERMS OF THE CLOSE CORPORATIONS ACT

It is important to re-emphasise that one can no longer form a close corporation because of the amendments to the Close Corporations Act, brought about by the Companies Act.[128] However, for purposes of this chapter the writer will examine the process as if one could still incorporate a close corporation because close corporations were the preferred choice for small business entrepreneurs as they catered for a small number of limited participants.[129]

Before the Companies Act came into effect, the Close Corporations Act previously permitted 1 to 10 people who qualified to be a member[130] in terms of the Close Corporations Act, to form a close corporation.[131] Once the close corporation was formed it became a juristic person just like a private company under the Companies Act, and consequently its members enjoyed the advantages of a separate legal personality such as limited liability.[132] Furthermore once a close corporation was formed it was bestowed with the same capacity and powers of a natural person to the extent that a juristic person could have such capacity or could exercise such powers.[133] A private company under the Companies Act is also bestowed with the same capacity and powers of a natural person to the extent that a juristic person can have such capacity or exercise such powers, alternatively to the extent of the private company's MOI and in particular ring fenced provisions in the case of a ring fenced company (RF company).[134]

The Close Corporations Act required any number of person(s) who qualified to be a member and who intended on forming a close corporation, to draw up a founding statement[135] in the

[128] Item 1 and 2 of Schedule 3 of the Companies Act read with s 2 and s 13 of the Close Corporations Act.
[129] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34.
[130] S 1 of the Close Corporations Act defines "member" as a person who qualifies for membership of a close corporation in terms of s 29 of the Close Corporations Act, and who is designated as a member in the founding statement of the close corporation, including (but subject to the Close Corporation Act), a trustee, administrator, executor or curator, or other legal representative of any person who is insolvent, deceased, mentally disordered, incapable or incompetent to manage his or her affairs, but excluding such person who has stopped being a member of a close corporation in terms of the Close Corporations Act.
[131] S 2(1) of the Close Corporations Act read with s 28 of the Close Corporations Act.
[132] S 2(2) and (3) of the Close Corporations Act.
[133] S 2(4) of the Close Corporations Act. JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 26.
[134] S 19 of the Companies Act. JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 26.
[135] According to s 1 of the Close Corporations Act a "founding statement" is a registered constitutional document of a close corporation, which includes an amended founding statement.

prescribed form (CK 1 form)[136] in any one of the official South African languages. Such founding statement was also required to be signed by or on behalf of every person who intended on becoming a member of a close corporation upon its registration.[137] The founding statement was a constitutional document intended to serve the same purpose that a MOI serves for a private company under the Companies Act.

The founding statement needed to include: (a) the full name of the close corporation (including a literal translation of the full name into another official South African language or a shortened form of the full name); (b) the principal business place of the close corporation; (c) the physical and postal address of the close corporation; (d) the full name, residential address and identity number of each member or the date of birth of each member (if there was a member who did not have an identity number); (e) the percentage size of each member's interest in the close corporation; (f) particulars relating to each member's contribution such as the amounts of money, and a description and statement of the fair value of any corporeal or incorporeal property or any services rendered with the purposes of the formation and incorporation of the close corporation; (g) the name and postal address of a qualified person who or firm/company which had consented in writing to the appointment as an accounting officer of the close corporation; and (e) the determined date of the financial year end of the close corporation.[138]

Consequently once the founding statement had been completed it would be registered with the Registrar of CIPC[139] and thereafter the Registrar of CIPC would issue a certificate of incorporation.[140] In this regard, with the absence of fraud or error, the production of a certificate of incorporation issued by the Registrar of CIPC (or a copy thereof) would serve as conclusive proof that all of the requirements (including precedent and incidental matters) relating to the registration of the close corporation in respect of the Close Corporations Act had been complied with, and the close corporation was duly incorporated under the Close Corporations Act.[141] The statutory registration cost of a founding statement was R100.[142]

[136] Item 6 of Schedule 1 (Fees) of Close Corporations Act.
[137] S 12 of the Close Corporations Act.
[138] S 12 of the Close Corporations Act.
[139] S 13 of the Close Corporations Act.
[140] S 14(1) of the Close Corporations Act.
[141] S 14(2) of the Close Corporations Act.
[142] Item 6 of Schedule 1 (Fees) of the Close Corporations Act.

Every close corporation was then required on payment of a prescribed fee to lodge an annual return in the prescribed electronic format[143] with the Registrar of CIPC by no later than the end of the month following the month within the anniversary of the date of the close corporation's incorporation occurred.[144] In addition, a copy of the close corporation's annual return would be kept at the close corporation's registered office.[145] The prescribed fee for the lodgement of an annual return would depend on the size of the close corporation's turnover, for instance; (i) a Close Corporation with an annual turnover of less than R50 000 000 would be required to pay a fee of R100 for the lodgement of its annual return, while a close corporation with an annual turnover of R50 000 000 or more would be required to pay a higher fee of R4 000 for the lodgement of its annual return.[146]

Consequently a close corporation's annual return would include the following information: (i) the close corporation's registered name (including the registered translated and shortened trade name if any); (ii) the close corporation's registration number; (iii) the close corporation's main business; (iv) the close corporation's incorporation date; (v) the end of the close corporation's financial year; (vi) the end period of the most recent annual financial statements which had been approved by the members of the close corporation and which the accounting officer had issued a report; (vii) the close corporation's registered or postal address; (vii) the annual turnover which was in the most recent annual financial statements and which had been approved by the members of the close corporation, and which the accounting officer had issued a report on; (ix) the close corporation's addresses, telephone number and other contact numbers; (x) the postal address, profession, practice or membership number, name or registration number (if the accounting officer was a firm or corporation)[147] of the accounting officer; (xi) the close corporation's members; (xii) the managers of the close corporation (if any); (xiii) the sum of the close corporation's members contribution; and (xiv) any other information relating to the disclosure in terms of the Close Corporations Act and its regulations which could be required in the close corporation's annual return.[148]

If a close corporation failed to lodge an annual return within the prescribed period then it would be required to pay a prescribed additional fee to the Registrar of the CIPC (but such additional fee payment could be waived by the Registrar if good cause was shown), which

[143] Items 12 and 13 of Schedule 1 (Fees) of the Close Corporations Act.
[144] S 15A(1) of the Close Corporations Act.
[145] S 15A(2) of the Close Corporations Act.
[146] Items 12 and 13 of Schedule 1 (Fees) of the Close Corporations Act.
[147] See definition of "accounting officer" in s 1 of the Public Accountants' and Auditors Act No. 80 of 1991.
[148] Regulation 16A of the Close Corporations Act.

would be accompanied by the late lodged annual return.[149] In this regard, the prescribed additional fee for the lodgement of an annual return would be R4 000, and the form of the late annual return lodgement would be in electronic format.[150]

Furthermore, members of a close corporation would be required within six months after the end of every financial year of the close corporation, to cause annual financial statements of that particular financial year to be made in one of South Africa's official language.[151] In this regard, the close corporation's annual financial statement would be made of a balance sheet (and any notes), and an income statement or a similar statement where such form was appropriate (and any notes).[152]

In essence, the close corporation's annual financial statements would fairly present close corporation's state of affairs at the end of a specific financial year and the results of the close corporation's operations would be in line with the general accepted accounting practice standards which would be appropriate to the business of the close corporation.[153] In addition, the annual financial statements would also disclose separate aggregate amounts at the end of the close corporation's financial year, of the member contributions, undrawn profits, revaluations of the close corporation's fixed assets and amounts of loans to and from the close corporation's members, and the changes in these amounts during the year.[154]

The Close Corporations Act then required the close corporation's annual financial statements to speak the same language as the accounting records.[155] In this regard, the close corporation's annual report would contain a report from an accounting officer which determined whether the 'annual financial statements were in agreement with the accounting records' of the close corporation; and a report from the accounting officer which reviewed the 'appropriateness of the accounting policies' that were 'represented to the accounting officer as having been applied in the preparation of the annual financial statements'.[156]

Akin to private companies, the provisions relating to the (mandatory) auditing of annual financial statements of private companies also now apply to already existing close

[149] S 15A(3) of the Close Corporations Act.
[150] Item 14 of Schedule 1 (Fees) of the Close Corporations Act.
[151] S 58(1) of the Close Corporations Act.
[152] S 58(2)(a) of the Close Corporations Act.
[153] S 58(2)(b) of the Close Corporations Act.
[154] S 58(2)(c) of the Close Corporations Act.
[155] S 58(2)(d) of the Close Corporations Act.
[156] S 58(2)(e) of the Close Corporations Act read with s 62(1)(c) of the Close Corporations Act.

corporations.[157] For example, this means that the annual financial statements of close corporations would be also be required to be audited depending on: (i) the close corporation's annual turnover; or (ii) the size of the close corporation's workforce; or the nature and extent of the close corporation's activities.[158] Consequently factors such as desirability of public interest and the economic and social significance of the close corporation company would also (and still also) play a role in the determination of compulsory auditing of the close corporation.[159]

Furthermore, the close corporation's financial statements would be approved and signed by a majority member who holds at least 51 per cent of the member's interest, or members of the close corporation who in aggregate hold at least 51 per cent of the members' interest in the close corporation.[160]

2.4 COMPARATIVE ANALYSIS

2.4.1 Limits on numbers, and types, of members

After scrutiny it is evident that the Companies Act has embraced the Close Corporations Act, as just like the Close Corporations Act, the Companies Act allows for a single person to form and manage a formal business entity in a simple manner similar to that which existed under the Close Corporations Act.[161] One may also argue that the Companies Act represents an improvement on the Close Corporations Act, as it does not prescribe a ceiling point of 10 people who may want to form a small incorporated business.[162] Not having a numeric restriction is an improvement because this adequately caters for scalability of a company should the company wish to grow without experiencing unnecessary regulatory red tape.[163] Furthermore not restricting the equity pie to natural persons is also an improvement because

[157] S 58(2A) of the Close Corporations Act.
[158] S 58(2A) of the Close Corporations Act read with s 30(2)(b) of the Companies Act.
[159] S 58(2A) of the Close Corporations Act read with s 30(2)(b)(i) of the Companies Act.
[160] S 58(3) of the Close Corporations Act. HA van Wyk, J Rossouw, 'IFRS for SMEs in South Africa: a giant leap for accounting, but too big for smaller entities in general' (2009) *Meditari Accountancy Research*, Vol. 17 Issue: 1 pp.99-116.
[161] S 13(1), s 57(4) and s 66(2)(a) of the Companies Act read with s 2(1) and s 28 of the Close Corporations Act.
[162] S 13(1) of the Companies Act read with s 2(1) and s 28 of the Close Corporations Act.
[163] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42.

this allows a company to bring on board juristic personae which may have the financial muscle to boost the company to the next level.[164]

However it can also be argued that it was never the philosophy of the Close Corporations Act to cater for a large number of people who want a slice of the equity pie because the Close Corporations Act was a shoe made for small formal businesses.[165] Furthermore, it is submitted that regardless of the advantage of allowing a large number of equity participants because of the potential ease in increased finance or capital of a private company, such advantage comes at the expense of simplicity as equity players may be large powerful complex businesses who have many shareholders wanting to influence the business culture or business politics or business strategies, thus making accountability a difficult task. In the same vein it can be argued that an investor who wants to invests a lot of money or capital in a close corporation, would in most scenarios want to be an equity member with the majority members' interest in order for such investor to be in a position to influence or control corporate strategies, corporate culture and corporate politics.

2.4.2 Simplicity of formation

At first glance, it appears that the Companies Act has not done a splendid job with regards to simplicity and formation as a person who wants to form a private company is required to fill in two company constitutional documents (the MOI and NOI), while on the other hand a person who wants to form a close corporation only needs to fill in one company constitutional document (the founding statement).[166] However, the argument that the formation of a close corporation is much simpler than that of a private company is futile if it can be proved that a founding statement is as voluminous as a MOI and a NOI of a private company.[167] Although this paper does not go into the voluminousness of the MOI, NOI and the founding statement, at first glance the standardised short form MOI and the NOI do not appear to be much more voluminous than the standard founding statement.

2.4.3 Costs

[164] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42.
[165] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 456 and 464.
[166] S 13(1) of the Companies Act read with s 12 of the Close Corporations Act.
[167] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 14.

Even though the CIPC states that the cost of registration of a private company is R125,[168] the Companies Act paints a different picture, as the costs of forming a private company are clearly higher than the costs of forming a close corporation, which were limited to R100.[169] In terms of the Companies Act the costs of forming a private company can easily amount to R475.[170]

2.4.4 Administrative duties and financial reporting

However a private company does share some of the same 'administrative duties' as a close corporation such as filing of annual returns, preparing financial statements and auditing such financial statements.[171] The preparation of annual returns, financial statements and the auditing of financial statements may discourage entrepreneurship in the formal sector for both private company shareholders and close corporation members, as an ordinary entrepreneur who lacks accounting acumen will be required to pay an accountant or an auditor for some professional advice of annual returns, financial statements and the auditing of financial statements.[172]

It is argued that users, managers or owners of small businesses such as close corporations do not need the 'extensive and complex information provided in general purpose financial statements' which are required in terms of International Financial Reporting Standards (IFRS) requirements, as these IFRS financial disclosure requirements do not 'yield cost-effective and useful information being provided to users of the financial statements' of small businesses such as close corporations.[173]

However, it can be argued that in order for most small businesses to move forward they will at some stage require financing from third parties such as financial institutions who require audited or independently reviewed financial statements in order to advance loans to such

[168] Registering our Company available at http://www.cipc.co.za/index.php/register-your-business/companies/, accessed on 13 October 2014.
[169] Regulation 14(1)(a) of the Companies Act read with Annexure 2, item 2 of Table CR 2B (Commission Fee Schedule) of the Companies Act read with Item 6 of Schedule 1 (Fees) of the Close Corporations Act.
[170] Regulation 14(1)(a) of the Companies Act read with Annexure 2, item 2 of Table CR 2B (Commission Fee Schedule) of the Companies Act read with Item 6 of Schedule 1 (Fees) of the Close Corporations Act.
[171] S 30(1), s 30(2)(b) and s 33 of the Companies Act read with s 15A (1) and s 58(1) of the Close Corporations Act.
[172] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 458.
[173] HA van Wyk, J Rossouw, 'IFRS for SMEs in South Africa: a giant leap for accounting, but too big for smaller entities in general' (2009) Meditari Accountancy Research, Vol. 17 Issue: 1 pp.99-116.

small businesses.[174] As a result, paying an accounting professional to prepare financial records and audit or independently review financial statements is not a disadvantage but rather an opportunity cost for growth/forward momentum of a small business such as a close corporation and the growth of an economy.[175]

Furthermore, statutory non-compliance can be fatal as failure to comply with the statutory requirements of filing an annual return will result in the CIPC assuming that the private company and/or close corporation is no longer in business or is no longer intending on doing business in the near future.[176] Consequently, such non-compliance with annual returns may lead to the deregistration of the private company or the close corporation, which has the effect of withdrawing the juristic personality of the private company and the close corporation and therefore ceasing the existence of the private company or close corporation.[177]

The statutory costs of filing an annual return are more expensive for a private company than that of a close corporation.[178] Furthermore it submitted that the convenience of mandatory electronic filing of annual returns for private companies and close corporations[179] regrettably fails to take into account that some small entrepreneurs may find it difficult to operate and/or have access to a personal computer and the internet.

However, it is not all doom and gloom as a private company or a close corporation can be exempt from the administrative duty of having its financial statements audited.[180] This exemption is however artificial for private companies as they must still file a financial

[174] Geldenhuys, C 'Audit vs. Independent Review' South African Institute of Tax Professionals available at https://www.thesait.org.za/news/116111/Audit-vs.-Independent-Review.htm, accessed on 9 July 2018.
[175] Geldenhuys, C 'Audit vs. Independent Review' South African Institute of Tax Professionals available at https://www.thesait.org.za/news/116111/Audit-vs.-Independent-Review.htm, accessed on 9 July 2018.
[176] Companies and intellectual Property Commission Annual Returns available at *http://www.cipc.co.za/index.php/manage-your-business/manage-your-close-corporation/compliance-obligations/annual-returns/*, accessed on 3 December 2014.
[177] Companies and intellectual Property Commission Annual Returns available at *http://www.cipc.co.za/index.php/manage-your-business/manage-your-close-corporation/compliance-obligations/annual-returns/*, accessed on 3 December 2014.
[178] Item 8 of Table CR 2B (Commission Fee Schedule) of the Companies Act read with items 12 and 13 of Schedule 1 (Fees) of the Close Corporations Act.
[179] Companies and intellectual Property Commission Annual Returns available at *http://www.cipc.co.za/index.php/manage-your-business/manage-your-close-corporation/compliance-obligations/annual-returns/*, accessed on 3 December 2014.
[180] S 30(2)(b) and s 30(2A) of the Companies Act read with s 58(2A) of the Close Corporations Act.

accountability supplement to their annual return if the private company is not mandatorily or voluntarily required to have its annual financial statements audited.[181]

2.5 CONCLUSION

Knight believes that the trade-off for maximising flexibility with regards to the formation of companies was the compromise of elegance and simplicity.[182] However, one must always bear in mind that with any new legislation there is an inherent risk that novelty may result in misunderstandings, which at first glance may appear to make things seem more complex than they are.[183] Therefore it may be argued that the Companies Act will be fully understood once it has been test driven by members of the legal fraternity and ordinary South Africans.[184]

[181] Regulation 30(4) of the Companies Act.
[182] P Knight 'Keep it simple and set it free: The new ethos of corporate formation' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42 at 3.
[183] P Knight 'Keep it simple and set it free: The new ethos of corporate formation' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42 at 3.
[184] P Knight 'Keep it simple and set it free: The new ethos of corporate formation' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42 at 3.

CHAPTER 3: DUTIES OF SHAREHOLDERS AND DIRECTORS v DUTIES OF MEMBERS

3.1 DUTIES OF SHAREHOLDERS OF A PRIVATE COMPANY IN TERMS OF THE COMPANIES ACT

If a private company has only one shareholder[185] then 'that shareholder may exercise any or all of their voting rights pertaining to [the private] company on any matter, at any time, without notice or compliance with any other internal formalities, except to the extent that the company's MOI provides otherwise'.[186]

Furthermore, if all the shareholders of a private company are also directors of the private company then

> 'any matter which is required to be referred by the board to the shareholders for a decision, may be decided by the shareholders at any time after being referred by the board, without notice or compliance with any other internal formalities, except to the extent that the MOI provides otherwise, provided that: (i) every [shareholder-director] was present at the board meeting when the matter was referred to them in their capacity as shareholders; (ii) sufficient [shareholder-directors] are present in their capacity as shareholders to satisfy the quorum requirements set out in s 64 [of the Companies Act]; and (iii) a resolution adopted by the [shareholder-directors] in their capacity as shareholders has at least the support that would have been required for it to be adopted as an ordinary[187] or special resolution,[188] as the case may be, at a properly constituted shareholders' meeting;[189] and (iv) when acting in their capacity as shareholders, those [shareholder-directors] are not subject to any provisions of s 73 to s 78 [of the

[185] According to s 57(1) of the Companies Act the term 'shareholder' has the same meaning attributed to it in s 1 of the Companies Act, but includes a person who is entitled to exercise any voting rights in relation to the private company, irrespective of the form, title or nature of the securities to which those voting rights are attached.
[186] S 57(2)(a) of the Companies Act.
[187] S 1 of the Companies Act defines an 'ordinary resolution' as a resolution which is adopted with the support of more than 50 per cent of the voting rights exercised on that particular resolution or a higher percentage which is permitted in terms s 65(8) of the Companies Act at a shareholders meeting or by the holders of the private company's securities acting other than a meeting contemplated in s 60 of the Companies Act.
[188] S 1 of the Companies Act defines a 'special resolution' as a resolution which is adopted with the support of at least 75 per cent of the voting rights exercised on that particular resolution or a different percentage which is permitted in terms s 65(10) of the Companies Act at a shareholders meeting or by the holders of the private company's securities acting other than a meeting contemplated in s 60 of the Companies Act.
[189] S 57(4)(a) of the Companies Act.

> Companies Act] relating to the duties, obligations, liabilities and indemnification of directors'.[190]

Consequently according to s 64(1) of the Companies Act a quorum for a shareholders' meeting will be met if there is a presence of shareholders who at least, in total, are allowed to exercise 25 per cent of the voting rights in respect of at least one matter to be decided at that particular meeting.[191] Furthermore, a matter will only be considered in a shareholders meeting if there is a shareholders' quorum on that particular matter at the time the matter is called on the agenda.[192]

However, the MOI of a private company may specify a lower or higher percentage instead of the required 25 per cent for the quorum of a shareholders meeting or the quorum for any intended matter to be decided upon at a meeting.[193]

It is interesting to note that irrespective of the abovementioned 25 per cent requirement for a meeting quorum, if a private company has more than two shareholders then the required 25 per cent or any percentage figure stipulated in the MOI will not be the sole decisive factor for a meeting to begin as a meeting will only validly begin if at least three shareholders are present at the meeting and the requirements in s 64(1) of the Companies Act or the MOI (if different) are satisfied.[194]

Before any person may attend or participate in a shareholders meeting, the Companies Act requires such person to present satisfactory identification.[195] In addition, the Companies Act requires the presiding person at the shareholders meeting to be 'reasonably satisfied that the right of that person to participate and vote, either as a shareholder or as a proxy for a shareholder, has been reasonably verified'.[196] Unless one wants to verify the truthfulness of a proxy's identity, it is very difficult to see how the requirement for a presentation of satisfactory identification is relevant to a small company, as shareholders of a small company will in most likelihood know the identification of each other very well. As a result, it is submitted that the requirement to present satisfactory identification to the presiding person in

[190] S 57(4)(b) of the Companies Act.
[191] S 64(1)(a) of the Companies Act.
[192] S 64(1)(b) of the Companies Act.
[193] S 64(2) of the Companies Act.
[194] S 64(3) of the Companies Act.
[195] S 63(1)(a) of the Companies Act.
[196] S 63(1)(b) of the Companies Act.

a shareholders meeting is useless to a small business and is only relevant to a large business which has many shareholders who do not know each other.

Once a shareholders meeting quorum or the quorum of a matter to be considered at a shareholders meeting, has been established, unless if the private company's MOI or rules provide otherwise, a shareholders 'meeting may continue or the matter may be considered, so long as at least one shareholder with voting rights entitled to be exercised at the shareholders meeting or on that matter, is present at meeting'.[197]

However, if a private company has only one shareholder then sections 59 to 65 of the Companies Act will not apply.[198] For example, this means that the abovementioned requirements relating to identity, meeting quorum and an adjournment will not be applicable to private companies which only have one shareholder.[199]

According to the case of *ABSA Bank Limited v Eagle Creek Investments 490 (Pty) Ltd*[200] it has been accepted that shareholders do not owe a fiduciary duty towards the private company in which they hold shares.[201] However, as already shown in this chapter, there are situations in which the Companies Act allows only shareholders to make decisions which can positively or negatively impact the private company.[202]

In this same vein and because of potential conflicts and abuse which may exist between shareholders, in particular between majority shareholders (indirectly the private company) and minority or dissenting shareholders, it can be argued that the shareholders owe some sort of a fiduciary duty towards each other (and possibly directors) in order to make sure that there is no intentional prejudicial conduct committed.[203]

3.2 DUTIES OF DIRECTORS OF A PRIVATE COMPANY IN TERMS OF THE COMPANIES ACT

Under the Companies Act the business and affairs of a private company must be managed by or under the direction of the private company's board of directors, which subject to the MOI

[197] S 64(9) of the Companies Act.
[198] S 57(2)(b) of the Companies Act.
[199] S 57(2)(b) of the Companies Act.
[200] 2014 ZAWCHC.
[201] *ABSA Bank Limited v Eagle Creek Investments 490 (Pty) Ltd* 2014 ZAWCHC at paras 25 and 26 read with para 38.
[202] S 20(2), s 57 and s 64 of the Companies Act.
[203] S 163 and s 164 of the Companies Act.

has the authority to exercise all powers and perform any functions of the company.[204] Consequently the board of a private company must consist of at least one director in addition to the minimum number of directors that the private company must have in order to meet any requirement either in terms of the Companies Act or the private company's MOI, to appoint an audit committee, or a social and ethics committee as contemplated in s 72(4) of the Companies Act.[205] However, the private company's MOI may provide for a higher number of directors in substitution for the minimum number of one director as required by the Companies Act.[206]

It must be noted that a person will not qualify to be a director if they are: '(a) a juristic person; (b) an emancipated minor or under a similar legal disability; or (c) ineligible in terms of the requirements set out in the company's MOI'.[207]

In addition, a person will be disqualified to be a director if they:

> '(i) have been prohibited by a court or declared to be delinquent in terms of the Companies Act or the Close Corporations Act; or
>
> (ii) are an unrehabilitated insolvent;
>
> (iii) have been prohibited by public regulation from being a director;
>
> (iv) have been criminally convicted in South Africa or another country, and imprisoned without an option of a fine, or fined more than the prescribed amount for theft, fraud, forgery, perjury or an offence –
>
> > (1) involving fraud, misrepresentation or dishonesty;
> >
> > (2) connected to the promotion, formation or management of a company, or connected with being placed under probation by a court in terms of the Companies Act or the Close Corporations Act; or
> >
> > (3) falling under the Companies Act, the Insolvency Act No. 24 of 1936 (Insolvency Act), the Close Corporations Act, the Competition Act No. 89 of 1998 (Competition Act), the Financial Intelligence Centre Act No. 36 of 2004

[204] S 66(1) of the Companies Act.
[205] S 66(2)(a) of the Companies Act.
[206] S 66(3) of the Companies Act.
[207] S 69(7) of the Companies Act.

(FICA), the Securities Services Act No. 36 of 2004 (SSA) or the Prevention and Combating of Corruption Activities Act No. 12 of 2004 (PCCA Act)'.[208]

However, the disqualification status of a director will terminate after: '(a) five years after the date of removal from office or the completion of the sentence imposed for the relevant offence; or (b) at the end of one or more extensions determined by a court [which cannot be more than five years] from time to time, on application by the [CIPC in terms of the Companies Act]'.[209]

The Companies Act permits non-compliance in certain instances where a private company has only one director; as such a single 'director may exercise any power or perform any function of the board at any time, without notice or compliance with any other internal formalities, except to the extent provided for in the private company's MOI'.[210] In addition, if a private company has only one director then the private company will be exempt from the requirements set out sections 71(3) to (7) (removal of directors where a company has more than two director), s 73 (board meetings) and s 74 (directors acting other than at meeting) of the Companies Act.[211]

A director who is authorised by the board of a private company is mandatorily required to call a board meeting if the board meeting is required by at least two directors of the private company.[212] However, the private company's MOI may specify a higher or lower number than the statutory minimum requirement of two directors in order to mandatorily call a board meeting.[213] Alternatively, a director (authorised by the board) may call for a board meeting at any time.[214]

Subject to what is stated in the private company's MOI, the general rule is that the 'majority of the directors must be present at a board meeting before any vote may be called at a

[208] S 69(8) of the Companies Act.
[209] S 69(9) of the Companies Act. S 69(10) of the Companies Act provides that after an application for extension by CIPC, a court will only grant an extension of no more than 5 years if the court after having regard to the conduct of the disqualified person at the time of application is satisfied that such an extension is necessary to protect the public.
[210] S 57(3)(a) of the Companies Act.
[211] S 57(3)(b) of the Companies Act.
[212] S 73(1)(b) of the Companies Act.
[213] S 73(2) of the Companies Act.
[214] S 73(1)(a) of the Companies Act.

directors meeting; and each director must have one vote on a matter before the board of the private company'.[215]

In terms of s 75(5) of the Companies Act if a director of a private company

> 'has a personal financial interest in a matter to be considered at a board meeting or knows that a related person has a financial interest in the matter, then the director:
>
> (a) must disclose the interest and its general nature before the matter is considered at the board meeting;
>
> (b) must disclose any material information relating to the matter and known to such director, at the board meeting;
>
> (c) may disclose any observations or pertinent insights relating to the matter if requested to do so by other directors;
>
> (d) if present at the board meeting, must leave the board meeting immediately, after making the disclosure of any material information relating to the matter and known to the director and/or after making a disclosure of any observations or pertinent insights relating to the matter (if requested to do so by other directors);
>
> (e) must not participate in the consideration of the matter, except to the extent contemplated in the above points (b) and (c);
>
> (f) while absent from the board meeting in terms of s 75(5) of the Companies Act
>
> > (i) must be regarded as being present at the board meeting for the purpose of determining whether sufficient directors are present constitute the board meeting; and
> >
> > (ii) the director must not be regarded as being present at the board meeting for the purpose of determining whether a resolution has sufficient support to be adopted; and
>
> (g) unless specifically requested or directed to do so by the board, must not execute any document on behalf of the private company in relation to the matter'.[216]

Consequently, it is important to note that s 1 of the Companies Act defines a 'personal financial interest' as a

[215] S 73(5)(b) and (c) of the Companies Act.
[216] S 75(5) of the Companies Act.

> 'direct material interest of that person, of a financial, monetary or economic nature, or to which a monetary value may be attributed but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act No. 45 of 2002, unless that person has direct control over the investment decisions of that fund or investment'.[217]

In addition s 1 read with s 2(1) of the Companies Act further crystalizes the situation of when an individual will be related to another individual by providing examples such as when: '(i) individuals are married to each other or live together in a relationship similar to a marriage; or (ii) individuals are separated by no more than two degrees of natural or adopted consanguinity or affinity'.[218] In this regard, an individual will be related to a juristic person 'if such individual directly or indirectly controls the juristic person'.[219]

Finally, juristic persons will be considered to be related to each other if: '(a) either of them directly or indirectly controls the other or the business of the other; or (b) either of them is a subsidiary; or (c) a person directly or indirectly controls each of them or the business of each of them'.[220]

Under the Companies Act, a director of a private company is required to disclose straightaway to the board, or to the shareholders of a private company which consists of a director who does not hold all of the beneficial interests in the issued securities,

> 'the nature and extent of his or her personal financial interest, and the material circumstances relating to the director or a related person's acquisition of the personal financial interest; if the director acquires a personal financial interest in an agreement or a matter in which the private company has a material interest, or knows that a related person has acquired a personal financial interest in the matter, after the agreement or the matter has been approved by the private company'.[221]

However, the Companies Act provides for an exemption on the applicability of s 75 which relates to a director's personal financial interest, if the director's decision 'may generally affect all of the directors of the private company in their capacity as directors; or if the director's decision may generally affect a class of persons, despite the fact that the director is

[217] S 1 of the Companies Act.
[218] S 1 read with s 2(1)(a) of the Companies Act.
[219] S 1 read with s 2(1)(b) of the Companies Act.
[220] S 1 read with s 2(1)(c) of the Companies Act.
[221] S 75(6) of the Companies Act.

one member of that affected class of persons, unless the only members of the class are the director or persons related or inter-related to the director'.[222]

Furthermore, the director's personal financial interest provision will not apply to a director of a private company if there is a 'proposal to remove that director from office as contemplated in s 71 of the Companies Act'.[223]

Moreover, the director's personal financial interest provision (s 75 of the Companies Act) will not be applicable to a private 'company or its directors if one person holds all of the beneficial interests of all the issued securities of the private company, and such person is also the only director of the private company'.[224]

The Companies Act imposes fiduciary duties on a director of a private company, which include the fiduciary duty of a director

> 'not to use his or her position of director, or any information obtained while acting as a director to: (i) gain an advantage for himself or herself, or for another person other than the private company or a wholly-owned subsidiary of the private company; or (ii) knowingly cause harm to the private company or a subsidiary of the private company'.[225]

Furthermore, the second set of the statutory fiduciary duties requires a director of a private company to 'communicate to the board of the private company (as soon as possible) any information which comes to the director's attention, unless the director: (a) reasonably believes that the information is immaterial to the private company or the information is public knowledge or is known by other directors; or (b) is legally or ethically bound not to disclose information which is considered to be confidential'.[226]

Whilst a third set of the statutory fiduciary duties, which incorporates the duty for care, skill and diligence, requires directors who act in their capacity as directors,

> 'to exercise their powers or perform their functions:
>
> (i) in good faith and for a proper purpose;
> (ii) in the best interest of the private company; and

[222] S 75(2)(a)(i) of the Companies Act.
[223] S 75(2)(a)(ii) of the Companies Act.
[224] S 75(2)(b) of the Companies Act.
[225] S 76(2)(a) of the Companies Act.
[226] S 76(2)(b) of the Companies Act.

(iii) with the requisite degree of care, skill and diligence that may be reasonably expected of a person who carries out the same functions in relation to the private company as those of the director; taking into account the general knowledge, skill and experience of that particular director'.[227]

However, the aforementioned three sets of statutory fiduciary duties (which includes the built-in duty of care, skill and diligence) are be subject to s 76(4) and (5) of the Companies Act.[228]

Consequently, a director who has been accused of breaching any one of the three fiduciary duties already mentioned in the third set of the fiduciary duties will be exonerated by s 76(4)(a) of the Companies Act if such director can prove that:

> '(a) s/he has taken reasonably diligent steps to become informed about the matter; (b) s/he had no personal financial interest in the matter, and had no reasonable basis to know that a related person had a personal financial interest in the matter or the director complied with the requirements of s 75 of the Companies Act (director's personal financial interest provision) with respect to any interest referring to personal financial interest or the reasonable basis to know that any related person had a financial interest; and (c) s/he made a decision, or supported the decision of a committee or the board with regard to the matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interest of the private company'.[229]

In addition, the Companies Act will consider a director to have complied with the statutory fiduciary duties to exercise power and perform functions as a director in 'good faith and for a proper purpose, in the best interest of the private company'; and with the requisite 'degree of care, skill and diligence' if the director relied on:

> '(i) the performance of any people referred to in s 76(5) of the Companies Act or any people to whom the board may reasonably have delegated (formally or informally by way of conduct) the authority or duty to perform one or more of the board's functions that are delegable under law; and

[227] S 76(3) of the Companies Act.
[228] S 76(3) of the Companies Act.
[229] S 76(4)(a) of the Companies Act.

(ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any person referred to in s 76(5) of the Companies Act'.[230]

In this regard, the list of people specified in s 76(5) of the Companies Act whom a director can rely on, include:

'(i) the employees of the private company whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;

(ii) legal counsel, accountants, or other professional persons retained by the private company, the board or a committee as to matters involving skills or expertise that the director reasonably believes are matters: (aa) within the particular person's professional or expert competence; or (bb) which the particular person merits confidence; or

(iii) a committee of the board of which the director is not a member, unless the director has reason to believe that the actions of the committee do not merit confidence'.[231]

It is important to note that a director of a private company will attract personal liability if a delictual claim is brought on the basis of a breach of a 'provision of the Companies Act, the private company's MOI, or a breach of the fiduciary duty to exercise the requisite skill, care and diligence'.[232]

Following the above mentioned consequences, a director of a private company will also attract personal liability for 'any loss, damage or costs incurred by the private company as a direct or indirect result of the director having being present at a board meeting but failing to vote against a harmful decision or action which results in a breach of a provision of the Companies Act, the private company's MOI, or a breach of the fiduciary duty to exercise the requisite skill, care and diligence'.[233]

However, unless the proceedings are for 'wilful misconduct or wilful breach of trust, a director of a private company may ask the court to partially or wholly relieve him or her from personal liability'.[234] In order for this application to be successful, the court will need to be satisfied that: '(a) the director acted reasonably and honestly regardless of the fact that the

[230] S 76(4)(b) of the Companies Act.
[231] S 76(5) of the Companies Act.
[232] S 77(2)(b) of the Companies Act.
[233] S 77(3)(e) of the companies Act.
[234] S 77(9) of the Companies Act.

director is or may be liable; or (b) it would be fair to excuse the director, having regard to the particular circumstances of the case (including those connected to the director of the private company)'.[235]

The statutory fiduciary duties of directors or the liability of a director cannot be expressly or impliedly excluded by an agreement, the private company's MOI or rules, or a resolution adopted by the company, as such action(s) will be treated as void.[236] Furthermore, no provision in an agreement or the private company's MOI or rules or resolution may be expressly or impliedly invalidate, limit or restrict any legal consequences emanating from an 'act or omission that constitutes a wilful misconduct or wilful breach of trust on the part of the director of a private company'.[237]

3.3 DUTIES OF MEMBERS IN TERMS OF THE CLOSE CORPORATIONS ACT

Members of a close corporation inherently wear the cap of a shareholder and the cap of a director as they are equity owners in the close corporation and are also entitled to participate in the carrying on of the business of the close corporation.[238] Furthermore, members of a close corporation have equal rights in the management of the close corporation and the power to represent the close corporation in the carrying on of its business.[239]

Upon registration of a close corporation, every prospective member must make an initial contribution to the close corporation in the form of money, corporeal or incorporeal property, services rendered with and for the purpose of the formation and incorporation of the close corporation.[240] This is indeed a unique requirement to limited liability entities as the Companies Act does not expressly require the shareholders of a private company to make an initial capital contribution either by way of money, property or services rendered.[241] However, the aforementioned initial contribution requirement is not totally new to South

[235] S 77(9) of the Companies Act.
[236] S 78(2)(a) and (b) of the Companies Act.
[237] S 78(2)(b) of the Companies Act.
[238] S 30 of the Close Corporations Act read with s 46 of the Close Corporations Act. JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science* 40(1): 19-34.
[239] S 46(2) of the Close Corporations Act. JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science* 40(1): 19-34.
[240] S 24(1) of the Close Corporations Act.
[241] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science* 40(1): 19-34.

African business law as it is borrowed from the requirement of forming a partnership in South Africa.[242]

It appears that the close corporation initial contribution requirement is in line with the philosophy of the Close Corporations Act of having a close-knit corporation where every participant/member contributes in one way or another to the corporation.[243]

In this regard, the contribution of each member or the amount or value of the members' contribution may by agreement of all the members of the close corporation: '(i) be increased by additional contributions of money and/or property (corporeal or incorporeal) to the close corporation by existing members or by a prospective member of a registered close corporation in terms of s 33(1)(b) of the Close Corporations Act;[244] and (ii) reduced (provided that a reduction by way of repayment to any member of the close corporation is in line with s 51(1) of the Close Corporations Act)'.[245]

As previously mentioned, the Close Corporations Act only permits natural persons or a juristic person who is a trustee of a testamentary trust *(inter vivos*), and who is entitled to a member's interest,[246] to be a member of a close corporation, provided that:

> '(a) no juristic person is a beneficiary of that trust;
>
> (b) if a trustee is a juristic person then such juristic person shall not be directly or indirectly controlled by any beneficiary of the trust;
>
> (c) no juristic person is directly or indirectly a beneficiary of such trust;
>
> (d) the concerned member shall ensure as between himself or herself and the close corporation that s/he has all rights and obligations of a member;

[242] De Waal, M 'The essentialia of partnerships' available at https://mdwinc.co.za/2012/03/30/the-essentialia-of-partnerships/, accessed on 7 June 2019.
[243] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 464. JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science* 40(1): 19-34.
[244] S 3(1)(b) of the Close Corporations Act requires a prospective member of a registered close corporation to acquire his or her member's interest required for membership pursuant to a contribution made by such prospective member to the close corporation, in which case the percentage of his or her member's interest will be determined by an agreement between him or her and the existing members of the close corporation, and the percentages of the interests of the existing members in the close corporation shall be reduced in terms of s 38(b) of the Close Corporations Act.
[245] S 24(2) of the Close Corporations Act.
[246] S 1 of the Close Corporations Act defines "member's interest" as interest of a member of a close corporation which is expressed as an (equity) percentage in the founding statement of the close corporation.

(e) the close corporation shall not be obliged to observe or have any obligation with regards to any provision of or affecting the trust or any agreement between the trust and the concerned member of the close corporation; and

(f) if the number of natural persons (at any time) entitled to receive any benefit from the trust exceed 10 (when added to the number of members of the close corporation), the provisions of, and the exemption under the Close Corporations Act shall not apply regardless of any diminution in the number of members or beneficiaries'.[247]

Furthermore, a natural or juristic person (including a *nomine officii*) will also qualify to be a member of a close corporation if such natural or juristic person is a trustee, an administrator, an executor, a curator or a duly appointed or authorized legal representative of a member who is insolvent, deceased, mentally disordered, incapable or incompetent to manage his or her own affairs.[248]

However, two or more people will not be allowed to be joint holders of the same member's interest of a close corporation.[249] In addition, a person who is disqualified from being a director of a company in terms of the Companies Act will also be disqualified from participating in the management of the close corporation.[250] But a person who is disqualified from being a director in terms of the Companies Act may still participate in the management of a close corporation if such disqualified person holds '100 per cent of the members' interest in the close corporation; or if such disqualified person and other people who are related to the disqualified person, each consent in writing that the disqualified person participate in the management of the close corporation'.[251]

The Close Corporations Act views members of a close corporation as fiduciaries who owe a statutory fiduciary duty to the close corporation to: '(a) act honestly and in good faith by exercising the powers to manage or represent the close corporation in the interest and for the benefit of the close corporation, and not to act without or exceed such powers to manage or represent the close corporation'; (b) avoid a material conflict of interest between the concerned member of the close corporation and the close corporation, by not using his or her membership of or service to the close corporation to usurp an economic benefit which belongs to the close corporation for his or her personal gain; if direct or indirect material

[247] S 29(1), (1A) and (2) of the Close Corporations Act.
[248] S 29(2)(c) of the Close Corporations Act.
[249] S 30(2) of the Close Corporations Act.
[250] S 47(1)(c) of the Close Corporations Act.
[251] S 47(1B) of the Close Corporations Act.

interest does arise then the concerned member must notify all of the members of the close corporation '(at the earliest practicable opportunity in the circumstances)' of such material interest he or she may have in any contract of the close corporation; and a member of a close corporation must not compete in any way with the business of the close corporation.[252]

Consequently, a member who breaches their fiduciary duty by an act or omission will be held liable: (i) for any loss suffered by the close corporation as result of such breach; or (ii) for any economic profit or benefit derived by the member as a result of a breach of a fiduciary duty.[253]

Should a member of a close corporation breach the statutory fiduciary duty to disclose a direct or indirect material interest to all the other members of the close corporation, with regards to any contract of the close corporation, then the said contract will become voidable at the option of the close corporation; however, where the close corporation elects not to be bound, 'a court may on application by any interested person, if the court is of the opinion that in the circumstances it is fair to order that such contract shall nevertheless be binding on the parties, give an order to that effect, and may make any further order in respect thereof which it may deem fit'.[254]

Subject to the statutory fiduciary duty to act honestly and in good faith by exercising the powers to manage or represent the close corporation in the interest and for the benefit of the close corporation, any member's conduct will not amount to a breach of a fiduciary duty if such conduct was preceded or followed by a written approval of all members of a close corporation where such members were or are aware of all the material facts.[255]

In addition to the already mentioned fiduciary duties of members and similarly to director's fiduciary duties under the Companies Act, the Close Corporations Act also requires members to act with the reasonable care and skill of a person with the same experience and knowledge, when the member of the close corporation carries on the business of the close corporation, otherwise the member will be liable for any harm suffered and caused by the failure to act with reasonable care and skill.[256] However the Close Corporations Act provides a safety net as a member will not be liable for the failure to act with reasonable skill and care if the

[252] S 42(1) and (2) of the Close Corporations Act.
[253] S 42(3)(a) of the Close Corporations Act.
[254] S 42(3)(b) of the Close Corporations Act.
[255] S 42(4) of the Close Corporations Act.
[256] S 43(1) of the Close Corporations Act.

member's conduct was preceded or followed by written approval of all the members of the close corporation where such members were or are aware of all the material facts.[257]

Moreover, the Close Corporations Act allows a member of a close corporation to call a members meeting if such member provides a notice to every other member of the close corporation of the purpose of the members meeting.[258] Consequently, unless an association agreement provides otherwise, a members meeting notice must stipulate a reasonable date and time for the meeting and must stipulate a venue which is reasonably suitable for all attendees of the meeting.[259] The quorum for a members meeting will be satisfied if three-quarters of the members are present at the members meeting unless an association agreement provides otherwise.[260]

3.4 COMMENTARY

Unlike members of a close corporation, shareholders of a private company do not owe a fiduciary duty to the company/corporation.[261] At first blush, it appears to be more convenient to be a shareholder of private company than to be a member of a close corporation; however it must be noted that the position of a member of a close corporation is *sui generis* as a member of a close corporation occupies the position of shareholder and director.[262]

As a result, the member's statutory fiduciary duties under the Close Corporations Act appear to emanate more on the managerial side of the member's functions.[263] This means that it is not more burdensome to be a shareholder of a private company under the Companies Act than it is to be a member of a close corporation under the Close Corporations Act.

When contrasted with the Companies Act, the Close Corporations Act gives a disqualified person a second chance with regards to owning and managing a business provided that the disqualified person holds 100 per cent of the member's interest or has received written consent from the other members of the close corporation to participate in the management of

[257] S 43(2) of the Close Corporations Act.
[258] S 48(1) of the Close Corporations Act.
[259] S 48(2)(a) of the Close Corporations Act.
[260] S 48(2)(b) of the Close Corporations Act.
[261] ABSA Bank Limited v Eagle Creek Investments 490 (Pty) Ltd 2014 ZAWCHC at paragraph 25 and 26 read with paragraph 38. S 42(1) and (2) of the Close Corporations Act.
[262] S 30 of the Close Corporations Act read with s 46(1) of the Close Corporations Act. JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34.
[263] S 42(1) and (2) of the Close Corporations Act contrasted with s 75 and s 76 of the Companies Act.

the close corporation.[264] For example this means that under the Close Corporations Act an ex-convict or an insolvent person who cannot obtain employment is given a second chance in life by making their own business/employment.[265] It is submitted that this is good insofar as giving the disqualified person a second chance in life and an opportunity to participate in the economy which will promote one's constitutional right to dignity[266] and also yield tax revenue for the South African government. However, it may also be a concern for the stakeholders of a close corporation, such as creditors, as they do not have the power to make a member disclose, for instance, if a member has been insolvent or if a member was convicted of a crime related to dishonesty or theft.[267]

It is conceded that the statutory fiduciary duties of a director of a private company are very similar with the statutory fiduciary duties of a member of a close corporation.[268] For example both directors of a private company and members of a close corporation share the statutory fiduciary duties of exercising power and performing functions in good faith, honestly and for a proper purpose.[269] Both director(s) and member(s) are required not to use their position or information obtained as a result of their office for their personal gain at the expense of the private company or the close corporation (this duty includes the avoidance of a conflict of interest by a director or member with the private company or close corporation).[270] Finally, directors and members are also both required to act with the requisite degree of care and skill (although the Companies Act goes further by requiring diligence) of a director or member who has the same experience or knowledge, when such directors or members are performing their functions as directors or members.[271]

However, unlike the Companies Act, the Close Corporations Act appears to not expressly allow members of a close corporation for example to rely on legal counsel, accountants and other professional persons in order for members to be exonerated from charges relating to a breach of their fiduciary duties.[272]

[264] S 69(7), s 69(9) of the Companies Act read with s 47(1B) of the Close Corporations Act.
[265] S 47(1B) of the Close Corporations Act.
[266] S 10 of the Constitution.
[267] S 47(1)(c) of the Close Corporations Act.
[268] S 76(2) and s 76(3) of the Companies Act read with s 42(2) of the Close Corporations Act.
[269] S 76(3)(a) of the Companies Act read with s 42(2)(a) of the Close Corporations Act.
[270] S 76(2) of the Companies Act read with s 42(2)(b) of the Close Corporations Act.
[271] S 76(3)(c) of the Companies Act read with s 43(1) of the Close Corporations Act.
[272] S 76(5) of the Companies Act contrasted with s 42(4) and 43(2) of the Close Corporations Act.

Furthermore, although a meeting quorum can be altered by agreement, the statutory requirement of a quorum for a valid meeting (75 per cent of the close corporation's members) is higher under the Close Corporations Act than the Companies Act (25 per cent of shareholders who can exercise voting rights).[273] It is also interesting to note that unlike the Companies Act (presence of 25 per cent of shareholders who can vote on that matter), the Close Corporations Act does not have a statutory quorum requirement for matters to be considered on the agenda of a members meeting.[274]

3.5 CONCLUSION

The duties of members under the Close Corporations Act are very similar to the duties of directors under the Companies Act. Furthermore, insofar as ownership is concerned, the duties of members under the Close Corporations Act are also very similar to the duties of shareholders under the Companies Act.

It can be argued that the statutory fiduciary duties for members of a close corporation may be unnecessary for a small business entity as in most cases the owners of small business entities know each other very well (as such entities usually include family businesses) and usually require flexibility and simple business strategies/models.[275] However, one may also argue that the statutory duties of members, which have been borrowed from the Companies Act and incorporated in the Close Corporations Act, as well as the statutory duties of directors in the Companies Act cater for the scalability of a business entity which graduates from a small business entity to a medium and large business entity.[276]

[273] S 64(1)(a) of the Companies Act read with s 48(2)(b) of the Close Corporations Act.
[274] S 64(1)(b) of the Companies Act contrasted with s 48(1) of the Close Corporations Act.
[275] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 33.
[276] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42.

CHAPTER 4: CHARACTERISTICS OF A PRIVATE COMPANY AND CLOSE CORPORATION

4.1 INTRODUCTION

In the quest to determine whether the Companies Act adequately caters for small business entities in comparison to the Close Corporations Act, in the previous chapter this dissertation dealt with the determination of whether it is more difficult to be a shareholder and/or a director under the Companies Act than to be a member under the Close Corporations Act.

In continuation of the quest to determine whether the Companies Act adequately caters for small business entities in comparison to the Close Corporations Act, this chapter will determine whether a private company under the Companies Act has more burdensome obligations than a close corporation under the Close Corporations Act.

4.2 CHARACTERISTICS OF A PRIVATE COMPANY

4.2.1 Notice requirements

In terms of meeting notices, the Companies Act requires a private company to deliver a shareholder meeting notice to each shareholder of the private company at least 10 business days[277] before the proposed meeting is scheduled to begin.[278]

However, a private company's 'MOI may provide for a longer or shorter minimum shareholders' meeting notice period than that required by the Companies Act'.[279] Furthermore the Companies Act provides for a further exception to meeting notices by stating that a 'private company may call a shareholders meeting within less than the 10 business days' standard notice required by the Companies Act or the meeting notice period required by the MOI; on condition that that every person or shareholder who is entitled to exercise voting

[277] S 1 read with s 5(3) of the Companies Act defines "business days" as: (i) excluding the day on which the first event occurs; and including the day on by which the second event occurs; and (iii) excluding any public holiday, Saturday and Sunday.
[278] S 62(1)(b) of the Companies Act.
[279] S 62(2) of the Companies Act.

rights in respect of any item on the meeting agenda is present at the meeting and votes to waive the required minimum notice of the meeting'.[280]

The Companies Act places certain requirements on shareholders' meeting notices, such as having in writing and including the following information:

> '(i) the date, time and place for the shareholders meeting;
>
> (ii) the record date for the shareholders meeting;
>
> (iii) the general purpose of the shareholders meeting, and any specific purpose contemplated in a s 61(3)(a) of the Companies Act (written and signed shareholders meeting demand), if applicable;
>
> (iv) a copy of any proposed resolution which the private company has received notice of, and which is to be considered at the shareholders meeting;
>
> (v) a notice of the percentage of the voting rights that will be required for the proposed resolution to be adopted; and
>
> (vi) a reasonably prominent statement that:
>
> > (1) a shareholder entitled to attend and vote at the shareholders meeting is permitted to appoint a proxy to attend, participate in and vote at the shareholders meeting in substitution of the shareholder, or two or more proxies if the MOI of the private company so allows;
> >
> > (2) a proxy does not need to be a shareholder of the private company; and
> >
> > (3) satisfactory identification of the shareholders' meeting participants'.[281]

In the event of a shareholders meeting of a private company, a written shareholders meeting notice must include: '(a) the financial statements to be presented or a summarised form [of such financial statements]; and (b) the directions for obtaining a copy of the complete annual financial statements for the preceding year'.[282]

However, if there is a material defect in the giving of the shareholders meeting notice, the shareholders meeting may proceed only if every shareholder or proxy who is entitled to exercise voting rights on any item on the shareholders meeting agenda is present at the

[280] S 62(2A) of the Companies Act.
[281] S 62(3)(a) to s 62(3)(c) of the Companies Act read with s 63(1) of the Companies Act.
[282] S 62(3)(d) of the Companies Act.

shareholders meeting and votes in favour of the ratification of the defective shareholders meeting notice.[283]

If a private company has only one shareholder then s 59 to s 65 (shareholder meeting and shareholder resolution provisions) of the Companies Act will not apply.[284] For example, this means that the requirements of a meeting quorum and an adjournment will not be applicable to private companies which only have one shareholder.[285]

The members meeting notice requirements of a close corporations are very lax if compared to the meeting notice requirements of a private company.[286] For instance any member of a close corporation may call for a meeting by only sending a notice to every other member of the close corporation.[287]

Furthermore, unless the an association agreement states otherwise, only one thing is required to be included in a members' meeting notice if compared to the six items which must be included in shareholders' meeting notices for private company.[288] The only thing which must be included in a members' meeting notice is the details pertaining to a fix reasonable date, time and a reasonably suitable venue.[289]

4.2.2 Ethics committee

A private company may be required to have a social and ethics committee if it is desirable in the public interest having regard to the private company's: '(i) annual turnover; (ii) workforce size; or (iii) the nature and extent of the activities of the private company'.[290]

However, a private company which is required to have a social and ethics committee may apply to the Tribunal for an exemption to have a social and ethics committee.[291] Consequently, if the Tribunal grants an exemption then such exemption will be valid for 5 years or such shorter period determined by the Tribunal.[292]

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[283] S 62(4) of the Companies Act.
[284] S 57(2)(b) of the Companies Act.
[285] S 57(2)(b) of the Companies Act.
[286] S 48(1) and (2) of the Close Corporations Act.
[287] S 48(1) of the Close Corporations Act.
[288] S 48(2) for the Close Corporations Act contrasted with S 62(3)(a) to s 62(3)(c) of the Companies Act read with s 63(1) of the Companies Act.
[289] S 48(2)(a) of the Close Corporations Act.
[290] S 72(4)(a) of the Companies Act.
[291] S 72(5) of the Companies Act.
[292] S 72(6) of the Companies Act.

In this regard, a Tribunal may only grant an exemption for a social and ethics committee if it is satisfied that the private company is required by other law to have, and does have an alternative formal mechanism within its structures that substantially performs the same function as a social and ethics committee in terms of s 72 of the Companies Act and the regulations of the Companies Act.[293] The Tribunal may also only grant an exemption for a social and ethics committee if it is satisfied that '(having regard to the private company's nature and extent of activities) it is not reasonably necessary in the public interest to require the private company to have a social and ethics committee'.[294]

Should the private company not be granted an exemption by the Tribunal, the private company will be required to pay for all expenses reasonably incurred by the social and ethics committee, which may include costs or fees of any consultant or specialist used by the social and ethics committee in the performance of the social and ethics committee's functions.[295]

4.2.3 Board meetings

No board meeting may be convened if the private company (through its board) has not provided notice to all of the directors.[296] However subject to what is stated in private company's MOI, a board meeting may be convened even if the private company failed to give the required notice of the board meeting, or there was a defect in the giving of the notice, on condition that all the directors of the private company: '(i) acknowledge actual receipt of the required board meeting notice; (ii) are present at the board meeting; or (iii) waive the required notice of the board meeting'.[297]

A private company is required to keep minutes of the board meetings and any of the company's committees, and such minutes must include: (a) any declaration given by notice or made by a director as required by s 75 of the Companies Act (director's personal financial interest); and (b) every resolution adopted by the board.[298]

4.3 CHARACTERISTICS OF A CLOSE CORPORATION

[293] S 72(5)(a) of the Companies Act.
[294] S 72(5)(b) of the Companies Act.
[295] S 72(9) of the Companies Act.
[296] S 73(4)(b) of the Companies Act.
[297] S 73(5)(a) of the Companies Act.
[298] S 73(6) of the Companies Act.

4.3.1 Founding documents and address

A close corporation is required to keep its founding statement and any proof of the close corporation's registration at its registered office.[299] The close corporation's founding statement or any proof of the close corporation's registration must be open to inspection by any person during the business hours of the close corporation upon payment to the close corporation, of which must be R1 (or a lesser amount determined by the close corporation) for a person who is a non-member of the close corporation.[300] If contrasted to the Companies Act, this requirement to keep a founding statement open for inspection is unique as a private company under the Companies Act is not required to keep its MOI open for public inspection.[301] However, one may argue that the reason that a private company is not required under the Companies Act to keep its MOI open for public inspection is because such document can easily be requested from the private company. Alternatively, the most important details of a private company can be obtained from the official CIPC website.

The advantage of a legal entity having its founding statement or MOI open for public inspection is that it promotes transparency as the party who deals with the legal entity is able to know the authoritative limitations of the legal entity which it intends to do business with.[302] However, the disadvantage may be that a person who is irrelevant to the legal entity will get to know some of the intimate details of the legal entity which the legal entity may not want to disclose to any person.[303]

In addition, every close corporation is required to have an office and a postal address where all communications and notices may be sent to.[304] Furthermore, close corporations are required to record a report of the proceedings at the members meeting in a minute book, within 14 days after the date of which the members meeting was held.[305]

4.3.2 Accounting records

[299] S 16(1) of the Close Corporations Act.
[300] S 16(2) of the Close Corporations Act.
[301] S 15 of the Companies Act.
[302] FHI Cassim *et al Contemporary Company Law* 2nd Ed Cape Town: Juta, (2012) 14.
[303] Ibid 14.
[304] S 25(1) of the Close Corporations Act.
[305] S 48(3)(a) of the Close Corporations Act.

A close corporation must also keep accounting records which represent the state of affairs and business of the close corporation.[306] Consequently these accounting records are required to be in one of the official South African languages and must explain the transactions and the financial position of the close corporation, including: '(i) the records showing the close corporation's assets and liabilities, members' contributions, undrawn economic profits, revaluations of the close corporation's fixed assets and amounts of loans to and from the members of the close corporation; (ii) a register of the close corporation's fixed assets which show the dates of any acquisition and the cost of the fixed assets, depreciation of the fixed assets (if any), and whether any assets have been revalued, the date of the revaluation and the revalued amount of the asset(s), the dates of any disposals and the consideration received; (iii) the records containing entries of daily cash received and paid, in enough detail to allow the nature of the transactions and the names of the parties to the transactions to be identified (except in the case of cash sales); (iv) the records of all goods sold and purchased on credit by the close corporation, and the services received and rendered on credit by the close corporation, in enough detail to allow the nature of such goods or services and the parties to the transaction to be identified; (v) annual statements of the close corporation's stocktaking, and records which enable the value of the stock to be determined at the end of the financial year of the close corporation; and (vi) the vouchers which support the entries in the accounting records of the close corporation'.[307]

Interestingly, the Companies Act has the same mandatory requirement for private companies and actually demands more details from the accounting records of private companies than the details requested from the accounting records of close corporations.[308] Some of the details required in the accounting records of close corporations and private companies, such as revaluations of the legal entities' fixed assets, do not appear to be details which a layman can produce. As a result, the requirement to have the accounting records prepared to such detail will be burdensome to a small business as it will have to hire an accounting professional in order to obtain such information. This means that it can be a costly exercise for a small business to comply with both the Close Corporations Act and the Companies Act.

The accounting records must be kept in a manner which provides for adequate precautions against falsification and the facilitation of the discovery of any falsification of the close

[306] S 56(1) of the Close Corporations Act.
[307] S 56(1) of the Close Corporations Act.
[308] S 28 of the Companies Act read with Regulation 25 of the Companies Act.

corporation's accounting records.[309] Furthermore, the close corporation's accounting records must be kept at the business place(s) or the registered office of the close corporation, where it must be kept open for inspection by any member of the close corporation at all reasonable times.[310]

The accounting records which relate to the contribution by the close corporation's members, loans to and from the close corporation's members and payments to the close corporation's members, must have enough detail of individual transactions to enable the nature and purpose of the transactions to be clearly identified.[311] This disclosure requirement is welcomed as it encourages transparency which ultimately results in clean governance and enables the prospective member of the business to have an x-ray view of the financial dealings by the existing members of the business.[312]

If a close corporation fails to comply with the provisions which relate to the accounting records, then every member of the close corporation who is a party to such non-compliance or who fails to take reasonable steps to secure compliance by the close corporation with any such provision, will be guilty of an offence.[313] Consequently, in proceedings which relate to an offence of a failure to take reasonable steps to ensure compliance by a close corporation with the provisions dealing with accounting records, an accused member who can prove that they had reasonable belief and did believe that a competent and reliable person was charged with the duty of seeing any provision (of the Close Corporations Act) dealing with accounting records was complied with, and that such person was in a position to discharge such duty, and the accused members had no reason to believe that such person in any way failed to discharge that duty, will be entitled to use such proof as a defence.[314]

4.3.3 Financial year end

A close corporation is required to fix an annual financial year end date which must be the end of its financial year, being the close corporation's accounting period.[315] The close

[309] S 56(3) of the Close Corporations Act.
[310] S 56(4) of the Close Corporations Act.
[311] S 56(2) of the Close Corporations Act.
[312] FHI Cassim *et al Contemporary Company Law* 2nd Ed Cape Town: Juta, (2012) 14.
[313] S 56(5)(a) of the Close Corporations Act.
[314] S 56(5)(b) of the Close Corporations Act.
[315] S 57(1) of the Close Corporations Act.

corporation may change such date which signifies the end of its financial year; however the close corporation will not be able to change such date more than once in any financial year.[316]

In this regard, the duration of a close corporation's financial year shall be twelve months.[317] Furthermore, the first financial year of the close corporation must start from the date of the close corporation's registration and end on a date which is not less than three months or more than fifteen months after the date of the close corporation's registration.[318]

The requirement of a close corporation to have a financial year is not unique as the Companies Act also requires a private company to have a financial year which is the private company's accounting period.[319] Just like a close corporation, a private company may change its financial year at any time; however, it may not do so more than once during any financial year.[320]

4.3.4 Accounting officer

As previously mentioned in chapter 2 of this dissertation, a close corporation will be required to appoint an accounting officer in accordance with the Close Corporations Act.[321] In this regard, not everyone will be able to be an accounting officer as only a person who is a member of a recognized profession will be an accounting officer.[322]

[316] S 57(2)of the Close Corporations Act.
[317] S 57(3) of the Close Corporations Act.
[318] S 57(4)(a) of the Close Corporations Act.
[319] S 27(1) of the Companies Act.
[320] S 27(4) of the Companies Act.
[321] S 59(1) of the Close Corporations Act.
[322] S 60(1) of the Close Corporations Act. These are the following recognized professions which will entitle a person to be an accounting officer of a close corporation: (1) the South African Institute of Charted Accounts (GNR.2488 of 16 November 1984); (2) Accountants and Auditors registered in terms of the provisions of the Public Accountants' and Auditors' Act 51 of 1951 (GNR.2488 of 16 November 1984); (3) the Southern African Institute of Charted Secretaries and Administrators (GNR.2488 of 16 November 1984); (4) the Institute of Cost and Management Accountants (GNR.2488 of 16 November 1984); (5) the Association of Commercial and Financial Technicians of Southern Africa (GNR.2488 of 16 November 1984); (6) the Institute of Administration and Commerce in Southern Africa who have obtained the Diploma in Accountancy or the Diploma in Cost and Management Accountancy (GNR.1234 of 7 June 1985); (7) the Institute of Administration and Commerce in Southern Africa who have obtained the Diploma for Company Secretaries (GNR.206 of 7 February 1986); (8) Members of the Charted Association of Certified Accountants who have passed the examinations set by the said Charted Association of Certified Accountants in the relevant South African Business Laws and have, after three years appropriate practical experience, been allocated a practice number by the said Charted Association of Certified Accountants (GNR.993 of 27 May 1994); (9) the Senior Members of the South African Institute for Business Accountants (GNR.1906 of 5 July 1996); (10) Associate General Accounts of the SA Institute of Charted Accountants (GNR.150 of 30 January 1998); (11) the Members of the Charted Institute for Business Management (GN 758 of 18 July 2008); and (12) the Southern African Institute of Government Auditors (GN 167 of 26 February 2010).

This means that unless a person is part of a recognized profession, one will be forced to hire a professional who will be an accounting officer for their close corporation. Resultantly, if a small business cannot afford the services of a professional then the small business will be in breach of the Close Corporations Act. This is a not a welcomed requirement for a small business as it is burdensome to a small business which can barely break-even in terms of its finances.

Furthermore a member or an employee of a close corporation or a firm whose partner or employee is a member or an employee of a close corporate, will not be eligible to be an accounting officer of a close corporation unless all members of the close corporation provide written consent to such appointment.[323] This means that the costs of hiring an external person as an accounting officer may only be saved if a close corporation with only one member appoints that single member as its accounting officer; alternatively if all members agree to appoint a specific member as an accounting officer if the close corporation has more than one member.

The first appointed accounting officer of the close corporation who is named in the founding statement will officially occupy their position as an accounting officer from the registration date of the close corporation.[324]

Furthermore, if an accounting officer vacates their office due to a removal, resignation or otherwise, then the close corporation must appoint another accounting officer within 28 days from when the accounting officer vacated their office, provided that the appointment complies with the provisions relating to the registration of an amended founding statement of a close corporation.[325]

4.4 COMMENTS

As shown above, private Companies under the Companies Act have more onerous meeting notice requirements than close corporations under the Close Corporations Act.[326]

[323] S 60(3) of the Close Corporations Act.
[324] S 59(2) of the Close Corporations Act read with s 12(g)(i) of the Close Corporations Act.
[325] S 59(3) of the Close Corporations Act.
[326] S 48(2) for the Close Corporations Act contrasted with S 62(3)(a) to s 62(3)(c) of the Companies Act read with s 63(1) of the Companies Act.

However, a private company and a close corporation share similar duties when it comes to keeping records of the minutes of a board meeting or a members meeting.[327] Conversely, a close corporation is further required to keep its founding statement at its registered place (and place of business) so such document can be inspected during ordinary business hours.[328] As stated, this requirement is unique as a private company under the Companies Act is not required to keep its MOI open for public inspection.[329]

In terms of the requirements pertaining to a financial year, both the private company and the close corporation have very similar requirements.[330] The requirements of a financial year are welcomed for both small businesses and large businesses as they create the parameters for the accounting periods of a company in order for a company to determine whether it is doing good or bad in its years in business.

The Companies Act then comes with a new innovation where a private company may be required to have a social and ethics committee depending on whether public interest demands such committees to be formed taking into account the private company's 'annual turnover, workforce size, or the nature and extent of the activities' of the private company.[331] This regulatory requirement does not have a suffocating nature as a private company can apply to the Tribunal to be exempt from having a social and ethics committee if the private is required to have such committees.[332]

However, an existing close corporation is not subjected to the same standard as a private company insofar has having a social and an ethics committee and as a result a close corporation is not required to have a social and ethics committee.

The Companies Act also loosely imposes duties on a private company which relate to the giving of meeting notices.[333] This requirement is described as 'loose' because shareholders can waive such statutory requirement and also such statutory requirement is not applicable to a private company which only has one shareholder.[334]

[327] S 73(6) of the Companies Act read with s 48(3)(a) of the Close Corporations Act.
[328] S 16(1), s 16(2) and s 56(4) of the Close Corporations Act.
[329] S 15 of the Companies Act.
[330] S 57 of the Close Corporations Act read with s 27 of the Companies Act.
[331] S 72(4)(a) of the Companies Act.
[332] S 72(5) of the Companies Act.
[333] S 62(1)(b) of the Companies Act.
[334] S 62(4) and s 62(5) of the Companies Act read with s 57(2)(b) of the Companies Act.

4.5 CONCLUSION

Generally, close corporations have fewer duties than private companies. Where close corporations and private companies have the same or similar duties, such duties overlap each other and prove that the reason why one can no longer form a new close corporation is because the requirements which relate to a close corporation have been incorporated into the Companies Act.[335]

However, it is submitted that the close corporations under the amended Close Corporations Act (which amendments happened when the Companies Act came into effect) and private companies under the Companies Act, have requirements which are unnecessary for small businesses and which have the capability of crippling a small business which can barely make ends meet.[336]

[335] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42.
[336] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 464.

CHAPTER 5:FOREIGN LAW

INTRODUCTION

Generally speaking, in order for a country to determine whether it is doing a good job or not, such country needs to compare itself with other countries/jurisdictions around the world. As a result, this chapter will contrast how South Africa deals with legislating small businesses and large businesses in comparison to how other countries legislate small businesses and large businesses.

In this regard, this chapter will compare South African law against other common law jurisdictions (countries which have similar laws) such as New Zealand and Australia. In addition, this chapter will also compare South African law to German law, which does not have a common law jurisdiction with South Africa.

5.2 NEW ZEALAND

In New Zealand closely-held companies, are defined as companies where shareholders are also directors and there is no separation between the ownership and the management of the company.[337] The South African equivalent of a closely-held company is a close corporation under the Close Corporations Act as such legal entity has members (equivalent of shareholders) who are also considered to be directors as close corporations have no separation between ownership and management of the corporation.[338]

Commentators in New Zealand have been advocating for separate legislation for closely-held companies which will operate in conjunction with the New Zealand Companies Act 1993 (New Zealand Companies Act) which is a single legislation which regulates small businesses and large businesses.[339] It the South African context, the New Zealand Companies Act is

[337] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 543.
[338] S 30 of the Close Corporations Act read with s 46 of the Close Corporations Act. JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science* 40(1): 19-34.
[339] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 543.

equivalent to the Companies Act as the Companies Act governs both small businesses and large businesses.[340]

It has been argued in New Zealand that this proposed separate closely-held companies legislation should remove the distinction between shareholders and directors.[341] Consequently this means that the need to impose regulatory requirements on directors in favour of shareholders would be removed.[342] The reason for this submission is that there would be no need for director's liability for small companies as all the directors are usually the shareholders.[343] As a result, it would not be necessary for directors to report to shareholders, and it logically follows that any regulatory costs associated with director's liabilities for small companies would not be justified.[344]

But even if a director-shareholder were to breach the New Zealand Companies Act, it is unlikely that such a shareholder-plaintiff would take action against themselves as a director-defendant.[345] The same can also be said for a private company under the Companies Act where there are few directors who are all shareholders in the private company.

Furthermore, it is interesting to note that company law commentators in New Zealand have looked up to the Close Corporations Act as a role model in legislations for small formal business enterprises.[346]

New Zealand commentators argue that the United States of America (Uniform Limited Liability Company Act (1996)) and South African (Close Corporations Act) statutes have been successful in practice and as a result, New Zealand should carefully consider whether

[340] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *Acta Juridica: Modern company law for a competitive South African economy* 3-42.
[341] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 543.
[342] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 543.
[343] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 543.
[344] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 543.
[345] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 555
[346] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 544.

there are any compelling reasons for departing from the proven success of South Africa and the United States of America.[347]

Furthermore, New Zealand scholars believe that no legislative act can cater for both the small companies and large companies, as the needs of these companies are not akin.[348] In this regard (and to further reiterate) the South African Close Corporations Act has been cited as a legislative role model for small companies in New Zealand.[349] Resultantly, New Zealand company commentators concede that the South African Close Corporations Act has been successful in practice.[350]

5.3 AUSTRALIA

Small and big formal businesses in Australia, another country which is also a common law jurisdiction with South Africa, are governed under the Corporations Act 50 of 2001 (Australian Corporations Act). It is interesting to note that the Australian Corporations Act expressly distinguishes between small businesses (small proprietary company and small company limited by guarantee[351]) and large businesses (large proprietary company).[352]

At first glance the Australian Corporations Act is very similar to the South African Companies Act, however the Australian Corporations Act is distinguishable to the South African Companies Act as it expressly differentiates between small businesses and large bossiness.

Under the Australian Corporations Act, small businesses and large businesses are differentiated by the consolidated revenue in a specific financial year, the value of the consolidated gross assets at the end of a specific financial year and the business entities which the company controls.[353] For instance, a business will be considered to be a small proprietary company if it has a revenue of less than $25 million (or any other amount

[347] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 555.
[348] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 553 and 554.
[349] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 554.
[350] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 555.
[351] Small company limited by guarantee are companies which earn less than $250,000. See s 45B of the Australian Corporations Act.
[352] S 45A(2) and 45B read with s 45A(3) of the Australian Corporations Act.
[353] S 45A(2) read with s 45A(3) of the Australian Corporations Act.

stipulated by legislation), controls entities which are worth less than $12.5 million (or any other amount stipulated by legislation) or the company or entities which it controls have less than 50 employees.[354] While a large proprietary company will have the direct opposite requirements.[355]

Furthermore, under the Australian Corporations Act, a company must have at least one shareholder and a maximum of fifty shareholders.[356] In South Africa the capping of participants (shareholders) only exists under Close Corporations Act,[357] and also only existed under the 1973 Companies Act as the Companies Act has abolished the limitation of shareholders who want to participate in a company.

In Australia, most small business owners think independent directors are valueless to their organisations and as a result, separation of the roles and responsibilities of the board of directors and management is very minimal.[358] This Australian school of thought is very similar with the New Zealand closely-held companies school of thought which does not separate the ownership and the management of a company.[359] Furthermore, the Australian small business owners' school of thought is also in line in line with the philosophy of the Close Corporations Act which requires the business owners to also participate in the management of the business.[360]

In Australia, a number of small businesses do not naturally have an audit committee, audit remuneration committees or nomination committees.[361] Consequently, this illustrates that small businesses are concerned with improving their performance with the resultant benefits flowing to the owners and employees through effective decision making process; while larger

[354] S 45A(2) of the Australian Corporations Act.
[355] S 45A(3) of the Australian Corporations Act.
[356] S 113 and s 114 of the Australian Corporations Act.
[357] S 28 of the Close Corporations Act.
[358] K Heenetigala and A Armstrong 'Corporate governance issues facing small corporations in Australia' (2010) *Victoria University, Australia, paper submitted to the 2nd Finance and Corporate Governance Conference, Melbourne, Australia* 14.
[359] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 543.
[360] S 30 of the Close Corporations Act read with s 46 of the Close Corporations Act.
[361] K Heenetigala and A Armstrong 'Corporate governance issues facing small corporations in Australia' (2010) *Victoria University, Australia, paper submitted to the 2nd Finance and Corporate Governance Conference, Melbourne, Australia* 14.

businesses are more concerned with corporate governance which includes with structures and processes for decision making, accountability and control.[362]

Australian commentators argue that the fact that small businesses do not have or have a minimal percentage of independent boards, separation of ownership and control and board committees, indicates that small businesses either do not understand the importance of corporate governance or they are too small to adopt such governance systems.[363] This same argument can be made for owners of small formal businesses in South Africa, who are not naturally expected to adopt or understand complex governance systems which are better suited for large companies that require a system of check and balances.

Furthermore, in Australia, the mandatory compliance with accounting requirements of the Australian Corporations Act will generally depend on whether a company is classified as a small or large company for that particular financial year.[364] For instance a large company will be a mandatorily required to prepare audited annual financial report and directors' reports.[365] This is also the position in New Zealand as large companies are required to be audited and prepare annual returns.[366] As already set out in chapter 2 of this dissertation, the South African Companies currently provides a similar position to the Australian Corporations Act as depending on certain factors such as the turnover of a private company, a private company may be exempt from being audited, however it may still be required to be independently reviewed.[367]

5.4 GERMANY

In terms of the German *Gesellschaft mit beschrdnkter Haftung* (*GmbH*) (which may be translated to mean 'corporation with limited liability'), which is regulated by the *Gesetz betreffend die Gesellschaften mit beschrdinkter Haftung, 1892 (GmbHG*) there is no limitation on the number of members in a *GmbH*.[368] The GmbH also does not have a strict

[362] K Heenetigala and A Armstrong 'Corporate governance issues facing small corporations in Australia' (2010) *Victoria University, Australia, paper submitted to the 2nd Finance and Corporate Governance Conference, Melbourne, Australia* 14.
[363] K Heenetigala and A Armstrong 'Corporate governance issues facing small corporations in Australia' (2010) *Victoria University, Australia, paper submitted to the 2nd Finance and Corporate Governance Conference, Melbourne, Australia* 14.
[364] Chapter 1: Small Business Guide Part 1.5, s 10 of Australian Corporations Act.
[365] Chapter 1: Small Business Guide Part 1.5, s 10 of Australian Corporations Act.
[366] S 206(1)(a) and s 208(1)(a) of the New Zealand Companies Act.
[367] S 30(2)(b) of the Companies Act read with s 30(2A) of the Companies Act.
[368] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 315. Section 1 of the *GmbHG*.

separation between ownership and management of the corporation even though outsiders may operate as directors.[369] In the South African context this would appear to be a mixture of a close corporation under the Close Corporations Act and a private company under the Companies Act because there is no participation limitation but also there is no strict separation between ownership and management.[370]

Juristic persons as well as natural persons, and even associations without juristic personality, qualify for membership of the *GmbH*.[371] The *GmbH* is, therefore, a suitable legal entity not only for small businesses that remain a small business but also for small businesses that grow into and remain medium businesses.[372] Furthermore, the *GmbH* often forms part of groups of companies as either a holding *GmbH* or a subsidiary *GmbH* of other corporations or companies.[373]

Shares in a *GmbH* may be transferred to a juristic person, where in a close corporation interest (shares) cannot be transferred to a juristic person other than a juristic person in the capacity of a trustee of a trust *inter vivos*.[374] Generally speaking it is said that fewer restrictions apply to the transfer of a share in a *GmbH* as opposed to an interest in a South African close corporation.[375]

5.5 COMMENTS AND ANALYSIS

The Australian, German and South African (other than the Close Corporations Act) jurisdictions do not expressly have separate legislations which deals with the needs of small businesses, however the aforementioned jurisdictions have provisions in their company statues which either directly or indirectly accommodate small businesses. Based on the Close

[369] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 315 and 319.
[370] S 28 of the Close Corporations Act.
[371] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 315. Section 1 of the *GmbHG*.
[372] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 315.
[373] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 315.
[374] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 319. Section 29 of the Close Corporations Act.
[375] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 319.

Corporations Act, New Zealand is the one of the few jurisdictions which has business activists who want to have a separate legislation for small businesses.

It is submitted that small and medium sized private companies under the Companies Act would behave similarly to the German *GmbH*, as small and medium sized private companies under the Companies Act allow ownership for juristic persons as well as associations without juristic personality.[376] This is indeed a positive step as the increase of scope in ownership allows for an increase in the financial pool of funding and is in line with Knight's argument of having a single statute which adequately deals with scalability of a company which outgrows itself.[377]

However, it can be argued that despite its great job on scalability, the German *GmbH* is successful because it has not lost its philosophy of catering for small and medium businesses.

On the other hand, the New Zealand proposal for closely-held companies legislation and the Australian small business owners school of thought advocates for position which is akin to the Close Corporations Act. In particular, the New Zealand proposal pushes for a position which South Africa had before the coming into effect of the Companies Act, whereby 1973 Companies Act catered for large businesses and the Close Corporations Act catered for small businesses.

[376] N Olbrisch and J J Du Plessis 'Some Structural Differences Between the South African Close Corporation and the German *GmbH*' (1997-2) TSAR 315.
[377] P Knight 'Keep it simple and set it free: The new ethos of corporate formation', (2010) *ACTA JURIDICA: Modern company law for a competitive South African economy* 3-42.

CHAPTER 6: CONCLUSION

6.1 INTRODUCTION

According to s 7(b)(ii) of the Companies Act, one of the fundamental objectives of the Companies Act is to "promote the development of the South African economy by creating flexibility and simplicity in the formation and maintenance of companies".[378] Based on Chapter 2 of this dissertation, the Companies Act has done a good job in keeping in line with the aforementioned objectives; however a better job can still be done in achieving the objectives of promoting the development of the South African economy by creating flexibility and simplicity in the formation and maintenance of small formal companies.

6.2 COMMENTARY

6.2.1 Formation

At first glance, forming a private company under the Companies Act does not appear to be more of an administrative burden than forming a close corporation under the Close Corporations Act regardless of the fact that the formation of a private company requires two documents to be completed and signed while the formation of a close corporation would have only required one document to be completed and signed.[379]

Regardless of the above submission, it still appears that one is less motivated to form a small business under the Companies Act as opposed to other (former) avenues such as the Close Corporations Act. The reason for this unmotivated entrepreneurial attitude could be attributed to the regulatory and administrative hurdles which plague the Companies Act.[380] In other words, allowing individuals to form limited liability companies which are easy to incorporate, maintain and regulate will encourage an entrepreneurial spirit in the country.[381]

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[378] Companies Act.
[379] S 13(1) of the Companies Act read with s 12 of the Close Corporations Act.
[380] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 26.
[381] M Farrington 'A closely-held Companies Act for New Zealand', (2007) *Victoria University of Wellington Law Review* 559.

6.2.2 Undermining the philosophy of the Close Corporations Act

The decision of having a single companies Act legislating both small and large businesses; 'the de-emphasising of close corporations through additional onerous regulation and prohibiting the formation of new close corporations, is considered to be in sharp contrast with the basic philosophy underlying the Close Corporations Act which proved to be so successful'.[382] One of the fundamental reasons for creating the Close Corporations Act was that 'it was very difficult for a single statute (legislation) to provide a satisfactory legal form for the large and sophisticated as well as the small and often marginalised entrepreneurs'.[383] By incorporating the Companies Act, we have come full circle to the position which we previously had with the 1973 Companies Act (before the Close Corporations Act was created), as this was a legislation which was also thought to have adequately dealt with the required needs for small businesses (with restricted means and restricted access to professional advice) and large businesses.[384]

The Single Act approach

By having a single companies Act which may be onerous to small businesses, we run a risk that most of the small businesses' revenue may be spent on professionals such as auditors, accountants and lawyers in order to seek professional advice in complying with the Companies Act and interpreting same. Of course, the irony is that if small businesses do not comply with the company law then they will be shut down or heavily fined. However, it can be argued that requirements, such as for instance public interest score gauges and same shareholder same director requirements, provide adequate caveats for small businesses as these requirements prevent small businesses from hiring external professionals such as auditors.

[382] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 464.
[383] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 464.
[384] JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 464.

However, one similarly shares the same sentiments as *Darcy Du Toit* in such that small businesses were neglected, alternatively forgotten when the Companies Act was drafted/traded off for the Close Corporations Act.[385]

Lack of benefits

Furthermore, it can be argued (or rather re-emphasised), that the Companies Act regulatory requirements do not appear to have significant benefits for small businesses or closely-held companies.[386] As a result, the increased regulatory requirements in the Companies Act (and the Close Corporations Act) are an unjustified burden on small businesses and closely-held companies.[387]

Unnecessary Costs

In this regard, one of the crisp issues with the Companies Act is that the regulatory requirements imposed on directors to ensure accountability to shareholders do not have any benefit where all the directors of a small company (or closely held company) are also shareholders of the company; as transparency requirements in such instance are not justified.[388] As a result, the costs arising from such regulatory requirements are unjustified as they have no benefit for small formal companies.[389]

Exemptions, an empty promise

At first glance, the creation of thresholds for exemptions in the Companies Act may be viewed as appealing, given the cost and administration challenges which may face small businesses.[390] Furthermore, this may even be an argument that the Companies Act caters for the special needs of small formal business enterprises.[391] However, it can also be argued that

[385] D Du Toit 'Workers in Small Business: The Forgotten People. A comparative overview of Agenda for Labour Law Reform', (1995) *Industrial Law Journal 954*.
[386] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 551.
[387] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 551. JJ Henning 'The impact of South African company law reform on close corporations: Selected issues and perspectives' (2010) *Acta Juridica: Modern company law for a competitive South African economy* 464.
[388] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 581.
[389] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 581.
[390] J Freedman 'One size fits all – Small business and competitive legal forms', (2003) *Journal of Corporate Law Studies* 133.
[391] J Freedman 'One size fits all – Small business and competitive legal forms', (2003) *Journal of Corporate Law Studies* 133.

'thresholds can be confusing and transition from one category [with reference to the public interest score gauges] to another can be costly and require advice and decision making'.[392] Furthermore, in some instances, 'thresholds might create an incentive to business owners to avoid growth if they believe that loss of the benefits of an exemption will outweigh the benefits of a small amount of growth. Thus special provision for small firms could actually act as a barrier to growth'.[393]

6.3 CONCLUSION

The net result of this paper's proposals is a simple, flexible set of requirements suitable for small formal businesses (closely held companies) in South Africa, without onerous or unjustified compliance requirements.[394] Therefore the Companies Act should be implemented to meet the needs of small formal businesses (closely held companies) in South Africa.[395]

The Companies Act approach of a one-size fits all statute follows the approach adopted by the USA scholars of a 'one entity-fits-all'.[396]

Arguments have been made that those heterogeneous corporate forms existing under one statutory umbrella can lead to erratic case law, as some court decisions that only make sense for large companies may govern both small and large companies.[397] Conversely, judicial rulings that logically make sense for small companies may apply to both large and small companies.[398] Moreover, these differences may generate uncertainty because companies will not know, whether a particular decision will apply to them.[399] As a result of the

[392] J Freedman 'One size fits all – Small business and competitive legal forms', (2003) *Journal of Corporate Law Studies* 133.
[393] J Freedman 'One size fits all – Small business and competitive legal forms', (2003) *Journal of Corporate Law Studies* 133.
[394] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 581.
[395] M Farrington 'A closely-held Companies Act for New Zealand' (2007) *Victoria University of Wellington Law Review* 581.
[396] J Freedman 'One size fits all – Small business and competitive legal forms', (2003) *Journal of Corporate Law Studies* 133.
[397] TJ Wortman 'Unlocking lock-in: Limited liability companies and the key to underutilization of close corporation statutes' (1995) [Vol. 70:1362] New York University Law Review 1366.
[398] TJ Wortman 'Unlocking lock-in: Limited liability companies and the key to underutilization of close corporation statutes' (1995) [Vol. 70:1362] New York University Law Review 1366.
[399] TJ Wortman 'Unlocking lock-in: Limited liability companies and the key to underutilization of close corporation statutes' (1995) [Vol. 70:1362] New York University Law Review 1366.

aforementioned arguments, it is submitted that it would be efficiency enhancing to have separate legislations for small businesses and large businesses.[400]

However, it can be argued that the needs of small companies and close corporations do not warrant special treatment from other formal corporate entities as the limited benefit of a separate statue does not justify any adverse consequences which can be modified in a single general statute (the Companies Act).[401]

Henning is of the view that there is no company or corporate structure, type, subtype, species or subspecies in the Companies Act which is analogous to a close corporation.[402] At first glance one may argue that it is no longer worthy debating whether the Close Corporations Act is or was a suitable avenue for small formal businesses as the Close Corporations Act has been largely amended so it can be brought in line with Companies Act.[403] However, in the same vein one can argue that the amendments to the Close Corporations Act have created a more complex legal arena for small formal businesses compared to the previous Close Corporations Act regime.[404]

Indeed it appears that we have come full circle as once again, as South African company law has subjected small formal businesses to a single voluminous and complex legislation which is better suited for large companies.[405] Maybe in the future to come we will return to a separate legislation for small formal businesses, as in the 2017 national budget speech, Mr Gordhan stated that we need to consider, in the face of intractable economic hardships and disparities, whether South Africa should supplement its Constitutional Bill of Rights with a '*Charter of Economic Rights*' which would bind all of us to an economy which creates a supportive environment for micro, small and medium businesses and co-operatives.[406]

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[400] TJ Wortman 'Unlocking lock-in: Limited liability companies and the key to underutilization of close corporation statutes' (1995) [Vol. 70:1362] New York University Law Review 1366.
[401] TJ Wortman 'Unlocking lock-in: Limited liability companies and the key to underutilization of close corporation statutes' (1995) [Vol. 70:1362] New York University Law Review 1371.
[402] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation' (2015) *Journal for Juridical Science 40(1):* 19-34 at 27.
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[405] JJ Henning 'Identifying the structure envisioned for closely held incorporated business entities under the new statutory dispensation', (2015) *Journal for Juridical Science 40(1):* 19-34 at 33.
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A potential solution could also be for small companies to be governed by a diluted Close Corporations Act or legislation which is specifically aimed for only small companies; thereafter once a company grows to a certain revenue threshold and becomes an 'adult or big company', the company will need to be governed in terms of the Companies Act which adequately regulates large corporations.[407]

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UNIVERSITY OF KWAZULU-NATAL
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04 August 2020

Mr Lwazi Gumede (208512868)
School of Law
Howard College Campus

Dear Mr Gumede,

Protocol reference number: HSS/0764/014M
Project title: Small businesses and the South African Companies Act: Does one size really fit all?

Approval Notification – Amendment Application

This letter serves to notify you that your application and request for an amendment received on 30 July 2020 has now been approved as follows:

- Change in title

Any alterations to the approved research protocol i.e. Questionnaire/Interview Schedule, Informed Consent Form; Title of the Project, Location of the Study must be reviewed and approved through an amendment /modification prior to its implementation. In case you have further queries, please quote the above reference number.

PLEASE NOTE: Research data should be securely stored in the discipline/department for a period of 5 years.

All research conducted during the COVID-19 period must adhere to the national and UKZN guidelines.

Best wishes for the successful completion of your research protocol.

Yours faithfully

.....
Professor Dipane Hlalele (Chair)

/ms