

THE UNIVERSITY OF NATAL DURBAN

**THE SHORTCOMINGS OF THE COMMON LAW AND THE
COMPANIES ACT 61 OF 1973 IN REGULATING EXECUTIVE
REMUNERATION IN SOUTH AFRICA: IS THE CODE OF
CORPORATE PRACTICES AND CONDUCT THE ANSWER FOR
LISTED COMPANIES?**

BY

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Masters of Laws

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DECLARATION

I, Angelina Tlotliso Polaki, hereby declare that the work contained herein is entirely original and my own, except where specifically indicated in the text itself, and that this work has not been submitted in full or partial fulfillment of the academic requirements for any other degree or qualification at any other university.

Signed and dated at Durban on the 15th day of September 2003.



Angelina Tlotliso Polaki

ABSTRACT

King II articulated in an open manner, issues of disclosure, transparency, comparator remuneration packages and a robust approach to the payment of compensation in relation to poorly performing directors. While directors owe fiduciary duties to the company (shareholders present and future), by paying themselves huge packages, they do no longer act in the best interests of the company because awarding themselves exorbitant packages may frustrate their duty to maximise shareholder value. The solution is that their interests be linked to those of shareholders by requiring that their pay be linked to their performance. With the advent of corporate governance reforms, other stakeholder interests have to be taken cognisance of by directors in corporate decision making. As such, a huge gap between the salaries of rank and file employees and those of executive directors is seen as a conscious move to ignore the interests of legitimate stakeholders when there is no compelling reason to do so. To try and align the interest of shareholders and directors, it is felt that more emphasis has to be placed on actively engaging shareholders and employees in the determination of executive remuneration.

It is submitted that pay that is not linked to performance is a breach of fiduciary duties, in particular, duty to avoid conflict of interest. However, our common law and Companies Act 61 of 1973 fail immensely to address concerns relating to excessive remuneration pay. In particular, the business judgment rule precludes minority shareholders taking action on the basis of wrongs committed against the company by virtue of pay not being linked to performance. Neither has the introduction of corporate governance reforms impacted heavily on setting executive remuneration. They have not proved effective in curbing fat cat pay. It is acknowledged that these reforms have brought about a profound impact on attitudes in the corporate environment. However, numerous deficiencies, particularly in the context of South Africa can be identified.

This thesis serves as a means of establishing whether from a legal perspective, following recent reforms, the negative impact of exorbitant remuneration pay is of such a serious nature as to warrant more stringent regulation in one form or the other. South Africa should consider revamping and tightening current legislation, which as submitted is lacking in a number of respects. As a strategy to eradicate exorbitant pay, it is submitted that directors fiduciary duties have to be revised and legislated in order to successfully establish directors'

wrongdoing. It is felt that legislative enactment may be made stronger by the fact that it may have stronger and sharper teeth and hence able to reach where self-regulated codes are weak.

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CHAPTER 1

INTRODUCTION

1.0 Formulation of the Problem

This thesis investigates the law relating to the supervision and regulation of directors compensation in public companies in the light of King II report on corporate governance. In a company setting, it is undoubtedly clear that executive directors play a pivotal role. With the advent of recent corporate governance reforms, more emphasis is being placed on the separation of ownership and control. Directors are held accountable to shareholders and are given unfettered powers to run the company in their discretion.¹ Shareholders nominate them into these positions with the hope that they will run the business in a manner that will maximize the value of the company's equity. They not only have to protect minority shareholders interests but also to take into account the interests of all other stakeholders.

A company is not bound to pay its directors, unless the Articles of Association authorises it or unless members in a general meeting have approved the remuneration.² Depending on the nature and terms of the agreement reached between the company and the directors, the services they afford the company may be rewarded.³ Invariably in all companies, executive pay is determined by the board of directors and or remuneration committees. The upshot is that the board of directors responsible for setting executive remuneration is often accused of awarding packages that seem to be over the 'odds'. As a result, it is felt that they act in a self-serving manner while ignoring the interests of the shareholders (generating maximum shareholder return) and the company as a whole. For as long as these executives pursue

¹ T Mongalo 'Corporate Governance reforms and directors remuneration, a critical comparative analysis: Part 1' (Unpublished article), 2

² Cilliers & Bernade *Corporate Law* 3rd ed, 138

³ Du Plessis *Maaskappyregtelike Grondslae van die Regsposisie van Direkteure en Besturende Direkteure* 1992 *SA Merc LJ* 243

their own agenda rather than seek to improve the profitability of the company, they are seen to be imposing agency costs on investors.⁴

As early as 1990, public controversy over top managers' pay packages started receiving considerable attention in the media - The press released numerous articles highlighting the exorbitant remuneration packages that executive directors receive.⁵ There has been a widespread public outcry in South Africa and in other jurisdictions internationally about what are perceived as excessive increases in remuneration of senior managers and directors, particularly at a time of economic downturn, poor company results and centrally agreed wage restraint for other ordinary normal workers.⁶ South African executives have also not had to pay for the misfortunes of the companies they run. Due to this, much debate has arisen over whether such corporate 'fat cats' pay should be curtailed. The problem is exacerbated by managers who are seen as performing badly and ultimately lose their jobs, but leave with excessive 'golden handshakes' while the company would in fact, be paying for poor performance.⁷

Ordinarily, the interests of shareholders, on one hand, are to own a company that is directed by executives who are dedicated to maximizing shareholder return on the investments they made when they invested in the company. On the other hand, the directors' have an interest

⁴ BR Cheffins *Company Law theory structure and operation* (1997), 653

⁵ Some of the better-known public companies that recently awarded excessive pay are: South Africa's *Profurn's* Gavin Walker, for instance, walked off with a R5-million golden handshake while the company was left in ruins. *Didata* executives still earned \$3.7-million (R37-million) in 2001 despite a loss of 451.2-million for the year. Shares were trading above R60 at the beginning of that period but were below R10 a year later. They have not recovered ('Cutting off the fat' *Sunday Business Report* 7 July 2002. Eskom executive directors recently (March 2003) pocketed performance bonuses worth a total of R6.56 million for the past year amid a report that the electricity utility lost R129 million last year as a result of a bungled foreign exchange transaction. It further proposes to increase tariffs that are over inflation to try and fund its R50 billion capital expenditure over a period of 5 years. (*Mercury BusinessReport* 12 March 2003). Equally discrediting was the investor's reproach of the *Nedcor's* board for self-enriching themselves through a share incentive scheme which rewarded a number of directors for the performance of external companies in which Nedcor had invested. UK telecommunications giant *Vodafone* paid its chief executive, Christopher Gent, a £1.5-million bonus even though the company's share price had plunged.

⁶ 'Major controversy breaks out over top pay' www.eirofound.ie

⁷ Coleman Andrew, the former chief executive officer of SAA resigned from his position and he received a handsome \$28, 8 million golden handshake on departure available at Lynda Loxton 'Looking through the smoke and mirrors of SAA's financial results' *Business Report*, Tuesday 25 September 2001, <http://www.businessreport.co.za>

of getting the maximum reward for the successful running of the company. These interests often conflict because they do not have the same interests and incentives as shareholders, and they engage in a self-serving manner at the expense of shareholders.⁸ As Mongalo indicates, the prevailing thesis is that executives act in their own interest rather than endeavour to maximise shareholder value.⁹

Agency costs imposed by directors can be addressed at different levels. Pursuant to the principles developed by our courts, in the discharge of their obligations, directors are expected to exercise their fiduciary duties.¹⁰ Directors owe duties to act in a company's best interest, to avoid any conflict of interest between the company's interests and pursuing their own interests, and have to account for any personal profits accumulated while carrying on the company's business.¹¹ Our common law recognizes that directors owe their duty to the company (shareholders, present and future). By paying themselves huge packages, they do no longer act in the best interests of the company because taking huge packages may frustrate their duty to maximise shareholder value. Fiduciary duties are regulated at common law (particularly in case law). With exception of a very few common law and statutory rules limiting management powers, directors possess immense and almost unlimited powers in running their companies.¹² The ordinary common law remedies provided in our law are deficient and fail immensely in adequately solving these problems. Neither does the Companies Act 61 of 1973 deal with these issues sufficiently. It appears that existing mechanisms in our law are lacking in a number of respects. They do not have a shrinking effect on excessive executive remuneration packages that are without proper justification - They do not seem to curtail exorbitant remuneration packages being awarded to executive directors. Thus, the solution is that their interests be linked to those of

⁸ H Stock 'Warren Buffet takes \$60 000 pay cut' 20 March 2003, 5

⁹ T Mongalo 'Shareholder Activism in the UK highlights the failure of remuneration committees: lessons for South Africa' (Unpublished article), 2

¹⁰ RC Williams *Concise Corporate and Partnership Law* 2nd ed (1997), 152

¹¹ BR Cheffins (note 4 above), 653

¹² T Mongalo 'The emergence of corporate governance as a fundamental research topic in South Africa' (2003) SALJ 173, 180. In terms of the Companies Act 61 of 1973, various limitations discussed in subsequent chapters are imposed which preclude arrangements being made by directors and the company for payment of excessive amounts for their services. Certain forms of remuneration are prohibited unless the shareholders consent has been engaged or sought. Under the common law, minority shareholders can utilize Section 266 to obtain relief in circumstances where those running the company have arranged to pay themselves exorbitant salaries.

shareholders by requiring their pay to be linked to their performance. One may further argue that in today's corporate environment, other stakeholder interests need to be taken into account by directors in corporate decision-making. As such, a huge gap between the salaries of rank and file employees and those of the executive directors would be seen as a conscious move to ignore the interests of legitimate stakeholders when there is no compelling reason to do so. The issue therefore, for concern from a legal perspective is whether the negative impact of such excessive rewards is of such a serious nature as to warrant regulation in one form or the other.

For these reasons and many others, efforts have to be made in some quarters to try and limit such arrangements by imposing strict regulations and the law. Even with the introduction of the King Report on Corporate Governance for South Africa (2002), hereinafter referred to as King II, the issue of executive pay is still very problematic. In as much as it is acknowledged that the Code of Good Corporate Practices addresses to a large extent, disclosure, transparency, comparator remuneration and robust approach to the payment of compensation in relation to poorly performing directors, it is still deficient and needs to be fortified. South Africa may then look to other developed countries to try and resolve and curtail excessive remuneration, which may be succeeding in this regard.

This thesis is intended as a contribution to the development of remuneration supervision and regulation in a global context. Unlike other countries in the region, South Africa may be on the brink of becoming a strong industrial nation, provided the government succeeds in gaining control over the economic difficulties. The country has rich human and mineral resources, which need to be managed efficiently. To generate and maximize increased shareholder return and to maintain and motivate its workforce, companies must adopt good corporate practices and effectively deal with the disparity between pay at the top (executive director's) and pay at the bottom (employees), and must endeavour to strike a correlation between director's pay and performance. It is noteworthy that not much has been written on South African corporate governance with regard to directors' remuneration, but King II's introduction has probably had just as profound an effect on attitudes as any new rules and regulations. However, it has to be developed and restructured further to try and address the

problems relating to excessive pay to make it harder for bad bosses to walk away with undeserved millions.

B Outline of the discussion

The discussion is divided into six chapters each dealing with a specific topic relating to regulating directors remuneration. Each Chapter commences with a thorough discussion of South African law, followed by a discussion of what happens in other jurisdictions like Britain, United States of America and Germany. As far as possible, the points investigated in these systems are discussed in the same order to facilitate the comparison.

The following topics within the field of corporate remuneration committees' supervision and regulation are dealt with:

1. Principles and problems underlying executive remuneration
2. The position of the common law and the Companies Act 61 of 1973 on executive remuneration
3. Developments that led to corporate governance reform
4. Recommendations in corporate governance reform in South Africa and the United Kingdom
5. A critical analysis of the recommendations
6. Effectiveness of recommendations in the South African context
7. Conclusions/recommendations

1.0 THE PRINCIPLES AND PROBLEMS UNDERLYING EXECUTIVE REMUNERATION

The public company arena is not free of error and certain criticisms related to perceived excesses would be expected where a company's performance in respect of earnings, sustainability of share price, revenue, and its market share would not warrant substantial pay increases of the executive team.¹³ There can be no objection to good pay for good performance, but the justification for generous pay schemes is not always apparent, particularly where profits are falling or staff is being made redundant.¹⁴ The compensation of executives has caused heated debate and commentators have been very critical of the large increases in compensation received by directors of public companies, and of the methods adopted in setting pay and other components of compensation.¹⁵ A number of problems are leveled against executive remuneration. Not only is it regarded as spiraling out of control, but there are other discrepancies that raise concern that are associated with it. Shareholders and the labour workforce have been concerned with two main particular aspects over executive pay packages. These are firstly, it is not linked to performance in any way, and secondly, there is a disparity between pay at the top and pay at the bottom. These two concerns triggered the institution of corporate governance reforms in this area of executive remuneration.

1.1.1 THE POOR CORRELATION BETWEEN PAY AND PERFORMANCE

At a time when companies are keen to promote pay schemes on performance, too often the links between directors' pay and performance are viewed as non-existent.¹⁶ The argument that is posed is that if executive pay is not linked to performance, executive directors will relax and not place much effort in generating increased shareholder return, as they know that they will get paid anyway. Even if the share price, revenue profits and turnover,

¹³ L Johnson 'How much is too much? Or not enough?' (2001) *Australian Financial Review* 16, 20

¹⁴ C Hurst 'Special report: Executive pay' 30 August 2001 *The Guardian*

¹⁵ R Tricker *Corporate Governance* (2000) 704 For instance, a huge number of newspaper articles on exorbitant executive pay awards and their criticisms are leveled almost on a weekly basis.

¹⁶ L Johnson 'Companies should justify directors' remuneration packages' (2001) *Australian Financial Review* 16, 21

increase or decrease, they will not be affected in any way. The issue raised is that executive directors are contributing very little in terms of adding value to company share prices. For those who are failing to perform, at expected levels, executive remuneration can be utilized as a way of enhancing performance. Article 2.5.1 of the Code of Best Practices discourages uniform remuneration packages. Executive directors have a tendency of awarding themselves huge remuneration packages because they always feel they are getting a tiny fraction of what the companies make in profits.¹⁷ This is why they act in a self-serving manner to benefit themselves rather than endeavor to maximize shareholder return. Cheffins¹⁸ indicates that if top executives receive substantial rewards when company position is improving and meaningful penalties when performance is poor, then they should logically strive towards doing what is best for shareholders as a priority. Often, “executive directors are handsomely rewarded when the share price goes up, but hardly suffer any fall in such rewards should the equity value decline.”¹⁹ The Labour research service recently undertook an investigation into what directors are being paid in South Africa. It also looked into the continued failure of companies to disclose directors’ salaries.²⁰

Profurn’s Gavin Walker received a R5 million golden parachute while the company he headed was left in ruins.²¹ As recent as March 2003, Eskom executive directors recently (March 2003) pocketed performance bonuses worth a total of R6.56 million for the last year (2002). This included a massive R4.5 million for the financial director, and R2 million for its chief executive officer. Over and above the R4.5 million performance bonus for the finance director, he also got an annual salary of R821, 000 and an additional allowance of R344, 000, a 36.2% increase on his salary for 2001. This reward was made amid a report that the electricity utility lost R129 million last year as a result of a bungled foreign exchange transaction.²² One just wonders whether sound corporate governance principles

¹⁷ T Mongalo ‘*Corporate law and Corporate governance*’ 1st ed (2003), 220

¹⁸ BR Cheffins (note 4 above), 654

¹⁹ T Mongalo (note 17 above), 220

²⁰ ‘Why still secrecy around directors’ salaries’ (2002) Vol 26 (2), 42 the lack of transparency around directors’ fees was derived from a survey of 80 companies. Executive directors’ earnings are up by 23% from 2000 from an average of R1 511 323 for 2000 to an average of R1 859 626 for 2001. This is almost three times the rate of inflation, and three times higher than the increase of low paid workers.

²¹ A Shevel ‘*Cutting away the fat*’ www.sundaytimes.co.za/articles

²² K Phasiwe ‘*Eskom awards high powered bonuses*’ 12 March 2003 Business Report <http://www.businessreport.co.za>

were observed in this foreign exchange deal. A R4 million performance bonus for the financial director appears hardly justifiable while millions were lost.

In the UK, the average pay and pension package of executive managers in UK's 100 largest firms rose to £1.73 million last year at a time when the stock market had crashed by a quarter.²³ Vodafone also awarded £1.5 million to its chief executive officer when the share price continued to decline.²⁴ The National Association of Pensions Fund has urged its members to protest against remuneration practices at Barclays, Reuters, Shell and Schroders.²⁵ In Reuters, the association was puzzled as to why top management had earned bonuses worth £2.2 million in a year when the share price had fallen by more than two-thirds.²⁶ The same goes for BP's chief executive who collected £4.9 million in annual rewards and pension contributions in 2002.²⁷ The share price moves and dividend payments have fallen by nearly a quarter in the past three years.²⁸ In Germany, former directors of Mannesmann, a telecoms company that was taken over by British Vodafone in 2000, are being sued over executive payouts of €128 million at the time of the deal. The directors however deny any form of wrongdoing.²⁹

One foreign company that seeks to try and align pay and performance based on the company's profitability or market value is American Express. Its chief executive Ken Chenault received \$20,9million in 2002, a 25 per cent decline from 2001, as the company's shares fell 1 percent.³⁰ For us to try and align the interests of the company shareholders, on the one hand, and those of the executive directors, on the other, a correlation between

²³ K Griffith 'UK bosses earn more but return less' 21 May 2003 Business Report
<http://www.businessreport.co.za>

²⁴ A Shevel (note 18 above). Other equally discrediting rewards include Didata, which awarded its executives £3.7 million (R37 million) in 2001 financial year despite a loss of 451.7 million for that period. Shares were trading above R60 at the beginning of that period but were below R10 a year later – They have since not recovered.

²⁵ Ibid

²⁶ Ibid

²⁷ Ibid

²⁸ Ibid

²⁹ 'The fat cats are still grabbing all the cream' 27 April 2003 Business report,
<http://www.businessreport.co.za>

³⁰ Stock H 'Warren Buffet takes \$60 000 pay cut' <http://www.businessreport.co.za> 20th March 2003

executive pay and performance must be struck.³¹ Companies have to strive towards avoiding paying for failure. The Greenbury committee in the United Kingdom was formed in order to cure these ills on director's remuneration. In South Africa, para 2.5 of the Code of Corporate Practices and Conduct, Appendix V and Section 1 of the King II considers issues relating to executive pay.

Although the following pay components are still to be discussed in detail hereunder, they do not seem to be aligned in any way to performance. For one, share options, give executive directors the right to hold on to shares when the company is successful, and they do not feel the pinch when companies perform badly. They exercise the option when the share price has risen over the strike price in the market. If the share price drops below the strike price, the executive will not exercise the option and is in no worse off position.³² Share options are not aligned at all to performance in that they allow directors to benefit when the company is successful but do not get to penalize them when things are going badly. As Cheffins indicates, they operate in a sense as a one-way bet.³³ This poses a problem because in essence, if the company performance is below expected levels, shareholders incur genuine losses. The basic characteristics of share options are provided for in the Greenbury report on executive pay.³⁴ A severance package is another component of remuneration package that poses problems. It would seem that companies, which grant exorbitant golden handshakes, are actually paying for poor performance or reward for failure. This is so because in most instances, they are paid handsomely on their departure while the share price would have plunged. Section 1, Chapter IV, Para 13 of King II addresses this issue. It provides that full disclosure of severance pay has to be made to avoid abuse of the process. Greenbury Report makes mention of this concern in para 1.7 and 7.2 of its report. Companies with strict policies that link performance to pay packages seem to be the solution to justifying hefty compensations. However, in as much as we

³¹ In a recent survey held by the Incomes Data Services in 1999, it was noted that executive pay in the UK rose on average 17.6 per cent in 1998 and that there was really no correlation between remuneration and company performance.

³² BR Cheffins (note 4 above), 657

³³ Ibid.

³⁴ Para 6.24 and 6.25

aspire for good governance, a number of problems associated with this concern can ensue.³⁵

1.1.2 THERE IS A DISPARITY BETWEEN PAY AT THE TOP, AND PAY AT THE BOTTOM

Another concern is that there is an unjustifiable rift between what a chief executive officer gets and what ordinary workers get. The concern is that executive pay increases way above the inflation rate while the workforce rises in with or even below the inflation rate.³⁶ Most recently (August 2003), the South African Reserve Bank governor, Tito Mboweni, who accepted a 12 per cent pay rise in 2002, received a further 9 percent hike on his salary package for the year to March 2004, which is more than double the inflation target set for the year.³⁷ While the level of executive pay is an internationally emotive issue, the problem in South Africa is that it has become politicized. Congress of South African Trade Unions (Cosatu) and related interested parties allege that the gap between executive remuneration packages and those of rank and file employees is reflective of the apartheid wage gap and has to be resolved.³⁸ Cosatu and other concerned unions' are of the opinion that this disparity can impact negatively on the performance and productivity of employees at lower levels. As Mongalo³⁹ points out, it can lead to labor unrests, as information on executive remuneration will be utilized by trade unions to try and justify claims for increased wage packages for ordinary workers. The Hampel Committee at para 4.2 and the

³⁵ These will be discussed more fully in Chapter 4. It is arguable that once director's pay fluctuates constantly, as a result of trying to link performance and pay, directors may probably leave for more stable surroundings, and as a result, the company will lose the skill and expertise that the director possessed. In addition, the market price may be influenced by other external factors that may lead to humongous market crash (E.g. the US September 11th 2001) episodes. We saw the dollar and other currencies plummet low but this in no way was related to the performance of individual directors within their companies. *'Are top managers worth it? viewpoint'* www.guardian.co.uk/viewpoint

³⁶ BR Cheffins (note 4 above), 657-658

³⁷ M Le Roux 'Mboweni's wage target is higher than SA's' *Business Report* 21 August 2003, 1. The governor is being criticized for accepting such a huge package as he has been urging employers to keep the inflation target in mind when making salary determinations. The Central Bank has set inflation targets at between 3 percent and 6 percent for the year. The bank's justification is that the remuneration committee in deciding pay packages does take cognizance of the inflation target but has to consider other factors as well. The Federation of Unions of South Africa accuse the governor of applying double standards and of being a hypocrite as he recently criticized labour unions of fuelling inflation by excessive wage demands.

³⁸ Mnyanda 'Companies dismiss call to disclose executive pay' *Business Day*, 2 April 1996,10

³⁹ T Mongalo (note 15 above), 222

JSE Listing Requirements (Schedule 22) note that this is an area of concern that may lead to resentment and it notes that those who make decisions must be 'sensitive to the wider scene, including pay and employment conditions elsewhere in the group, especially when determining annual salary increases.'

Cosatu aims to gain support to try and alleviate and reduce the wage gap as promoted by the Employment and Equity Act of 1998.⁴⁰ This Act upholds and endorses the constitutional right of equality and the exercise of true democracy; eliminates unfair discrimination in employment; ensures the implementation of equity to redress the effects of discrimination; requires the workforce to be broadly representative of the South African population; and it also promotes economic development and efficiency in the workforce. Presently, in South Africa, the wage ratio is at 50:1 and 100:1.⁴¹ Cosatu calls for a reduction of this gap to 8:1.⁴² It makes reliance on other jurisdictions like New Zealand and Switzerland, where the gap has been tremendously reduced.⁴³ It is felt that there is a need to narrow down the wage gap within companies as a step towards moral and social responsibilities, which are internal concerns to a company's success. This is not just a problem in South Africa only; in the United Kingdom, the pay differential between directors and their employees grew by more than 50 per cent between 1994 and 2001.⁴⁴ In America, the average chief executive officer of a medium sized corporation earns 531 times as much in pay, bonuses and stock options as the average factory worker.⁴⁵

The Hampel Committee also acknowledged that disclosure of spiraling managerial compensation can impact on the workforce and the morale of the employees can be affected tremendously.⁴⁶ However, it should be noted that companies will not ordinarily risk losing directors who are skilled by reducing their compensation packages over low ranking employees who earn far less. It would seem that the rates at which executive

⁴⁰ M Henderson 'SA executives are not such fat cats' Cape Argus 18 September 2002

⁴¹ Ibid

⁴² The government's target, on the other hand is a ratio of 12:1

⁴³ (Note 40 above)

⁴⁴ A Shevel (note 21 above)

⁴⁵ A Kakabadse 'Corporate governance in South Africa: Evaluation of the King II Report (Draft)' (2002) *Journal of change Management*, 314

⁴⁶ Para 4.2 Hampel Report

directors and ordinary employees are paid at largely depend on the industry and situation of each company. In as much as King II advocates that salaries should be paid in accordance with qualifications and with the value executives add, it is submitted that other stringent measures should be adopted to try and curtail excessive rewards.⁴⁷ Bonuses, on the other hand, should also be realistic and in line with performance. The issue that remains is to determine how best these can be resolved.

In today's corporate environment, other stakeholder interests need to be taken into account by directors in corporate decision-making. As such, a huge gap between the salaries of rank and file employees and those of the executive directors is seen as a conscious move to ignore the interests of legitimate stakeholders when there is no compelling reason to do so.

1.2 THE NATURE OF EXECUTIVE REMUNERATION

Remuneration packages for top management are largely based on external market related salary surveys and packages within comparable companies.⁴⁸ This not only applies to the level of pay of executive directors, but it also applies to the nature of the components of remuneration and the proportionate demarcation between basic pay and performance related incentives.⁴⁹ It is worth noting that the fact that a person is appointed as a director does not ipso facto entitle him to claim remuneration.⁵⁰ However, if provision for remuneration is made in the articles, such provision affords sufficient authority to apply funds of the company as remuneration on the basis set out in the articles. If the articles do not provide for it, the company may still pay remuneration in terms of a contract entered into between the director and the company. As King II advises, in reviewing individual elements of executive directors' packages, the remuneration committees have to take advice from independent consultants as well.⁵¹

⁴⁷ King II, para 2.4.2

⁴⁸ T Wixley, G Everingham ' *Corporate Governance* ' 1st ed (2002), 56

⁴⁹ Ibid

⁵⁰ Cilliers & Benade *Corporate Law* 3rd ed (2000), 138

⁵¹ Ibid, 59; King II par 2.7.8

1.3 AUTHORITY TO DETERMINE EXECUTIVE PAY

Ordinarily, under South African company laws, the company in a general meeting determines the remuneration of the directors.⁵² The Articles of association empowers the board of directors to appoint individuals to executive positions and then set their pay.⁵³ In other words, it is the board of directors, which, according to traditional corporate governance, sets executive remuneration packages. Articles 61 and 62 of Table A and B restates this position as follows

‘the directors may from time to time appoint one or more of their body to the office of managing director or manager for such term and at such remuneration (whether by way of salary or commission or participation in profits or partly in one way and partly in another) as they may think fit and may revoke such appointment’.

In the case of *Brown v Nanco (Pty) Ltd*,⁵⁴ some shareholders made an application under section 266(3) of the Companies Act⁵⁵ for the appointment of a provisional *curator ad litem* to investigate a claim which the respondent company was alleged to have against four of its directors. The dispute arose between the shareholders and the directors with regard to whether the directors were entitled to any remuneration over and above that which the company in a general meeting had authorized. Article 66 of the company’s Articles made provision for the determination of the director’s remuneration by the company in a general meeting from time to time. Pursuant to this Article 66, the company had set the remuneration of the directors in certain amounts. In addition, the directors of the company had authorized the payment to four of them of certain further additional amounts, which were termed as ‘management commissions’. Furthermore, Article 87 of the company’s article provided that ‘a director may hold any other office or position of profit in the company, other than that of auditor, in connection with his directorship, and may be appointed thereto upon such terms as to remuneration, tenure of office and otherwise as

⁵² Table A and B (articles 54 and 55)

⁵³ T Mongalo (note 17 above), 213

⁵⁴ 1976 (3) SA 832 (W)

⁵⁵ Companies Act No 61 of 1973

may be arranged by the directors, subject to the terms of any agreement entered into in any particular case.’

The issue raised required an interpretation of the meaning and effect of Article 87, which remained the only clause under which a justification of these payments could be made. Elliot J was of the view that there was a *prima facie* cause of action for the recovery of the management commission paid to the directors. The court upheld these additional payments, on the basis that the directors performed such burdensome duties that it was considered that the remuneration fixed by the company in general meeting was not adequate, and were as such, entitled to receive extra remuneration, which amount would be fixed in line with the profits generated by the company.

From the above case, it can be appreciated that there is a distinction between management remuneration and director’s fees. The latter comprises of fees that are paid to directors on attending meetings and carrying out other related duties. The former, which forms the core of this thesis, refers to what executive directors receive for carrying out managerial activities on behalf of a company. Often, top executive directors of public companies do not bother to claim and receive their directors’ fees, which tend to be negligible when compared with their own pay packages.⁵⁶ Over and above the retainer that they are entitled to, they also receive other fringe benefits that ordinarily can be found in executive remuneration packages.⁵⁷ The components of these pay packages will be discussed hereunder.

⁵⁶ “SA companies disclose remuneration of non executive directors’ *The Boardroom*, April 1998. This article reports that PE Corporate Services carried out a survey of 212 companies at the end of 1997, which reveals that non-executive directors earn a retainer or fee calculated on a monthly, quarterly or annual basis. Their responsibilities comprise of the following: attending board meetings; attending other committee meetings; special projects or consultancy work; and other activities such as assisting with the budget reviews and strategic planning. The average daily fees paid to non-executive directors are R 3850 for board meetings; R2990 for committee meetings; R2390 for special projects and other activities. The average number of days spent by non-executive directors annually on each activity is 6,4 days attending board meetings; 5,9 days attending committee meetings; 18,9 days on special projects and consultancy work; and 25,5 days on other activities. Thus, the average annual retainer earned by a non-executive is about R147 779.

⁵⁷ They are entitled to other benefits like lavish office accommodation, car allowances, housing subsidies, accident and life insurance, car and travel expenses, holiday accommodation, club subscriptions, rental and lease payments etc. A non executive director will get R1, 2million on average per month

1.4 COMPONENTS OF EXECUTIVE REMUNERATION

The Code of Corporate Practices and Conduct in clause 2.5, Appendix V of King 2 Report and para 6.14 of the Greenbury Report provides an overview and guidelines of the composition of an executive package. The Code of Corporate Practices and Conduct in clause 2.5.4 provides that ‘companies should provide full disclosure of director remuneration on an individual basis giving details of earnings, share options and all other benefits’. These comprise of the following

1.4.1 BASIC SALARY

Salaries are determined on a periodic basis. They do not change according to company performance; as such, it does not really matter whether the share price plummets or goes up. Even though it does not fluctuate with performance, it may be reviewed from time to time when an assessment of all employees of the company is undertaken.⁵⁸ It is set with reference to external market data, relating to similar companies based in the area and internationally, which are comparable in terms of size, market sector, business complexity and international scope.⁵⁹ Individual performance and any increased responsibilities may also be taken into consideration.⁶⁰ In South Africa, basic salary usually consists of over half of an executive director’s remuneration package. Even though some components of remuneration fluctuate in accordance with the performance of the company, basic salary is a guaranteed item of the remuneration package and does not usually oscillate. Recent corporate reforms move towards performance related components of remuneration such as annual bonus schemes and long term incentive schemes which may impact heavily on increased basic salaries, which as King II states in para 2.5.5 of the Code, that ‘performance related elements of remuneration should constitute a substantial portion of

⁵⁸ Para 3.4 of King II Appendix V moves for dates for review of such basic salaries to be an appropriate time for evaluating the performance of individual directors, on which dates, salaries may also be adjusted.

⁵⁹ Extract from Anglo American plc’s 2001 Annual Report (remuneration report).

⁶⁰ Ibid

the total remuneration package of executives in order to align their interests with the shareowners’.

1.4.2 BONUS SCHEME

This component may be structured in a variety of ways. The most common form being a short-term incentive scheme annual bonus plan. In various companies, executive directors maybe eligible to participate in an annual bonus plan, which is typically based on the achievement of short-term performance targets, which are relevant to individual executive directors.⁶¹ In South Africa, some companies try to make it a guaranteed item in the remuneration package of a director and yet ordinarily, it is only to be granted to executive directors upon targets being met. The fundamental basis of having components of executive pay linked to corporate performance is to give management an incentive to run the company in a way that enhances shareholder return and also improves corporate performance.⁶² The 2001 annual reports of Johnnic Communications (Johncom) and South African Breweries (SABMiller), reflect that Paul Jenkins earned total emoluments of R3, 2 million, of which R1, 8million was a bonus; Irene Charnley received R4 million, of which R2, 8 million was a bonus; Paul Edwards received R11million, of which R8 million was a bonus; and Jacob Modise earned R3, 4million, of which R2 million was a bonus. Charnley and Edwards have both since resigned.⁶³ In a typically large company, executive directors can receive between 15 to 20 percent of bonus as calculated on the remuneration packages.⁶⁴

1.4.3 LONG TERM INCENTIVE PLAN (LTIP)

This form of incentive is set over a long period of time. Should the company reach its targets within such a period, directors would then be entitled to such payments. It differs

⁶¹ T Wixley, G Everingham (note 48 above), 59

⁶² T Mongalo (note 17 above), 216

⁶³ ‘Sunday Times editors note’ 13th September 2002 *Sunday Times*

⁶⁴ B Cheffins, R Thomas ‘Should shareholders have a greater say over executive pay?: Learning from the US experience’ (2001) *Journal of corporate law studies* 277, 278. See also ‘Executives must perform for cash’, SA *Sunday Times*, 10 September 2000, www.suntimes.co.za In all the instances cited above, the bonus component of the executive remuneration made up well over 50 per cent of the entire remuneration packages of these executives. One may then conclude that these are exceptions from the general practice.

from short-term annual bonuses in that it is awarded after several years rather than on an annual basis.⁶⁵ A director can then either receive this benefit in the form of money or shares. Mongalo indicates that it operates in such a way that once the plan is set up, a number of years will go by and a determination is made whether the company has managed to exceed its performance targets.⁶⁶ These are not common in South Africa. Nedcor, a group of South African banks, recently formulated an LTIP structure, in which it was to reward a number of its directors for the performance of external companies in which it had invested.⁶⁷ The effect of the scheme was that the participants would lose nothing if the value of investments declined, yet gain much more if it increased.⁶⁸ The incentive was not at all linked to the performance of each director in his or her own respective companies. This proposal aroused media and investor protests; the chairman sought to justify the scheme but was forced to withdraw it. Anglo American plc awarded its first LTIP in 2001 at an annual value of 120 per cent of basic salary for the chief executive and one times basic salary for the other main board executive directors.⁶⁹ In order to align the interests of shareholders and executive directors, the company assisted the directors to build up a shareholding in the company through this arrangement. Its annual report indicates that within five years, the executive directors will be expected to acquire a holding of shares with a value of one and a half times base salary, in the case of the chief executive, and one times base salary in the case of other executive directors.⁷⁰

In the UK, companies must generally seek shareholder approval before introducing a new long-term incentive scheme.⁷¹ As these schemes serve to align the interests of shareholders and executives, this approval is usually given, even when the potential rewards are significant. In addition, shareholders have the opportunity to give ongoing approval as, under best practice guidelines, they can vote on remuneration reports at company annual general meetings. However, these votes are only 'advisory' in nature, and as such, are likely to have a limited impact. Approval of director's remuneration reports for the

⁶⁵ T Mongalo (note 15 above), 216

⁶⁶ Ibid

⁶⁷ A Kakabadse (Note 45 above), 306

⁶⁸ T Mongalo (note 17 above), 216

⁶⁹ Anglo American plc 2001 Annual Report, as quoted by T Wixley, G Everingham, 59

⁷⁰ Ibid

⁷¹ R Booker 'Getting a fair day's pay' 16 August 2002 *The Guardian*

financial year in listed companies is governed by section 241A of the UK Companies Act, 1985. In terms of this section, companies ought to give all their members notice of intention to pass an ordinary resolution at a meeting, prior to the meeting meant for reviewal of financial annual accounts of the company. Most recently, in May 2003, GlaxoSmithKline company shareholders declined to vote on the CEO's golden parachute of 22 million in the event of his dismissal, irrespective of underperformance. Fifty one per cent of the members in attendance at the meeting rejected the golden handshake.⁷² Similar results reflecting shareholder activism can be seen in other multinational companies – 23 per cent of the shareholders at Shell and 33 per cent of members at Barclay's plc rejected salary packages.⁷³ It is clear from these incidents that the shareholders are really tired of top executives who are handsomely rewarded for non-performance. There is really no justification for such excessive payouts when equity share prices plummet.

1.4.4 SHARE OPTIONS

As earlier indicated, share options have always been criticized as benefits that are not linked in any way to performance. It is alleged that share options allow management to benefit when a company is doing well but do not penalize such individuals when performance is unsatisfactory.⁷⁴ In this case, the company enters into an agreement with the executive that the company will sell the shares held in the company at a predetermined price and the executive will sell or dispose these shares during or at a particular time in the future. The advantage is that the price at which the executive director will buy will be the agreed price arrived at the time they entered into the agreement with the company. Thus, there is a build-in incentive to exercise the share options granted when the company's share price rises above the strike price or exercise price. Obviously, if the market price at the time the option is exercised is higher than the company's share price, the executive would benefit since he will be buying the shares cheaply, without having had to make the capital

⁷² T Mongalo 'Lots of filthy lucre: Shareholder activism in the UK may be signifying the failure of remuneration committees' Enterprise July 2003, 50

⁷³ Ibid

⁷⁴ Ibid

expenditure to buy the shares. Presumably, the directors will work harder so that the market price will be much higher than the exercise (or agreed) price. If the market value is higher, they will exercise the option, and then sell the shares so bought at a profit. This is because at the time the director exercises the option, the shares are bought at a discount, thus generating a profit for the director.

Undoubtedly, the directors holding such options will not exercise the option by purchasing shares at the time the market value is less than the agreed (or exercise) price. The directors will exercise the options when the company is performing well and logically, they will refrain from selling their shares when the company is performing poorly. As it is, there will be a loss of profitable opportunity but the executive will be in no financially worse off position.⁷⁵ The Code of Corporate Practices and Conduct (King II), makes provision for this form of incentives in 2.5.6 and 2.5.7. King II recommends that disclosure of the option price and the price of the shares at the time it is exercised should be made. Non-executive directors are also entitled to the same benefits.⁷⁶ In South Africa, an executive officer will receive about 10 per cent of his or her compensation in the form of share options.

1.4.5 PERKS/PERQUISITES

King I makes mention of the different types of benefits in kind, that executive directors may be entitled to. Benefits in kind (or perks) include benefits such as a fully paid for company car, holiday home, pension contributions, life assurance, health and disability insurance, clothing allowances overseas holidays, lavish office accommodation, club membership fees and many others.

⁷⁵ Ibid

⁷⁶ Para 2.5.6 of the Code of Corporate Practices and Conduct. The grant of share options to non-executive directors is subject to shareholder approval at an AGM. This results in the dilution of their independence. Greenbury Report at 6.24 and 6.25 summarize the characteristics of executive remuneration.

1.4.6 SEVERANCE PACKAGES

Strictly speaking, these are not a component of remuneration package. An executive director may be fired, dismissed or resign from his duties in terms of Article 65(c) of Table A before his term of service expires. Section 220 (1) (a) and (7) of the Companies Act gives the company the powers to terminate a managerial service contract before the expiration of a director's term of office expires. The section reads as follows

'a company may, notwithstanding anything in its memorandum or articles or in any agreement between it and any director, by resolution remove a director before the expiration of his period of office'. It goes on to read that

'nothing in this section shall be construed as depriving a person removed thereunder of compensation or damages which may be payable to him in respect of the termination of his appointment as director or of any appointment terminating with that of director or as derogating from any power to remove a director which may exist apart from this section'

The director may ultimately have to resign from his position as an executive director. Where an executive director has a five-year contract and is terminated after just two years, it means it still had three years to run and the director may wish to sue the company. It follows then that where a service contract is prematurely terminated, a director can in these circumstances sue on the basis of breach of contract. Such cases do not usually end in courts of law because companies are not keen to attend to lengthy court proceedings, which may ultimately affect the financial position of the company as it brings disrepute to the name and performance of the company. The general public and other companies may decline to invest in such a company on discovery that such a director was not performing well.

The damages usually agreed on settlement are golden handshakes. Depending on the time that was left at the time the contract was terminated, the damages involved in these golden

parachutes can be excessive - The longer the term of the contract, the greater the damages payment would be.⁷⁷ Many companies see such payouts as a better price to pay than to endure image destruction that could be brought about by litigation. Therefore, executives tend to have the upper hand when negotiating golden handshakes because they know that companies are not willing to face embarrassing litigation, which places them before the media. They are usually termed rewards for failure.⁷⁸ A typical example in South Africa is the Coleman Andrews (former CEO of South African Airways) saga, who resigned from his position 18 months before the expiration of his four year service contract.⁷⁹ Besides the large salary he earned he managed to secure a golden handshake in the amount of \$28,8million (about R230 million) when he departed. Shareholders of GlaxoSmithKline, Europe's largest drug maker, recently (May 2003) rejected proposals on executive pay of some top managers on the basis that salary and severance packages were not linked to share performance.⁸⁰ They are urging the company to change its chief executive's severance plan, which would pay him up to \$28 million if he were fired. The concern as voiced by some investors is that 'Glaxo's scheme has significant rewards that are not tied to outstanding performance'.⁸¹ It is felt that this plan does not meet best practice standards for UK corporate governance. The Greenbury committee observed some of these concerns over severance packages and King II goes a step further and requires full disclosure of severance packages, where, as it says 'abuse can take place'.⁸²

It is acknowledged that it is in the company's best interests to make the above benefits available to its employees and directors, and to attract and retain suitable talented staff. A company that does not offer the type of benefits as mentioned above may well find itself in a weak bargaining position in attracting staff, especially skilled staff. McLennan submits

⁷⁷ Greenbury Committee on the dynamics of severance packages in para 13, 7.3 and 7.8

⁷⁸ The UK Department of Trade and Industry recently (May 2003) published proposals to try and curb exorbitant pay packages termed 'Rewards for failure'. Sapa AP 'Unions hail UK paper on fat cat pay' *Business Report*, Friday 6 June 2003: www.businessreport.co.za

⁷⁹ L Loxton 'Looking through the smoke and mirrors of SAA's financial results' *Business Report*, Tuesday, September 25, 2001 <http://www.businessreport.co.za>

⁸⁰ Note 72 above

⁸¹ Glaxo shares are said to be trading at about a third lower than in late 2000, when Jean-Pierre Garnier, the chief executive, received £2.4 million in salary and bonus in 2002. The shares have fallen 17 per cent in the past 12 months, compared with a 23 per cent decline in the benchmark FTSE 100 index.

⁸² Para 1.7 and 7.2. A Smerdon *Practical Guide to Corporate Governance* (1998), 70-72

that because these benefits are so well established, it would seem unnecessary to make provision for them in the Companies Act.⁸³ This is so because these are enjoyed by employees in both private and public companies. Moreover, it would not be feasible to attempt to prescribe what benefits should be made available for any given enterprise. Because of the nature and activities carried on by different companies, the extent to which any benefits are provided must depend upon the needs of each individual company. A large public company might offer a wide variety of benefits.⁸⁴

King II recommends that lengthy service contracts should be avoided and further recommends that all service contracts should not exceed a period of three years in duration unless an extension is otherwise approved by shareholders and it is disclosed and motivated with reasons.⁸⁵ It follows, then, that if such consent is sought and given, an executive director can still be a beneficiary of a rolling contract, which constantly renews itself.⁸⁶

Following recent scandals at, amongst others, WorldCom and Enron in the United States of America, it should be observed that while corporate directors are still to carry out their obligations owed to the company as a whole, companies will not regain investor trust for as long as chief executives compensation, including share options, rises while shares of their companies fall in value.⁸⁷ High pay may undermine companies' morale and pay structures, or create competition for the top jobs so that succession politics instead of sound business management becomes the priority.⁸⁸ Of course the people driving a company's success need to be appropriately rewarded for their achievements, but until companies have the proper checks and balances at the heart of their management, there is a danger that shareholders – and millions of ordinary people who rely on such investments could see money due to them diverted to unjustified schemes.⁸⁹

⁸³ J McLennan 'Misapplication of company funds – a proposal for reform' (1993) SALJ, 654

⁸⁴ Ibid

⁸⁵ Clause 2.5.9 of the Code of Corporate Practices

⁸⁶ Greenbury Report para 7.4; Mongalo (note 15 above), 217

⁸⁷ 'Warren Buffet takes \$60 000 pay cut' 20 March 2003, <http://www.BusinessTimes.co.za>

⁸⁸ Hunt 'Executive pay' 30 August 2001 *The Guardian*

⁸⁹ Ibid

In the light of the discussion above, it is apparent that stringent corporate governance principles in South Africa have to be resorted to as a way of dealing with the problem of executive remuneration. The question is whether our law and systems in place can assist us in resolving and inhibiting excessive remuneration packages.

CHAPTER 2

THE COMMON LAW PERTINENT TO EXECUTIVE REMUNERATION

2.0 COMPANY DIRECTORS

All companies must necessarily act through individuals. The Companies Act provides that every public company must have at least two directors, every private company one.⁹⁰ The articles usually regulate the number of directors and their appointment.⁹¹ The company in a general meeting usually elects them.⁹² Even though a classification of directors is not found in statutes, a distinction is made between executive and non-executive directors in modern company structures.⁹³ An executive director is a director who is involved in a day-to-day management of the company and or is in full time salaried employment of the company. A non-executive director, on the other hand, is a director who is not involved in day-to-day management and is not salaried employee of the company.

The importance of a non-executive director is illustrated by the fact that the status of the non-executive director was comprehensively considered in recent reviews of corporate governance.⁹⁴ As a general rule, non-executive directors attend and vote at meetings of the board, but do not work full time for the company and have no service contract, whereas

⁹⁰ Section 208(1); Table A art 53 and Table B art 54. Section 2 of the Companies Act 61 of 1973 defines a director as 'any person occupying the position of director or alternate director irrespective of the name by which he may be designated.

⁹¹ HR Hahlo *South African Company Law through the Cases: A Source Book* 5th ed (1991), 330

⁹² Table A arts 66-69; Table B art 67

⁹³ The distinction between executive directors and non executive directors was discussed in *Fisheries Development Corporation of SA Ltd v Jorgensen* 1980 (4) SA 156 (W), wherein the court made a distinction in respect of a director's duty of care and skill. Margo J confirmed that the extent of this duty depends to a considerable extent on the nature of the company's business and on any particular obligations assumed by or assigned to him. In that regard, the court held, there is a difference between the full time or executive director, who participates in the day to day management of the company's affairs or of a portion thereof, and the non executive director who has not undertaken any special obligation. The latter would not be required to give continuous attention to the affairs of his company. However, the non-executive director should not assume that his duties would always be less onerous. Since the modern non executive director is likely to be professionally qualified, or at least endowed with a particular expertise, the degree of skill demanded of him is likely to be greater than that required of his counterpart some years ago.

⁹⁴ Cadbury Report, King II Report

executive directors have a service contract under which they work full time for the company.⁹⁵ The King Commission identified four distinct functions as part of non-executive directors' duties. They need to bring their special expertise and knowledge to bear on the strategy, enterprise, innovative ideas and business planning of the company. Secondly, they can monitor and review the performance of the non-executive management more objectively than the executive directors. Thirdly, they can play a role in resolving conflict of interest situations, for example, the remuneration of executives, succession and hostile take-overs. Fourthly, they can act as a check and balance against the executive directors.⁹⁶

In view of the importance of their role, the committee recommends that, whilst recognizing the shortage of trained and experienced people to be appointed directors in South Africa and even if the chair is an independent non-executive director, no board should have less than two non-executive directors of sufficient calibre that their views will carry weight in board decisions.⁹⁷

2.1 DIRECTORS FIDUCIARY DUTIES

In accordance with the common law principles derived from the English law, it is accepted that directors stand in a fiduciary relationship to the company they serve.⁹⁸ These duties exist in addition to the various statutory duties contained in the Companies Act.⁹⁹ Company directors generally owe these fiduciary duties to the company as a whole. Our common law requires that the directors of a company should act bona fide and in the best interests of the company.¹⁰⁰ The entity to which the directors owe fiduciary duties is commonly described as 'the company as a whole' which is interpreted as the shareholders collectively, 'all the shareholders, present and future', and the company as a separate legal entity

⁹⁵ Hahlo, 327; King II par 2.4.3 of the Code

⁹⁶ King I par 4.8

⁹⁷ King I par 19.6.3

⁹⁸ T Wixley & G Everingham (Note 45 above), 25

⁹⁹ J McLennan 'Directors' Fiduciary Duties and the Company's Act' (1983) SALJ 417 provides a comprehensive list of director's statutory duties.

¹⁰⁰ Cilliers & Benade *Corporate Law* 2nd ed (1992), 156; Gower LCB *Company Law Gower's Principles of Modern Company Law* 5th ed (1992)

respectively.¹⁰¹ Modern management takes the view that company directors should consider not only the interests of present and future shareholder's but also those of certain other interest groups and, possibly, those of the State and the general public.¹⁰² It is submitted nonetheless, that, director's fiduciary duties remain owed to the company and that the existing principles of company law adequately address this issue. However, director's compliance with fiduciary obligations cannot be evaluated without taking cognizance of all surrounding circumstances. It is logical to balance the interests of different stakeholder groups, which include creditors, and employees of the company against the duties owed by the directors to the company as a whole. The director who breaches these duties is personally held liable to the company.¹⁰³ A breach of these fiduciary duties enables the company or shareholders to sue the wrongdoers in terms of the common law derivative action or in terms of the statutory derivative action provided for by section 266 of the Companies Act 61 of 1973.

In South Africa and the UK, executive remuneration can potentially be challenged in the courts on the basis that pay has been determined in a manner constituting a breach of the duties of care, loyalty and good faith owed to a company by its directors.¹⁰⁴ In this context, the issue is whether any member can sue on the basis that the amount awarded as executive remuneration is prejudicial to the interests of the company as a whole. By paying themselves huge salary packages, it is submitted that the directors do no longer act in the best interests of the company and this frustrates their duty to maximize shareholder value. It is contended that there are limits to the generosity of companies to their employees: the stage can be reached when it has to be determined whether generosity goes beyond what is in the interests of the company.¹⁰⁵ A notable instance is the case where the company's performance has declined drastically, and the share price has plummeted, but company directors are still awarded excessive bonuses and severance packages for those exiting office in reckless disregard of the company's performance. Thus, the solution is that the

¹⁰¹ Havenga MK 'Fiduciary duties of company directors with specific regard to corporate opportunities' (1998) University of the Orange Free State (Doctoral Thesis)

¹⁰² M Havenga 'The company, the constitution, and the stakeholders' 1997 (5) *Juta's Business Law*, 134; King II

¹⁰³ J McLennan 'Directors' Fiduciary Duties and the Companies Act', 417

¹⁰⁴ BR Cheffins *Company law theory structure and operation*. 665

¹⁰⁵ J McLennan 'Misapplication of company funds', 655

directors' interests be linked to those of shareholders by requiring that their pay be linked to their performance.

Not only can the directors be held to be in breach of their fiduciary duties in this instance, but the director may, also be held liable for damages under the general principles of the law of delict to the company and its members where the director has acted negligently in the execution of his duties and thereby causing financial loss to the company and its members whose shares have diminished in value as a result of that negligence.¹⁰⁶ As Williams indicates, this liability arises not out of the general fiduciary duties owed to the company but arise out of the director's general duties under the law of delict, which duties are owed to society as a whole.¹⁰⁷ In *McLelland v Hullet and others*, plaintiff's claim arose out of the defendant's failure in their capacities as directors of a company of which the plaintiff was both a director and shareholder, to carry out an undertaking to acquire certain land on behalf of the company, thereby causing the value of the plaintiff's interest in the company to be diminished. It was held that because it was inevitable that the defendants would have foreseen that plaintiff's shareholding would diminish in value as a result of their decision and they had a duty to make sure that payment was made. It was indicated that a reasonable person in the position of the defendants would have performed the duty and prevented the harm from occurring. The considerations which justified a conclusion that the defendants conduct in relation to the plaintiff should be regarded as unlawful were that the defendants conduct was prima facie unlawful in the sense that it was a wrong committed against the company, the defendants being bound by a legal duty in favour of the company to avert the harm which flowed from their wrong and being liable to be sued by the company on their failure to do so.

Using the same analogy, one can intimate that where the company performance degenerates, and the board of directors still get to award excessive remuneration packages to directors, they should be held negligibly liable as they ought to foresee the loss the company and shareholders would likely suffer as a result of their negligent act of awarding

¹⁰⁶ *McLelland v Hullet* 1992 1 SA 456 (D) 464

¹⁰⁷ RC Williams *Concise Corporate and Partnership Law* 2nd ed (1997) 152

excessive salary pays. Obviously, where parachute handshakes amongst other components of executive remuneration are awarded, pure economic loss is suffered as a greater portion of company monies is utilized, which directly impact negatively on the share price and shareholder return. Inasmuch as negligence on the part of the directors is ratifiable in terms of the law, where the director obtains a benefit at the expense of the company, such acts cannot be condoned, as they constitute a fraud on the minority. It follows therefore that where exorbitant packages are awarded, directors stand to personally benefit immensely and these wrongs cannot be ratified - They have to reimburse back the monies they acquired for themselves back to the company.

It is recognized that a director owes fiduciary duties with the result that he has the duty to act in good faith towards the company, to exercise his duties of care and skill, to exercise his powers as a director for the benefit of the company, and to avoid a conflict of interest between his own interests and those of the company.¹⁰⁸ In the event of a breach of fiduciary duties, the directors are to be held liable to the company for any damages, which it sustained as a result.¹⁰⁹ Directors are also regarded as having some of the attributes of trustees, notably as regards assets of the company, which are in their hands or under their control.¹¹⁰

From the above, it can be seen that directors' fiduciary duties are important for the purpose of executive remuneration in that in their determination of executive remuneration, the directors have to weigh the two interests together and work within what is essentially in the best interests of the company. While it is generally left to the general meeting to determine the remuneration packages of directors qua directors, the determination of the remuneration of the managing director and other full time executive directors is almost invariably left to the board. Even though a director cannot take part in the deliberations of the board when it considers his own service contract, this means that in effect the top executives determine their own remuneration.¹¹¹ Awarding excessive remuneration packages that cannot be

¹⁰⁸ Cilliers & Benade (note 45 above), 139

¹⁰⁹ RC Williams (note 102 above), 153

¹¹⁰ *Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano* 1981 (2) SA 173, 198

¹¹¹ *Blythe v The Phoenix Foundry Ltd* 1922 WLD 87

aligned to their performance amounts to a breach of their fiduciary duties. As such, in the event of such excess amounts being awarded, the company is wronged and has a right to a claim in damages against the beneficiaries or directors. The company can utilize remedies provided under the law to recoup back these monies. They should not lose sight of these fiduciary duties and their duty to exercise skill and care in the determination of directors pay packages.

Various duties arise from the fiduciary relationship between directors and the company.

2.1.2 EXERCISE OF POWERS IN GOOD FAITH

The paramount duty of directors is to act bona fide in what they consider to be in the best interests of the company.¹¹² It is left to the directors in the exercise of their business judgment to decide how the interests of the company may best be promoted. The courts will interfere only if no reasonable director could have concluded that a particular course of action was in the interests of the company.¹¹³

2.2.2 AVOIDANCE OF CONFLICTS OF INTEREST AND DUTY

Directors are required not to put themselves in a position where there is, or may be, a conflict between their personal interests and their duties to the company.¹¹⁴ A possibility of conflicting interest will be found where the reasonable man considering the relevant facts and circumstances of the particular case would think that there is a real possibility of conflict.¹¹⁵ One of the most significant and obvious conflicts of interest which directors face is in the setting of their remuneration. It was indicated earlier that Table A of the Companies Act provides that the board may determine the remuneration of the managing and executive directors. In South Africa, it has to be determined whether this is indeed the

¹¹² Ibid

¹¹³ Schulze H 'Breach of a fiduciary duty by a director of a company' (1995) De Rebus Issue 335, 699

¹¹⁴ Havenga 'Fiduciary duties' 1995 SA Merc LJ 435; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 177

¹¹⁵ *Boardman and Another v Phipps* (1967) 2 AC 46 (HL)

right approach to adopt or not. Another typical example where a conflict of interest and duty may suffice would be of directors holding directorships in competing companies.

Cross-directorships entail that a director in one company may sit as a non-executive director in another company. It would mean therefore that in setting remuneration packages, such director is effectively setting their own remuneration pay based on what other executive directors in other comparable companies earn. While it is acknowledged that as the Listing Requirements stipulate, that ‘no director should be involved in deciding his or her own remuneration’,¹¹⁶ its effectiveness remains very questionable when regard is had to the fact that the ultimate decision or say on directors’ remuneration rests with the board of directors, the members of which are colleagues of a director who may have recused himself or herself in order to enable his or her individual pay package to be discussed and decided in his or her absence. It seems to me that the directors end up giving their colleagues high pay increases in the hope that when it is their turn, these colleagues would be equally or reciprocally generous. Obviously, the absence of such a director when a determination of his or her pay is made does not really make a difference as to the package he or she will ultimately get. The absence of a director in the discussions of his or her remuneration has not seen any narrowing of the pay gap between directors and other rank employees. Neither has it led to the curtailment of remuneration packages.

With the recent corporate reforms, it is believed that disclosure and accountability to shareholders in this area is essential. However, it is submitted that it does not prevent or do away with directors engaging or doing away with directors’ conflicting interests in this regard.

2.2.3 SECRET PROFITS

As espoused above, a company director has no right to remuneration unless such right is given to him by the articles or contractually.¹¹⁷ The company may recuperate any other

¹¹⁶ Para 22.7.10

¹¹⁷ Hahlo (note above), 369

pecuniary gain received by a director.¹¹⁸ A director's use of corporate assets in order to make a secret profit for himself is clearly a breach of his fiduciary duties.¹¹⁹ In *Robinson v Randfontein Estates Gold Mining Co Ltd*,¹²⁰ Robinson was chairman of the respondent company and he attempted unsuccessfully to purchase the farm for the company. Later onwards, he bought the farm for £60,000 through an agent and sold it shortly afterwards to a subsidiary of the company for £275 000. The court ordered him to repay the profit of £215 000 made by him. He could have possibly avoided this had he made full disclosure to the company and the company had agreed to it.

In *Regal Hastings Ltd v Gulliver*,¹²¹ the House of Lords held that the directors were liable to account if it was established that what they did was so related to the affairs of the company that it could properly be said to have been done in the course of their management and in utilization of their opportunities and special knowledge as directors, and that this had also resulted in a profit to themselves. The test for accountability as stated by Lord Porter was that

One occupying a position of trust must not make a profit, which he can acquire only by use of his fiduciary position, or if he does, he must account for the profits so made.¹²²

According to this formulation, therefore, it would seem that a director would be liable for any benefit acquired by virtue of his office, whether or not the advantage was acquired in the exercise of that office. Liability arises in this instance, if the benefit was acquired by virtue of the director's office as well as in the exercise of that office. In some jurisdictions, directors have been held accountable for profits made as a result of their use of the company's property or facilities, and for profits made by them on the resale of shares, which they acquired by using their positions, or issued to themselves.¹²³ It is submitted

¹¹⁸ Ibid

¹¹⁹ *Regal Hastings Ltd v Gulliver* 1942 (1) ALL ER 378 (HL)

¹²⁰ Ibid

¹²¹ Ibid, 391

¹²² Ibid, 395

¹²³ *Parker v McKenna* (1874) 10 Ch App 96

herein that, there is merit in the strict application of this rule in respect of large public companies, whose directors are well-paid fiduciaries.

Directors have to account for the money and shares that are given to them.¹²⁴ A strict rule can have the positive effect of encouraging them to do their best for their companies. Since the prohibition is, in any event, only against secret profits, the director is relieved of any possibility of a breach of duty if disclosure is made to and approval is obtained in a general meeting. However, it is submitted that, as shall be seen hereunder, disclosure does not necessarily curtail excessive pay packages.

Cilliers et al indicates that a director may obtain no other advantage from his office *than that to which he is entitled by way of director's remuneration*.¹²⁵ It is submitted that exorbitant remuneration awards constitute an advantage to which a director is not entitled. The directors' awarding themselves exorbitant pay packages that are not aligned to performance can be equated to the duty against making secret profits in the sense that the packages they award themselves are in fact, shareholder monies, or company monies, which the company is deprived of. The directors are in fact, depriving the company of its corporate opportunity, which rightfully belongs to the company. Such awards should be regarded as breaches of fiduciary duty in the above context. It is submitted that pay that is not aligned to performance is tantamount to advantages that directors may not obtain for themselves, as these are over and above what they are rightfully entitled to by virtue of holding their directorship positions. Boards of directors should therefore be made to account for each and every component in each director's package, and whether or not it is indeed justifiable.

Furthermore, it was pointed out earlier that directors are regarded as trustees of company property, which is in their custody and under their control.¹²⁶ Accordingly, the company may claim the property from the 'delinquent directors', or may claim any 'profit' the director may have made as a result of their breach of duty, or damages in respect of any

¹²⁴ Havenga M 'Director's fiduciary duties under our future company law regime' 1997 (9) SA Merc LJ 310

¹²⁵ Cilliers & Benade (Note 45 above), 141

¹²⁶ Larkin M 'The fiduciary duties of the company director' 1979 (2) SALJ 11

loss thereby caused to the company.¹²⁷ The board of directors can then be sued on the basis that they wrongly acquired for themselves the share of profits of the company, which they could not validly claim. It is submitted here that such awards constitute unjust enrichments on the directors' part.¹²⁸ It is maintained here that directors should not be placed in positions of potential conflict of duty and self-interest.¹²⁹ Their services to the company do not go unrewarded and therefore, liability should be attached should they award excessive remuneration packages. They must be held liable in damages to the company for any 'loss' the company suffered in consequence of their acts. The recovery of the profit that they made must be recovered on the basis that the director is accountable to the company.¹³⁰

Note should be taken that the directors need not be acting dishonestly in awarding exorbitant remuneration packages. Professor Naude' observes that directors can abuse their powers even when they act in the honest belief that they are doing what is for the good of the company.¹³¹ They must act honestly, but honesty is not sufficient. The courts adopt an objective approach in this regard. In *Re W & M Roith Ltd*,¹³² the controlling director shareholder organized an arrangement in terms of which the company would pay a life pension to his widow. No suggestion of bad faith was made on his part; nonetheless, the transaction was ultimately struck down on the basis that it was intended to operate solely for the benefit of the widow and not the company. In the same breath, where there is a measure of self-interest in the conclusion of excessive remuneration deals that are meant to personally benefit the directors and not shareholders or the company as a whole, such pay packages should be struck down on the same basis. It is submitted that it is against the spirit of corporate governance for board members to jointly pass a vote for such deals while aware that there exists no alignment of pay and performance of individual directors.

¹²⁷ *Robinson v Randfontein Estates gold Mining Co Ltd* 1921 AD 168, 179

¹²⁸ J McLennan 'Company Directors – Fiduciary Duties' (1989) 1 SA Merc LJ 123, 129

¹²⁹ Means of avoiding unjust enrichment by directors will be discussed in Chapter 4

¹³⁰ J McLennan 'Company Directors – Fiduciary Duties' (note above), 131

¹³¹ As quoted in McLennan 'Misapplication of company funds – a proposal for reform', 651

¹³² (1967) ALL ER 427

2.3 MECHANISMS IN THE LAW THAT MAY CURTAIL AND AFFECT EXECUTIVE REMUNERATION

With the obvious abuse emanating from the fact that directors effectively set their own pay, and that members have some control over their fees, members previously had no control whatsoever over the total emoluments paid to a director in the form of salaries, bonuses, contributions to pension schemes and compensation for loss of office. In the old regime, members could just make reliance on the information they perused in annual financial statements and there was not much that they could do except to complain at the AGM that the remuneration packages were grossly excessive and that the emoluments of the chairman and chief executive were obscene.¹³³ In fact, directors could very easily vote themselves long term service agreements in the case of executive directors, and generous contracts for consulting and similar services in the case of non-executives. The Companies Act imposes some restrictions on directors who liberally assess their own worth and services, and set their own pay.

2.3.1 RESTRICTIONS ON BENEFITS

2.3.1.1 THE COMPANIES ACT NO 21 OF 1973

In terms of the Companies Act, a few mechanisms that deal with restrictions that may impact on executive pay are provided for. For instance, section 221 (1) of the Act restricts the powers of directors to issue shares. The issue of shares by directors is made subject to the prior approval of a general meeting.¹³⁴ It provides that directors' powers with regard to the allotment or issuing of share capital can only be validated upon the company approving to such proposal in a general meeting. Shareholders have a right to know how much is being allotted by way of shares to directors and other parties and benefits and these have to appear on the agenda of every annual general meeting.¹³⁵ It should be noted however that this restriction relates to the total benefits that members may make; there is nothing to

¹³³ PL Davies *Gowers Principles of Modern Company Law* 6th ed (1997), 630

¹³⁴ Cilliers & Benade (note 45 above), 152

¹³⁵ J McLennan 'Misapplication of company funds: a proposal for reform', 658

prevent members from specifying maximum amounts that may be given to individual beneficiaries.¹³⁶

Furthermore, in terms of this section, it is clear that directors cannot in any way issue shares to themselves as a way of compensating themselves without prior authority to do so from the company. This however, does not in any way curtail the granting of excessive remuneration to directors. This section does not impede directors exercising their share options. It does not seem that this section will limit or play a crucial role in curtailing exorbitant executive compensation.

The other restriction provided for in terms of the Act is section 222 (1) (a), which limits the issuing of shares and debentures to directors. The issue of shares by directors to themselves and their beneficiaries may only take place in very limited circumstances.¹³⁷ Directors are precluded from allotting shares to other directors or their nominees, or to a body corporate which acts on the instructions of a director, or at a general meeting where a director holds more than 20 per cent of the voting rights unless approval has been sought from the company in a general meeting.¹³⁸ This proviso does not as well seem to work towards constricting excessive remuneration packages because directors can justify hefty share allotments before members in a general meeting who as practice has shown, never really query such allotments.

Furthermore, as already mentioned, the company may decide to assign directors share options. In terms of section 223, directors can only validly subscribe for share options if it can be established that they received no undue preference, or if approval is made by a

¹³⁶ Ibid. There is nothing that precludes members from stipulating the maximum amounts that may be given to directors. It might just as well be a good idea if the Act were to require not only disclosure, but also scrutiny and justification over benefits exceeding a specified amount in any given year.

¹³⁷ Cilliers & Benade (*note 45 above*), 152

¹³⁸ Or unless such shares are allotted under an underwriting agreement (Sec 222(1)(b)); or unless the shares allotted are in proportion to existing holdings and on the same terms and conditions as apply to other shareholders (Sec 222 (1)(c)); or unless the shares allotted are offered on the same terms and conditions as to members of the public (Sec 222 (1)(d))

special resolution, or where the right is given to a salaried director in his capacity as an employee of the company.¹³⁹ The provision reads that

No option or right given directly or indirectly to any director or future director of a company in terms of any scheme or plan, to subscribe for any shares of that company... on any basis other than that laid down in section 222 (1) (c)¹⁴⁰, shall be valid unless authorized in terms of a special resolution of that company. The provisions to this section read as follows

- (a) the term 'future director' shall not include a person who becomes a director of the company after the lapse of six months from the date upon which such option or right is acquired by such person; and
- (b) no such option or right shall be invalid in terms of this section if such director or future director of the company holds salaried employment or office in the company and is given such right in his capacity as an employee.

It is clear that directors can only be afforded share options upon the special resolution being granted. Note is taken that the requirement for a special resolution does not apply to executive directors since they are employees of the company and the right to share options is given to them in their capacity as employees through their service agreements. It follows therefore that the passing of a resolution does not act as a serious obstruction to a company awarding generous share options. Instead, special resolutions might be made in order just to try and lure and retain talented executives.¹⁴¹

The other relevant provision is section 227 that relates to the payment to directors for loss of office or in connection with schemes of arrangements and takeovers. It prohibits a company from paying a past director or retiring director (or director of its subsidiary or holding company) any benefit for loss of office or in connection with their retirement from

¹³⁹ Cilliers & Benade (note 45 above), 152

¹⁴⁰ It provides that if the shares allotted are in proportion to existing holdings and on the same terms and conditions as apply to other shareholders

¹⁴¹ King II; Mongalo, 240

office, unless full details are disclosed to the members and approved by special resolution. However, in terms of section 227(6), 'this provision does not apply with reference to any bona fide payment made or benefit or advantage granted by way of damages for breach of contract or by way of a pension, including any superannuation allowance, gratuity or similar payment in respect of past services'. It follows therefore that the company would still have to pay a departing director a golden handshake and in such a case, no special resolution would necessarily have to be passed.¹⁴²

It is submitted that to deter abuse in cases where the company is not in a position to bargain at arm's length, not only must there be disclosure, but insider transactions such as those above must be made susceptible to liability. The court would then have to view these transactions in an objective manner; if it is satisfied that the transaction constitutes an abuse of the process, it could then avail the company a remedy. Often, in order to lure and retain competent executive directors, attractive benefits are awarded but these are given by way of contracts in their capacity as employees. As such, hefty packages can be awarded notwithstanding the fact that the directors concerned are not performing beyond expected levels. It is submitted that awarding excessive remuneration to directors that is not aligned at all to performance constitutes such abuse as advocated by McLennan.¹⁴³

Last but not least, the Companies Act precludes a board of directors from selling most of a company's assets unless shareholders agree in a general meeting. It makes provision for the non-disposal of the undertaking or a greater part of assets of the company in terms of section 228. This section calls for those making decisions to carefully consider the best interests of the company.¹⁴⁴ The directors do not have powers to dispose of the whole or the greater part of the assets of the company. This section is problematic because the directors can still sell the assets of the company one by one, and it would not be possible to say that, at any time, they were disposing of the whole or a greater part of the assets. Thus, they

¹⁴² Similar provisions in the UK are made: *Section 312-315* of the UK Companies Act makes provision for these exceptions

¹⁴³ J McLennan 'Misapplication of company funds', 660

¹⁴⁴ J McLennan, *Director Fiduciary Duties*, 438

would not need any approval of shareholders in such a case.¹⁴⁵ It would appear that if directors sell the assets in consecutive transactions one by one at any one time, it would not be possible to say that they were disposing of the whole or the greater part of the assets. As such, they do not require the approval of members, but if they sell the assets all in one go, they have no power to do so without a resolution of members.¹⁴⁶ In a large listed public company, it is doubtful whether one can safely say exorbitant remuneration packages constitute the whole or the greater part of the assets of the company.¹⁴⁷ This is so because invariably, the pay packages do not account for a greater percentage of the companies' assets.

DISCLOSURE OF REMUNERATION PACKAGES IN ANNUAL FINANCIAL STATEMENTS

In terms of Section 286 of the Companies Act, a company is required to prepare its financial accounts on an annual basis, which have to indicate the aggregate amount of compensation paid to directors. The statement has to disclose emoluments received by directors in terms of Section 297, which include directors' fees, bonuses, salary and expense allowances. The amount of pensions paid or receivable by directors and past directors and compensation paid to present and past directors and details of directors' service contracts in terms of section 289 have to be set out as well. These financial statements have to be presented before shareholders annual general meeting. However, even though the Companies Act clearly makes provision for such disclosures, the spiraling remuneration packages of directors over the years show that these sections have not really had any effect on decreasing the wage gap and directors pay that is not aligned to performance. In essence, companies seem to be engaged in a box ticking exercise or rather do so out of compliance with the rules rather than with the spirit of the section. Disclosure does not at all oblige directors to consider the interests of shareholders given the facts that it is left in their hands what matters to report on. In any event, even with the advent of

¹⁴⁵ Ibid, 439

¹⁴⁶ JS McLennan 'Directors Fiduciary duties and the Companies Act' 1983 SALJ 417, 439

¹⁴⁷ J McLennan, 'Directors fiduciary duties and the Companies Act', 438

corporate law reforms (King II), directors are only expected to report on remuneration policies but are not obliged to implement such processes.¹⁴⁸

Section 297 (1) – (10) of the Companies Act stipulates that there should be full detailed disclosure of the total directors emoluments and pensions paid or received by the directors, the amounts of any compensation paid to directors and past directors in respect of loss of office and details of directors service contracts in the annual financial statements. This section focuses on ensuring adequate disclosure so that shareholders have sufficient information available to make informed decisions regarding remuneration. The recommendation by King Committee on corporate governance that there should be full and clear disclosure of the total of executive and non-executive director's earnings broken down into headings describing the nature of the compensation has led to the amendment of this section.¹⁴⁹ However, while disclosure of individual remuneration packages has been adequate, the existing South African best practice framework and mechanisms have not led to satisfactory disclosure of remuneration policies. Arguments have been leveled that mandating detailed disclosures may ultimately result in increased compensation levels. For instance, despite the relatively comprehensive and long standing American and UK disclosure requirements, American executive pay is the highest in the world.¹⁵⁰ In the South African context, there has really been no evidence to show that disclosure of remuneration packages in annual financial statements works towards curbing exorbitant pay being awarded. For this reason, it would seem that section 297 does not assist in the curtailment of hefty remuneration packages.

The remuneration is to be the subject of recommendations to the board of the proposed remuneration committee.¹⁵¹ The chairperson of the committee is expected to attend all AGM's in order to answer all questions put forward by the members. In England, the Cadbury Committee and Greenbury Committee made similar recommendations.

¹⁴⁸ T Mongalo 'Two steps forward, one step back: Directors' duty to act for the benefit of the company revisited in the aftermath of corporate governance reforms' (Unpublished article) 1, 14

¹⁴⁹ Section 197 (1A)(a)

¹⁵⁰ PLC Global Counsel 'Executive compensation disclosure in Germany, the UK and the US' October 2002 Vol VII Number 8,30

¹⁵¹ King II, para 2.5.4

2.3.1.2 STATUTORY RESTRICTIONS ON DIRECTORS' REMUNERATION IN THE UK

2.3.1.3 THE UK COMPANIES ACT 1985

Section 318 and 319 of the UK Companies Act impose restraints on the liberality on directors' fees. Section 318 requires that every company has to keep a copy of the service agreement of each director of the company or its subsidiary or a memorandum of its terms if the agreement is in writing.¹⁵² The memorandum has to be kept at the registered office or principal place of business,¹⁵³ and copies of which must be made open to inspection by any member of the company without any charge.¹⁵⁴ However, rights of inspection are never really used in practice even in the case of public companies. This right is limited to members and one can argue that if it were extended to employees as well, whose interests the directors are expected to protect in their exercise of their duties to the company, then, disclosure requirements would be met to an extent and it would deal with the abuse flowing from board members having control of their own remuneration. However, it does not seem as if this section works towards curtailing excessive awards of remuneration as practice has shown that members hardly ever utilize this option.

Section 319, on the other hand, appears to be more effective. It precludes any term that would stipulate that 'any director employed whether under a contract of service or for services, which may last for more than 5 years without being terminable by the company or terminable only in specified circumstances unless the term is first approved by a resolution of the company in a general meeting.'¹⁵⁵ In recent years, members in a general meeting do reject long-term service agreements which are not determinable by the company until the

¹⁵² Section 318(1)

¹⁵³ Section 318(3)

¹⁵⁴ Section 318(7)

¹⁵⁵ Section 319(1)(2)(7)

directors reach retirement age or later.¹⁵⁶ However, rolling contracts do not seem to fall within the ambit of the section, which contracts when terminated by the company, will always have about five years to run.

Section 312 is another important provision that precludes directors from awarding themselves hefty packages. It provides that shareholders must give their approval before the company provides ex gratia payments to a director on leaving office. However, this provision is not applicable where a director is entitled to benefits emanating from a contractual agreement. As such, the board cannot be restricted in awarding payments to a departing executive as part of a settlement under which he agrees to forego the right to sue for damages for breach of his unexpired service contract.

Furthermore, Schedule 6 of the Act contains provisions that require that disclosure to shareholders and the public of directors' remuneration is to be included in the director's report.¹⁵⁷ Section 325(3) requires that the register of directors' interests should be kept and must contain information about share options that may have been granted to directors. Disclosure does not seem to be providing the solution to the problem. Directors still seem to be awarding themselves generous salaries and share option packages even though the companies they are running may not be performing 'over the odds' and may not necessarily require any great entrepreneurial flair.¹⁵⁸ This provision has not proven to be effective at all in curtailing exorbitant pay packages.

2.3.1.3 UK'S RECENT REFORMS ON DISCLOSURE REQUIREMENTS

With regard to the disclosure of compensation of executive directors, the company's annual accounts must be availed to all members prior to or at each AGM. In terms of Section 241 of the UK Companies Act 1985, the board is expected to disclose the total remuneration payable to all directors, including any amounts received under executive service contracts.

¹⁵⁶ PL Davies (note 130 above), 631

¹⁵⁷ Ibid, 632

¹⁵⁸ One may find that the company actually needs a rigorous cutting of costs, notably the dismissal of significant numbers of employees.

The accounts must state the full pay of the chairman, the number of directors falling within specified bands of remuneration and any compensation made to a director for loss of office. It should be noted that the Act does not mandate that individual director's pay be provided. Neither does it require that a breakdown of the constituent parts of each director's remuneration package be made. The UK government found these provisions lacking and recently formulated regulations that supplement current legislation.

The new UK directors' remuneration disclosure requirements are contained in the Directors' Remuneration Report regulations 2002 (the DRR Regulations), which have amended the disclosure requirements of the Companies Act, including an insertion of a new Schedule 7A.¹⁵⁹ These requirements are also contained in the Companies (Summary Financial Statements) Amendment Regulations 2002, which amend the Companies (Summary Financial Statements) Regulations 1995, and require that summary financial statements include certain of the new remuneration disclosures. These amendments build on the current law regulation and best practices that are set out in the UK Companies Act 1985, the UK Listing Rules and the UK Combined Code of Principles of Good Governance and Code of Best Practice. In addition to preparing the director's remuneration report, a company must continue to comply with paragraph 1 of Part I, and all of Parts II and III of Schedule 6 to the Companies Act, which require disclosure in the notes to the company's annual account of the aggregate amount of director's emoluments, loans to directors and other transactions between a director and the company.

The new legislation mandates that all public quoted companies must produce a directors' remuneration report as part of their annual reporting cycle. The remuneration report only requires disclosure of directors' remuneration. Unlike the US approach, calls to extend the new law to senior managers of public companies were rejected.¹⁶⁰ In terms of section 244 of the Companies Act, the report by the board of directors has to be prepared and published within the time frame as the quoted company's annual report and accounts. It then has to be tabled before the company's shareholders; debenture holders and other persons entitled to

¹⁵⁹ J Baird, P Stowasser 'Executive Compensation disclosure requirements: The German, UK and US approaches', PLC Global Counsel (2002) 7 (8), 32

¹⁶⁰ Ibid, 32

receive notice of general meetings in terms of section 238 of the Act. The report has to be placed before an annual 'advisory' shareholder vote in terms of section 241A of the Companies Act. The remuneration report has to include a forward-looking statement of policy on directors' remuneration. This is an expansion on the existing obligation in the UK Listing Rules (Para 12.43A(c)), as it requires certain specific disclosures as part of the policy statement. In particular, a detailed summary of the performance conditions applicable to share options and long-term incentive schemes entitlements for each individual director and an explanation of why they were chosen; a summary and explanation of the methods to be utilized in assessing whether the performance conditions are met. The requirements also mandate that an explanation be given if any director's entitlement to share options or under long incentive schemes is not subject to satisfaction of a performance condition.

The new requirements also obligate that any significant amendment proposed to be made to the terms and conditions of any director's entitlement to share options or long term incentive plans be reported on. In addition, details of any comparator company in the same industry that is used in determining performance conditions for share options or long incentive plans should be made. An explanation of the relative importance of the elements of a director's remuneration that are, and are not, performance related have to be disclosed. The statement of policy must also cover in summary form, an explanation of the company's policies regarding the duration of, and notice periods and termination payments under, directors' service contracts. It is important to also note that exclusion of information regarding performance criteria for share options and long term incentive schemes is not permissible on grounds that the information is commercially confidential.¹⁶¹ Disclosure of performance criteria for annual bonus awards is not required, although best practice is to make such disclosure. This is indeed a significant development in the regulation of executive remuneration.

Last but not least, the new regulations mirror the US approach and stipulate that the remuneration report must include a performance graph which shows the total shareholder

¹⁶¹ Schedule 7A, paragraph 3

return for the preceding five financial years for a holding of shares of the class of the quoted company's equity share capital whose listing or admission to dealing has resulted in the company falling within the definition of 'quoted company'.

Disclosure of sums receivable in respect of the relevant financial year whenever paid and sums paid in the relevant financial year if not received in respect of any period has to be made. Schedule 7A, paragraph 1(2) stipulates that information reported on a specific person must be shown in a manner that links the information to the particular person by name.

Most significantly, it should be noted that the remuneration report is subjected to audit in terms of Schedule 7A, Part 3. The auditors have to report on the levels of non-compliance and any inconsistencies between the information audited and the company's audited accounts. A disclosure of all emoluments and compensation details must be provided. The salaries, fees, bonuses and any other allowances the director is entitled to have to be disclosed. In the event of resignation, compensation for loss of office and any other payments made in connection to the termination of qualifying services has to be made.

With regard to share options, disclosure of details of options held at the beginning and end of the relevant financial year has to be made; in each case a differentiation of options having different terms and conditions has to be made; and most importantly, any performance criteria upon which the award or exercise of an option is conditional, including a description of any variation to the performance criteria during the year. A comprehensive detail of long-term incentive schemes held by each director at the commencement of the financial year and end has to be availed. The report has to capture and identify scheme interests awarded, varied and vested during the year under review. The values involved and their form, the dates of appointment and cessation as director have to be succinctly outlined. Other important information that relates to remuneration packages has to be captured as well.¹⁶²

¹⁶² This includes any information on amounts pertaining to retirement benefits paid to or receivable by such persons in excess of the retirement benefits to which he or she was entitled on the later of 31st March 1997

The company must avail details of the service contracts of all directors; the dates, unexpired terms and notice periods of the service contracts of any person who has served as a director during the relevant financial year must be provided. Details of any significant awards to any past director of the company during the relevant financial year and provision for compensation payable on early termination must be described. The contractual terms and conditions attached that are necessary in estimating the liability of the company in the event of early termination have to be disclosed.¹⁶³

Companies are still however, expected to comply with some of the pre existing disclosure requirements. As indicated earlier, Schedule 6 of the Act contains provisions that require that disclosure to shareholders and the public of directors' remuneration be included in the director's report.¹⁶⁴ Section 325(3) requires that the register of directors' interests should be kept and must contain information about share options that may have been granted to directors.

In terms of section 241A of the new legislation, which basically reiterates the existing requirements under Chapter 13 of the Listing Requirements for shareholder votes to approve employee share schemes and long-term incentive plans; the remuneration report must be put to a shareholder vote at the annual general meeting of the company. The vote taken is advisory in nature and is therefore not binding on the board of directors. It protects the company from negative votes that may affect existing contractual compensation entitlements. Moreover, it is unlikely that directors could agree to sign contractual agreements with salary packages that are conditional upon shareholder approval. It is submitted that it does not really assist the situation in any way because the company itself would be very concerned by the messages sent by a negative vote. The Board of directors

and the date on which the benefits first became payable (*Schedule 7A, paragraph 13*). Significant awards to persons who had previously been directors of the company including for loss of office (*Schedule 7A, paragraph 14*) and any director's accrued benefits and transfer values under defined benefit pension schemes, and contributions paid or payable by the company on behalf of a director to money purchase pension schemes (*Schedule 7A, paragraph 12*). Sums paid to a third party in respect of a director's services have to be disclosed as well. (*Schedule 7A, paragraph 15*)

¹⁶³ Schedule 7A, paragraph 5

¹⁶⁴ *Ibid*, 632

can always motivate why the packages are so high and even though active shareholders may strike down excessive packages but often, often, they engage in a box ticking exercise. It's only recently that we have seen a few companies failing to vote on packages that they felt were not aligned to performance.¹⁶⁵ Inasmuch as it would be more helpful for company members to pass a vote on the remuneration report as whole, more focus should be made on the remuneration policy of the company.

There are however a number of shortcomings with regard to these new disclosure requirements. It is felt that disclosure requirements should have been extended to public company's senior management in order to provide a more fuller complete picture of the company's compensation philosophy and to address any possible problems caused by senior managers refusing to accept board seats in order to avoid the disclosure requirements. It is submitted herein that regardless of these new developments in the UK, newspaper reports received almost on daily basis bear evidence that excessive remuneration packages awarded to directors are still being approved to date and are still spiraling out of control. There is still no alignment of pay and performance. The amendments in the Act do not seem to have had any much effect on inhibiting such awards.

2.3.1.4 US DISCLOSURE REQUIREMENTS UNDER ITEM 402, REGULATION S-K

Disclosure requirements are generally governed and contained in Item 402 of the Regulation S-K. In terms of this regulation, tabulation of all compensatory benefits accorded to directors must be set out comprehensively in the annual financial statement for the period under review.¹⁶⁶ Details of employment contracts and other arrangements have to be made, insider participation, and a report by the compensation committee outlining the reasons for their compensation decisions. Significantly, the board of directors has to avail a report that describes the relationship between compensation and corporate performance. The board has to include a performance graph that outlines the company performance on

¹⁶⁵ GlaxoSmithKline case

¹⁶⁶ J Baird, P Stowasser, 36

the basis of shareholder return that is compared against the market index in the same industry. As in the case of South Africa and the UK, disclosure of remuneration packages has to be reported on an individual case for each executive director during each of the last three fiscal years. The report is on the basis of base salary, bonuses and other annual compensation, long term incentive awards (LTIP) awards made, any other awards including termination payments, options granted including present base values to each named executive. An annual report outlining the company policy of the compensation committee, the relationship between corporate performance and aggregate executive compensation and the performance measures that the committee considers in awarding remuneration has to be prepared.¹⁶⁷ Unlike the comparable UK requirements, the report is not required to discuss forward-looking compensation policy. It is also to note any dissenting members in decision reached by the committee and a summary of reasons for such a dissenting decision, any modification or rejection by the board of directors of any decision of the compensation committee.

The whole object of the Securities Exchange Commission (SEC) is said to be that shareholders who are dissatisfied with executive compensation should vote, not litigate.¹⁶⁸ The SEC issues 'comment letters' to companies requiring rectification of compensation committee reports that the SEC regards as unsatisfactory or deficient. Even though this may be perceived as a good move in that the reports are highly scrutinized, the decisions of compensation of executives are still left entirely in the hands of the compensation board, and it does not seem as if these comment letters would have any effect of striking down excessive remuneration that is not aligned to performance. There have not been many cases that have been reported in this regard. One can legitimately question the efficacy of this move given the fact that in the US, there has yet been no record of a compensation package that has been struck down on the basis that the report from which it emanates is deficient or unsatisfactory.

¹⁶⁷ Ibid, 39

¹⁶⁸ Ibid, 40

Notwithstanding the efforts made to try and promote more transparency and disclosure mechanisms, executive remuneration is still spiraling out of control. Disclosure does not seem to be providing the solution to the problem. Directors still seem to be awarding themselves generous salaries and share option packages even though the companies they are running may not be performing 'over the odds' and may not necessarily require any great entrepreneurial flair.¹⁶⁹ These provisions have not proven to be effective at all in curtailing exorbitant pay packages.

From the above, it does not seem as if the South African and the UK and the US Companies Acts have succeeded in curtailing excessive remuneration packages in public companies. It is submitted that the Acts do not in any way dissuade and prevent directors receiving excessive remuneration packages. From these sections, it is clear that there is no statutory provision which requires shareholders to approve directors' remuneration or that enables them to reduce remuneration packages on the basis that the company is simply paying too much.

2.3.2 JUDICIAL REGULATION OF EXECUTIVE REMUNERATION

Notwithstanding the fact that there is no provision that entitles the court to strike down director's remuneration on the basis that the package is too much, there are some circumstances where it is possible for relief to be granted as a result of complaints concerning executive pay.¹⁷⁰ In *Guinness v Saunders*¹⁷¹ director with special expertise was appointed a member of the committee of the directors to act for the company in connection with a take over. The committee agreed to the director's additional remuneration on terms, which enabled him to claim and to be paid £5, 2 million. The articles of the company provided that special remuneration could be granted only by the full board. The court ordered the director to return the remuneration to the company on the basis that the transaction was voidable at the instance of the company. As such the director and the

¹⁶⁹ One may find that the company actually needs a rigorous cutting of costs, notably the dismissal of significant numbers of employees.

¹⁷⁰ T Mongalo, 223

¹⁷¹ (1990) 2 AC 663 (HL.)

company had to be returned to their former positions.¹⁷² It also considered that the director was not entitled to be paid on a quantum meruit basis, or otherwise. The learned Lord Templeman had this to say

A shareholder is entitled to compliance with the articles. Article 92 provides clearly enough for the authority of the board of directors to be obtained for the payments of special remuneration and the submissions made on behalf of Mr Ward, (the director)... are more ingenious than plausible and more legalistic than convincing.

This case indicates that in making executive remuneration decisions, procedures in place have to be followed meticulously. If a deviation from the ordinary procedures is made, then the pay can be set aside on this basis.

In *Blythe v The Phoenix Foundary Ltd*¹⁷³ it was held that directors could not pass a valid resolution to increase their own remuneration unless they held all shares in the company. This can be supported by what King II points out, that a director may not vote at a meeting at which his own remuneration is considered. Hahlo¹⁷⁴ makes reference to *Trek Tyres Ltd v Beukes*¹⁷⁵ and *Gundelfinger v African Textile Manufacturers Ltd*¹⁷⁶ in support of this view and says that a director whose remuneration package is in issue need cast a vote at such director's meeting. Obviously, in a large listed public company, it is not feasible that all directors be owners of all the share capital in the company. This situation as espoused in Blythe's case is envisaged in a private company or in a small public company, where all directors might have vested interests in the form of shares in the company.

A typical example of a case where the court made an intervention where pay was not at all aligned to performance is *Roger v Hill*..¹⁷⁷ The court was of the view that it could justly provide a remedy against a company if payment made to executives constituted a waste.

¹⁷² PL Davies (note 130 above), 613

¹⁷³ 1922 WLD 87

¹⁷⁴ Hahlo *South African Company Law through cases 5th ed* (1991) Juta, 219

¹⁷⁵ 1957 (3) SA 306

¹⁷⁶ 1939 AD 314

¹⁷⁷ (1933) 289 US 582

The court indicated that the compensation paid to directors should not be so large as in substance and effect to amount to spoliation or waste of corporate property.¹⁷⁸

2.3.2 COMMON LAW AND STATUTORY DERIVATIVE ACTION

Breaches of fiduciary duties enable shareholders or the company to sue the wrongdoers in terms of common law derivative action or in terms of statutory derivative action provided for by section 266 of the Companies Act 61 of 1973. These actions can be used to challenge director's decisions about executive pay.

2.3.2.1 COMMON LAW DERIVATIVE ACTION

Executive remuneration can further be challenged under the common law derivative action on the basis that pay has been determined in a manner that constitutes a breach of the duties of loyalty and good faith owed to a company by its directors. It is arguable that pay that is not linked to performance is tantamount to breach of fiduciary duty to act in the best interests of the company. As earlier pointed out, the directors' fiduciary duties are owed to the company as a whole. Awarding excessive pay constitutes mala fide conduct on their part and goes against their duties of good faith, conflicts of interest and duty against making secret profits. Shareholders can be able to prove unratifiable wrong committed against the company by virtue of pay not being linked to performance. In this regard, the rule in *Foss v Harbottle*¹⁷⁹ determines that the majority has the right to bar an action by the minority whenever they may lawfully ratify alleged misconduct, and secondly, that it is normally the exclusive right of the company to sue upon a corporate right of action.¹⁸⁰

¹⁷⁸ Ibid, 591

¹⁷⁹ (1843) 2 Hare 461

¹⁸⁰ The rule was defined clearly in *Prudential Assurance Co Ltd v Newman Industries Ltd and Others* (1982) ALL ER 254 in the following terms: 1. The proper plaintiff in an action in respect of a wrong alleged to be done to a corporation is prima facie the corporation. 2. Where the alleged wrong is a transaction which might be made binding on the corporation and on all its members by a simple majority of the members, no individual member of the corporation is allowed to maintain an action in respect of the matter because, if the majority confirms the transaction, *cadit quaestio*: or, if the majority challenges the transactions, there is no reason why the company should not sue. 3. There is also no room for the operation of the rule if the alleged wrong is ultra vires the corporation because the majority of members cannot confirm the transaction. 4. There is also no room for the operation of the rule if the transaction complained of could be validly done or

Minority shareholders may institute a derivative action on behalf of the company against the wrongdoers who are guilty of a breach of their fiduciary duties to the company, if the wrongdoers are able to prevent the company from suing them in its own name because they control a majority of the votes at a general meeting, or because they are otherwise able to prevent a general meeting from resolving that the company shall sue them.¹⁸¹ Williams indicates that the alleged fraud involves an abuse of power, and not fraud in the narrow sense of the word.¹⁸² The abuse of power consists of an unfair discrimination of a nature that benefits the majority at the expense of the minority. It can also be translated as constituting a transfer of advantages from the minority to the majority and finally, consists of a scenario where the majority precludes the company from instituting legal action to recoup assets that properly belong to it.

A derivative action may therefore be brought when a corporate opportunity has been usurped. A derivative action will only sustain where it can be established that there was fraud on the minority. It further has to be proved that the wrongdoers' are in control of the company and as a result, can easily prevent the company from bringing an action against themselves.¹⁸³ In *Cook v Deeks*,¹⁸⁴ a derivative action succeeded and the defendants, being majority shareholders, were ordered to account to the company for all the profits that they had made out of a new contract that they had secured for themselves in due disregard of the interests of the company as a whole. The wrongdoers had appropriated for themselves a business opportunity which the company would otherwise have enjoyed. The effect of the decision in this case is that although the shareholders may vote as they please, the majority cannot appropriate the company's assets to themselves at the expense of the minority.¹⁸⁵ In the same breath, excessive directors' remuneration can be challenged if those who decide

sanctioned only by a special resolution or the like, because a simple majority cannot confirm a transaction which requires the concurrence of a greater majority. 5. There is an exception to this rule where what has been done amounts to fraud and the wrongdoers are themselves in control of the company. In this case the rule is relaxed in favour of the aggrieved minority, who are allowed to bring a minority shareholders' action on behalf of themselves and all others. The reason for this is that, if they were denied that right, their grievance would never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue.

¹⁸¹ Gower *Principles of Modern Company Law*, 647

¹⁸² RC Williams (note above), 241

¹⁸³ *Pavlides v Jensen* (1956) 1 Ch 565,575; Mongalo, 268

¹⁸⁴ 1916 (1) AC 554

¹⁸⁵ McLennan J 'Company Directors – Fiduciary duties' (1989) 1 SA Merc LJ 123, 128

on such pay fail to comply with their duties of loyalty and good faith that are owed to the company as a whole. In *Zemco v Jerrom-Pugh*¹⁸⁶ reliance was made on these duties to try and set aside remuneration payments made. It was intimated by the Greenbury committee that it was incompatible with the duty to act in the best interests of the company for directors to agree to pay 'over the odds'.¹⁸⁷ In *Roger v Hill*,¹⁸⁸ the court struck down director's remuneration packages on the basis that the amounts constituted a spoliation or waste of corporate property. The court had this to say

...If a bonus payment has no relation to the value of services for which it is given, it is in reality a gift in part and the majority of stockholders have no power to give away corporate property against the protest of minority.¹⁸⁹

Pay that is not linked to performance has to be regarded as an unratifiable wrong committed against the company on the basis that it constitutes a fraud upon the minority. In this case, because the board, as the alter ego, is in control as the mind of the company, set their own remuneration packages, and would not allow the company to sue in the event of aggrieved members wishing to institute action against them; their acts should be deemed as unratifiable on this basis. They cannot appropriate the company's assets to their own benefit to the detriment of the minority shareholders. More so, where the packages received are unjustified when contrasted with individual performances of management as such, constitute a waste of company assets. Obviously, excessive amounts that are not aligned to performance directly have an impact on the shareholder's equity, as it would be substantially reduced. It is fraud of shareholder monies, which is tantamount to awarding gifts of which the minority shareholders have no power or say over. These awards cannot therefore be ratified by a resolution of members at a meeting.

What one has to establish at this juncture, is whether it can be said that in a publicly quoted company, where directors in control are wrongdoers, but really do not have voting control

¹⁸⁶ (1993) BCC 275 As quoted in *Mongalo T*, 223

¹⁸⁷ Para 6.7

¹⁸⁸ *Ibid*

¹⁸⁹ *Ibid*, 591

for them to be regarded as being in control, they are really in control as they do not constitute the majority. In South Africa, Mongalo indicates that often, in listed companies, all shareholders are minority shareholders in that no shareholder holds more than even 25 per cent of the shares.¹⁹⁰ In most instances, directors own tiny fractions of shares in a publicly quoted company they engage their services in and therefore do not constitute the majority. Hence why it would not be easy for one to conclude that they are the wrongdoers in control. For this reason, it might be very difficult for the minority shareholders to establish breach of fiduciary duties on the basis that the wrongdoers in control have breached their fiduciary duties owed to the company as a whole.

As Mongalo points out, it is unlikely that shareholders who wish to assert their rights in listed companies would resort to common law derivative litigation to discipline management due to the fact that wrongdoer control is a great obstacle in listed companies to derivative litigation.¹⁹¹ He goes on to say that it would be difficult to prove wrongdoer control because executives and non-executive directors rarely own large stakes in publicly quoted companies; as such, as potential wrongdoers with regard to a breach of duty, it would be impossible to establish wrongdoer control. As such, even if there is a wrong to the company that cannot be ratified, wrongdoer control is a major obstacle in publicly quoted companies in South Africa. It is submitted that in the light of the setting of remuneration packages for directors, wrongdoer control should be viewed from a different perspective; the courts should decide it on the basis of holding office as a director, and not the stake that directors have in the company. This is so because effectively, as the alter egos of the company engaged in making key managerial decisions, they are in 'control' and have to be held accountable for all decisions that impact negatively on the company's equity.

In as much it is acknowledged that the wrongs cannot be ratified where fraud or abuse of power is alleged, or where the directors exercise their powers mala fide or for an improper

¹⁹⁰ T Mongalo 'Corporate governance reforms and directors' remuneration, a critical comparative analysis: Part 1, 3

¹⁹¹ T Mongalo 'Two steps forward, one step back: directors duty to act for the benefit of the company revisited in the aftermath of corporate governance reforms', 17 (*Unpublished article*)

purpose, it is further submitted however, that it would be very difficult for shareholders to prove breach of trust on the basis of disloyalty and mala fides simply because excessive remuneration packages have been awarded. In addition, it is doubtful whether this would be the way to go as companies never really initiate any proceedings in court against boards of directors who have approved and granted unwarranted compensations.

Then again, as McLennan¹⁹² puts it, there are a number of problems associated with this form of derivative action. While there is no guarantee that the applicant shareholder(s) may succeed, the costs associated with moving such application can be immense. This in its own way deters individual parties from instituting any proceedings against the wrongdoers. The wrongdoers may also make it difficult for minority shareholders to secure or access relevant information pertaining to the action as such information is in their (wrongdoers') custody.¹⁹³ Even though King II advocates for transparency and disclosure of remuneration packages, the wrongdoers in control can still hide some critical information that might assist the applicants in their action. Moreover, as fraud is very difficult to prove, it can be very difficult for the applicant in evidence to prove fraud or negligence on the part of the board of directors on the basis of having awarded excessive remuneration packages. Based on these facts, the common law derivative action may not avail us a solution to the problem of curbing excessive pay. The problems and difficulties associated with the common law derivative action led to the introduction of the statutory derivative action in South Africa.

2.3.2.2 STATUTORY DERIVATIVE ACTION

In terms of section 266 of the Companies Act, individual shareholders can move an application to the court for the appointment of a provisional curator ad litem, who then investigates the irregularities alleged to have been committed by the wrongdoers in control (board of directors). Individual shareholders do not get involved in the suit directly, and the curator will then report back to the court. Based on the report submitted, the court in

¹⁹² J McLennan 'The condonation of companies of wrongs committed against themselves' 1998 (115) SALJ 129

¹⁹³ Mongalo, 272

exercising its discretion will then decide whether or not to appoint a final curator ad litem, who will then institute proceedings against the wrongdoers. The section reads as follows

Any member of the company may initiate proceedings on behalf of the company against any director or officer, (past or present) notwithstanding that the company has ratified the wrong complained of, in circumstances where –

- a) a company has suffered damages or loss or has been deprived of any benefit as a result of a wrong, breach of trust or breach of faith that has been committed,
- b) the wrong, breach of trust or breach of faith has been committed by any director of that company or by any past director or officer while he was a director or officer of that company and
- c) the company has not instituted proceedings to redress the wrong.

2.3.2.3 DIFFICULTIES ASSOCIATED WITH JUDICIAL REGULATION OF EXECUTIVE PAY

Individual shareholders can challenge an executive pay award on the basis of breach of duty or trust. However, this section is problematic in a number of respects. For one, the right to sue is regarded that of the company,¹⁹⁴ as such, the company is deemed the rightful plaintiff and it will be difficult for the shareholders to prove that they are entitled to bring proceedings on behalf of the company. In addition, in the event of the members succeeding against the wrongdoers, any benefit that could accrue to a plaintiff shareholder is only if the success of the trial would lead to substantial increases in the company share value.¹⁹⁵ Often, members do not bother to make these applications because they stand to gain on an equal basis should any other member successfully sue¹⁹⁶; and then again, they are not guaranteed to win as this lies solely in the discretion of the court. Mongalo¹⁹⁷ notes that the other deterring factor is the fact that shareholders generally own shares or portfolios in dozens of listed companies, hence why members never really feel the need to pursue a

¹⁹⁴ Mongalo, 276

¹⁹⁵ Ibid

¹⁹⁶ Ibid, See also Cheffins (1997) who makes reference to free riding tactics, 257

¹⁹⁷ Ibid, 277

derivative action. In South Africa, however, very few cases have been reported to date on members utilizing this section to try and discipline management.¹⁹⁸ In any event, the success of the statutory derivative action will largely depend on the court's willingness to intervene in decisions of the board, which as already espoused, is unlikely, based on the business judgement rule.

The above signifies that courts of law have tried to lay down and protect the interests of shareholders of the company, against devious motives of some of the directors. However, practice has shown over the years that courts of law are unlikely to find a breach of duty in respect of executive remuneration. In America, for instance, it can only be found if payments are found to constitute waste. Other than *Roger v Hill*¹⁹⁹, no other successful suit has been brought against a large quoted company in the US. The same reluctance can be seen in the recent case of *Re Walt Disney Company Derivative Litigation*²⁰⁰. In this case, a shareholder sought to challenge a \$140 million severance package to a departing senior executive. The court dismissed the action on the basis that the court would not second guess the decisions of the Board except in rare cases where a transaction may be so outrageous on its face that the Board could not have been exercising proper business judgment. It went on to say that except in rare cases, where a transaction was so outrageous on its face that the board could not have been exercising proper business judgment, the court would intervene. It indicated that where fraud is not alleged, a judge should respect decisions of directors particularly in matters of executive compensation. It recognized that while directors have a duty of care towards the company, they cannot be held liable for errors of judgment in certain instances. For these reasons, the court could not overrule the severance package just on the basis of the size of the award. In Australia, section 243K of the Companies Act makes provision for approval of executive packages by shareholders – they are to be approved unless the package is exempted on the basis that it is reasonable.²⁰¹

¹⁹⁸ Even though the Companies Act was introduced in 1973, very few cases have been reported on the utilization of this section.

¹⁹⁹ *Supra*

²⁰⁰ (1998) 731 A.2d 242

²⁰¹ Havenga M 'The business judgment rule: should we follow the Australian example?' 2000 (12) SA Merc LJ 25. See also BR Cheffins, 674

However, it is submitted that South Africa cannot adopt this reasonableness test, as it is too vague.

2.3.2.3 PREJUDICIAL OR OPPRESSIVE CONDUCT

Executive remuneration can further be challenged under section 252 on the basis that it is oppressive and unfairly prejudicial to the interests of the shareholders and the company. The section reads that

Any member who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable to him or some part of the members, may apply to court for an order in terms of subsection (3)'.²⁰²

Subsection (3) stipulates that the court has wide powers 'to bring to an end the matters complained of'. Misappropriation of corporate assets clearly falls within the ambit of the section. It is submitted that exorbitant remuneration packages constitute a misappropriation of company funds and is prejudicial to the interests of the company as a whole.²⁰² This section gives shareholders the right to apply to a court for relief where it appears that the remuneration paid to a director is so excessive as to result in prejudice to the company. With this provision, minority shareholders can sue without being concerned about the procedural constraints imposed by the rule in *Foss v Harbottle*. Williams indicates that in the determination of whether such conduct was unfairly prejudicial, unjust or inequitable to the shareholders, the motive behind the conduct may be relevant, but of most concern is the result and effect that the conduct and will have on the members.²⁰³

²⁰² In terms of section 459 of the UK Companies Act 1985, excessive remuneration can be regarded as unfairly prejudicial to the interests of shareholders.

²⁰³ RC Williams (note above), 245

Breaches of directors' fiduciary duties may establish unfair prejudice to minority shareholders, at least in a private company and in a small public company.²⁰⁴ However, for public companies, this section would not preclude such exorbitant packages being awarded. This is purely because invariably, judges make reliance on the business management rule and are usually reluctant and refrain from making business decisions, or as it is usually put, from second guessing the decisions of company directors. As McLennan puts it, the major difficulty is the law's reluctance to place the courts in a position where they are to be the arbiters of the wisdom of commercial decisions.²⁰⁵ In *Levin v Felt and Tweeds Ltd*,²⁰⁶ the Appellate Division indicated that 'It is no part of the business of a court of justice to determine the wisdom of a course adopted by a company in the management of its own affairs'. Centlivres CJ put the matter this way

Counsel for the appellant correctly admitted that the court is not concerned with the commercial wisdom of the scheme, yet in order to prove that it was not bona fide he endeavored to show that there were other and better ways of raising additional working capital...In the absence of any allegation that the directors acted mala fide this amounts to asking this court to usurp the functions of the directors and to consider what is the best for the company from the business point of view. This is not the function of the court of law.²⁰⁷

In the United States, the same objective standard for directors' competence applies and is well established.²⁰⁸ It appears that this rule operates to relieve the directors of liability in most instances, if not all. For these reasons, aggrieved shareholders who initiate proceedings against the company directors hardly ever succeed in the courts of law. The restrictions that affect and regulate executive remuneration packages in listed companies do not seem to curb and deter excessive awards of remuneration packages. It seems therefore that based on this principle, aggrieved members are unlikely to succeed in courts of law on their claims against boards that award themselves handsome or generous packages.

²⁰⁴ Havenga MK, 83

²⁰⁵ McLennan J '*Misapplication of company funds – a proposal for reform*' (1993) 644, 650

²⁰⁶ 1951 (2) SA 401

²⁰⁷ *Ibid*, 414

²⁰⁸ PL Davies (note 130 above), 600

It is submitted that much reliance cannot be placed on the judiciary intervening in matters pertaining to executive remuneration, as in the few decisions cited above; courts appear to be very reluctant to take decisions on excessive pay packages. The question that remains is whether any reliance can be made on boards of directors to try and resolve these issues.

One may assume that boards are best suited to assist in curbing excessive remuneration packages. However, in South Africa, it appears that in practice, one out of two directors will be executive directors.²⁰⁹ As such, when salaries are determined, it cannot be expected that objectivity and reasonableness will be exercised. They will be biased and will want to get the best out of the company. For this reason, the boards do not seem to be the best option to resolve the issue of excessive executive remuneration. This is one reason why modern corporate democracy moves for independent remuneration boards, which are to consist of independent executive directors who have no attachment or contractual links with the company. It is believed that they will come up with reasonable judgments. It is however unclear how this would curb generous packages given the nature of system adopted in this jurisdiction. The Greenbury Committee at para 1.12 takes note of the potential conflict of interests with respect to executive pay and it advocates for independence of directors who sit in remuneration committees. Para 4.12 of the Hampel Report rubber stamps this recommendation but it notes that even though a remuneration committee sits on and decides executive pay packages, the members are still part of the board and whatever decisions they reach are regarded as the boards decisions. These recommendations, as shall be discussed hereunder, have their own limitations and failures.

It is clear from the above that our courts are not really enthusiastic to regulate managerial remuneration in public companies. The courts seem to have left it in the boards and shareholders discretion to determine what reasonable remuneration packages to afford directors. Because of the attitude that they take, it is clear that one would not recommend that courts be adjudicators of executive pay.

²⁰⁹T Mongalo '*Corporate Governance reforms and directors' remuneration, a critical comparative analysis: Part 2*' (Unpublished article), 5

CHAPTER 3

DEVELOPMENTS THAT LED TO CORPORATE GOVERNANCE REFORM

As a result of massive corporate failures and scandals, various legal systems recognized the need for control of company management. While it was seen that regulating executive remuneration in companies by making reliance on common law principles was failing in a lot of respects, it was felt that other methods of achieving this control be resorted to, so as to try and formally regulate company management.²¹⁰ In view of the law explored in the previous chapter, both English and South African panels on corporate governance recommended that corporate governance be regulated by means of Codes of Conduct. Consistent with this reasoning, the UK's Cadbury, Greenbury and Hampel Committees sought to influence managerial behavior by issuing guidelines designed to improve links between executive pay and corporate performance. The origin and rationale behind each of the committees that came up with these proposals shall be discussed hereunder. The character and content of the recommendations or provisions of the Codes as applicable to executive remuneration in South Africa shall be explored in the next chapter.

3.1 THE UNITED KINGDOM

3.1.2 THE PHILOSOPHY BEHIND THE COMMITTEES

As already espoused in the previous chapter, the functions and responsibilities of corporate directors arise by virtue of the juristic nature of a company. Since it cannot act on its own behalf, company acts are conducted through representatives, one of which is the board of directors; who are entrusted with management of the company's business.²¹¹ Company management can only be effective if those who manage it are granted some certain measure of freedom and discretion in the exercise of their function. On the other hand, effective

²¹⁰ The other method of achieving this control is by means of a supervisory board as found in German. See Chapter 7

²¹¹ Havenga MK '*Fiduciary duties of company directors with specific regard to corporate opportunities*', 1

control of management is vital in the interests of the company itself, its shareholders and its creditors. This basic philosophy was reiterated by the Cadbury Committee in England:

No system of corporate governance can be totally proof against fraud or incompetence. The test is how far such aberrations can be discouraged and how quickly they can be brought to light. The risks can be reduced by making the participants in the governance process as effectively accountable as possible.²¹²

For this reason, company directors are subjected to various duties as categorized in the previous chapter, and effective control is largely dependent upon the efficient enforcement of these duties.

The main discussions in this chapter are based on the committees commissioned following traditional corporate governance failures and some of the instruments relied on for good corporate governance. The main events, which provoked the process, in the late 1980s and early '90s, were the accounting systems failures, which characterized the collapse of Polly Peck plc and the Bank of Credit and Commerce International, and the comprehensive governance failures, which led to the Maxwell scandal.²¹³ It involved the substantial collapse of the Daily Mirror newspaper and the plundering of the Mirror employees' pension fund by a dominant chairman and chief executive officer who was unchecked by his compliant and supine board of directors and a body of investors, (including some major financial institutions) who had earlier been warned that Maxwell 'could not be relied on to exercise proper stewardship of a publicly quoted company' by a report by government inspectors some twenty years before, but continued to support him.²¹⁴ These events led not only to concerns over the reputation of the London markets but also to a widespread public and political concern.

²¹² *Report of the Committee on the Financial Aspects of Corporate Governance* (1992) par 7.2

²¹³ Rickford J 'Do good governance recommendations change the rules for the board of directors' Position paper for the Siena Conference on company law and capital market law. 30 March 2000 http://www.econ-pol.unisi.it/scdbanc/CONFERENZA/FILE_PDF/8-Rickford.pdf

²¹⁴ *Maxwell v Department of Trade and Industry* (1974) QB 523 CA

However, even though earlier scandals produced a strong legislative reaction, by the 1990s, the Thatcher and Major Governments had lost hope in company legislation and the inclination was towards governance through codes of practices, which it was felt would curtail bad business practices.²¹⁵ There still remains a strong bias in British company law against legislative intervention in institutional and structural aspects of company governance. For instance, the duties of individual board members and the general constraints on the proprietary powers of shareholders are a matter of case law.²¹⁶

Among the plethora of cases that culminated into corporate scandals in the UK, *Guinness plc v Saunders*²¹⁷ as previously discussed, exposed some of the shortcomings of the old traditional corporate board systems, awards of exorbitant remuneration packages and its inadequate checks and balances. Another case that shows that traditional corporate governance has its own failures is *Polly Peck International plc v Asil Nadir and Others*,²¹⁸ wherein the chief executive director of a public company with over 200 subsidiaries was signatory to all the branch accounts of the company and was in direct control of all its funds. He allegedly misappropriated the company's funds in the tune of over £378 million and left the company in ruins. It is apparent that no proper checks and balances were followed in these companies. It became clear with the fall of Polly Peck International plc that executive directors enjoyed dominance in boards in the UK and that there was a need of placing proper checks and balances in companies, particularly in instances where the positions of chief executive director and the chairman of the board are combined and non executive directors are not as vigilant.²¹⁹

As a result of the public outcry in the UK over excessive remuneration packages, there was a need for regulation or some investigation into these issues. In response, the UK Financial Reporting Council, the London Stock Exchange and the accountancy profession

²¹⁵ Ibid

²¹⁶ However, this is about to change as a result of the recommendations by the Company Law Review Steering Group in its Final Report, which recommendations have been endorsed in the White Paper on Modernizing Company law issued by the Department of Trade and Industry (DTI).

²¹⁷ Supra

²¹⁸ (1992) 2 Lloyd's Rep. 238

²¹⁹ Mongalo, 194

commissioned the establishment of the Cadbury Report in May 1992, together with its Code of Best Practices to try and address the financial aspects of corporate governance.²²⁰

3.1.3 THE CADBURY REPORT

Its aim was to review those aspects of corporate governance specifically related to financial reporting and accountability. It came up with recommendations entitled '*the Report of the Committee on the Financial Aspects of Corporate Governance.*' The Code of Best Practice drawn by the committee was directed at the boards of directors of all listed companies in the United Kingdom. It covered guidance on the board's role, including in particular the need to ensure that the board is not dominated by one individual and is structured and operated so as to maintain its independence;²²¹ it recommended that listed companies comply with its Code or include a statement in their annual reports justifying their non-compliance.²²² It emphasized the need and importance of independent non-executive directors on the board including the qualities for each individual non-executive director, required procedures for setting and disclosing directors' pay.²²³ It further moved for the establishment and implementation of board committees like remuneration committees and audit committees. It dealt extensively with issues of controlling executive remuneration packages, systems of control to employ to avoid misuse of funds and maintenance of effective internal controls and relationships with external auditors, how often directors were to hold meetings and how boards should generally operate.

For the promotion of good governance, it advocated for a differentiation to be made between the roles of the chairman and that of the chief executive director. The report confirmed that all directors are equally responsible in law for the board's actions and

²²⁰ It was headed by Sir Adrian Cadbury, and was named after him.

²²¹ Cadbury did not however advise that the roles of chairman and chief executive should be split

²²² The London Stock Exchange adopted in its Listing Rules requirements (Section 12.43 now replaced) that listed companies should report to shareholders in the annual report on their compliance with the code and that this report should be audited.

²²³ Mongalo, 194

decisions.²²⁴ Certain directors may have particular responsibilities, as executive or non-executive directors, for which they are accountable to the board. It makes emphasis on the fact that regardless of the specific duties undertaken by individual directors, it remains the task of the board collectively to ensure that it is meeting its obligations.²²⁵ The committee identifies two important contributions by non-executive directors to the governance process. It moves for the reviewing of the performance of the board and of the executive.²²⁶ Secondly, taking the lead where potential conflicts of interest arise.²²⁷

In view of the importance of independent judgment on issues of key appointments, the Committee recommends that all boards require a minimum of three non-executive directors, one of whom may also be the chairman of the company, provided he is not also its executive head.²²⁸ The appointment should be for a specified term and reappointment should not be automatic.²²⁹ It further recommended that, apart from their directors' fees and shareholdings; the majority of non-executives should be independent of the company. They should therefore be independent of management and free from any business or other relationship, which could materially interfere with the exercise of their independent judgment.²³⁰ At least three non-executive directors should form an audit committee with written terms for reference, which deal clearly with its authority and duties.²³¹ As a rule, executive directors attend and vote at meetings of the board, but do not work full time for the company and have no service contract, whereas non-executive directors have a service contract under which they work full time for the company.²³²

The Cadbury Committee thus envisages specific recognition of and a much more important role for non-executive directors.²³³ The independence of these directors is emphasized. However, their duties are not discussed. In respect of membership of a remuneration

²²⁴ Havenga MK, '*Fiduciary Duties of directors with regard to corporate opportunities*', 59

²²⁵ Cadbury Report 20, par 4.3

²²⁶ Cadbury report 20-21, par 4.5

²²⁷ Cadbury report 21, par 4.6

²²⁸ Cadbury Report 22, par 4.11

²²⁹ Cadbury Report 59, par 2.3 of the code of Best Practice

²³⁰ Cadbury Report 22, par 4.12

²³¹ Cadbury Report 27ff, 59

²³² Hahlo '*South African Company Law through cases*', 327

²³³ Cadbury report Chapter 4, par 2.2.1, and par 4.9 of King I Report in South Africa

committee, it is recognized that this is not such a demanding task as would require training and skill. It is submitted that in the light of recent public outcry of spiraling remuneration packages of directors, even though their tasks, roles and functions of the non-executive directors may differ, the duties they owe to the company are the same. The distinction between executive and non-executive directors is less important in respect of their fiduciary duties in this regard.

Although the report deals with wider issues than executive pay setting, it makes recommendations on reformation of boardroom pay. It recommends that ‘boards should appoint remuneration committees, consisting wholly or mainly of non-executive directors and chaired by a non-executive director, to recommend to the board the remuneration of the executive directors in all its forms, drawing on outside advice as necessary. Executive directors should play no part in decisions on their own remuneration’.²³⁴ Tricker points out that these sentiments are echoed by many other shareholder and stakeholder bodies with an interest in executive pay setting.²³⁵ He goes on to say that remuneration committees should act as independent arbiters of executive compensation on behalf of shareholders. Failure to do so is tantamount to directors writing their own contracts with one hand and signing them with the other.²³⁶ This is one disadvantage of the Anglo-Saxon governance model adopted not only in the UK, but also in many other jurisdictions including the USA and South Africa.²³⁷ Even though there really is no legal requirement that spells out the governance structure and principles behind setting remuneration packages, more companies seem to be complying with the Cadbury report as they are revealing the existence of remuneration committees in their company reports and pay packages.²³⁸ This code was addressed to listed companies but the hope was expressed that as many other companies as possible would seek to meet its requirements.²³⁹

²³⁴ Cadbury Report para 4.42, p31

²³⁵ Tricker, (Note above), 335

²³⁶ Ibid, 336

²³⁷ This shall be discussed in more detail in subsequent chapters

²³⁸ Tricker, (Note above), 336

²³⁹ Cadbury Code 3.1 There seems to be an explicit abandonment of attempts to try and apply governance codes to unlisted companies. In as much as they are advised to comply, no focus is placed private institutions as this point.

3.1.4 GREENBURY COMMITTEE

The second stage in the development of good governance recommendations in the UK was the establishment in 1995 of the Greenbury Committee, which was under the chairmanship of Sir Richard Greenbury. It was formulated to try and deal exclusively with the issue of directors' remuneration.²⁴⁰ The concern which led to the establishment of this committee had less to do with governance and the operation of company boards and more with public and government disquiet about the levels of remuneration being awarded to directors, particularly to those in privatized utility companies.²⁴¹ The Code issued by Greenbury comprehensively elaborated on the provisions of the Cadbury code about executive director's remuneration, including provision for an independent remuneration committee of the board, whose composition would entirely be of independent non-executive directors, who would review performance and set remuneration levels for executive directors, thus ensuring that the responsibility for setting incentives and rewards is removed from the board as a whole. It also dealt with establishment of an annual audited remuneration report, in the name of the committee setting out the full details in relation to each individual director, and of all remuneration packages received and perquisites.²⁴² This committee was set up to try and deal with abuses relating to remuneration being paid to executive directors of companies who were regarded as non-performers, and who were also granted share options that were in no way aligned to performance.²⁴³ The recommendations made by the Greenbury committee moved for the promotion and need for greater transparency, which is echoed in King II report.²⁴⁴ The main thrust of the Greenbury Code of Best Practice was

‘Disclosure, transparency comparator remuneration and a robust approach to the payment of compensation in relation to poorly performing directors’.²⁴⁵

²⁴⁰ Smerdon, (Note above), 66

²⁴¹ Rickford, (Note above), 8

²⁴² Ibid, 9

²⁴³ Smerdon (Note above), 66

²⁴⁴ King II, para 2.5.10

²⁴⁵ Smerdon (Note above), 66-67

It is believed that greater disclosure of directors' pay packages would lead to a better understanding of directors' remuneration and possibly lead to a curtailment of excessive remuneration. The UK listing rules make it mandatory for listed companies to include a remuneration report to shareholders in the annual report and accounts that have details of remuneration of directors.²⁴⁶ It made emphasis on the need for the establishment of independent remuneration committees in boards of directors.

A further concern was with compensation packages on dismissal. In terms of section 319 of the UK Companies Act,²⁴⁷ a maximum notice period is set and the level of compensation for loss of office without a specific general meeting resolution endorsement is 5 years. Greenbury, supported by Hampel Committee, proposed a reduced 'normal' period of one year.²⁴⁸ The British Law Commission in their report on directors' duties and conflicts of interest proposed a reduction to three years.

3.1.5 HAMPEL COMMITTEE

The third stage in the development of good corporate governance codes in the UK was embodied in the work of a committee called the Hampel Committee, which was chaired by Sir Ronald Hampel. It was established in 1995 at the recommendation of the Cadbury Committee, to review the recommendations made by both the Cadbury Committee and Greenbury Committees and their operation. It reported on the implementation of the recommendations made by the other committees and proposed amendments, and more significantly, it extended the enquiry further by looking 'afresh' into the role in governance of shareholders and auditors.²⁴⁹

A number of concerns were raised in this report. In relation to executive remuneration, while Greenbury advocated for increased transparency, it noted that this had little or indeed no effect in checking the rate of its increase. The wage gap is still spiraling out of control

²⁴⁶ Ibid, 66

²⁴⁷ The UK Companies Act of 1985

²⁴⁸ Greenbury Report Chapter 7 and Hampel Report, 24

²⁴⁹ Rickford (Note above), 9

and this exceeded by a wide margin the rate of wage inflation in the economy as a whole. It is still believed in some quarters that the effect of Greenbury had actually increased the 'going rate', at least in the less generous companies.²⁵⁰ Others believe that one reason for the lack of restraint was that the levels of remuneration of executives are sky high, and as such were not well placed to carry the burden of asserting their control rights as institutional shareholders to restrain the level of director's remuneration.

Another concern raised by this committee related to the growing cost of compliance with the corporate governance codes. It was argued out by some that the proliferation of board committee meetings to monitor and police board operations was distracting boards from their main operational purpose, which in the British unitary board culture is to lead the high level strategy and monitor the operation of the business and that the emphasis on disclosure was leading to perfunctory box ticking and a preoccupation with process, rather than a focus on operational performance.²⁵¹ On reviewing the Cadbury and Greenbury committees' recommendations, Hampel reasserts the collective responsibility of the board; for instance, the report on remuneration should not in Hampel's view have been in the name of the remuneration committee, but of the board as a whole.

Hampel moved for the restructuring of the existing codes in a new form. It moved for a distinction to be made and reflected in the form of statements of general principles by reference to which boards were to declare their implementing philosophy, with implementing provisions being merely guidelines that develop the principles that will also reflect on earlier codes.²⁵² This distinction is reflected in the distinctions in the implementing Combined Code between 'principles' and 'provisions'.²⁵³

Most of the recommendations made by these panels were implemented by the London Stock Exchange and were encompassed in its Listing Rules, which were known as the Yellow Book; this was in a form of an appendix, known as the Combined Code which was

²⁵⁰ Ibid

²⁵¹ Ibid, 10

²⁵² Hampel Report, Chapter 2

²⁵³ The principles remain as principles but the explanatory guidance has become 'provisions' – See London Stock Exchange Listing Rule 12.43A and Combined code 'appended to' the Rules, (Combined Code)

included in the rules and this constituted a guide to corporate governance for listed companies on the Stock Exchange in London.²⁵⁴ The Hampel Committee recommended that the remuneration report to shareholders in the annual report and accounts is to be by the board as a whole and not by the remuneration committee only, as was previously envisaged by the listing rules.²⁵⁵

3.1.6 SOUTH AFRICA: KING REPORTS

THE RATIONALE BEHIND KING'S REPORTS

Previously, in South Africa, there were no financial journalists who could determine misdemeanors of executive directors' wrongdoings. As in the UK and the USA, over time, South African companies such as First Rand, De Beers Old Mutual and others that are listed on the London Stock exchange (LSE) were required to comply with the LSE listing requirements and therefore to adopt sound corporate governance standards.²⁵⁶ Kakabadse indicates that 'similar to the experiences of the stewardship of companies in the USA and the UK, the King Committee's initiatives on corporate governance in South Africa are, in part, a response to the corporate scandals that arose as a result of poor corporate governance practices in South African corporations'.²⁵⁷ The collapse of Masterbond in the early 1990's, in which millions of rands in shareholders' and policyholders' wealth were lost, has been high in the media spotlight.²⁵⁸ More recently, with less disastrous results but equally discrediting, was the investors' admonishment of the Nedcor's board for self-enrichment, in the form of share incentive scheme, which awarded a number of directors for the performance of external companies in which it had invested.²⁵⁹

²⁵⁴ Mongalo, 195

²⁵⁵ Smerdon (Note above), 67

²⁵⁶ Kakabadse (Note above), 305

²⁵⁷ Ibid

²⁵⁸ Ibid

²⁵⁹ Mongalo (Note above),

3.1.7 THE KING I AND II REPORTS

Along the UK model of reform, South Africa recently endeavoured to investigate a Code of Conduct for company directors. The report by the King Committee on corporate governance, under the chairmanship of Mervyn E King, was first published in November 1994. When it came into place, it had to consider aspects encompassing recent developments in South Africa; it had to consider the impact of the new Constitution of South Africa, Employment Equity Act and the Skills Development Act. More especially, it had to consider issues relating to affirmative action and black economic empowerment issues, which are characteristic and peculiar to South Africa alone.

The King Committee simultaneously published together with its report, the Code of Corporate Practices and Conduct, which has been made part and parcel of the Johannesburg Securities Exchange (JSE) Listing Requirements in Schedule 22. This report was reviewed and a comprehensive one, known as King II, was published and became operative from March 2002. All the recommendations made are directed at all companies listed on the main board of the JSE, large public entities as defined in the Reporting by Public Entities Act 93 of 1992, banks, financial and insurance entities as defined in the various Financial Services Acts, large unlisted dependent companies, large quasi-state entities such as control boards and cooperatives.²⁶⁰ The recommendations in King II are aimed at affected companies.²⁶¹

The report constitutes a blueprint for corporate governance in South Africa in the form of the Code of Corporate Practices and Conduct.²⁶² This code is important as it forms the

²⁶⁰ Havenga, (Note above), 403

²⁶¹ The *Code of Corporate Practices and Conduct (2002)* para 1.1 defines affected companies as 'all companies with securities listed on the JSE; banks, financial and insurance entities as designed in the various legislation regulating South African financial services sector; public sector enterprises and agencies that fall under the Management Bill including any department of state, or administration in the national, provincial or local sphere of government or any other functionary or institution (i) exercising a power or performing a function in terms of the Constitution; or (ii) exercising public power or performing public function in terms of any legislation, but not including a Court or a judicial officer.'

²⁶² Mongalo, (Note above), 199

basis of the recommendations made, which affected companies are to follow. However, these recommendations are not mandatory; listed companies will not be forced to comply with the listing requirements, but where there is no compliance and there are no reasons given for non-compliance, the company may be subjected to heavy penalties. The philosophy behind all corporate governance codes is 'comply or explain'. Companies are advised to comply with the Code as this would be indicative of company's good governance and shareholders will hence invest therein. In the context of corporate governance, a proper balance needs to be achieved between freedom to manage, accountability and the interests of the different stakeholders.²⁶³ Whereas the Cadbury recommendations involved the financial aspects of corporate governance and focused on integrity and shareholder dominance, the King committee was of the opinion that the emphasis should be on a participative entrepreneurial approach rather than a dominant one.²⁶⁴

Even though King II deals holistically with good governance,²⁶⁵ it does not deal comprehensively with the issue of executive remuneration. It contains specific guidelines that relate to, among other things, directors' remuneration. The JSE has encompassed this in its Code and all listed companies in the JSE have to comply, failing which, reasons have to be availed why they cannot comply.

With its recommended Code of Conduct, the King Committee recognized the need for independent supervision of larger companies. All companies are encouraged to adopt the Code. It is believed that self-regulation is the optimum way of improving corporate governance. The Code of Conduct is designed to achieve the necessary high standards of corporate behavior. King II suggests that its enforceability and achievement must be made via the support of prominent associations, which should bind their members to comply with

²⁶³ King II

²⁶⁴ Havenga MK, 404

²⁶⁵ It investigated financial reporting and accountability, good practices concerning the responsibilities of executive and non executive directors, the case for audit committees, the principle responsibility of auditors and the links between shareholders, boards and auditors. It also came up with a Code of ethical practice for business enterprises in South Africa, with due consideration of the special circumstances prevailing in South Africa, more particularly the emergence of a new class of entrepreneur being members of the disadvantaged communities.

the Code, by incorporating the principles in the listing requirements for main board companies on the JSE and by peer pressure.

It is noted however, that delisting rarely happens as a sanction. The problem is that even if it were, delisting of companies for non-disclosure may have the detrimental effect that investors will find it more difficult to get rid of their shares in the offending company by selling them. To try and promote disclosure of remuneration packages in annual financial statements, it is submitted that the same policy of shunning non-compliant companies adopted in England by institutional investors be adopted.²⁶⁶ These sanctions if imposed to all offending companies will be sufficient in South Africa to curtail poor management practices. It is noted however, that a single code of Conduct may not easily provide for the needs of all South African companies in view of the fact that they are of different sizes, nature and objects.

3.1.7 CODE OF CORPORATE PRACTICE

For the Code to be effective, mechanisms have to be developed to try and enforce it. In terms of Section 6 of King II, the Code can be enforced primarily by means of law and by self-regulation. In so far as law is concerned, most of the provisions in the Code are a duplication of what is already in existence in our company law. Section 1 covers fiduciary duties, duties of skill and care and others, which duties are pertinent in the Company's Act and at common law. These will be enforced in the ordinary course of events, as directors can be held liable for any wrongdoings by the courts. However, as discussed in the previous chapter, law enforcement has its own failures. For this reason, self-regulation was seen as a better means of trying to regulate companies. Self-regulation is a role that is largely played by the JSE through its Schedule 22. It restates what is in the Code of Conduct. All companies listed under the JSE have to comply with listing requirements. The stock exchange listed companies are required to provide full disclosure regarding directors'

²⁶⁶ Havenga MK, 406

salaries.²⁶⁷ The principles and recommendations made in the light of executive remuneration in the code shall be discussed hereunder. King II, Chapter 8 relates specifically with issues pertaining to executive pay. The principles and recommendations that form the basis of this branch of corporate governance shall be discussed in the subsequent chapter.

²⁶⁷ In the Netherlands, there is legislation that is at an advanced stage, which will give shareholders more say in the matter of remuneration for the board of directors. However, salaries, bonuses and golden handshakes remain matters for the company supervisory board to decide upon. <http://www.eiro.eirofound.ie/2003/05/Feature/NL0305102F.html>

CHAPTER 4

RECOMMENDATIONS IN CORPORATE GOVERNANCE REFORM IN SOUTH AFRICA AND THE UNITED KINGDOM

With the advent of corporate governance reforms both in South Africa and Britain, a specific duty to take account of stakeholder interests was seen as impractical and rather, disclosure was seen as an effective mechanism for catering for stakeholder interests.²⁶⁸ Essentially, the main objective in the recommendations pertaining to executive remuneration was the need for greater transparency, which is echoed in King II. It is felt that greater transparency will lead to a better assessment and understanding of awards made to directors, and possibly lead to the curtailment of exorbitant packages.

The Combined Code takes cognizance of the fact that there is no alignment between pay and performance. Section 2.5.5 states that

The performance related elements of remuneration should form a significant proportion of the total remuneration package of executive directors and should be designed to align their interests with those of shareholders and to give them keen incentives to perform.²⁶⁹

The underlying principle is that directors should be paid well when the company is thriving, and be penalized when the company is performing badly. This is hardly ever the case as invariably, they tend to receive good lucrative payments when the company is performing well and never really suffer the consequences by being penalized should performance fall below expectations. It is further felt that disclosure of the packages will lead to the curtailment of excessive packages.²⁷⁰

²⁶⁸ T Mongalo 'Two steps forward:', 13

²⁶⁹ See also Schedule 22 para 22.7.5

²⁷⁰ Para 2.5.4

It is felt that effective disclosure will highlight such pay that is not linked to performance and it is believed that directors would be too embarrassed to grant or receive such pay if and when they are aware that shareholders and other stakeholders are likely to criticize such packages. Elements of remuneration packages that often are criticized as not being aligned in any form to performance are share options and golden handshakes. Greenbury Committee makes note of the concerns over severance packages and King II goes a step further and requires full disclosure in respect of severance packages, where as it says 'abuse can take place'. The other concern leveled by the Greenbury committee is the granting of share options as a form of reward to executive directors. These are often exercised by directors when the company is performing well and refrain to use then when the company performance is poor.

King II states that companies should provide full disclosure of directors' remuneration on an individual basis giving details of earnings, share options and all other benefits.²⁷¹ This recommendation has now been included in the JSE Listing Requirements and as such, all publicly quoted companies will be forced to comply.²⁷² King II indicates that 'regulation by adoption of the philosophy of disclosure has a number of beneficial effects'.²⁷³ It states that disclosure has a shrinking effect.²⁷⁴ It is believed that greater transparency will be achieved if directors remuneration is fully disclosed, thus shrink excessive packages that are without proper justification.²⁷⁵ King II reiterates what Greenbury advocates for. It goes further and suggests that disclosure on an individual basis should be made.

The effect of disclosing on an individual basis is that it would be easier for shareholders to vote in favor or against the remuneration packages of each director based on the value each director would be adding to the company; thus, an alignment of pay and performance would be achieved. The Greenbury Committee attaches great importance to disclosure and transparency. The effect of disclosing on an individual basis is that it would be easier for shareholders to vote in favor or against the remuneration packages of each director based

²⁷¹ King II, Section 2.5.4

²⁷² N Payne 'Conditions of the crown' May (2002) *Accountancy SA*

²⁷³ King II, Section 2.4.3

²⁷⁴ King II, Section 6(a)

²⁷⁵ King II, Section 2.4.3

on the value each director would be adding to the company; thus, an alignment of pay and performance would be achieved. King II demands an individual disclosure as opposed to the aggregate amount of all directors being reported on. In this way, it is felt that non-performing directors can easily be identified and it would be difficult for the board to justify hefty packages that are not aligned to performance. King II further equates disclosure to sunlight, in line with the principle of transparency and indicates that 'sunlight is the best disinfectant'.²⁷⁶ King II notes that disclosure will lead to an exposition of corruption, misconduct and poor performance within the company.²⁷⁷ It would therefore aid in linkage of pay and performance. Not only is it perceived as aligning pay and performance, but it is believed it would decrease the wage gap that currently exists in South Africa. Disclosure is regarded as a means of curbing fat cat pay.

Another classical recommendation suggested by King II and Greenbury report is that the board of directors should delegate its powers over executive remuneration to an independent remuneration committee, which is to consist mainly of independent non-executive directors.²⁷⁸ This clause reads that 'Companies should appoint a remuneration committee or such other appropriate board committee, consisting entirely or mainly of independent non-executive directors, to make recommendations to the board within agreed terms of reference on the company's framework of executive remuneration and to determine specific remuneration packages for each of executive directors. This is, ultimately, the responsibility of the board. An independent non-executive director must chair this committee. In order to obtain his/her input on the remuneration of the other executive the committee should consult the chief executive officer, who may attend meetings by invitation. However, a chief executive should play no part in decisions regarding his/her own remuneration.' The idea is that because non-executive directors are not involved in the day-to-day management of the company, this non-involvement gives them the ability to act as a sounding board for executive directors and helps identify and

²⁷⁶ Sec 6(b)

²⁷⁷ Sec 6(c)

²⁷⁸ Clause 2.5.2 in King II and Para 1.12 of Greenbury report

properly deal with conflicts of interest.²⁷⁹ Nevertheless, their distance from the daily affairs of the company does not in any way diminish their responsibilities as directors.

It was felt that executive directors would likely be faced with a potential conflict of interests with regard to executive remuneration. Greenbury moved for delegation of responsibilities to a group of independent persons with the necessary expertise, knowledge of the company business but who did not have any financial interest in the remuneration decisions they made.²⁸⁰ The fact that the chairperson of the remuneration board must be an independent non-executive director is stressed.²⁸¹ He must have nothing to do with the operational functioning of the company. It was felt that because non-executive directors are not full time employees of the company, they would deal with issues of executive remuneration in a more detached way and would then make recommendations to the board. The Hampel Committee also endorsed this recommendation and it added that it should be remembered that the remuneration committee is part of the board and the latter is the one that takes a final and collective responsibility.²⁸² Schedule 22 restates what King II recommends and supports the idea of creating remuneration committees.²⁸³

The Code of Best Practices makes provision for other important guidelines in respect of director's remuneration. In terms of para 2.5.1, 'levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board'. Nevertheless, this simple requirement suggests that an important influence upon the level of pay will be based on external labour market constraints, which are based on comparisons with the pay levels of similar executives in similar sized companies.²⁸⁴ In the strive towards

²⁷⁹ P Steyn 'Corporate governance' *Corporate Werks* Vol 3 September 2002

²⁸⁰ Para 4.3 and 4.8

²⁸¹ 'Corporate governance series: *Being a director; duties and responsibilities*' Institute of Directors September 2000. The primary role of the remuneration committee is to ensure that the company's directors and senior executives are fairly rewarded for their individual contributions to the company's overall performance; and demonstrate to all stakeholders that the remuneration of senior executives is set by a committee of board members who: have no personal interest in the outcome of their decisions; and to give due regard to the interests of the shareholders and to the financial and commercial health of the company.

²⁸² Para 4.2 of its report

²⁸³ Para 22.7.1

²⁸⁴ K Keasey, M Wright *Corporate Governance* 1997, 65

balancing executive compensation and performance, provision of sufficient incentive to align the interests of managers to those of the owners has to be carefully considered.

Para 2.5.2 stipulates that ‘membership of the remuneration committee or board committee that considers executive remuneration must be disclosed in the annual report and the chairperson of such committee should attend annual general meeting to answer any questions from shareowners’.

In terms of section 2.5.6, ‘Share options may be granted to non-executive directors but must be the subject of prior approval of shareowners (usually at the annual general meeting) having regard also to the specific requirements of the Companies Act. Because of the apparent dilution of independence, in some international markets the view is that non executive directors should preferably receive shares rather than share options.’ Share options are considered an essential element of performance incentives under Schedule 22.²⁸⁵ Even though share schemes are perceived as giving directors a personal financial interest in seeing the share price rise, thus ensuring an alignment of shareholders and directors’ interests, it is often criticized as conferring windfall gains that have nothing to do with directors’ efforts.²⁸⁶ Greenbury and Hampel both recommend that shareholders should be invited specifically to approve all new long-term incentive plans, which potentially commit shareholders funds over more than one year, or dilute the equity.²⁸⁷ In this way, shareholders can be able to strike down share options that they feel are not justifiable under the circumstances.

In addition, clause 2.5.7 stipulates that where there is a proposal to re-price share options, this should be the subject of prior shareowners approval and details should be provided of each director’s share options which stand to benefit from any such proposal. And then again, if share options are to be issued at a discount to the ruling price, shareowners are to vote separately on this clause in the trust deed. Greenbury totally discourages share options

²⁸⁵ Para 22.7.6

²⁸⁶ Greenbury Report para 6.27 and para 6.28

²⁸⁷ Hampel Para 4.20, Greenbury Para 5.33

schemes that are granted at a discount.²⁸⁸ It further moves that these options should not be exercisable within a period of three years.²⁸⁹ While other people may argue that share options be retained as a way of aligning pay and performance, others may move for its total eradication as an element of performance related incentives.²⁹⁰

These guiding principles were reiterated in the listing requirements of the JSE Securities Exchange. Companies should be headed by an effective board, which can both lead and control the company. The board should comprise a majority of non-executive directors, of whom sufficient should be independent of management for minority interests to be protected.

The King Code further envisages a situation where service contracts are not to exceed a period of three years. It recommends that if service contracts exceed this period, full disclosure of this fact with reasons should be given and the consent of shareowners should be obtained. Greenbury feels that to avoid payment of large severance packages in the event of termination of services for unsatisfactory performance, service contracts should be shortened to one year or less.²⁹¹ King II at para 3.5 states that ‘every effort should be made to promote acceptance of the necessity for, and benefits of, a realistic realignment of director remuneration’. Further, requirements to disclose remuneration in annual reports is seen as a constructive opportunity to communicate with shareholders on all aspects of remuneration’.²⁹²

King II does not deal directly with the role of compensation consultants. In para 2.7.8, it suggests that ‘board committees should be free to take independent outside professional advice as and when necessary’. Greenbury Committee also acknowledges that it is normal for companies to retain and make use of such experts. It notes that these parties must however avail directors’ advice that combines quality of judgment with independence.²⁹³

²⁸⁸ Greenbury Report Para 6.29

²⁸⁹ Greenbury Report Para 6.34

²⁹⁰ See Chapter 5 on criticisms of recommendations.

²⁹¹ Greenbury Report para 7.11 and para 7.13

²⁹² Para 3.5 of Appendix V to King II

²⁹³ Paragraph 4.17

King II further advises that non-executive directors should carefully consider the number of directorship positions that they take up. This is merely to ensure that the companies on which they serve enjoy the full benefit of their expertise, experience and knowledge. Greenbury Committee, on the other hand, discourages direct cross-directorship arrangements. The Hampel committee, like King II, does not make an analysis in detail of the role of compensation consultants and does not make any mention of cross directorships. Schedule 22 of the JSE Listing Requirements does not directly address the cross-directorships. The only inference that can be made that mention was made of these issues is when at 2.5.2 states that remuneration committees should be composed of independent non-executive directors and the definition of independent director makes it clear that the director must, among other things, 'be free from any business or other relationship which could be seen to materially interfere with the individual's capacity to act in an independent manner'. One can then advance an argument that cross directorships fall within the ambit of this scenario.

Even though it may seem these recommendations go a long way towards addressing concerns relating to executive remuneration, they have numerous drawbacks associated with them. These shall be discussed in the following chapter.

CHAPTER 5

A CRITICAL ANALYSIS OF THE RECOMMENDATIONS

In the light of the recommendations in the Codes previously discussed, it is clear that shareholders want executives' remuneration packages tied to their real contribution to value creation.²⁹⁴ Pay has to be seen to be bearing more correlation to performance. In this chapter, one seeks to evaluate the recommendations made and whether they really do lead to the link between pay and performance being created. Often, it is argued that if executive directors receive substantial rewards when the company's situation is improving and meaningful penalties when performance is poor, then it follows that they should place a higher priority on doing what is best for shareholders. However, as previously discussed, empirical statistics show that executive remuneration the world over is still not aligned to performance. The different codes have been in place for some time; notwithstanding, remuneration packages are still spiraling out of control. Despite the efforts that have been made in different quarters to try and address these issues, executive pay in South Africa and the UK is still not structured as envisaged in the Codes. This chapter seeks to review the need to examine the operation of the law and the Code of Good Practice.

5.1 DISCLOSURE

One major recommendation that King II, in chapter 4.1.13 makes is that fuller disclosure of severance packages should be made. Greenbury also makes mention of this concern and feels that it has to be addressed.²⁹⁵ Often, there is no link between the golden handshakes and performance. As was stressed earlier, these lucrative packages are awarded on departure following poor share price performance. Disclosure is criticized by some proponents who indicate that it can impact on the workforce in the sense that dramatic

²⁹⁴ T Mongalo 'Lots of filthy lucre: Shareholder activism in the UK may be signifying the failure of remuneration committees' *The Enterprise* July 2003, 50

²⁹⁵ Para 1.7 and 7.2

increases in pay levels can affect the morale within the company.²⁹⁶ It is also felt that disclosure will affect productivity of employees. Thus, increased disclosure will lead to increased demands of greater pay from other lower ranking employees in the company, which may result in working strains and time waste.²⁹⁷

A number of other disadvantages of disclosure are leveled. Directors feel that disclosure impacts negatively on their own personal and professional lives.²⁹⁸ Not only is it regarded as an infringement of their privacy, but their security is threatened as well.²⁹⁹ It is felt that it would impact negatively on the work environment as top paying firms can easily lure away staff of other lower paying companies. On discovery of what other directors in comparable companies earn, the more powerful companies will entice directors to better paying positions in their own companies. This results in other companies losing valuable skills and workers.

In as much as Section 297 of the Companies Act mandates that companies disclose aspects of the aggregate amount of compensation paid to directors, it is submitted that disclosure has no effect whatsoever in curbing handsome awards being made and narrowing down the wage gap that still exists in South Africa. Instead of being linked to remuneration, the remuneration packages are still spiraling out of control with no link to performance whatsoever. There is no evidence that can be adduced to prove that the desired effect has been achieved. On the contrary, the issue of executive pay has caused much more concern as corporate directors are still accepting huge gains on share options and golden handshakes among other components. It is submitted that instead of achieving the results as anticipated by King II and Greenbury, disclosure leads to continued increase of executive pay.

²⁹⁶ Hampel Committee

²⁹⁷ W Phelps 'Reigning in executive pay and perks' 15 August 2002 <http://www.startribune.com/stories>

²⁹⁸ Anonymous 'Why still the secrecy around directors remuneration' *South African Labour Bulletin* April 2002

²⁹⁹ Ibid. It is felt that disclosure makes them easy targets for kidnappings and extortion.

5.2 REMUNERATION COMMITTEES

Both the South African and UK Codes of Corporate Practice and the JSE Listing Requirements endorse the establishment of remuneration committees. Clause 2.5.2 of the Code in King II and para 4.3 of the Greenbury Report state that ‘companies should appoint a remuneration committee or such other appropriate board committee, consisting entirely or mainly of independent non-executive directors, to make recommendations to the board within agreed terms of reference on the company’s framework of executive remuneration and to determine specific remuneration packages for each of executive directors. This is, ultimately, the responsibility of the board. An independent non-executive director must chair this committee. In order to obtain his/her input on the remuneration of the other executive the committee should consult the chief executive officer, who may attend meetings by invitation. However, a chief executive should play no part in decision regarding his/her own remuneration.’

It is believed that because non-executive directors are not full time employees like executive directors of the company, they will exercise their independence and good knowledge for the benefit of the company and they will not have a direct financial interest; as such, they will not act in a self serving manner. Thus, because of their independence, it is hoped that they will assess issues pertaining to executive remuneration in a more detached manner and be in a position to make recommendations to the board of directors.³⁰⁰ The Hampel Committee at para 4.12 also endorsed this recommendation.

Remuneration committees (RC’s) have however not proved to be effective at all in eradicating offensively high executive pay.³⁰¹ As Mongalo indicates, there is no evidence that companies with remuneration committees paid their executives lesser packages than those companies which do not have RCs.³⁰² Neither can it be said that there is more linkage of performance and pay. There is no evidence further to show that the rift that exists

³⁰⁰ T Mongalo Lots of filthy lucre: 50, 51

³⁰¹ UK’s Sunday Times, 31 October 1999 as quoted in T Mongalo (note 280 above)

³⁰² Ibid

between pay at the bottom and pay at the top has decreased gradually since the introduction of these committees. For one, para 2.5.2 of the Code of Good Practices and Conduct stipulates that the chief executive officer of the company should be consulted and may attend the remuneration committee meetings. Even though such director will play no part in the determination of his or her own salary, in that such party's salary has to be decided in their absence, the fact that they are made party to the committee acts in their favour in that directors ultimately award their colleagues high pay package increases in the hope that when their own turn comes, their colleagues would reciprocally be generous. This can be justified by the fact that since the introduction of corporate law reforms in this area, we have not seen any narrowing of the pay gap between directors and rank and file employees. Bias also remains a concern over the non-executive directors' independence. Non-executive directors are nominated by the nomination committee who work with the chairman of the board of directors over such selections. As such, these individuals may be reluctant to antagonize and question generous executive pay packages recommended.³⁰³ This matter is exacerbated by the fact that the CEO is to attend at remuneration committee meetings on an advisory basis. A number of other criticisms are leveled against remuneration committees.

5.3 COMPENSATION EXPERTS

To begin with, the King II promotes that the committees should engage independent consultants or advisors. King II, at para 2.7.8 recommends that 'Board committees should be free to take independent outside professional advice as and when necessary'. Greenbury Report at para 4.7 makes an acknowledgement that professional advice should be sought, which advice is to combine quality judgment with independence. The practice in South Africa and the UK is that the board of directors itself will engage compensation experts. They are not hired by remuneration committees; as such their independence is really questionable. Even though these compensation experts can prove beneficial to the company, it is argued that because they are well informed about what other companies in comparable companies are paying, they do not exercise their independence. Their

³⁰³ Cheffins. T Thomas 'Should shareholders have a greater say over executive pay 277, 286

objectivity is open to question.³⁰⁴ This is mainly because for them to secure clientele, they tend to recommend sky-high packages. This assists them in that they will not acquire a reputation for recommending frugal packages within management circles.³⁰⁵ For these reasons, it is felt that these compensation experts will justify hefty remuneration packages regardless of the fact that they would not be aligned in any way to company performance.³⁰⁶

5.4 CROSS DIRECTORSHIP

King II in clause 2.4.5 of the Code encourages appointments of a majority of non-executives to sit in remuneration committees. However, as noted in previous chapters, one in two directors in South Africa will sit as a non-executive director in other companies. This is problematic in that in setting remuneration packages of executives, these non-executive directors are perceived to be indirectly setting their own pay.³⁰⁷ As Mongalo says, 'they are setting, albeit indirectly, the going rate for executive pay in a more general sense'.³⁰⁸ Their independence is questionable in this regard. Even though it is unclear whether the no-conflict rule prohibits a person from being a director of competing companies,³⁰⁹ it is submitted that this directly impacts on their fiduciary duty of avoiding a conflict of interests. Because they sit as non-executive directors, they would indirectly benefit, as the recommendations they make will influence what the comparator market has

³⁰⁴ BR Cheffins *Company law, theory structure and operation*, 667; See also T Mongalo 'Corporate governance reforms and directors' remuneration, a critical comparative analysis: Part 2, (unpublished article) 9

³⁰⁵ BR Cheffins (Note 296 above) 667; T Mongalo, *Enterprise*, 52

³⁰⁶ Some Scholars argue that these compensation experts can justify excessive remuneration packages by indicating that the company should not lose talented executives by paying them poorly. All of this is done notwithstanding the fact that the company will be performing badly. It is further argued that in some instances, they tend to justify these packages by saying that executives should receive high pay as the company might be getting behind. Therefore, their recommendation to increase packages ensures that the overall pay in the company rises to the average pay in the comparator market even though corporate performance may be poor. *Ibid*; Cheffins, 667

³⁰⁷ BR Cheffins (Note 296 above), 669

³⁰⁸ *Ibid*, 52

³⁰⁹ In *London & Mashonaland Exploration co Ltd v New Mashonaland Exploration co Ltd* (1891) WN 165 Chitty J refused to restrain a director who had never acted as a director or attended a board meeting of the plaintiff company from acting as director of the competing defendant company. In another case, *Bell and Another v Lever Brothers Limited and Others* (1932) AC 161 (HL), 195, Blanesburgh LC considered this case as authority for a general statement that a director is normally free to be a director of a competing company.

to offer on average. King II and the JSE Listing Rules do not make an analysis of the role played by compensation experts and both make no mention of directors avoiding sitting on different boards and advising on executive remuneration. Neither does the Hampel Committee deal with the issue of cross directorship. The Greenbury Report, on the other hand, at para 4.8 explicitly discourages the practice of cross-directorship. However, it would seem that remuneration committees are not really the solution to the concerns that culminated into reforms in this area of corporate governance.

5.5 OTHER PROBLEMS POSED BY THE RECOMMENDATIONS

The problem that a company that wishes to enforce a strict policy on linking pay and performance so as to be able to justify hefty packages is that such a company will be met with difficulties. It is not an appealing idea and not feasible to have directors' pay fluctuating on a monthly basis as a result of a company trying to align pay and performance. One can argue that the directors will probably leave the company for much more stable surroundings and as such, the company will lose the skill and experience that the director had.³¹⁰ King II reiterates this fact at para 4.9.

It is submitted that it is not in all cases that the share price will plummet as a result of the non-performance of directors. As Mongalo points out 'a variety of factors unrelated to the skill and effort of the top management will influence a company's share price'.³¹¹ There are peculiar instances that may lead to an economic boom or market crash.³¹² Moreover, the strength of the market will influence share prices regardless of what the individual executive might do in terms of performance.³¹³ It is felt that a director should not be penalized for the fall in share prices because non-performance is not the only factor that may affect shareholders' equity.³¹⁴ In any event, often, the performance of an executive

³¹⁰ Aslam 'U.S pay gap widens' 2 November 1999 <http://www.globalpolicy.org>

³¹¹ T Mongalo 'Corporate governance reforms and directors remuneration, a critical comparative analysis: Part 2, 20

³¹² See note 33 above

³¹³ T Mongalo (note 289 above)

³¹⁴ BR Cheffins (Note above), at 681 indicates that even if share prices constituted a reliable estimate of a company's future earnings stream they do not necessarily provide an accurate indication of an executive's efforts or abilities.

director is not visible and cannot be measured until after several years have gone by. Even then, only the most skilled observer or board of directors can be able to detect this non-performance.

The other problem posed by a strict alignment of performance and pay relates to the swings in the executive director's income. It follows that if pay is tight to share price performance, such package will fluctuate dramatically periodically depending on how well the share price is performing. Thus, because individuals would prefer to earn a stable income, the strict linkage of pay and performance leads to an unsatisfactory option to pursue. Cheffins indicates that a key element of the argument in favour of tying managerial pay to corporate performance is that senior executives are self-interested individuals who need financial incentives to exert their best efforts.³¹⁵ Hence, if a strict application of linking pay and performance is made, they would be demotivated and would not perform at such high levels as expected of them.

Furthermore, King II in para 2.5.1 recommends that 'levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board'. It is felt that the global business world is a very competitive market; as such, because of its nature, companies compensate its directors services handsomely based on the comparator market. By restraining companies and forcing them to enforce strict policies of aligning pay and performance, it would be very difficult for a company adhering to these policies to secure highly qualified executives who would endeavour to maximize shareholder return and generate expected profits. Rather, such qualified experts would leave for greener pastures where they would be better paid for the services they render.

Para 2.5.6 of the King Code stipulates that 'share options may be granted to non executive directors but must be the subject of prior approval of shareowners (usually at the annual general meeting) having regard also to the specific requirements of the Companies Act. Because of the apparent dilution of independence, in some international markets the view is that non executive directors should preferably receive shares rather than share options.' It is

³¹⁵ BR Cheffins (Note above), 679

not very easy to justify share options, given the fact that the directors that benefit there from are highly paid executives. Often, such awards are seen as greediness on the part of directors and lead to accusations of shareholder exploitation.³¹⁶ It is suggested herein that companies do away with granting share options to directors, as they can never be perfectly aligned to performance. Even though King II does not outlaw the granting of share incentive schemes to non-executive directors, it is submitted that these are undesirable in that we cannot have the same incentives (share options) that are similar to those afforded to executive directors being awarded to non-executive directors. These are the very people who King II suggests should sit in remuneration committees (remuneration committee, which are to consist of a majority of independent non-executive directors). As a result, it becomes very difficult for non-executive directors to exercise restraint, and to make decisions on incentives for executives without a conflict of interest. Non-executive directors should not be allowed to participate in the company's annual bonus plan, share option scheme or long term incentive plan.

As was earlier noted, Schedule 22 of the Listing Requirements in 22.7.10 reads that 'no director should be involved in deciding his or her own remuneration'. However, by engaging them in share options, they are in a way setting their own pay, which runs contrary to this principle. By awarding them share options, their independence will be diluted, which is an essential quality, which they should bring to the board's deliberations.³¹⁷

Furthermore, at para 2.5.6, King II suggests that 'performance related elements of remuneration should constitute a substantial proportion of the total remuneration package of executives in order to align their interests with those of the shareowners, and should be designed to provide incentives to perform at the highest operational standards.'

³¹⁶ M Henderson 'Creating a two-tier labour force (March 2002) *Accountancy SA*, 17

³¹⁷ Para 4.12 of the Cadbury's Report

CHAPTER 6

EFFECTIVENESS OF THE RECOMMENDATIONS IN THE SOUTH AFRICAN CONTEXT

The main difference between the Cadbury and King Reports is that King's terms of reference were much wider than those of Cadbury as they included the matter investigated by Cadbury as well as a Code of Ethical Practice for business in South Africa.³¹⁸ The report was drafted during the period of the important 1993 elections in South Africa and therefore deals with the practicalities of affirmative action. It states that it is vital to recognize that strategies to reduce inequality must be based on the commercial reason that the strategies are necessary to survive and thrive in the new South Africa.³¹⁹

6.1 THE STAKEHOLDER MODEL OF GOVERNANCE IN SOUTH AFRICA

The primary goal of business in the apartheid era was essentially the maximization of shareholders' wealth. With the advent of corporate governance reforms, the business is to include not only a wealth creating focus, but has also to include activities which would contribute to the distribution of wealth and income so as to enable the larger South African community to benefit from a more extensive scope of corporate social responsibility.³²⁰ The stakeholder model is premised on the theory that there are groups, in addition to shareholders, who have claims on a corporation's assets and earnings. Employees, as one of the interest groups are seen as having a different claim from shareholders and creditors over the company's assets. Its financial contribution to the company is in the form of human capital and this model advocates for protection of employees interests.³²¹ King II draws heavily on this model. King II makes an attempt to influence the level of care and skill that is required from directors to permit them to engage the corporation in activities

³¹⁸ JJ Du Plessis 'Corporate governance: Some reflections on the South African law and the German two-tier board system' (1996) 4 CRIC 29, 34

³¹⁹ King I, Chapter 17 Para 4 Appendix on Affirmative Action

³²⁰ D Botha 'Confusion in the King report' (1996) 8 SA Merc LJ 26, 29

³²¹ Ibid, 35

for public benefit, regardless of whether shareholder gain is specifically enhanced. It recognizes the need to strengthen and enhance the standards of managerial accountability and recognizes executive remuneration as one of the problem areas in existing systems within companies where a differentiation is made between ownership and management.

6.2 SOUTH AFRICA'S DISTINCT CHARACTERISTICS AND CONCERNS

The King committee was tasked with a mandate to have regard to the special circumstances existing in South Africa, more particularly the entrance into the business community of members of disadvantaged communities.³²² During the apartheid era, all aspects of socioeconomic and political well being were governed by racially discriminatory laws. These discriminatory laws had, by the time apartheid was dismantled, created such racial inequities that meaningful efforts had to be taken to redress them.³²³ In order to try and give the marginalized majority of previously disadvantaged people access to capital and to try and allow them into the business, affirmative action had to be encompassed not only in the Constitution³²⁴ as part of the right to equality, but King I and II also gave it recognition.³²⁵ It is considered as good governance practice. The all inclusive measures adopted for the betterment of corporate governance practices takes not only the shareholders interests, but it also redresses the inequalities of the past which were created by segregation laws.

6.2.1 ERADICATION OF THE APARTHEID WAGE GAP

The main concern in South Africa is then to eradicate the apartheid wage gap between executives and rank and file employees. In a jurisdiction where the majority of previously disadvantaged individuals are black, who previously could not engage in skilled work because of the apartheid laws, they comprise the majority of rank and file employees in

³²² D Botha 'Confusion in the King report' (1996) 8 SA Merc LJ 27, 37

³²³ T Mongalo 'Corporate governance reforms and directors' remuneration, a critical comparative analysis: Part 1, 22

³²⁴ The Constitution of South Africa 1996

³²⁵ King I Chapter 8; King II Chapter 5, section 4

listed companies.³²⁶ As a result, a dramatic increase in executive pay may be seen, more especially by the unions, as the perpetuation of apartheid policy and the strengthening of the apartheid wage gap.³²⁷ In this environment, a growing wage disparity can create problems since it offends notions of equality that workers may have.³²⁸ This is one of the reasons why it is felt that King II might have erred for suggesting that the unitary system modeled along the Anglo American system is the ideal system for South Africa. It failed to consider the advantages of a two-tier board structure, which has employee representation in the upper supervisory board. It is submitted that employee participation and concentrated shareholding may encourage better corporate governance. It is seen as a promotion of equality between all persons with equal rights. As one writer had to say

A well-ordered system of private ownership is a means of promoting human dignity and liberty and assures personal security to the individual. It is indispensable for the exercise of personal initiative and, finally, it constitutes a right, which is united intimately with human activity, a right which derives its strength and virtue from the fruitfulness of employees. The owner of property must not use it selfishly without regard to the social purposes which it would serve. Thus, private property must be safeguarded, but where protection of private rights is concerned, special regard must be had for the unpropertied. We do not deny that, for a state to exist at all, there have to be differences of degree among its citizens, and these differences will persist, however much forms of government change. However, the state should intervene vigorously on behalf of the unpropertied employees, It is not possible for everyone to contribute in the same way or to an equal extent. The capital provider should have no superior position over the employee in society or before the law. They are equals with equal rights. The state must intervene whenever the public interest or a part of a particular class is harmed or endangered.³²⁹

³²⁶ T Mongalo, 22

³²⁷ Ibid

³²⁸ BR Cheffins (Note above), 658

³²⁹ M Yavasi 'Shareholding and board structures of German and U.K companies' (2001) *The Company Lawyer* 47, 51

6.2.2 SOUTH AFRICAN DECREASED LEVELS OF SHAREHOLDER ACTIVISM WITHIN COMPANIES

With regard to granting shareholders much more say in approving individual remuneration packages of directors, the position in South Africa is that often, if shareholders are granted vast voting powers in the determination of executive remuneration, they most probably are not going to exercise the rights; rather they tend to rubberstamp the recommendations made by the remuneration committee.³³⁰ Shareholders feel that remuneration committees are better placed to deal with issues pertaining to executive remuneration. They feel that because the committee would have made various consultations with remuneration experts and have had an opportunity to weigh the packages against what other situated companies are paying, they are better positioned to handle such issues. For this reason, shareholders would be more inclined to say that the remuneration committee is better positioned to deal with these decisions. This can be justified by the fact that in South Africa, we have not seen to date any activism of shareholders within companies. Unlike recent developments in the UK, where shareholders of GlaxoSmithKline (GSK) recently struck down executive packages, we have not had cases of shareholders voting against directors' pay. It is hoped that with increased shareholder activism, South African companies could possibly see more alignment being achieved of pay and performance and that interests of all other stakeholders, in particular, employees will be taken cognizance of before executive remuneration packages are decided.

Though King proposes that shareholders be granted more say over performance related executive remuneration setting, when we draw upon the experience in the UK and the US, where empirical studies indicate that shareholder voting only operates as a potential check when pay arrangements deviate far from the norm,³³¹ in the South African context, these findings imply that implementing the shareholder oriented reforms that have been canvassed would fail to address fully the concerns raised by critics of executive pay. It is

³³⁰ BR Cheffins (Note 296 above), 670 The author indicates that in most instances, shareholders have taken a 'hands off' approach.

³³¹ DTI, 'Byers to strengthen link between pay and performance' Press Release P/2001/132 (7 March 2001); R Shrimley and S Targett, 'Spotlight on Executive Pay Deals', Financial Times, 8 March 2001, 33.

felt that shareholders do not often attend meetings and if they do, they hardly ever apply their minds to the resolutions proposed.³³² As Cheffins suggests, it is unlikely that shareholders will see this as a serious problem and may understand that generous remuneration can be required to align pay and performance and to attract and retain talented executives.³³³ However, shareholder involvement may have some impact or potential to increase adherence to corporate governance standards and in particular, to decisions made by directors on setting pay. It is felt that it is not likely to cause any adverse consequences in South Africa.

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³³² T Mongalo 'Two steps forward, one step back|: Directors' duty to act for the benefit of the company revisited in the aftermath of corporate governance reforms', 5

³³³ BR Cheffins *Company Law theory structure and operation*, 694

³³⁴ DTI, 'Byers to strengthen link between pay and performance' Press Release P/2001/132 (7 March 2001); R Shrimley and S Targett, 'Spotlight on Executive Pay Deals', *Financial Times*, 8 March 2001, 33.

³³⁵ T Mongalo 'Two steps forward, one step back|: Directors' duty to act for the benefit of the company revisited in the aftermath of corporate governance reforms', 5

³³⁶ BR Cheffins *Company Law theory structure and operation*, 694

6.2.3 INCREASED LEVEL OF CROSS DIRECTORSHIP HOLDINGS WITHIN COMPETING COMPANIES

During the apartheid regime, we had a system characterized by a concentration of power within the hands of a few individuals or companies. As a result, many business enterprises became nests of complex cross holdings.³³⁷ Inasmuch as King II recommends that directors should be weary of the number of directorships they take up in different companies, to enable the particular companies to benefit fully from their expertise and knowledge, in South Africa, one in two directors holds directorships in other competing companies.³³⁸ Evidence from P3 Management Consultants' survey indicates that in the ten highest paying South African companies, over half the members of each company remuneration committee currently serve as executive directors on other companies.³³⁹ In the new South Africa where black economic empowerment is promoted, it is felt that greater opportunities being availed previously disadvantaged individuals would decrease the burden of having to sit in many boards and would therefore reduce the level of conflicting interests within companies in making remuneration recommendations to the board. Greenbury Committee foresaw the problems associated with such holdings and totally discouraged cross holdings.

6.2.4 LACK OF TRANSPARENCY AND SEGMENTAL DISCLOSURE

King proceeds on the premise that there was a separation of ownership from control and therefore improving accountability was seen as paramount. King II's main emphasis was placed on standards of managerial accountability or the reduction of 'agency costs'. This is why emphasis is made on the roles played by non-executive directors, shareholders and others in holding management to account for its actions.³⁴⁰ Disclosure is seen as an important ingredient of being held accountable. However, in South Africa, listed companies pay inadequate attention even to the simplest requirements of the Code of

³³⁷ T Mongalo 'Corporate governance issues requiring urgent attention in South Africa? An analysis' (Unpublished article), 3

³³⁸ T Mongalo (Note above),

³³⁹ These conclusions were drawn from the 2000 and 2001 Fortune magazine and Hay Group (P3 Management) surveys of the world's most admired companies.

³⁴⁰ Ibid, 5

Conduct outlined in King's reports. Transparency and segmental disclosure appear to be absent in most corporations, with only the top 30-40 companies introducing certain performance measures.³⁴¹ The CEO of the Peoples Bank indicates that disclosure demotivates millions of black people because there are not enough black people in top positions, this will further decrease their perception about the corporate strata keeping in mind that during the apartheid regime people of colour were not allowed to progress all the way up the corporate ladder.³⁴²

With greater enhancement of black economic empowerment, it is felt that we will see a greater number of top positions being taken up by previously disadvantaged people and the concerns raised in setting pay packages being addressed to a greater extent. However, while it is acknowledged that directors have various skills and expertise that are utilized to generate maximum profits for the company, given the South African situation, and the level of skill required of directors, companies will keep increasing their pay as an incentive to keep the company running. If there was an increase in skilled and experienced workers, there would not be need for such measures.

6.2.5 LACK OF QUALIFICATIONS AND EXPERTISE OF LOW RANKING EMPLOYEES

Inasmuch as efforts are being made to try and wage the gap between top ranking executives and file employees, the problem in South Africa is that most file ranking employees who comprise of a majority of blacks do not hold the necessary expertise and qualifications to engineer the company and to make informed decisions on enhancing shareholder value and equity. As such, while trying to deal with these imbalances, their own performance has to be aligned to their pay, and it would be quite difficult to close down the gap between these different sets of people who serve the company differently. Executive recruitment market has become more aggressive in recent years. Companies are now engaged in a war that is fought for talent, which in South Africa is in short supply. For these reasons, if companies

³⁴¹ A Kakabadse 'Corporate governance in South Africa: Evaluation of the King II Report' 305, 307

³⁴² Anonymous 'Why still the secrecy around directors remuneration' *South African Labour Bulletin* April 2002

insist on linking pay to performance, they would have difficulties in attracting or retaining talented executives. It is submitted that a strict alignment of interests of employees and shareholders will be realistically impossible to achieve. Neither will it be easy to reduce the wage gap to such levels as would be regarded as acceptable within South African business environment and vigilant labour movements.

Furthermore, in considering the special circumstances prevailing in South Africa, the Committee accepted the concept of not permitting the same individual to be the chairman and the chief executive officer. It however noted that there are many instances in South Africa where the position of chairman and chief executive are held by one person or combined by force of circumstances.³⁴³ Depending on the size of each company, some companies may decide it to be more cost effective to have one individual holding these positions. Because it is left in the companies discretion to decide whether or not to separate the two, often, companies would rather not pay than incur extra expenses which it may feel is unwarranted. The King committee however doubted whether there is, in South Africa, a sufficient pool of trained and experienced people available to serve as non-executive directors. It acknowledged that as a result of this limited pool of skilled people, conflicts of interest often arise.³⁴⁴

6.2.6 DECREASED LEVELS OF JOB MOBILIZATION

Although King II feels that the levels of remuneration in South Africa should be sufficient in order to attract, retain and motivate quality executives to boards, it is felt that even though they have to be attractive, companies should not lose sight of the linkage of pay and performance of each individual executive. In our context, executive directors do not shift between different jobs all the time. Their movement within companies has been very low; as such there is no need to fear that if a strict policy is taken to align their interest to shareholders by linking pay and performance, they will most likely leave for greener

³⁴³ King I, Clause 2.6.1

³⁴⁴ King I, Clause 2.6.2

pastures. It is felt that chances of executives leaving for greener pastures when they are dissatisfied are limited and therefore exaggerated.

6.2.7 ADOPTION OF REMUNERATION COMMITTEES AND THE INADEQUATE DISCLOSURE LEVELS OF PAY PACKAGES

With regard to remuneration committees, although King II motivates for their establishment, there is currently no legal requirement for South African companies to spell out governance structures or to even explain the principles behind setting remuneration packages. Existing evidence reflects and supports the view that public companies are, to some extent, adhering to the King recommendations.³⁴⁵ More companies are however responding to the King recommendations and are revealing the existence of remuneration committees in their company reports.³⁴⁶ However, the current extent of compensation disclosure in company accounts is woefully inadequate. The information disclosed is left to the discretion of individual companies. Under current reporting rules, there is really insufficient information to properly value performance related incentives and other issues in a systematic way across companies. The adoption of remuneration committees alone does not guarantee the setting of appropriate pay levels. To a limited extent, the recommendations of King II are to be welcomed as they create a formal structure for top pay setting. Shareholders are now better informed about remuneration decisions than ten years ago. However, for these decisions to be regarded as truly independent, other principles have to be taken into account.

³⁴⁵ Kakabadse 'Corporate governance in South Africa: Evaluation of the King II report' 305, 313

³⁴⁶ Ibid

6.2.8 ANGLO AMERICAN BOARD STRUCTURE EVIDENCES LACK OF INDEPENDENCE

The Anglo American structure adopted by King does not evidence any form of independence of the board in setting corporate directors pay. Even though the Code of Corporate Practices clearly indicates that executive directors should not play any role in the determination of their own pay packages, there is still a significant number of executives sitting in boards. In most of the South African listed companies, the chief executive director or chairman actually sits on the remuneration committee. Even though he has to absent himself when his pay is tabled, it is felt that there is a potential problem in that if as chair he decides on who to nominate and how much to pay other members, he determines indirectly, his own pay package.

6.3 CONCLUSION

It is felt that in South Africa, given the countries past socio political and economic situation under apartheid, issues pertaining to black economic empowerment require urgent attention. Failure to address these imbalances could be viewed as failure of the self-regulatory system of corporate governance. As such, one can move that the Codes be supported by some form of legislation to try and deal with these concerns. As observed by Kihumba, 'self regulation codes have some weaknesses and limitations which can only be cured by official regulations'.³⁴⁷ He goes on to say 'legislative enactment may be made stronger by the fact that it may have 'stronger and sharper teeth and hence able to reach where self regulated codes are weak'. It is felt therefore that a case for legally binding regulation of methods of setting executive compensation packages should be looked into.

³⁴⁷ Kihumba 'Setting governance policies: Codes or regulations?' Global corporate governance trust conference, Connecticut, 10 July 2000. <http://www.gcgf.org/library/speeches/Kihumba.doc> as quoted in T Mongalo 'Self-regulation versus statutory codification: Should the new regime of corporate governance be accorded statutory backing?' (Unpublished article) 1, 16

CHAPTER 7

RECOMMENDATIONS AND CONCLUSIONS

The legal systems investigated above recognize the need for control of company management. One method of achieving this control is by means of a supervisory board as found in the German system.

7.1 THE GERMANIC TWO TIER BOARD STRUCTURE VIS-A-VIS UNITARY SYSTEM

It should be remembered that in South African companies, authority to determine executive pay customarily rests in the hands of the board of directors.³⁴⁸ By virtue of the composition of company boards, this can pose a problem in that by setting directors remuneration collectively, they may effectively be able to determine what to pay themselves. There are essentially two forms of corporate governance structure. First, the South African corporate governance structure, which represents the Anglo-American corporate governance structure, has a single-tier board of directors. The board lays down broad principles, makes major decisions, selects officers and agents, and has officers who execute those policies.³⁴⁹ In the single-tier system, executive and non-executive directors sit on one board. Secondly, in the German two-tier board structure, a supervisory board, which is not involved in the day to day running of, the business watches over the managers and reports on them to the shareholders.³⁵⁰ The two-tier board structure is devised in a manner that there are two levels, the supervisory level that is comprised of shareholders and employee representatives.³⁵¹ This division of responsibilities was designed to afford shareholders a body, which could act for them to check, supervise and correct the active management. It has two levels; the upper supervisory board and the lower management board. All

³⁴⁸ R Cheffins, R Thomas 'Should shareholders have a greater say over executive pay?: Learning from the US experience' Vol 1 Part 2 December 2001 *Journal of Corporate Law Studies* 277, 284

³⁴⁹ M Yavasi 'Shareholding and board structures of German and UK companies' *The Company Lawyer* vol 22 (2) February 2001 47, 48

³⁵⁰ German Public Limited Liability companies Act of 1965, Section 111

³⁵¹ T Salzberger 'Three ideas for the two tier board approach' <http://www.legamedia.net>

interested parties are represented on the supervisory boards. This board system has employee representatives in the upper supervisory board.

Therefore, shareholders and other parties can make use of control rights over the managers. The upper supervisory board consists of 50 per cent of shareholder elected representatives and 50 per cent of individuals elected by the employees.³⁵² The supervisory board is totally independent and does not take any part whatsoever in the management of the company. Its main role is to supervise and monitor the management board. With the exception of employee representatives, members of the supervisory board are elected by the shareholders. The supervisory board appoints and removes the management board. This means that the supervisory board is the second supreme organ of a company after the general meeting of the shareholders.³⁵³ Supervisory boards cannot have overlapping membership with the management board.

In South Africa, King II recommends that guidance be sought from remuneration committees, which are to be composed of a majority of outside directors. However, as seen earlier, these have proved deficient in many respects. It is submitted that where all stakeholders are party to decision making, voting against the company's accounts when presented at the board meetings can exert pressure on directors who award themselves hefty packages. It is unlikely that they would recommend packages that are over the 'odds' when they know that there are watchdogs overlooking their conduct. The unitary system as it currently applies in South Africa and other jurisdictions is such that executive and non-executive directors sit in the same board and attend meetings together. As such, it becomes very difficult for non-executive directors to monitor or supervise their own colleagues.³⁵⁴ Non-executive directors in a unitary board structure will find it untenable to supervise or act as watchdogs to their executive colleagues. Thus, expecting them to play a pivotal role in influencing reasonable executive pay level would be to ask too much of them. For these

³⁵² T Mongalo 'Corporate governance reforms: Part 2, 22

³⁵³ TJ Andre' 'Some reflections on German Corporate governance: A glimpse at German supervisory boards' *Tulane LR* Vol 70 (1996) 1819, 1822

³⁵⁴ Some scholars indicate that they get to know each other on a personal level, more especially where there are cross directorships within companies.

reasons, a two-tier board system may be the solution to the problem of offensively high executive pay levels.

There are some demands from organized labour in South Africa that worker participation at board level should be made compulsory.³⁵⁵ Cosatu and other labour movements propose that 'the principle of granting workers the right to elect fifty per cent of the members on company boards be agreed'.³⁵⁶ It is proposed that a two-tier board structure may work much better in the South African context than the unitary system. The whole idea behind corporate governance reforms was to operate the company in a way that gives cognizance to all stakeholders' interests, including employees and shareholders. Given the peculiar circumstances of South Africa, King II ought to have taken the all inclusive approach of corporate governance to greater lengths and should have recommended changes to the core of directors' duties in order to accommodate the interests of different stakeholders.³⁵⁷ It should not have followed the Anglo American approach which disregards to a great extent, the interests and roles of stakeholders within the company. It is felt that the unitary system has proved a failure in this regard. These parties are nominated to these positions in order that they can be able to question the board when excessively high amounts are paid to directors.

It is felt that remuneration committees do not seem to work in a manner that works towards curtailing executive pay. Because these committees comprise solely of directors, they tend to be bias when determinations of executive pay are made; thus, as already seen, they set, in their own way, their own pays. Introducing employees to this level will ensure a much-needed sense of balance in the setting of executive remuneration.³⁵⁸ It is noted however, that it does have its own shortfalls. It is understood that employees (low ranking) and shareholders may lack the necessary expertise and skill with regards to what constitutes setting executive remuneration. However, these do not outweigh the benefits that can be

³⁵⁵ The South African Labour Movement Social Equity and Job Creation: *The key to a stable future* issued by the Labour Caucus at Nedlac, incorporating Cosatu, Nactu and Fedal (1996) 34 par 5.3

³⁵⁶ Ibid

³⁵⁷ T Mongalo 'Corporate governance issues requiring urgent attention in South Africa? An analysis, (Unpublished article), 9

³⁵⁸ BR Cheffins, 673

ripped by engaging and or adopting the Germanic independent two-tier board system. With the proper training and engagement of qualified professional consultants, these parties can play a pivotal role in executive remuneration decision making than if these decisions are just delegated to executive directors who are unable to generate expected returns purely on the basis that they impose increased agency costs on shareholders. Boards can appoint competent persons to sit in these committees.

It is felt that in addressing the apartheid wage gap that exists in South Africa, the two-tier board with employee representatives in the supervisory board would address this concern. A two tier board structure, although undoubtedly slower, and probably operationally more frustrating, could provide the structural conduit for balancing the interests of all stakeholders.

The two-tier board system is not only beneficial in the context discussed above; it has an advantage over the unitary board structure in that where a company has been wronged, and it has to be determined who has to sue, it would be unacceptable to have a resolution not to sue carrying the votes of potential defendants.³⁵⁹ A decision to condone taken by a board under the wrongdoer or his supporters would be a travesty. The two-tier system prevents this problem as an independent board has power to condone a wrong committed against the company. It was however indicated in Chapter 3 that under our current regime, condonation cannot be achieved in prejudice situations and therefore, excessive executive remuneration awards should not be ratifiable wrongs as it constitutes a fraud on the minority.³⁶⁰ However, because an independent board has power to condone wrongs, the rules could possibly be relaxed and the wrongs committed (awarding exorbitant remuneration in total disregard of company interests) could be regarded as falling outside the purview of unratifiable wrongs as propounded in the case of *Prudential Assurance Co Ltd v Newman Industries Ltd and Others*.³⁶¹ The Germanic two-tier system provides answers to many of the compelling problems associated with the unitary system. Through

³⁵⁹ J McLennan 'Wrongs to company: Condonation', SALJ, 136

³⁶⁰ See also J McLennan (Ibid), 139

³⁶¹ Note 176 above

this system, a broader spectrum of interests in the company are formally recognized and it ensures that exclusive shareholder and director control is not the norm anymore.³⁶²

7.2 EXPANSION OF DISCLOSURE REQUIREMENTS

Disclosure requirements do not act as deterrence to the curtailment of executive remuneration. The JSE Listing rules still grant companies leverage to decide whether or not to disclose remuneration packages. As such, corrupt directors may still find the need to fail to disclose packages, which they well know that shareholders at the AGM may query. The Listing requirements just indicate that reasons for non-disclosure should be revealed. It is recommended that in South Africa, disclosure requirements modeled along the newly introduced UK disclosure regulations be adopted in the Companies Act. The government should make disclosure requirements more onerous. Our disclosure regulations have to be restructured so that shareholders can have the necessary information to enable them to assess a company's policy on boardroom pay. A publicly quoted company would have to then divulge a wider range of information dealing with the link between pay and performance, including performance graphs that highlight where matters stand. It is felt that full disclosure with justifications will embarrass overpaid executives and will grant shareholders much more leverage to ensure that pay is linked to performance. This is confirmed by King II in section VI, who indicates that disclosure highlights misconduct and non-performance.

In terms of the new UK Section 401A individual packages should be justified in the records and the level of performance of each director is to be specified in the financial statement. With these more stringent rules, it would be much more difficult for directors to walk away with undeserved shareholder monies.

³⁶² JJ Du Plessis 'Corporate governance: Some reflections on the South African law and the Germanic two tier board system' 1998 (4) CLDS, 29

7.3 ENHANCEMENT OF SHAREHOLDER PARTICIPATION IN SETTING EXECUTIVE PAY

Bolstering shareholder involvement in the determination of executive pay is another option for reform. The current legal position is that whenever the articles of association authorize the board of directors to make decisions on a company's behalf, the general meeting cannot dictate to the directors how to exercise its powers.³⁶³ As such, shareholders in South Africa cannot exercise any form of control over executive remuneration except where the Companies Act grants them some measure of control to pass resolutions.³⁶⁴ While South African companies must be able to attract and retain the best executives in the world, the linkage between pay and performance is also rightly a matter of concern to shareholders. It was shown earlier that when directors receive generously handsome packages, these will in some measure lead to a dissipation of profits which otherwise would be available to shareholders.

Moreover, granting executive directors performance related incentives like LTIPS and share options lead to a dilution of existing equity which would result in shareholders getting a significantly less voting power and lower earnings per share.³⁶⁵ In as much as granting them greater direct say might probably not address fully the concerns raised over executive remuneration; it is believed that their contribution would not impact negatively on managerial remuneration in South Africa. Section 401A of the UK Companies Act grants shareholders much more say in the determination of executive pay.³⁶⁶ The fact that shareholders can now vote on director's pay for the first time since company law was changed in 2002 has forced some business leaders to make clear that they will reduce pay and bonuses of their senior bosses.³⁶⁷

³⁶³ *Automatic Self Cleansing Filter Syndicate v Cunninghame* (1906) 2 Ch 34

³⁶⁴ See Chapter 3

³⁶⁵ B Cheffins, R Thomas 'Should shareholders have a greater say over executive remuneration', 287

³⁶⁶ A number of disadvantages have been leveled against shareholders passing resolutions on executive remuneration. For one, in the UK, Section 376 of the companies Act 1985, an individual shareholder or small group of investors must own at least 5 per cent of the voting rights of a company in order to make an AGM proposal. Often, only a tiny fraction of investors control sufficient votes to make a shareholder proposal at an AGM.

³⁶⁷ K Griffiths 'UK bosses earn more but return less' *Business Times* 21 May 2003

The point is, shareholder funds are utilized to finance directors' salaries, as such, they should at least have a say in the matter.³⁶⁸ Indeed, it would be contrary to principles of corporate democracy if they did not; hence why boards of directors are authorized by members to take up decisions.

Even though shareholder's votes are regarded merely as advisory, and therefore may not have much direct influence over the setting of executive pay, it can prove effective in that where boards know that there is shareholder activism within the company, which may see the packages set struck down on the basis of non performance, such boards would approach the issues of setting directors pay with much more caution and would more than likely heed the recommendations made by shareholders. King II reiterates this and says that 'requirements to disclose remuneration in annual reports are seen as a constructive opportunity to communicate with shareholders on all aspects of remuneration'.³⁶⁹

One may argue that it would be impracticable to call a meeting of members every time a company wished to make a benefaction. However, with remuneration reports being tabled at the AGM with the financial statements, it follows that the company would have to make executive remuneration awards at particular periods for approval by shareholders at a members meeting. Thus, shareholders should give approval of all remuneration packages and South Africa should envisage the possibility of mandatory rules on shareholder involvement in decision-making in this field. It is submitted that South African shareholders can vote against the company's accounts when presented at the AGM can exert pressure on directors who award themselves hefty packages to strike them down. They can also express concern by declining to approve the re-election of directors who were members of a company's remuneration committee. However, as practice has shown, shareholders hardly ever raise any concerns in this regard. It is submitted that stringent rules relating to shareholder power voting over executive remuneration should be increased and endorsed. It should be made easier for shareholders to propose resolutions and to vote

³⁶⁸ J McLennan '*Misappropriation of company funds: a proposal for reform*', 658

³⁶⁹ Para 3.5 of Appendix V

at AGMs on executive pay. They should also be allowed to vote on the board's remuneration report on an annual basis. It is recommended that if a listed company fails to secure shareholder approval in accordance with the law and Listing Rules, such company be censured or be removed from the listing register.

With regard to the length of service contracts of executive directors, King II at 2.5.9 indicates that it does not favour lengthy service contracts and makes a suggestion that none should exceed three years in duration unless the shareholders approve an extended contract and full disclosure and reasons are made. In order for us to avoid rolling contracts, which King II does not really address, it is proposed that the length of service contracts be shortened further to an annum. In this case, shareholders could endorse, by resolution, agreements with a term of one year. Greenbury report indicates that the permitted duration should be one year, with longer contracts being prohibited unless approved at a general meeting of the shareholders.³⁷⁰ In this way, companies would be subject to shortened rolling contracts, which constantly renews itself. In this way, in the event of directors exiting office, the company will be saved a lot of money, which could be utilized to pay for handsome golden parachutes. Shareholders should be granted leave to use a special resolution that requires a three quarters majority of the votes cast to displace the obligation to vote on each remuneration package. The recommendation made by King II of a reduction in service contracts is welcomed. However, it is felt that the law still has to be developed further and it is the author's view that these contracts be endorsed at a general meeting where shareholders should pass a special resolution to authorize any longer contracts in this regard. In this way, shareholders will be seen to be actively involved in the setting of executive remuneration.

7.4 PERFORMANCE RELATED INCENTIVES

With regard to performance related packages, it is recommended that golden handshakes be clearly stated in the contract of employment and the circumstances under which it shall be paid out must be discussed. The amount agreed upon and the terms upon which such

³⁷⁰ Para 7.12 and 7.13

monies would be payable should then be approved by not only the remuneration committee and the board of directors, but shareholders must also be party to such a decision. It was seen earlier that in the UK, shareholders of GlaxoSmithKline recently struck down a severance package of one of the directors and refused to pass a resolution on it.³⁷¹ The pre-contract agreement will enable the board to have proper checks and balances in place before the executive who is likely to benefit from golden handshake becomes a member of the decision making team or board of directors of the company.

It was earlier intimated that there is no alignment of performance and shareholders interests. A director who is awarded share options does not get to lose his or her net asset worth should the market plummet, as he or she will not exercise the option held; no one can compel such directors to sell, even though the plummeting shares are directly linked to their bad performance. The alignment of risk between shareholders and directors can be improved and achieved more effectively at lower cost to the company with some simple reforms of share options and bonuses. As a solution to this problem, one may suggest that ordinary shares, rather than share options, be awarded to directors as an incentive. The use of share appreciation schemes rather than options means that the stock base is not diluted.³⁷² In line with recent corporate governance reforms, non-executive directors can forgo a portion or all of their director's fees to subscribe for ordinary shares in the company.³⁷³ This way, they will strive for the betterment of the company and its increased market share prices.³⁷⁴ One may still argue however, that the directors in issue can still utilize the fees that they receive to purchase the shares. However, it would work better in the sense that their fees will better be aligned to their performance in the company. In addition, the timing of the exercise of such options could be made a term in the contract of service so as to remove speculative gains from timing the sale date to maximum effect.³⁷⁵

³⁷¹ Note 342 above

³⁷² Tricker, 337

³⁷³ This has recently been suggested by the UK Secretary of Trade in its proposal, passed for comment by the public on how best to curb exorbitant director's payouts and share options for failed fat cat executives. This is in response to the public outcry over corporate director's pay. 'Hewitt to propose laws to curb fat-cat payouts' www.Businesstimes.co.za 5 June 2003

³⁷⁴ King II briefly makes reference in passing to this issue, that in some jurisdictions' markets, the view is that non-executive directors should receive shares rather than options.

³⁷⁵ Tricker, 337

It is noted that as a result of remuneration committee's composition of a majority of non-executive directors, it becomes very difficult for non-executive directors to exercise restraint, and to make decisions on incentives for executives without a conflict of interest. It is inappropriate for the remuneration committee to make recommendations on the basis of remuneration of non-executive directors. Even though some scholars³⁷⁶ feel that it should be a matter for the board as a whole, and that shareowners should vote on and approve the recommended packages, it is submitted that this role should rather be left with independent supervisory boards as adopted in the two-tier board system applied in Germany. Non-executive directors should not be allowed to participate in the company's annual bonus plan, share option scheme or long term incentive plan. It is recommended that to avoid the bias associated with non-executive directors setting pay, eradication of share options would lead to the curtailment of exorbitant remuneration packages.

7.5 NEW TAX MEASURES

It is proposed that the government should consider new tax measures relating to top pay. As a way of curbing excessive pay, perhaps South Africa could also look to the United States of America for guidance. In this jurisdiction, Bill Clinton in his campaign pledge in 1993 spurred changes to the Internal Revenue Code, which meant that a corporation that paid an executive more than \$1 million annually could treat the expenditure as deductible for tax purposes only if the additional amount was paid pursuant to a performance based plan.³⁷⁷ However, a plan can only be performance based if the shareholders ratify the scheme. Hence, if a company wants to avail itself of the deduction when it introduces a stock option scheme, those owning equity must have a say in it. South Africa can adopt the same policy and set a minimum threshold amount within which tax concessions can be attained.

³⁷⁶ T Wixley, G Everingham, 56

³⁷⁷ B Cheffins, S Thomas 'Should shareholders have a greater say over executive remuneration', 298

It is submitted that limits should be set with regard to interlocking directorships. Rules that will impose the maximum number of boards in which a director can participate either as an executive or a non executive director have to be devised. It is felt that service on too many boards can interfere with an individual's ability to perform responsibilities. Most importantly, it interferes with their duties to avoid conflict of interest in as far as executive pay is concerned.

7.6 LEGISLATIVE REGULATION

Other means of reducing executive remuneration entail engaging government regulation on legislation reforms. The government can impose some levels or measures to preclude pay rises exceeding specified designated levels, such as the rate of inflation.³⁷⁸ Even though the control of prices may to some extent prove difficult and not beneficial in the long run, to try and deal with the imbalances of pay packages to top executives and low ranking employees, government can enact a law to say that remuneration paid to top management in a company should not be more than a specified number of times larger than the salary of the average employee.³⁷⁹

It is further submitted that even though legislation lacks flexibility and can have a negative effect in setting pay packages, the South African Companies Act 61 of 1973 should be revisited and revised to an extent that it should include recent developments. The current legislation and the common law do not work towards curtailment of executive remuneration. It is felt that legislation will create a greater consciousness of the overriding duty owed to companies particularly among those who administer companies but are not trained in company law. As McLennan indicates when quoting Professor Naude that 'the

³⁷⁸ BR Cheffins (Note 296 above), 701

³⁷⁹ These plans were attempted in the US in 1973 but failed wherein a law was passed to say that no executive could receive a pay rise of more than 5 per cent in any given year, even if an individual was moving to a better job with another company. In this instance, invariably, all did not change any jobs. This scheme was altered to read that the pay ceiling did not apply when people took a new job with a different company. This proved unproductive since everyone became willing to change employers. For this reason, the entire plan was abandoned.

very visible statutory liability forces circumspection on directors and creates an awareness of the available remedy for minority members'.³⁸⁰

Even though a difficult and complex area of the law, it would be desirable to codify civil remedies for breach of director's duties. Sections underpinning director's fiduciary duties to his company by regulating conflicts of interest would assist in tackling abuses which the common law has failed to prevent or address. As previously discussed, directors setting their own pay constitutes such obvious conflict of interest. It is believed that this would be the right approach to adopt.³⁸¹ It is also essential that there be effective disclosure and accountability to shareholders in this area in respect of publicly quoted companies. It is submitted that once a statutory statement of duties is enacted, the common law duties will be linked to the particular jobs performed by each director, irrespective of the actual talents of the directors who perform the roles. For these reasons, it is the author's view that common law fiduciary duties of directors and disclosure requirements in financial statements be legislated. The long-term effects of this move would see the wage gap decreasing and pay being aligned to a greater extent to performance.

7.7 CONCLUSION

It was seen that judicial intervention does not seem to be a realistic solution and strategy to adopt for addressing the concerns raised in relation to executive pay. Because of the pragmatic approach adopted by the courts, probabilities of successfully challenging excessive remuneration are very restrictive. If executive pay litigation in South Africa were used on a frequent basis and directors were aware that it is a realistic possibility, it would be an incentive on their part to address shareholders interests and they would turn to them by involving them more in decisions pertaining to their pay. Obviously, by involving shareholders and employees more, and getting them to ratify their conduct, the directors would be protected from allegations of breaches of their duties of care and loyalty. As such,

³⁸⁰ J McLennan 'Misappropriation of company funds:' 663

³⁸¹ In the UK, the company law review steering group issued out a Final Report in June 2001 and advances recommendations to government on simplifying and modernizing the law applicable therein; in particular it provides a legal framework for all companies and makes proposals on among other things, the revision of the Companies Act 1985.

one can recommend that legislature propose new laws that will inhibit director's salaries spiraling out of control.

Given the concerns raised regarding the Code of Good Practices and the inefficiencies in our common law and the Companies Act 61 of 1973, it is evident that these instruments have to be tightened a bit, particularly in relation to the obligations of shareholders in governance (both in exercising voting power and in engaging in considered dialogue with companies on disclosures and the obligations of companies to communicate with shareholders in the annual general meeting. Directors must act in what is believed to be in the interests of the company. Even though current legislation and the common law is lacking in this field of corporate governance reforms, it is felt that to enhance and to make directors weary of their duties to the company and all stakeholders, the law should take a complete turn and be remodeled along the lines of the UK legislation. It is acknowledged that a correlation between pay and performance in the UK has not been achieved yet, it is felt that the new regulations encompassed in the Companies Act 1985 and the new proposals issued out by the UK Department of Trade and Industry will work more towards curtailing exorbitant remuneration packages being awarded.

Amid recent corporate scandals pertaining to shocking self enrichment schemes that directors engage in, it is felt that in South Africa, these practices will ultimately come to an end given the stringent regulations enacted and suggested shareholder activism or involvement in South Africa. The limitless prerogative of directors having the ultimate say on setting remuneration packages including their own should come to an end. With shareholders taking the lead in actively scrutinizing directors pay, a true alignment of pay and performance will ultimately be struck; it is hoped that we will also see the wage gap decreasing to expected levels in South Africa and the world over.

The roles of other stakeholders should also not be lost sight of. Employees' should actively be engaged in committees set for the determination of executive remuneration. Their participation will lead to the wage gap being radically cut in that members at such committees will remain weary of the interests not only of shareholders, but of employees as

well. Surely, while motivations are made for increases in pay packages of executives, the low ranking officers will not be forgotten. They will see to it that the differences as to cause concern over such packages are considered.

It remains to be seen whether an alignment would ultimately be struck between pay and performance or whether other guidelines have to be developed which would require those making decisions on executive pay matters to be sensitive to the needs of the wider scene including pay and working conditions elsewhere in the company. The introduction of shareholder activism should be seen as a positive move towards introducing some measures in curtailing corporate fat cats pay.

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