

SHAREHOLDERS' INTERESTS VERSUS SOCIAL DEMANDS: INCONGRUOUS AGENDAS

1 Introduction

In this note the chasm between shareholder and stakeholder interests in the running of the corporation in an emerging economy in general, and the third world country in particular, is considered. A study of two corporate governance models is undertaken with the intention to demonstrate that inclusive corporate governance which does not relegate stakeholder interests to the periphery is more efficient under the Two-Tier Board than the Anglo-Saxon model which is followed in South Africa. The reality of an entrenched corporate governance model which is supported in the South African Companies Act 61 of 1973 (the Anglo-Saxon model) is appreciated; hence it is argued that it is unlikely that South Africa might, in future, change to the Two-Tier board. The answer to the international revolution of realising societal expectations lies either in the King Report on Corporate Governance in South Africa (2002) (hereinafter King II) or modified corporate mindset, or both. It is also argued that the proposals in the Policy document of the Department of Trade and Industry (DTI) (*South Africa Company Law for the 21st Century: Guidelines for Corporate Law Reform*, May 2004, GN 1183 GG 26493 23-06-2004 May 2004, also available at <http://www.dti.gov.za/ccrdlawreview/companylaw.htm>) for optional representation of stakeholders on boards and the proposed inclusion of the statement recognising stakeholder interests in the Companies Act constitute a good start to changing the corporate mindset towards being stakeholder-sensitive.

It is argued that the focus of King II on the triple-bottom line approach is negated by its ambivalence on enforcement and the status of stakeholders in the South African corporation. The article then concludes that in a country which emerged from a history of entrenched overt racism, a significant recognition of stakeholder interests is critical to the socio-economic need for transformation to create a stable civil society.

Globalisation has given rise to remarkable increase in the power of the global corporation. Events in the corporate sector can have negative repercussions not only for the shareholders of that particular corporation but also for society at large, either in that particular country or internationally. The emergence of powerful multinational corporations has led to a demise of state authority. The spate of corporate failures, however, has precipitated a move towards strengthening corporate governance rules to ensure that companies are well governed. Indeed it has been opined that companies contribute enormously to the economic and social wellbeing of our societies (Worthington "Corporate Governance: Remedying and Ratifying Directors Breaches" October 2000 (116) *LQR* 638).

Since the dawn of the democratic dispensation, South Africa has endeavoured to ensure that its corporate governance system is continuously evolving towards improvement. The aim is to bring the legislative and regulatory framework in line with the high standards adopted by some of the developed countries.

After a decade of this exercise it is worthwhile to ponder and reflect on a critical aspect of corporate governance, namely the concept of the shareholder as the owner of the company. In this note it is argued that the endorsement of the traditional system of enhancing shareholder value through corporations and simultaneously meeting stakeholders' demands through corporate social responsibility in South Africa, is open to considerable doubt. Many developed countries have realised that the company is not exclusively for shareholders' wealth creation. However the problem is in demystifying the old notion that shareholders are "owners" of the corporation and that the directors' primary and exclusive duty is to create wealth for the shareholders. Another problem which arises when analysing the shareholder and stakeholder paradigm is the move from exclusively financial reporting to the triple-bottom line approach.

It is also argued that the corporate governance model that South Africa utilises, the Anglo-Saxon model, is not vigorous enough to ensure that shareholders and different stakeholder interests are considered in the operation of the company.

The United States has promulgated the Sarbanes-Oxley Act of 2002 to ensure a high standards of corporate governance. It will also be useful to ascertain whether the South African self-regulatory model of corporate governance is the answer or whether we should legislate.

2 Brief historical perspective

The definition of corporate governance is not settled in literature. According to the King Report on Corporate Governance in South Africa (1994) (hereinafter "King I", par 1) corporate governance is defined as the system by which companies are directed and controlled.

The primary document dealing with corporate governance in South Africa is King II. It was formulated under the aegis of South African private business institutions and draws its spirit from similar reports in the United Kingdom and the United States (for an in-depth analysis of the historic development of King II see Mongalo "The Emergence of Corporate Governance as a Fundamental Topic in South Africa" 2003 *SALJ* 173 175-179).

The path that South African corporate governance reform has taken is unique in the sense that it was located within the context of South African experiences and African cultural heritage. In King II there are references to the underlying ethos of *ubuntu*, an African concept which stresses the principle of reciprocally honouring the inherent worth of all members of the community. Indeed, Charkham opined that "in the UK and elsewhere, corporate governance is set in the framework of its political and social history and attitudes". (Charkham *Keeping Good A Company: A Study of Corporate Governance in 5 Countries* (1994) 1. See further Smerdon A

Practical Guide to Corporate Governance (1998) 3, where it is submitted that “[C]orporate structures vary from country to country. They are the product of the local economic and social environments”.)

King II provides for the responsibility of the company to its stakeholders ((King II) par 5). In this respect it focuses on the companies’ social responsibility. Mervyn King comments that:

“All stakeholders now have an interest in the company and corporate governance has expanded far beyond financial matters. This has given rise to the concept of triple-bottom line reporting where social, economic and environmental issues now need to be reported in a sustainable manner” (King “Corporate Governance: Adopting an Inclusive Approach” May 2002 *Management Today* 28).

Of critical importance in this regard is that companies should have a clear, sustainable and integrated approach to give effect to the triple-bottom line concept.

To appreciate the argument advanced in this note it is perhaps fitting to begin by explaining the concepts which form the basis of the note: the Anglo-Saxon and Two-Tier Board models of corporate governance and the “triple-bottom line approach” to corporate management. The Anglo-Saxon model is derived from the UK Companies Act of 1884 which enshrined the concept of a company as a legal entity separate from its owners. In this model there is a single board of directors appointed by members and reporting to them on the stewardship of the corporation. Members also appoint auditors to ensure that members of the company, especially shareholders, receive independent and reliable information on the financial standing of the company (see generally Wixley and Everingham *What You Must Know About Corporate Governance* 1ed (2002) 3). This in turn enables shareholders and other interested parties to make informed investment decisions on the authority of an independent voice.

The Two-Tier Board proper, a “German” model (which also exists in Austria, and the Netherlands and finds echoes in the Scandinavian approach), is a “stakeholder model”. (For an in-depth analysis of the Two-Tier board system see Du Plessis “Corporate Governance: Reflections on the German Two-Tier Board System” 1996 *TSAR* 20; and Salzberger and Theisen “Three Ideas for the ‘Two-Tier’ Approach” http://www.legemedia.net/dy/articles/article_15789.php#.) The interests of shareholders are paramount, although stakeholder interests are not relegated to the fringe. The model entails two boards; the first one is a supervisory board (*der Aufsichtsrat*) with no executive power, but with authority to appoint, approve or remove a manager of the board. Employees and shareholders are represented on this board. The second one is a management board (*der Vorstand*) which is responsible for the ongoing management of the enterprise and has the responsibility of reporting to the supervisory board (Wixley and Everingham 4). It has been opined that in Germany economic criteria come second to social duty and the company is obliged to the community in which it stands (Charkham 8).

The “triple-bottom line”, a phrase coined by John Elkington in 1994, means that the board of directors needs to balance and integrate economic

and social development and environmental protection in the operation of their companies (Visser and Sunter *Beyond Reasonable Greed: Why Sustainable Business is a Much Better Idea!* (2002) 65; and Naudé "Sustainability Reporting Simplified" February 2005 *Accountancy SA* 22-24, 22). This broad concept of sustainability reporting has been widely adopted by the business world. Indeed, King II provides that every company should report, at least annually, on the nature and extent of its social transformation, safety, health, and environmental policies and practices (King II par 5.1). The guidelines on corporate law reform also give special attention to the "triple-bottom line" approach where it provides that in the new company legislation:

"Disclosure should extend not only to financial information, but should include statements on compliance with public interest legislation, including Black Economic Empowerment Act, environmental regulation and labour regulation. This is generally referred to as Triple Bottom Line Accounting" (*Guidelines for Corporate Law Reform* 41).

3 Shareholders versus stakeholders

As mentioned earlier, the South African corporate governance model perceives the company as a vehicle for maximising shareholders' wealth. The common law position in this regard has been that reference to the duties of directors to act in the best interests of the company means that they should act in the best interests of shareholders as a general body. (In this regard see the Australian case of *Kinsela v Kinsela Russel Pty Ltd* (1986) 10 ACLR 395 CA NSW 401, where it was decided that "the proprietary interests of the shareholders entitles them as a general body to be regarded as the company when questions of duties of directors arise".) Given the social background in South Africa and international trends, it was critical that the King Committee lay down guidelines for ethical practices in business. King II further gives credence to this where it provides explicitly that every company should report at least annually on the nature and extent of its social transformation, ethical, safety, health and environmental policies and practices (King II par 5).

It is submitted that although the socio-economic conditions of the country have to be taken into account, the emerging global trend in corporate governance is to shift from focusing on the financial aspect of the company to broad initiatives embracing diverse issues. The vexed question is the viability of incorporating a balanced and meaningful contribution to groupings pursuing contrasting agendas. In other words, how can one expect harmony and sustainability in business between shareholder wealth-maximising initiatives, and societal or stakeholder interests?

The running of the corporation as a tool for creating shareholder wealth is not a virtue. Sappideed opines that the providers of long-term debt finance also have ownership rights in the corporation which needs to be safeguarded and further, that a duty to maximise shareholders' wealth creates perverse incentives, because it invites managers to maximise wealth in whole or in part at debt holder's expense (Sappideed "Fiduciary Obligation to Corporate Creditors" 1991 *JBL* 365, 395). It is submitted that debt holders in the company are stakeholders and that Sappideed provides an example

of how maximising shareholder value can be adversative to advancing stakeholder interests.

In their evaluation of King II, Kakabadse and Korac-Kakabadse argued precisely that proposing a corporate governance model where companies have to satisfy shareholders' demands by their ability to harness market forces while requiring them, by dictates, to satisfy stakeholders might raise substantial tensions (Kakabadse and Korac-Kakabadse "Corporate Governance in South Africa: Evaluation of the King II Report" 17 January 2002 (Draft) Vol 2 No 4 *Journal of Change Management* 305 312).

It is submitted that one of the myriad aspects of corporate governance is the achievement of an optimal balance between running the company for the benefit of shareholders and ensuring that the company, wherever possible, contributes to the economic and social programmes where it is located. This may be referred to as a broad concept definition of corporate governance (adapted from Mongalo 2003 *SALJ* 117). The point of departure in this regard should be to accept that companies are in business to make profit, and that not all companies will be able to contribute to, for instance, social reform initiatives.

It should be appreciated that, in terms of King II, directors are not only responsible for relations with the stakeholders, but are accountable to the shareholders (King II par 5). If the "narrow concept definition of corporate governance" is favoured in South Africa instead of the broad concept, a rationale for providing for the responsibility of directors to stakeholders is more apparent than real. This submission is further supported by Mongalo where he suggests that if the concern in corporate governance reform is to do away with shareholders' return, the question is whether the goal of considering stakeholders' interests will ever be achieved (Mongalo 2003 *SALJ* 177 fn 35).

While King II raises the importance of ethical practices it, however, lacks the organisational developmental technique of ensuring the implementation of those ethical practices, including the shift towards a stakeholder sensitive management.

It is submitted that, when faced with corporate decision-making, stakeholder interests will always be relegated to the periphery whenever the decision is likely to jeopardise shareholders' wealth creation. King II seems to have tried, ineffectively it is submitted, to bridge the gap between shareholders and stakeholders by making provision for independent non-executive directors. One of the primary duties of non-executive directors is to act as "buffers" between the executive directors and the company's outside shareholders; that is, they monitor the executive actions and question executive decisions and are required to ensure that the company is acting in a "responsible" way and in the best interest of the shareholders and other stakeholders. (Pass "Corporate Governance and the Role of Non-Executive Directors in Large UK Companies: An Empirical Study" 2004 Vol 4 No 2 *Corporate Governance International Journal of Business in Society* 52 59). Potential limitations on the role of non-executive directors in this regard are disconcerting. The first challenge is the multiplicity of boards on which most non-executive directors sit. The value which they add to the boards on which

they sit is therefore questionable. Second, they are appointed on a part-time basis and the question which arises is whether it is prudent to rely on part-time “outsiders” to keep boardrooms in check. Thus, non-executive directors may be unable to devote sufficient time to the company to really understand the needs of the company (Pass 58-60). If the role of non-executive directors is questionable in South Africa, it is submitted that bridging the gap between stakeholder and shareholder interests will remain elusive. Indeed, it has been argued that in the South African context a robust debate is required on the extent to which non-executive directors can realistically be expected to perform the roles expected of them. (Dlamini “Shareholders Show Their Muscle” City Press 20-02-2005 available at <http://www.finance24.com>).

It is also worth noting that the concern regarding non-executive directors resulted in the UK government appointing the Higgs Commission under Derek Higgs to review the role and effectiveness of non-executive directors on corporate governance matters. The Higgs Report was published in January 2003 (available on http://www.dti.gov.uk/cld/non_exec_review).

While companies might embrace, as some have done, the idea of non-executive directors, the vexed question is whether a non-executive director sitting on the unitary board structure would be able to resist the allure of short-term equity based capital demands adversative to stakeholder interests (Kakabadse and Korac-Kakabadse 313). The point being made is that in the current South African Anglo-Saxon model of corporate governance, stakeholder interests will never be truly given effect to; the balancing of interests of the parties with conflicting agendas is open to considerable doubt.

The treatise on corporate governance models reveal that the Two-Tier Board model is more suitable than the Anglo-Saxon model for any country intent on initiating a broad-based, stakeholder- and shareholder-inclusive corporate governance model. Given that the South African socio-political environment, is intent on redressing the imbalances of the past that promoted perverse socio-economic conditions which still persist, the country cannot afford exclusively to adopt a model where maximising shareholder value will be pursued at all costs. Mongalo captured the essence of the changing nature of corporate governance thus:

“It is indeed true of a modern company that profit, or need of it, cannot be the only bottom line in company operation. The post industrial era brought with it the realisation that companies were not operating in vacuum. The shibboleths of the exclusive approach or shareholders supremacy at all cost approach started to fall apart ... During this time, companies realized that the ‘inclusive approach’ represents the future of every company” (Mongalo 2003 *SALJ* 191).

He argued that the inclusive approach recognizes that, whenever developing the company strategy, stakeholders such as the community in which the company operates, its customers, its employees, and its suppliers need to be considered. We are currently witnessing this process taking root under the term “Corporate Social Responsibility”. It is now worthwhile for any company to be seen to be investing in the community it serves through various initiatives. Although the “rules of the game” in corporate governance have changed, there are grounds for scepticism under our model.

4 Corporate governance models

It can be argued that the concept of corporate governance is universal and somehow derived from countries which have pioneered the initiative of passing Corporate Governance codes. Different countries strive to adopt different models that are conducive to their societies or seek to ensure that their models resonate well with the policies of the respective countries. Charkham argues that in corporate governance models everyone is to some extent imprisoned by their history, social, political and economic realities (Charkham 1). South Africa is no exception. King II among other things, makes recommendations regarding gender issues and black economic empowerment, which are initiatives to realise the socio-economic need for transformation to create a stable civic society and sustainable economic development (King II par 4).

In addition, various statutes (Basic Conditions of Employment Act 75 of 1997; the Employment Equity Act 55 of 1998; the Skills Development Act 97 of 1998; and the Skills and Development Levies Act 9 of 1999) have been passed to realise the above mentioned priorities and many others, the latest example being the Broad-Based Black Empowerment Act (53 of 2003). It is however submitted that, if one appreciates the gaping chasm that exists between the citizens in the country, both in terms of skills and access to opportunities, it will take time to realise the goal of ensuring the meaningful participation of the majority of previously disadvantaged South Africans in the economy. However it should be stated that legislation in every aspect of the economy, to ensure such participation, will not be conducive to sustainable economic growth in general and attracting foreign direct investments in particular. It is submitted that it is debatable whether the widely accepted Anglo-Saxon model is favourable to South African society.

The main difference between the two models is that the Anglo-Saxon model is traditionally directed at maximising shareholder value whereas the Two-Tier Board seeks to balance the interests of both the shareholders and the stakeholders. This difference is succinctly set out thus:

“The implication is that the former (shareholder perspective) relies on ‘quick money’, ie, reasonably foreseeable return on investment, whereas the latter focuses more on ‘slow money’, ie distribution of investment over a long period involving a greater number of directly (or even indirectly) connected stakeholders” (Kakabadse and Korac-Kakabadse 313).

Considering the circumstances under which business operations are conducted in South Africa, coupled with the transformation agenda, it may be argued that the Two-Tier Board system is more suitable for the country than the current Anglo-Saxon model which is more convenient in a “market place focused on short-term perspective to the detriment of general economic performance” (Wixley and Everingham 8). It is submitted that the Two-Tier Board model is one of the measures to balance the divide between shareholder and stakeholder interests. It is clear from the German experience that the system can be operationally more wearisome; for instance unions, shareholders, and other stakeholders sit on the supervisory board, and these may delay reaching of consensus on various issues but it can be one of the ways in which business can move from the notion of

individualism to inclusiveness. It has been said that viewed in its entirety the Two-Tier Board system has proved to be meaningful in Germany. (Du Plessis 41. It is appreciated that there might be contrasting views on the efficacy of the Two-Tier Board system in Germany.)

Companies are now realising that it is no longer good enough to look at the company's financial standing; the stakeholder concept has taken root (King May 2002 *Management Today* 28). However, not all companies embrace the idea that in addition to their shareholders they also have to be genuinely concerned about different stakeholders. Shareholders are also in the position to curb any move towards stakeholders' activism if this is considered antithetical to their aspirations to maximise wealth. Whether the company's practice will put it in the best position in its compliance with corporate governance rules will not be an issue. Shareholders can vote against any initiative as they are entitled to vote in their own interests.

A cursory reading of King II reveals that the interests of the shareholders will always be pivotal, thus relegating the stakeholders' interests to a secondary position. It is submitted that in any stakeholder interests initiatives issues will be determined on the "cost/benefit analyses" (what the company is going to gain in return). If this submission is correct, the question that arises is whether the responsibility of the directors to the stakeholders as contained in the King Report can meaningfully be attained. The question is whether, in its self-regulatory mode, the King Report will succeed in striking the necessary balance between the incongruous interests of shareholders and stakeholders.

5 Enforceability

Compliance with the King Report is not compulsory. It derives its teeth, partly but not satisfactorily, from the JSE Securities Exchange South Africa (JSE) Listing Requirements. King I provided that its recommendations should form part of the listing requirements for companies on the main board of the JSE (Chapter 19 par 2.1). King II provides that the code applies to all companies listed on the JSE Securities Exchange. Sanctions imposed by the JSE Listing Requirements for non-compliance with the King Code or listing requirements vary depending on the nature of the company or entity that has failed to comply. (Sanctions are imposed under s 1 of the JSE Listing requirements and vary from suspension of the listing of the company's securities; power of censure; publication of those responsible for breaching the requirements and termination of the listing.) One of the shortcomings of the JSE in this regard is that listed companies are only required to disclose the reasons for failure to comply with King II (s 1 of JSE Listing Requirements). These undoubtedly open doors for selective disclosure and a box-ticking compliance.

It is not clear how the directors are responsible for the relations with the stakeholders as provided in the code. In this respect it has been submitted that:

"It is difficult to understand the committee's insistence that directors are *accountable* to the company and only *responsible* to other stakeholders. What does this mean? Does it mean that stakeholder interests are independent of

or subordinate to the interests of shareholders? Are directors entitled to treat stakeholder interests as ends in themselves or consider them as means to ensuring the success of the company in the collective best interest of shareholders? ... Thus there is a lot of confusion in King II on the issue of stakeholders" (Mongalo "Governance and the Constitution: A Case for Broadening the Stake-holder" in Pete and Du Plessis (eds) *Constitutional Democracy in South Africa 1994-2004* (2004) 174).

It is submitted that in as much as King II is ambivalent on the issue, the significant recognition of stakeholder interests might remain an elusive goal. The structural basis of South African corporate law is founded on the accountability of directors to the shareholders. Unless there is a change from that model, shareholders will always be "owners" of the company/corporation and the ultimate beneficiaries.

Certain companies realise that stakeholder interests are worth their attention. Much depends on who the company would perceive as its stakeholders. Many companies who have reported on compliance with the code and triple-bottom line concept do not meet the objectives the committee was striving for (Khoza "Corporate Governance: Integrated Sustainability Reporting" May 2002 *Management Today* 18 20). The tick-box approach is prevalent. It will be difficult to defuse this trend as long as reporting is on a voluntary basis.

It is submitted that it is unlikely that the government, as the power that can strike a necessary balance between competing interests, can at this stage or in the near future intervene. Indeed, it has been suggested in the company law reform policy document that the current corporate governance model will be retained and that stakeholders' representation on the board will be optional (*Guidelines for Corporate Law Reform* 39). Contrasting views abound. The corporate law reform policy document's patent stance that South Africa cannot simply follow the Anglo-Saxon model of "shareholder dominance" theory and putting the stakeholder argument in its constitutional perspective need to be welcomed as both in keeping with international trends, our socio-economic realities and the supremacy of the Constitution (the Constitution of the Republic of South Africa Act 108 of 1996). The policy document provides that:

"It is proposed that in the South African context, the company law needs to take account of stakeholders such as the community in which the company operates, its customers, its employees, its suppliers and the environment in certain situations mandated by the Constitution and related legislation" (*Guidelines for Corporate Law Reform* 26).

The argument of paramount importance in this regard is that for corporate law to be congruent with the Constitution and consequential legislation, shareholder interests should be balanced with those of other stakeholders "when this is appropriate and/required by the Constitution and related legislation". It is however crucial that there is "a degree of consensus on how far the role of each stakeholder can go to minimise or avoid the tendency to place unrealistic expectations on business, government and the civil society" (Dlamini "Why Trust and Credibility are Important for Business" *Sunday Times Business Times* 2004-10-17 www.sundaytimes.co.za 6). For an illuminating discussion on how stakeholder interests can be protected

through the prism of the Constitution, see Mongalo (178-180) where it is argued that “For law not to require directors to consider their (stakeholders) interests in South Africa’s peculiar socio-economic environment is for law to fail as an engaged participant in the reform of corporate law post-1994”.

It is hoped that this is a realisation that the current rigid affirmation of the Anglo-Saxon model of corporate governance is antithetical to the socio-economic realities in the country. In endorsing the stakeholder model South Africa will be following states like the State of Massachusetts where as early as July 1989 the law provided that:

“In determining what he reasonably believe to be in the best interest of the corporation, a director may consider the interests of corporation’s employees, suppliers, creditors and customers, the economy of the state, region and nation, community and societal considerations, and the long-term and short-term interests of the corporation and its stockholders, including the possibility that these interests may be best served by the continued independence of the corporation” (s 65 of Mass. Gen. Law Ann. ch.156B).

Furthermore, communicating information to stakeholders without involving them in corporate decision-making smacks of paying lip service to the triple-bottom line approach which is one of the important components of King II. (See s 4 King II (2002); and Mongalo “South Africanising Company Law for a Modern, Competitive Global Economy” 2003 *SALJ* 93 115.)

Part of the answer lies in the companies’ change of heart. (See Botha “The Changing Business of Business in South Africa: Some Comments on Developments in the Scope and Control of the Social Responsibility of Business in South Africa” 1994 *SA Merc LJ* 90 95: “It is a debatable and controversial point as to whether some form of legislation will be enacted to influence and/or control the nature and extent of corporate social responsibility.”) There are many proponents for change from a shareholders’ model to a broader stakeholder’s model. Internationally, there has been a growth of “stakeholder-orientated shapeshifters”. (See Visser and Sunter “Beyond Reasonable Greed” September 2002 *Accountancy SA* 3 5. The authors list companies like 3M, AT&T, The Body Shop, Canon, Electrolux, Hewlett Packard, Levi Strauss, Reebok, Unilever, Volkswagen and Volvo.) In South Africa, while there is room for scepticism, the edifice has begun. Companies are accepting the importance of stakeholders’ interests (Botha 1994 *SA Merc LJ* 91-92). What is critical is that many stakeholders believe that executives do not run companies for the benefit of consumers or investors but for personal ambition and financial gain, and that the companies act with impunity to the damage they cause to societies (the depletion of its resources and exploitation of social capital) and the environment (through the emission of toxic gases and waste products) (Bhasa “Global Corporate Governance: Debates and Challenges” 2004 Vol No 2 *Corporate Governance International Journal of Business in Society* 5 8). It is therefore important that business engages with stakeholders to restore trust and credibility damaged by the spate of corporate governance scandals locally and internationally.

It is submitted that the relationship between government and the business sector can efficiently be productive without promulgating legislative material which more often than not scares off potential investors. This is even more

relevant to emerging markets like South Africa. The prevention of government intervention in the form of legislation can be achieved by the companies themselves. Companies in general and directors in particular have to wholeheartedly accept their share of the responsibilities that came with socio-economic changes in South Africa and that business has changed to include not only wealth creation, but also activities of critical importance which would contribute to the redistribution of wealth, partnering the government in its initiatives to push back the frontiers of poverty and ensuring that the majority of South Africans are introduced to participate meaningfully in economic activities and ultimately realising the goal of sustainable economic development. Naidoo argues that “the most significant obstacle to the implementation of good corporate governance and meaningful social, ethical and environmental accountability lies in the way management thinks within an organisation” (Naidoo *Corporate Governance: An Essential Guide for South African Companies* (2002) 148).

While King II is ambivalent on the issue of enforceability and stakeholder interests, the King Committee should be commended for raising corporate governance awareness in South Africa in the past decade of democracy. Whether King II, in its Anglo-Saxon mode, is sufficient to raise corporate governance standards on issues of stakeholder and shareholder relationships in particular and the triple-bottom line approach in general is debatable. However the proposals of the DTI pave the laudable way forward on the issue of stakeholder interests. As hinted earlier, caution needs to be exercised lest unrealistic expectations be placed on business. It should also be recognised that “silent stakeholders” such as local communities and “the environment” may be less easily identifiable and less coherent in articulating their viewpoints (Simmons “Managing in the Post-Managerialist Era: Towards Socially Responsible Corporate Governance” 2004 Vol 42 No 3/4 *Management Decision* 601 604) but their recognition, together with other stakeholder interests, should begin with a clear articulation of their importance in 21st century business operations.

6 The role of legislation: aligning shareholder and stakeholder interests

It is perhaps fitting to start by mentioning that although King II is a comprehensive code on corporate governance in South Africa, it is not the law. Its formation was not initiated by the DTI and non-compliance with it is not visited with legal sanctions.

There are contradictory opinions as to whether statutory corporate governance rules are the only way of ensuring high corporate governance standards. On a balanced view, Charkham opined that the regrettable fact about codes is that they affect least those who need them most, the good follow them and the bad avert their gaze. However the author is quick to say that voluntarism has its own shortcomings even though excessive legislation may be counterproductive (Charkham 262). There are advantages as there are disadvantages for the self-regulatory corporate governance regime and it is generally accepted that the “pros” outweigh the “cons” (see generally Mongalo “Self-regulation Versus Statutory Codification: Should the New

Regime of Corporate Governance be Accorded Statutory Backing?" 2004 *Obiter* 264).

In the context of the stakeholder-shareholder relationship, those charged with reform of company law in South Africa treated the issue of statutory codification with a requisite perceptive restraint. The position in this regard is clear; first, advancing the interests of stakeholders is not a subordinate consideration to the primary goal of directors to act in the best interest of the shareholders; second, the advancement of certain stakeholders may be best achieved through separate legislation; and third and most importantly, allowing the enforcement of rights for all legitimate stakeholders in company law would lead to multiplicity of unnecessary and avoidable litigation (*Guidelines for Corporate Law Reform* 27). It is submitted that a combination of statutory and voluntary measures is a feasible alternative.

It is submitted that for an emerging economy like South Africa, following the international trend of a flexible philosophy of "comply or explain" and complementing it, where appropriate, with statutory backing is inevitable. As hinted earlier, the multitude of statutory material will increase the costs of doing business in the country and ultimately stifle sustainable economic development. The complementary legislative and self-regulatory environment is conducive to attracting foreign direct investment into the country. Indeed, it has been opined that the brittleness and rigidity of legislation cannot dictate the behavior or foster trust which is fundamental to superior corporate performance but the codes can and should regularly evolve to lead best practice in the boardroom and raise the bar for performance (Higgs 3-4).

7 Conclusion

The contrasting ideologies of shareholder and stakeholder interests can be difficult to reconcile. King II will not be able to ensure the responsibility of directors towards stakeholders. However, change is inevitable and companies are realising that they have to be part of the community where they are situated and that this comes with responsibility. Furthermore, there is an international apprehension on the challenges faced by business in the changing expectations of society towards business. South Africa cannot afford to be left unscathed if we are to be serious and competitive players on the international scale.

The commitment by companies to seriously advance the interests of various stakeholder groups is currently questionable. It is submitted that there are three challenges that pose a difficulty to inculcating a culture of moving beyond maximising wealth only for shareholders. First, the self-regulatory nature of the South African primary corporate governance instrument, that is, King II; second, the propensity of shareholders to vote against any initiative perceived not to be value-maximising and third, the failure of companies to compromise on their value-maximising initiatives.

On the first challenge, clearly voluntarism has its own shortcomings but excessive legislation can also be counterproductive and in South Africa it will not work. Promulgating legislation on critical corporate governance issues

raised in this paper will be the equivalent of stultifying the economy as a whole. (For advantages and disadvantages of self-regulatory corporate governance see Mongalo 2004 *Obiter* 275. The author argued that “in a well organised corporate environment, codes of best practice should work harmoniously with the statutory enactments or official regulations”. International trends also point towards the efficacy of adopting voluntary compliance supported by the legal system. Amongst voluntary corporate governance reports one can mention: The Hilmer Report of 1993 (Australia); the Cadbury Committee of 1992 (UK); the Vienot Report of 1995 (France); Greenbury Report of 1995 (UK); Peters Report of 1997 (Netherlands); Hampel Report of 1998 (UK); and Bajaj Committee Report of 1999 (India).) The solution therefore, is to be vigorous in attempts at achieving the optimal balance between shareholder and stakeholder interests.

There is nothing that can be done by the voting pattern in the companies' general meetings; shareholders will always be influenced by value-maximising when they cast their votes. Due to the improbability of legislation on the issue raised in this note, the challenge is on the companies to break down the walls of reluctance in their dealings, decision makings, policies and values and shift from pure wealth creation principles to the broader ideology of responsibility to stakeholder interests. Failure in this respect will mutate itself into a difficult, if not impossible, mission of finding an appropriate balance between social, economic and environmental development which, it is submitted, is the essence of King II.

Siyabonga Shandu
Legal Researcher, Natal Provincial Division: High Court