

**SHAREHOLDER ACTIVISM: THE BIRTH OF A NEW PHENOMENON IN SOUTH
AFRICAN CORPORATE LAW**

by

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KEY TERMS

Shareholder activism; shareholders; corporate governance; stakeholders; directors; company (ies); media, employees; board, transformation.

REFERENCES

The use of he, him and his encompass the female gender and are used for convenience purposes only.

CHAPTER 1

INTRODUCTION

1.1 PURPOSE OF THE STUDY

Shareholder activism as a concept is a growing phenomenon in the South African corporate world and is gaining momentum. In other jurisdictions such as the United States of America ("USA") and the United Kingdom, shareholder activism has reached peak levels, and companies there are accustomed to it. In these jurisdictions shareholder activism is regarded as a normal way of making sure that shareholder voices are heard and taken into account. In recent years, in South Africa, shareholder activism has been on the rise and companies listed on the JSE Ltd ("the JSE") have been placed under the spotlight by shareholders for different reasons. Reasons vary from company to company and are influenced by different factors applicable to a particular company.

The purpose of this study is to look at the concept of shareholder activism, its history, causes and influence. The study will also look at the types of shareholders in a company and their role in shareholder activism. Furthermore, the purpose is to look at the role played by the media in influencing shareholder activism.

1.2 SCOPE OF THE STUDY

Companies in South Africa as juristic persons are governed by the Companies Act 61 of 1973 ("the Act") and other related legislation. As from 01 July 2010 the Companies Act 71 of 2008 ("the Companies Act 2008") will be in place to govern companies. The Act will be repealed, as it is regarded as old fashioned and not suitable to current business models, trends and environment. However, both the Act and Companies Act 2008 make provisions for the role of all the shareholders in a company.

The provisions of both Acts and other related legislation will form part of this study. Also, the King Report on Corporate Governance for South Africa - 2002 ("King Report II") will be substituted by the King Report on Corporate Governance for South Africa - 2009 ("King Report III"), from 01 March 2010. The main reason for the introduction of King

Report III is to include some provisions and to make the governance guideline to be on par with the rest of the Companies Act 2008.

This is a comparative study on issues of shareholder activism that affect companies in the USA, the UK and South Africa. It will further look at the terms “shareholder” and “stakeholder” and outline their definitions. The meaning of shareholder activism will also be investigated.

Just like any other concept, shareholder activism has its origins. This study will investigate the history and development thereof. The legislation and different theories that are associated with its development will also be given attention.

The different classes and types of shareholders in a company will be given attention. Their role in shareholder activism and within a company will be looked at. Special focus will be given to the nature, powers, rights and duties of all the shareholders in a company. Shareholders and directors are an integral part of any company, therefore their conduct in relation thereto will be investigated. Equally, the role of a company as a juristic person will be taken into account.

There are different reasons for the occurrence of shareholder activism. Special attention will be given to the nature of shareholder activism and the causes thereof. Its influence may have certain outcomes, which will also be given attention.

Finally, this study will look at the role of media in shareholder activism, in comparison to the role played by courts. The different forms of media will be looked at. The study will conclude with conclusion and possible recommendations for jurisprudence and for companies and shareholders.

1.3 DEFINITION OF SHAREHOLDER AND STAKEHOLDER

A shareholder is an owner of equity or shares in a company.¹ They are investors who stand to benefit from the company's growth or lose when the company's fortunes deteriorate. Shareholders' interests are intrinsically linked to those of the company. The

1 Ross *et al* 2005: 905.

shallow definition of a shareholder is that it is an owner of shares in a company.¹ An extended definition of a shareholder is that it is a stakeholder, a person with an interest or concern in something, especially business.² Stakeholder has a wider meaning referring to an employee, a shareholder, a supplier, a customer, community or a trade union.³ Stakeholders are interest groups in a company.

In the USA, shareholders are referred to as stockholders. Thompson⁴ refers to corporate stakeholders as including investors, creditors, political groups, the “environment”, customers, communities, employees, trade associations, suppliers and governments.

Waddock⁵ differentiates between primary and critical secondary stakeholders. His differentiation is of importance. Primary stakeholders are those stakeholders that are immediately affected by a company’s operations and policies. They interact with a company on a daily basis. Whereas critical secondary stakeholders are also affected, they are not immediate bearers of company decisions. For example if a company announces that it will close certain manufacturing plants, the first persons to be affected are employees, as they are primary stakeholders.

Employees are likely going to lose their income, whilst the state as a critical secondary stakeholder may not be directly affected, in the short-term but in the medium to long-term through the inability of companies to fulfill their tax obligations. If companies cannot pay taxes, the state revenue will decrease and the state cannot fulfill its obligations. In light of the above, anyone, natural or juristic who is affected by company’s business operations qualifies to be defined as a stakeholder.

1 A definition according to The Concise Oxford Dictionary ninth edition.

2 A definition according to The Concise Oxford Dictionary ninth edition.

3 Waddock 2000: 325. See also Thompson 2005: 57.

4 2005: 57.

5 2000: 325. Waddock refers to primary stakeholders as including owners, employees, customers and suppliers and critical secondary stakeholders include communities, governments, environmentalists, labour unions and human rights activists amongst others. See also Licht 2004: 650; where he states that stakeholders include creditors, employees, customers, local communities and the environment. Again see Licht 2004: 722; where he states that a stakeholder in an organisation is any group or individual who can affect or is affected by the achievements of the company’s objectives. This definition implies that a list of stakeholders should include governments, competitors, consumer advocates, environmentalists, special interest groups and the media. See also King III: 100.

1.4 BACKGROUND TO SHAREHOLDER ACTIVISM

Shareholder activism is a growing phenomenon in corporate South Africa and has gained momentum since early 2000s. The reasons for the upsurge may differ. It may be because more and more shareholders become aware of their rights and duties in companies or because South Africa is part of globalization, and therefore gets influenced and affected by what happens in other parts of the world.

South Africa is an attractive investment destination and an important role player in world affairs such as politics, law, economics *etc*, and therefore cannot escape unscathed by what happens globally. Politics, law and economics are social sciences that are not separable and are indispensable everywhere in the world. They have an influence on each other, for instance politics influence law and economics and *vice versa*.

Furthermore, South Africa is highly regarded internationally by its counterparts as an important trade partner. Even the legislation recognises and provides for the creation and use of companies in a manner that enhances the economic welfare of South Africa as a partner within a global economy.¹ It was therefore important that the South African government promulgated the Companies Act 2008, which will become effective in July 2010, to be on *par* with international developments and business standards.

It is therefore important to investigate and study the concept of shareholder activism to understand its effects and influence.

The problem of collective action by shareholders has preoccupied corporate law for decades.² To that effect, the history of shareholder activism can be traced back to the USA from the 1930's. Investors in the USA at the time wanted to be involved in decision making in companies in which they held shares, or at least to be kept abreast about any decisions taken. Prior to that time shareholders were seen not to be highly interested in the affairs of companies as long as they received their dividends or return on their investment. This view led to the emergence of the term "*shareholder apathy*" or "*shareholder passiveness*" or the lack of desire to be involved.

1 S 7 (d) of the Companies Act 2008 confirms the fact that South Africa is a player in world affairs.

2 Rock 1991: 448.

Until recently, in South Africa for example, shareholders were often not bothered by corporate governance policies and issues such as the appointment of directors, employment equity, sustainability, risk management and transformation.

In the South African context, non-involvement is further perpetuated by the fact that shareholders lack knowledge of activism or they believe that directors are there to manage companies on their behalf. This is evident from the low attendance of annual general meetings and other special meetings of companies.

For instance, companies that boast thousands of shareholders on their share registers sometimes find it difficult to fill a boardroom during shareholders meetings. That is a consequence of shareholder apathy.

Black¹ suggests that most modern corporate scholars, especially those with law and/or economics backgrounds accept that shareholder passivity is inevitable. However, shareholders have been encouraged to be more than speculators and to be owners concerned with the wellbeing of their companies and to constantly check whether directors practice good corporate governance or not.² Shareholders should police directors to ensure that laws, business ethics and principles are an integral part of companies.

Shareholder activism has taken root globally, notwithstanding that share ownership is dispersed through institutions throughout the world.³ Both the Act⁴ and the Companies Act 2008⁵ do offer shareholders the right to have a say in drawing up proposed resolutions, as is the case with the USA's Securities Exchange Act, 1934. However, in practice only directors propose resolutions and shareholders' only vote in favour, against or abstain. Notices of shareholders' meetings also do not inform shareholders that they have rights to table or propose resolutions. Proposed resolutions are often similar in style and content to the ones that were proposed in previous years.⁶ Similarly, directors

1 1990: 522.

2 Rademeyer *et al* 2003: 768.

3 King II: 13.

4 S 185 of the Act.

5 S 65 of the Companies Act 2008.

6 Examples of common resolutions are:

(a) *Resolution to approve and adopt financial statements;*

in shareholders' meetings do not offer shareholders a chance to make proposals. Generally, shareholders are not aware that they have rights to propose resolutions, hence the monotony of the proposed resolutions from year to year.

The Act provides for a procedure to approach the courts in instances where shareholders are disgruntled or feel unfairly treated.¹ For example, shareholders may approach a court if their proposed resolutions are not included in the notices of the meetings.² It is a very rare occurrence in South Africa that shareholders invoke the provisions of the Act, due to a probable lack of knowledge or legal costs. In the USA though, shareholders remained passive despite legal efforts to, through proxy rules, facilitate shareholder voice.³ It is however not clear why shareholders remained passive. It is possible that they saw legislation as not helping, as Rule 14A-8 was too restrictive on resolutions that might be proposed.

There are different reasons that may lead to a "revolt" or an "uprising" by shareholders. One common cause is the failure by directors to comply and act in accordance with corporate governance principles. In the recent past, corporate South Africa has seen more and more shareholders raising their unhappiness on the manner in which the companies are being managed, and have somehow taken tough steps to voice their concerns. It is therefore important to first look at the meaning of the term "*shareholder activism*".

1.5 DEFINITION OF SHAREHOLDER ACTIVISM

Shareholder activism is about taking action or getting involved by asking questions, demanding accountability and offering suggestions by shareholders to management. It is

-
- (b) Resolution to elect directors;*
 - (c) Resolution to place unissued shares under the directors' control;*
 - (d) Resolution to renew general authority to directors to issue shares for cash;*
 - (e) Resolution to approve the auditors' remuneration;*
 - (f) Resolution to approve directors' emoluments;*
 - (g) Resolution to renew the general authority granted to the directors to repurchase shares.*

1 S 252. See also S 163 of the Companies Act 2008.

2 S 185. See also S 65 of the Companies Act 2008.

3 1990: 523.

a way that shareholders can claim their power as company owners and to influence a corporation's behavior¹.

Activism means a policy of vigorous action in a cause, especially in politics.² Therefore, shareholder activism has its origins in politics. It is in politics where the terms activists and activism are commonly used. Shareholder activism therefore means a vigorous action by an owner or a person with an interest in a company. This means that primary and secondary critical shareholders referred to by Waddock are all entitled to be activists as they are interest groups in a company. Interest in a company by shareholders may take any size or form.³

Activist shareholders use an equity stake in a corporation to put pressure (public or otherwise) on its management.⁴ According to Haigh *et al*,⁵ shareholder activism is a process by which shareholders of a listed company, under the provisions of securities legislation, can request members to meet and vote on specified resolutions. Shareholder activism therefore is a way of getting the attention of top management and the board of directors.⁶ In seeking attention, shareholders use public spaces to communicate their feelings to managements. Publicity is sometimes sought by shareholders if private or direct engagements have failed to bear fruit.

According to Guay⁷ shareholder activism is a mixture of socially responsible investment, corporate governance and shareholder capitalism. Shareholders may demand companies to be sustainable and to comply with principles of good governance. Smith⁸

1 <http://www.foe.org/international/shareholder/toolsfordemocracy.html>. Accessed on 12/06/2008.

2 A definition according to The Concise Oxford Dictionary ninth edition.

3 For example an interest may be a minority or a majority depending on the number of shares a shareholder is holding. The interest may be ordinary or preferential depending on the class of shares a shareholder is holding. See also Davis *et al* 1994: 160, where he states that the interests of institutional investors are numerous, diverse and often contradictory.

4 http://en.wikipedia.org/wiki/Activist_shareholder. Accessed on 23/03/2009.

5 2004: 60, common social issues include corporate governance and employment policies and the extent of involvement in specific industries such as armaments manufacturing or gambling. Common environmental issues include recycling and waste disposal policies and the extent of involvement in industries such as logging and mining.

6 Schwab 1998: 1023.

7 2004: 128.

8 1996: 227. See Smith 1996: 228, where he asks the question whether shareholder activism is effective as a source of monitoring.

on the other hand states that shareholder activism includes monitoring and attempting to include changes in the organisational control structure of firms not perceived to be pursuing shareholder-wealth-maximizing goals. Shareholders are likely to revolt against management if their investments are under threat or not achieving expected maximum levels.

Shareholder activism can take several forms such as proxy battles, publicity campaigns, shareholder resolutions, litigation and negotiations with management.¹ The common method of activism is publicity campaigns. It is often invoked after proxy battles, negotiations and shareholder resolutions failed to achieve anything. Shareholder activism is good for shareholders return.²

Shareholders invest in companies primarily because they are enticed by prospects of huge financial returns. As such, investing in a company is necessitated or influenced by a number of factors, such as policy formulation, leadership, history of performance, dividend payout *etc.* If any of these factors are non-existent, potential investors are likely going to withdraw.

Generally, shareholder activism relates to shareholders' rights to be involved to a certain extent in some decision making especially on issues relating to corporate governance. Bad or good decisions affect a company in many ways. Good business decisions translate to positive returns and huge dividends and bad ones translate to disinvestment and a possibility of liquidation. In many instances, shareholders raise their concerns when company decisions affect them negatively or when decisions do not favour them.

1.6 CONCLUSION

The involvement of South Africa in world economic affairs is good for the South African economy. If the economy or the country benefits from such engagements, companies too are likely to benefit, so are the shareholders in the chain of beneficiaries. Sound economic policies, shareholder democracy and vibrant shareholder society may attract investors. Equally, potential investee companies may be scared, especially if they view shareholder activism as a threat to their business or are not custodians of good

1 http://en.wikipedia.org/wiki/Activist_shareholder. Accessed on 23/03/2009.

2 Kekana 2005: 26.

governance in their countries of origin. It is to this effect that shareholders have to be educated on issues of shareholder activism, so as to be able to guard their investments and not do things that may scare investors. Shareholder activism should be about robust debates not violence.

Shareholder activism should be welcomed by the South African corporate world as it brings new thinking dynamics to company boards, as shareholders might find new of different ways of looking at problems the board may not have explored. It brings diverse views. It also helps in making sure that companies are not involved in unethical and immoral business dealings. Fraud and corruption should not be tolerated by shareholders, no matter how minute. Companies should not become feeding schemes for greedy managers, and active shareholders would act as a second buffer against that. The board should be the first point of management supervision.

Directors in South African companies have for a long time seemingly operated unchallenged and unchecked. They have largely been implementing policies that in the main benefit them, directly or indirectly. Active shareholders and a vibrant media have largely changed all this. Directors do not just pay lip service on these issues. In most cases they are made to account by their minority shareholders, because whatever affects the company negatively, also affects their investments and returns. The more shareholders get involved, the more companies will be corporate governance compliant and hopefully the more the investment returns and therefore more investment opportunities.

The state should make the environment conducive for both the companies and shareholders. Conducive environment means that the state as a shareholder has to make policies that benefit all the interest groups equally.

CHAPTER 2

THE HISTORY AND DEVELOPMENT OF SHAREHOLDER ACTIVISM

2.1 INTRODUCTION

It is important to trace the origins of shareholder activism and the reasons for the emergence of this phenomenon in South Africa. The history and the development thereof in the United States of America ("USA") will be analysed. This will help in showing how shareholder activism manifests itself in the USA.

As shareholder activism from the USA had an influence in the United Kingdom ("UK"), snapshots of shareholder activism in the UK will be highlighted. This will show how shareholders in the UK conduct themselves and what the consequences of their activism are. South Africa as a major role player in world affairs has not escaped the influence of shareholder activism and therefore its development will be outlined.

In the South African context, it is important to look at some issues that are a precursor to shareholder activism. The reasons for activism in South Africa compared to the USA and UK may differ although in the main there are many similarities, such as transformation, employment equity, director remuneration, leadership *etc.*

The period of development under review will be pre-1930's to date. The different theories and legislation that formed part of this development are to be looked at. A glance at the applicability and relevance of these theories in modern business is important, as is the legislation that has been streamlined according to modern times. For example the Companies Act 71 of 2008 ("the Companies Act 2008") has been promulgated to be on par with legislation in other developing or developed economies.

2.2 DEVELOPMENT IN THE UNITED STATES OF AMERICA

USA is a super power in world affairs. They are a developed economy and one of the most industrialised nations in the world. They largely influence what happens around the world economically and politically. Even shareholder activism started in the USA, and has spread across the world over the years. The truth is that shareholder democracy efforts to increase shareholder power within corporations appear to have come of age,

both within the USA and elsewhere in the world.¹ This is evident from legislation like Sarbanes-Oxley Act, 2002, which seeks to protect shareholders since the outbreak of the Enron scandal. In South Africa, the King Report on Corporate Governance for South Africa-2009 (“King III”) and its predecessors do encourage shareholder activism in companies.

2.2.1 PERIOD PRE-1930

Historically shareholder activism process was an attempt by investors to get information out of firms and points of view in firms that otherwise would not be there². Historians trace the conflict between shareholders and managers of publicly traded corporations back to the eighteenth century English East India Company.³ It is not clear what the sources of the conflicts were. However, there is a view that these conflicts originated because of legal and regulatory constraints that emanated from populist political pressures.⁴

There is also an argument that shareholder activism emerged in the mid-twentieth century and gained momentum in the early seventies.⁵ During the twentieth century, USA companies shifted from being run by founder-owners and descendents to management by managers.⁶ Prior to then control rested in the same hands, and as time passed and firms grew larger, there was a separation of control and ownership, which resulted in control being shifted from the entrepreneurs to managers and ownership vested in the hands of un-organised shareholders who were not involved in day-to-day management.⁷

1 Fairfax 2008: 2. According to Bebchuk 2003: 44, increased shareholder power would be desirable if such change would improve corporate performance and value.

2 <http://www.foe.org/international/shareholder/toolsfordemocracy.html>. Accessed on 12/06/2009.

3 Marens 2002: 365. He states that activists of the 1940's and 1950's tend to be regarded as the starters of shareholder activism

4 Davis *et al* 1994: 141. According to Davis management's control in a company is contingent on rules that are determined externally by the state and the allocation of corporate control depends on political struggles among management, capital and various governmental bodies.

5 Marens 2002: 365. He states that typical explanations of the rise of shareholder activism focus on the emergence of advocates of social issues in the early seventies.

6 Marens 2002: 365.

7 Davis *et al* 1994: 141.

There are different views on what led to the rise of shareholder activism in the USA. One view is that the rise of shareholder activism was partly because of effective anti-takeover measures by companies and anti-takeover legislation passed by the government.¹ Before the 1930's, executives benefited from a regime when shareholders were powerless because of historical regulations that made it difficult for institutional investors to engage in collective action and to influence management even if they had the financial muscle to do that.²

Another view is that it was not the failure of the market for corporate control but its success that promoted shareholder activism.³ This cannot be entirely true as experience has showed that when shareholders get good returns they do not pay much attention and only react when times are tough. The collapse of the stock market or Wall Street in 1929 saw a rise in grievances relating to shareholder rights.⁴ It is not clear what the grievances were, but they could be related to the fact that shareholders lost on their investments during the economic meltdown.

After the stock market collapse, scholars, politicians and investors were convinced that an oversight role over management of companies was required, as there was no reason for shareholders to expect growth in stock price if some method of policing was not put in place.⁵ This shows that prior to the market collapse, shareholders were just investors who had no interest in the affairs of companies in which they invested.

2.2.2 PERIOD DURING 1930's-1960's

During these periods activists continued to confront management on issues of corporate governance and policies in a systematic way by taking advantage of the space created by the Securities and Exchange Commission ("SEC").⁶ Even after World War II activists spearheaded campaigns against companies on issues of corporate governance, corporate social responsibility, political controversies and labour disputes.⁷ Eventually

1 Song *et al* 2003: 318.

2 Loring *et al* 2006: 321.

3 Davis *et al* 1994: 159.

4 Marens 2002: 368.

5 Marens 2002: 370.

6 Marens 2002: 366.

7 Marens 2002: 366. Known activists included the Gilbert brothers, Wilma Soss, James Peck and the leadership of Association of Independent Telephone Unions (AITU).

corporate USA became an instrument used by political and social groups for social change.¹ This shows that the issue of fighting for sustainability comes a long way and it's only in recent years that the world is taking it seriously.

According to Marens² there was a shareholder activist in the 1940's by the name of Lewis Gilbert, who referred to shareholders as owners and partners in companies and always insisted that as owners shareholders had a right to have expectations. It is clear that Gilbert, to a certain extent, spearheaded shareholder activism during the 1940's as he had also asked the board of Bethlehem Steel why they deserved a pay rise after the company performed badly.³ This shows that the fight against hefty pay for directors by directors originated decades ago and still persists.

The trend of questioning management on non-financial issues also grew, as the Federation of Women Shareholders led by Wilma Soss, was formed in the late 1940's.⁴ Soss attended shareholder meetings and confronted management on non-financial issues and enquired about possibilities of appointing women directors to the boards of companies, at which she was usually rebuffed.⁵ It is still a challenge even today to get women directors appointed to boards of directors. This is also a problem in South Africa.

However, the actions of Gilbert and Ross have led to the reporting by companies more on financial matters disappearing slowly and other issues such as sustainability, transformation and employment equity getting the lime light in company reports.

2.2.2.1 USA SEC RULE 14A-8

Because of the unhappiness of investors after the collapse of Wall Street in 1929, corporate legislation in the form of Securities Exchange Control Act of 1934 ("SEC Act")⁶ was enacted. The relevant provision of the SEC Act is Rule 14A-8.

1 Loring *et al* 2006:321.

2 Marens 2002: 372.

3 Marens 2002: 372.

4 Marens 2002: 372.

5 Marens 2002: 371.

6 Loring 2006: 322. Rule 14A-8 establishes the conditions needed for a proposal to be placed on a company's proxy statement. This is made to ensure shareholder participation in important company decisions.

The SEC Act proxy rules were meant to benefit passive institutional investors, however activist shareholders reaped many of its benefits.¹ This rule allowed shareholders to submit proposals of up to 500 words in length in order to change the firm's corporate governance structure, and the firm's management was supposed to include these proposals in the firm's proxy forms and allow the shareholders to vote on them.² It was meant to provide shareholders with the right, subject to certain limitations, to hold a shareholder vote on issues the proposing shareholder considered important.

However, for the first three decades of the rule's existence small individual shareholders submitted most resolutions and this rule was generally used as an opinion forum on issues mostly related to internal corporate governance.³

According to Dhir,⁴ the SEC Rule 14A-8 provided for corporate tools to facilitate shareholder-to-shareholder and shareholder-to-management dialogue. This shareholder proposal mechanism was not meant to usurp the powers of management but to provide shareholders with an opportunity to express their views.⁵ Those who favored the SEC Act were of the view that it was going to restore a golden age of informed and active shareholders as the conditions before then never allowed most shareholders to attend annual general meetings.⁶

In the early 1980's it was argued that this rule be abolished on the grounds that in its entire history only two shareholders' proposals that were not supported by management had ever been approved by shareholders.⁷ This may so because management frustrated frustrated or blocked shareholders' efforts to make their views known.

1 Briggs 1994: 147.

2 Strickland 1996: 322.

3 Brownstein 2004: 26.

4 Dhir 2006: 377. SEC provides for "proper subject for action" which is interpreted as to mean proposals that relate directly to the affairs of a particular corporation and those proposals with general political, social or economic matters are not within the meaning of "proper subjects for action by security holders". The social provision of Rule 14A-8 was deleted in 1976 and the test for proper subject was: (1) business matters that are mundane and (2) do not involve any substantial policy or other consideration.

5 Dhir 2006: 376.

6 Marens 2002: 369. According to Loring 2006: 322, Rule 14A-8 was implemented to augment shareholder involvement in corporate governance but shareholders remained passive.

7 Brownstein 2004: 23.

2.2.2.2 NEGOTIATED AGREEMENTS

Negotiated agreements are agreements between shareholders and the firms' management, when management consents to changes proposed by shareholders before a submission is made.¹ To this effect, shareholders used SEC Rule 14A-8 and negotiated agreements to raise their concerns and to challenge management.² They used these two popular ways to influence the governance of corporations, namely formally through the proxy system and informally through negotiations or negotiated agreements.³ Firms are likely to negotiate if they have more shareholders and low insider ownership.⁴

In South Africa, agreements of this nature are largely not recorded and as a result directors are likely not going to be held accountable and responsible for deviating from the terms of such contracts. What normally happens is that a shareholder raises an issue privately with management and management would perhaps promise to attend to it, but nothing gets done with the hope that the shareholder may forget and let go of the issues. The example is that of the Public Investment Corporation ("PIC")⁵, which has raised issues of corporate governance, transformation, empowerment *etc*, in some of the companies in which it invests. These issues were often ignored, as they were not recorded down in a document of commitment. This attitude largely influenced activism by the PIC. Directors cannot be held accountable for non-fulfillment of promises made, unless they enter into contracts with shareholders.

2.2.2.3 NEXUS OF CONTRACTS APPROACH

Although there are various theories for classifying internal governance institutions of firms, there are two basic theories that captured the most of the competing theories,

1 Strickland 1996: 322.

2 Strickland 1996: 322.

3 Davis *et al* 1994: 159.

4 Strickland 1996: 322.

5 Public Investment Corporation Limited is a hundred percent state owned organisation that is responsible for managing funds for public servants. It is a creature of the Public Investment Act of 2004. It is the biggest investor in South Africa and it manages R786.8 billion funds on behalf of its clients. Its clients include Government Employees Pension Fund (91.7%), Unemployment Insurance Fund (3.5%), and Compensation Commissioners: Pension Fund (1.1%), Compensation Commissioners (1.0%), Associated Institutions Pension Fund (1.4%) and other (1.3%). Source: PIC Annual Report 2008.

namely, the “*nexus of contracts*” approach and the “*means axis*” approach.¹ The *nexus* of contracts approach refers to a set of mechanisms or policies that link the corporations, the capital markets, the state and federal governments to ensure efficiency of corporate control in the USA.² This is a policy that is negotiated and adopted by companies and the state. Davis³ believes that the origins of the separation of control and ownership and the rise of shareholder activism, the functioning of boards of directors and the enactment of anti-takeover laws in favour of managers would present anomalies for the *nexus* of contract approach.

The *nexus* of contracts approach is also known as the contractarian model. This model denies that shareholders own a corporation and that shareholders are many factors of production bound together in a complex web of explicit and implicit contracts.⁴ Under this approach, directors and officers are treated as contractual agents of the shareholders with fiduciary obligations to maximize shareholder wealth.⁵ The board is regarded as a *nexus* of the set of contracts among the factors of production making up the firm.⁶ Directors are therefore expected to implement and respect contracts that are put in place. Shareholders and directors are important factors of production.

In South Africa different sector charters, such as the Financial Services Charter, Mining Charter *etc*, are in place and to a larger extent influence the relations between the shareholders. For example, the Mining Charter is meant to address issues related to black economic empowerment and transformation in the mining sector and the Financial Services Charter is meant to addresses the same issues in the financial services sector.

The Employment Equity Reports submitted by companies on a yearly basis to the Department of Labour, is another example of a *nexus* of contracts.

1 Bainbridge 2003: 547.

2 Davis *et al* 1994: 146. According to Licht 2004: 653, the corporation is a *nexus* of power relationships beyond being a *nexus* of contracts. See also Grantham 1998: 579 where he states that the *nexus* of contracts theory, a company is treated as a collective noun for the web of contracts that link the various participants, which include shareholders, management, employees and creditors. The function of a company therefore, is conceived as the facilitation of the parties' bargains.

3 Davis *et al* 1994: 146.

4 Bainbridge 2003: 547.

5 Bainbridge 2003: 548.

6 Bainbridge 2003: 559.

2.2.2.4 “ONE AXIS” AND “MEANS AXIS” APPROACH

This theory suggests that shareholders own the corporation and accordingly directors and officers are merely stewards of the shareholders interest.¹ Along “one axis”, theories of the firm are plotted according to whether they emphasise managerial or shareholder supremacy.² On the other end of the “means axis” lies managerialism, that perceives the corporation as a bureaucratic hierarchy dominated by professional managers, whereby directors are figureheads, while shareholders are non-entities.³ The confusion created by the *means axis* and the *one axis* may result in shareholder apathy. Companies that are managed by directors who subscribe to the *means axis* approach are not likely to allow shareholders to make their proposals known.

2.2.3 PERIOD DURING 1960-1990

In the 1980's the rise of shareholder rights movements resulted from three trends, namely:⁴

- (a) *the increasing corporate ownership in the hands of institutional investors, particularly public pension funds;*
- (b) *the elaboration of enforcement of standards of fiduciary responsibility for private pension funds; and*
- (c) *a set of grievances sufficiently accessible to unite shareholders.*

During this time boardroom behaviour was, rightly or wrongly, perceived as unresponsive, uncaring and mercenary.⁵ This is also an impression created in South African corporate that directors do not care about non-financial issues and concentrate more on the bottom line in order to enrich themselves at the expense of shareholders.

1 Bainbridge 2003: 547. See also Bainbridge 1993: 1423 where he quotes from the well known case of *Dodge v. Ford Motor Co.* 170N.W.668.684 (Mich. 1919). In this case the court made the following ruling: “A business corporation is organised and carried on primarily for the profit of stockholders. The powers of directors are to be employed for that end”.

2 Bainbridge 2003: 547. See also Stout 2002: 1189, where he states that shareholder supremacy view is that a corporate exists only to make money for its shareholders. He further quotes Berle, who states that “all powers granted to the corporation or the management or to any group within the corporation are at all times exercisable only for the ratable benefit of all shareholders as their interest appears” and Merrick Dodd who argues for “a view of the business corporation as an economic institution which has social service as well as profit making function”.

3 Bainbridge 2003: 548.

4 Davis *et al* 1994: 153.

5 Ettorre 1992: 11.

Ownership of most corporations shifted and became concentrated in the hands of institutional investors rather than individual shareholders.¹

Shareholder activism, as measured by shareholder resolutions proposed by institutional investors grew dramatically in the late 1980's with the number of anti-management shareholder resolutions in target firms having increased from 40 in 1987 to 153 in 1991.²

During this era shareholder activism influenced changes in corporate governance as the SEC increased the scope of issues open to shareholder vote on proxy³ and shareholder activism achieved a degree of unprecedented success primarily as a result of social movement of institutional investors.⁴ The past twenty years witnessed a significant increase in the number of shareholder proposals submitted to public corporations.⁵

2.2.4 PERIOD OF THE 1990'S

During this period, shareholders worked to strengthen their powers within corporations by seeking to remove perceived impediments to their voting authority.⁶ Shareholder activism by institutional investors became an increasingly important feature in the corporate governance landscape.⁷ This resurgence of shareholder activism by institutional investors checked the system to decreasing control, and yet the paradox of widespread ownership and limited access to power remained a central feature of corporate enterprises.⁸

In 1991, the Amalgamated Clothing and Textile Workers Union ("ACTWU") put a proposal forward that asked Dayton Hudson Corporation to report on its equal employment opportunity initiatives and on purchases from minority and female owned sellers⁹. Dayton Hudson attempted to exclude the proposal on the basis that employment issues involved mundane business matters relating to business

1 Davis *et al* 1994: 141.

2 Davis *et al* 1994: 155

3 Davis *et al* 1994: 155.

4 Davis *et al* 1994: 156. See Loring 2006: 322, where he states that shareholders remained passive until the proxy rules were amended.

5 Brownstein 2004: 23.

6 Fairfax 2008: 2. The impediments included classified boards, the plurality standard for board elections and the inability to nominate directors on the corporation's board.

7 Song *et al* 2003: 318.

8 Murphy 2003: 68.

9 Dhir 2006: 380.

operations.¹ Some companies in South Africa have the same attitude of dismissing issues as mundane, instead of addressing shareholders' concerns. Because of this kind of attitude, most social responsibility issues are often treated as having low priority.²

In 1992, the SEC passed new laws that allowed shareholders to communicate amongst themselves. This led to shareholders having a chance to negotiate directly with the management and to rely less on the proxy proposals.³

There are thus two methods of shareholder activism that emerged, namely: ⁴

- (a) by presenting shareholder proposals on corporate governance issues at the company's annual shareholders' meetings; or*
- (b) by holding private negotiations with the company's board of directors and managers.*

These developments brought management and shareholders together. The latter approach may reduce confrontation at annual general meetings between shareholders and directors.

2.3 DEVELOPMENTS IN THE UNITED KINGDOM

The development of shareholder activism in the UK was based on the same model and principles as the USA's. This is evident from the recommendations of the Committee on Corporate Governance ("CCG") 1998a, which were aimed at effecting relationships between investment institutions and investee companies.⁵ The recommendations focused on the issue of encouraging growth of shareholder activism and also the development of closer communication and decision links between companies and

1 Dhir 2006: 380. SEC sided with the union by refusing to issue a no-action letter and reasoned that issues of affirmative action and equal employment opportunities involve policy decisions beyond those personnel matters that constitute the company's ordinary business. In contrast, one month later the SEC permitted Wal-Mart Stores Inc to bar a virtually identical proposal submitted by Amalgamated Clothing and Textile Workers Union. The SEC held that Wal-Mart's day-to-day practices of employment, which include those practices related to equal employment opportunity and affirmative action are by their nature practices that directly relate to the conduct of a company's ordinary business operations.

2 Regis 2001: 76.

3 Gillan *et al* 2000: 279.

4 Song *et al* 2003: 318.

5 Solomon *et al* 1999: 290.

institutional investors.¹ The CCG model was based on the USA's SEC model. The Cadbury report also explained that institutional investors should use their voting rights as they have a responsibility on behalf of their clients and that they should vote to effect change rather than to disinvest.² A vote is a powerful tool at the disposal of shareholders.

As a result, mutterings about "fat cats" and "personal fiefdoms" gave way to a wave of activism that has extended from big corporate governance campaigners such as the Association of British Insurers ("ABI") and other major investment institutions.³ Most of the complaints by corporate governance campaigners were about directors who refused to heed the concerns of shareholders, who trampled on the code of good practice and who treated the companies they managed as personal fiefdoms or their position in organisations as a one way ticket to huge private wealth, irrespective of their business performance.⁴

The debate about shareholder activism, its value and its dangers boiled to a heated climax, because the limits of what constitutes legitimate shareholder activism become totally blurred and vulnerable to extremism.⁵ In some instances, directors complain that shareholders intrude in business issues that have nothing to do with shareholder issues.

Three key trade bodies, namely the National Association of Pension Funds "(NAPF)", the Investment Managers Association ("IMA") and ABI agreed on a new code of principles that would require fund managers to be more activist and to disclose voting records to their clients.⁶ At the same time the Organization for Economic Co-Operation and Development revived its principles on corporate governance, to call for greater power for shareholders to vote against executive pay packages and to nominate directors for boards.⁷

1 Solomon *et al* 1999: 288.

2 Solomon *et al* 1999: 290.

3 Howarth 2003: 6. Other investment institutions included Schroders, Legal and General, Norwich Union and Standard Life.

4 Howarth 2003: 6.

5 Lascelles 2000: 22.

6 Howarth 2003: 6.

7 Howarth 2003: 6.

By 2001 many companies faced tough questions from shareholders on how much they paid their executive directors.¹ Below are snapshots of shareholder activism in the UK.

2.3.1 SNAPSHOTS OF SHAREHOLDER ACTIVISM IN THE UNITED KINGDOM

2.3.1.1 GLAXOSMITHKLINE²

The directors were put under pressure by shareholders to publish a revised pay policy, after shareholders voted down the directors' plan to pay the chief executive, 22 million pounds, when he was to be dismissed for poor performance.

2.3.1.2 CARLTON³

Investors in ITV, a newly merged Granada and Carlton, forced the chairman-elect to stand down. Dissatisfaction centered around his management style, Carlton's performance and corporate governance arrangements in the newly formed company. The opposition was led by Fidelity International.

2.3.1.3 EUROTUNNEL⁴

The company challenged dissident investors to go through the French courts if they wanted to force a general meeting to allow a vote aimed at ousting the board. Pressure for change from a consortium of small investors followed the announcement of a six percent decline in revenues and a warning that a big debt refinancing will be needed in coming years.

2.3.1.4 BARCLAYS⁵

The board was forced to address concerns over the planned elevation of the chief executive to the post of chairman after ABI wrote to the then chairman, demanding a "full and public explanation" of the proposed move. The appointment appeared to run contrary to the Higgs code of corporate governance, which advises against the promotion of chief executives to chairmen.

1 Gleason 2001: 50.

2 Howarth 2003: 06.

3 Howarth 2003: 06.

4 Howarth 2003: 06.

5 Howarth 2003: 06.

ABI's action was seen as a test case for the Higgs reform, which were designed to bolster corporate governance following the Enron and WorldCom financial scandals.

2.3.1.5 HOLLINGER¹

Dissident investors led by a New York investment company, Tweedy Browne, forced the chief executive to step down over payments made to him and other executives. He retained the chairman, but could have lost it had the threatened legal action against him went ahead.

2.3.1.6 WEST HAM FOOTBALL CLUB²

A consortium of shareholders wrote to other investors calling for action to oust the chairman, the finance director, and the managing director. Accusations leveled at the chairman included "dereliction of duties". This resulted from his move the previous year to change the clubs' articles of association.

This led to default borrowing covenant and prevented an automatic independent audit, but raised suspicions that the board did not want to submit to a third-party examination of the company's books.

2.3.1.7 B SKYB³

The board fended off shareholder revolt over the appointment of a new chief executive. Accusations of nepotism, complete arrogance and the refusal to consider concerns of shareholders were levelled at the new chief executive. A key issue was whether enough time was given to search the market for a replacement chief executive officer.

2.3.2 CONCLUSION

In GlaxoSmithKline, it is understandable why shareholders could not approve such an amount for a person who was dismissed for non-performance. It was a clear case of a golden handshake and rewarding failure. In South Africa a similar situation was experienced at Johncom

1 Howarth 2003: 06.

2 Howarth 2003: 06.

3 Howarth 2003: 06.

The media, minority shareholders and analysts expected Johncom management to explain the circumstances that led to the axing of its chief executive officer and they also expected to be enlightened on a golden handshake paid to the chief executive officer.¹

Shareholders are within their rights to raise their concerns on important issues such as the management style, financial performance and corporate governance as they did in Carlton.

Shareholders are expecting a company to refinance its operations and activities and to increase revenues for the benefit of the shareholders, otherwise, shareholders may want to oust the entire board, as was the case at Eurotunnel.

It was a good thing at Barclays, by shareholders to demand a full and public explanation as to why a chief executive was to be promoted to a position of a chairperson against the codes of corporate governance.

As it was a case in Hollinger, GlaxoSmithKline and Westham Football Club, shareholders have a right to oust a board that is not performing and not meeting shareholder expectations.

2.4 DEVELOPMENT IN SOUTH AFRICA

The Companies Act 61 of 1973 ("the Act")² does make provision for aggrieved shareholders to approach a court and seek relief against directors of a company. "Aggrieved" is a general term that encompasses actions that may directly or indirectly affect shareholders. Shareholders irrespective of their shareholding are guaranteed access to courts if they feel aggrieved by the actions of directors. In certain instances companies do need a majority of shareholders before certain actions can be resolved and implemented.³

1 Hlengani 2006: 69. The golden hand shake was rumoured to be around R15 million. Before the chief executive officer was fired he got a pay rise of 31%. The shareholders were asking why a chief executive officer's salary was hiked and then fired without a proper explanation.

2 Sections 252, 258 and 266 of the Act.

3 Section 199 and 228 of the Act.

As in the USA, aggrieved shareholders in South Africa prefer to deal with their corporate governance issues publicly through media. The reason for this might be that the media is considered faster and cheaper, unlike approaching courts that may deliver a final verdict after weeks, months or even years in certain circumstances.

Investors in USA corporations were challenged to make a response to the system of apartheid in South Africa.¹ Because of the activism by foreign companies and governments in the form of sanctions made the South African government reconsider its policy of apartheid. As the political climate changed after the 1994 democratic elections, there was more pressure put on companies by civil society and the government to change their policies to reflect the demographics of the country.

As a way of doing away with the apartheid policies, the government enacted a number of legislation with the aim to transform the economy and empower previously disadvantaged individuals, for example the Employment Equity Act,² Preferential Procurement Act,³ Broad Based Black Economic Empowerment Act ("BBBEE"),⁴ Skills Development Act,⁵ Sector Charters.⁶ The Codes of Good Practice ("Codes") as issued by the Department of Trade and Industry ("DTI").⁷ The King Reports on corporate governance also emphasise the importance of transformation black economic empowerment.

1 Spratlen 2001: 74.

2 Act 55 of 1998. Its objective is to give historically disadvantaged individuals or groups equal employment opportunities. Historically disadvantaged individuals means black people, women and people with disabilities who were disadvantaged by the system of apartheid.

3 Act of 2000. The objective of this Act is to make sure that preference is given to previously disadvantaged individuals or enterprises when procurement is made.

4 Act 53 of 2004. Before the enactment of this Act black economic empowerment focused more on ownership. This Act has broadened the scope of black economic empowerment to include management control, employment equity, skills development, preferential procurement, enterprise development and socio economic development.

5 The Skills Development Act 97 of 1998 encourages companies to develop the skills of their employees.

6 These are Sector Charters that are meant to drive transformation in different sectors of the economy, for example the Financial Services Charter and the Mining Charter *etc.*

7 The Codes emanate from S 9 of the BBBEE Act to address issues black economic empowerment with regard to ownership, management control, employment equity, skills development, enterprise development, preferential procurement and corporate social investment.

Shareholder activism has been on the rise and as recent as 2001, the life insurer, Sage, was under fire by a retired chartered accountant, who expressed his dissatisfaction with the procedures at the annual general meeting, where his questions were answered in a dismissive manner and were not minuted.¹ Companies do have a tendency not to minute important issues that are perceived to be problematic, thorny and those that directors wish could just fade away.

Since the adoption of King II in 2002, institutional investors and individuals have made some progress in changing the conduct and attitude of directors. There is also a concerted move at the highest level to improve and enforce best practice standards for governance and the programme, has all the right ingredients of accountability, transparency and other “apple pie goodies” so eloquently preached and so frequently ignored.²

South Africa is no exception to the reasons that led to the development of shareholder activism worldwide. In South Africa, shareholder activism originated as a result of non-compliance with corporate governance policies as outlined in the guidelines of the King II.³ Furthermore, it is influenced by socio-economic and political factors such as failure to to comply with government policies, such as affirmative action, black economic empowerment, employment equity and transformation. The historical basis of this is that both private and public companies were mostly owned, controlled and managed by white males to the exclusion of other races and sexes. That is why government introduced legislation to address the imbalances.

2.4.1 CORPORATE SCANDALS

The failures and corporate scandals of companies such as Masterbond, Tollgate, LeisureNet, Unifer, Saambou and CNA raised serious questions with regard to corporate governance in South Africa. The main concern thereafter was how to ensure good corporate governance and thus reducing the risk of company failures.⁴

1 Hasenfuss 2001: 70.

2 Greenblo 2008: 2.

3 The seven characteristics of good corporate governance are: discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. If companies do not adhere to these guidelines they may encounter shareholder unhappiness and subsequent to that, activism.

4 Rademeyer *et al* 2003: 767.

Thomas¹ quotes Allan Gray managing director, Simon Marais, as having said that ultimately shareholder action is about standing for the rights of the small man who has been ripped off for too long. Many investors have stated repeatedly that huge executive remuneration is not always justified. In the recent past companies have seen an increase in the number of shareholder activists. Also, in 1990's shareholders activism also became connected to labour unions through pension funds.²

Companies are increasingly required to have an inclusive approach when it comes to all the shareholders. The communities, employees and other stakeholders need to be considered when companies are developing their strategies.³ King II and King III are only a set of guidelines that are a base for shareholder activism as they outline corporate governance principles that companies should follow. These reports are recommendations, not legislation and companies may choose to follow or ignore them. If companies chose to ignore the recommendations, they are likely to be viewed as ignorant, arrogant and uncaring.

2.5 CONCLUSION

It is clear that shareholder activism in the USA was robust during its stages of development. Prior to the era of development, shareholders were generally apathetic and less involved. There are similarities between the issues that led to the development of shareholder activism in South Africa, the UK and the USA. Policies of affirmative action, corporate social investment and employment equity as they are applied in South Africa today, emanate from the USA.

For example, Soss raised issues of women empowerment, Gilbert raised issues of non-performance and director remuneration. Soss and ACTWU raised issues of equal employment opportunities and procurement from minority and female owned companies. These similar issues are raised by the PIC and are included in the Broad Based Black Economic Empowerment Codes of Good Conduct. Another similarity is that of the King Reports with the CCG and the Cadbury report, encourage the involvement of

1 2002: 47.

2 Marens 2002: 365.

3 Mammatt 2004: 2.

shareholders in decision-making. The King Report of 1994 was a product of the Cadbury report.

South African shareholders must be educated on the provisions of the Act and the Companies Act 2008 on their rights to propose resolutions. However, legislation must have a clear proxy system akin to the USA's SEC Rule 14A-8. It must have clear guidelines on issues the shareholders may be entitled to propose and should not be used as opinion forums.

To enforce the rights of shareholders in South African companies, directors and shareholders should enter into negotiated agreements and the theories of "*nexus of contracts*" and "*one axis*" must be entrenched in companies as they are of relevance to the South African modern corporate environment.

South African individual shareholders should follow the examples of Ross and Gilbert and be not afraid to raise issues of concern. Equally, South African institutional shareholders must follow in the footsteps of USA's institutional investor ACTWU and UK's institutional investors NAPF, IMA and ABI and have a code of principles that would encourage them to be more involved. Other institutional investors should also be encouraged to join Allan Gray and the PIC in fighting for shareholder rights.

CHAPTER 3

CLASSIFICATION OF SHAREHOLDER ACTIVISTS

3.1 INTRODUCTION

There are two kinds of shareholders in a public company, namely, majority and minority shareholders. These can be institutional or individual shareholders. Shareholders can also be ordinary or can be preferential depending on a class of shares they own. Institutional shareholders can be private equity funds, public pension funds, social groups, business associations *etc.* Both individual and institutional shareholders face different motivations and challenges in both their abilities and decisions to become active in corporate governance.¹

There are three groups of people with an interest in the activities of a company namely, the shareholders, employees and the general public.² Shareholder activists embrace the corporate governance environment and apply more general pressure on directors to act on majority resolutions.³ Their goals range from financial (increase of shareholder value through changes in corporate policy, financing structure, cost cutting, *etc*) to non-financial (adoption of environmentally friendly policies, *etc*).⁴

According to Marens⁵ there are four types of shareholder activists, the first type being the advocates of governance reform. These are shareholders who are concerned with takeover policies, executive compensation, and the procedures for electing directors. The second type is that of social activists. These are shareholders who are advocating for policies related to civil rights, environmental protection and labour standards. Social activists can also be split into investors with social as well as financial interests and those who would like to advance a certain political agenda.

1 Bolodeoku 2007: 112.

2 Murphy 2003: 67. See Licht 2004: 652, who states that a more sensible analysis-reflected in modern economic theory of the firm acknowledges that the corporate enterprise comprises several constituencies that are both interdependent and indeterminate.

3 Brownstein 2004: 66.

4 http://en.wikipedia.org/wiki/Activist_shareholder. Accessed on /23/03/2009.

5 Marens 2002: 366.

The promulgation of the Securities and Equities Act ("SEC Act") in the United States of America ("USA") was viewed as an example of political interference with a political agenda.¹ In the South African context the first type can be associated with the Public Investment Commission ("PIC") the second type with the labour federation Cosatu, the third type can be compared to social network groups.

Shareholder democracy enhances the interests of shareholders, particularly the ability of social investors to collaborate with other investors to advance the concerns of all corporate constituents.² The criticism leveled against shareholder activists is that they are only concerned with achieving a short-term payoff at the expense of long-term profitability.

For example, other activists would press for long-term, more socially beneficial perspective on corporate decision makers too obsessed with the market and short-term shareholder value.³ It has been established that there is a clear link between long-term profitability of a business and social performance in five categories of environment, advancement of women, advancement of minorities, charitable giving and community action.⁴

Hereunder the different types of shareholders, their nature and objectives will be looked at. Attention will also be given to their role in shareholder activism and corporate governance.

3.2 INDIVIDUAL SHAREHOLDER ACTIVISTS

An individual means a natural person.⁵ These are shareholders who own shares in their individual and personal capacity. The shares are registered in their name and are direct beneficiaries. They are people who invest in shares of a company whose profit maximization is a major objective.⁶ Unlike institutional shareholders, individual shareholders' disinvestment in a company does not have an impact on the share price,

1 Marens 2002: 368.

2 Fairfax 2008: 32.

3 Haberstroh 2003: 67.

4 Dhir 2006: 373.

5 See definitions in the Companies Act 2008.

6 Loring *et al* 2006: 323.

as their shareholding is often minute.¹ They are probably more risk averse than powerful institutional investors and are thus looking for the highest expected return commensurate with an acceptable level of risk.²

Their place in a corporate structure, their functions, the importance and advantages of scrutinizing the acts of management and being proactive, is the first step in creating shareholder activism amongst individual shareholders.³ In recent years, directors of several listed companies have been labeled as fraudulent and arrogant, whilst others have been labeled as selfish, reckless and negligent.⁴ Too few directors have been called to account and when that happens, on occasions individual complainants are humiliated and treated with disdain.⁵

For example, Johncom independent non-executive director, Tom Wixley, was chairing a shareholders' meeting and was immediately annoyed when Theo Botha, a well-known individual activist raised his hand for a question:⁶

Wixley: How many questions do you have?

Botha: It depends on how you answer them.

This is an example that most companies do not like to be put under spotlight. Again, this is an example of spats that normally occur at shareholders meetings between shareholders and directors. As a result, in many instances shareholder meetings do not last for long because individual shareholders are afraid to ask pertinent questions, owing to the arrogant attitude sometimes displayed by directors. Sometimes it is difficult to make a quorum in a general meeting, because of non-attendance by individual shareholders.

3.3 INSTITUTIONAL SHAREHOLDER ACTIVISTS

Experience indicates that market failures in relation to governance are at least in part, due to absence of institutional shareholders.¹ An institutional shareholder can be a

1 Haberstroh 2003: 69.

2 Loring *et al* 2006: 323.

3 Rademeyer *et al* 2003: 768.

4 Kok 2006: 1.

5 Kok 2006: 1.

6 Mamise 2007: 1.

juristic person or a group of persons. Institutional investors include other corporates such as the banks, building societies, trusts, insurance companies, investment schemes, pension funds *etc.*

They owe fiduciary duties to their own shareholders or beneficiaries and therefore are frequently and primarily concerned with enhancing shareholder wealth.² Unfortunately their beneficiaries' interests are sometimes not the same as those of the companies in which they are invested, which then leads them to choose their own investors over the company. They are likely to use their voting effectively and for their own interests.³ An institutional investor generally wields more power and this power has an impact on voting because they are occasionally able to put pressure on management to convince a company to implement a proposal without going through with a vote.⁴

Over the last forty years, the institutional holding of stock increased rapidly.⁵ At first glance, these dramatic developments held the promise of enormous changes to corporate law.⁶ In the USA theorists had hoped that institutional activists would replace the preceding corporate takeover era, reinforce market pressure on managers and boards of directors, to maximize value for shareholders.⁷ The role of institutional shareholder activism arises due to a conflict between managers and shareholders.⁸

In the USA, T Boone Pickens founded the United Shareholders Association ("USAss"), that grew to about 64 000 members.⁹ In the United Kingdom ("UK"), the Social

1 King III: 10. King encourages institutional investor to vote and engage with companies. This will ensure that governance best practice principles are more consistently applied.

2 Loring *et al* 2006: 323. See also Camara 2005: 226. Institutional investors most of the time are interested in increasing shareholder value.

3 Camara 2005: 223.

4 Loring *et al* 2006: 323.

5 Rock 1991: 447, states that by 1950 pension funds owned less than one percent of equities, while institutional holders as a group held approximately eight percent. By 1989 pension funds alone owned slightly more than twenty-six percent of equity of securities and institutions held in excess of forty-five percent. Of the top fifty corporations ranked by 1989 stock market, forty five had institutional ownership in excess of thirty-three percent and twenty-five in excess of fifty percent.

6 Rock 1991: 448.

7 Haberstroh 2003: 67.

8 Gillan *et al* 2000: 279.

9 Rock 1991: 450.

Investment Forum (“SIF”), a trade association of socially responsive investors identified shareholder activism as one of its central objectives.¹

In South Africa, institutional shareholders are known for their apathy towards participating actively in shareholder meetings.² A number of factors might influence this attitude. Costs involved in pursuing shareholder activism could discourage shareholders especially if a shareholder has a small shareholding or where the desired outcome is not a certainty.³ This may be viewed as an excuse in the modern days of information technology, as technology can be used to reduce the high costs that impede on shareholder activism.⁴ In recent years though the PIC and some private equity funds have spearheaded shareholder activism and have made their presence felt.

Institutions have become increasingly active shareholders and shareholder proposals have received substantial shareholder support of more than forty percent of the votes cast.⁵ They have grown large enough so that a limited number of institutions own a sizeable percentage of the shares of most public companies.⁶

However, corporate managers have responded warily to the growing institutional activism, giving further credence to the view that the institutionalisation of shareholding has fundamentally altered corporate law.⁷ They have become wary of institutions such as the PIC as they are concerned that these institutions will dig deeper into the affairs of companies and uncover serious issues of corporate maladministration. On the other hand, against the escalating pressure tactics on the part of shareholder activists, directors are wary of taking stands that may be perceived rightly or wrongly as “anti-democratic” or “anti-shareholder”.⁸

1 Murphy 2003: 72.

2 King II: 44.

3 Rademeyer *et al* 2003: 770.

4 Rademeyer *et al* 2003: 771.

5 Rock 1991: 449.

6 Black 1990: 523.

7 Rock 1990: 450.

8 Brownstein 2004: 66.

Institutional investors often have large holdings in individual firms and selling off such holdings has an exit cost, such as the downward pressure on the share price.¹ In some instances, companies tend to listen to majority institutional shareholders, as they know that a disinvestment by such shareholders may affect the share price.

That is why Sasol and Barloworld could not totally ignore the PIC when it insisted on the appointment of black directors to their boards. However, being a fund manager and an activist shareholder are not necessarily a diametrically opposite agenda, nor can the value necessarily be destroyed by a shareholder pursuing non-return-generating issues such as the insistence by the PIC on the transformation of the Sasol board.²

In the USA they have a Council of Institutional Investors ("CII") which is made up of one hundred and twenty public and private funds and its purpose is to encourage member funds as major shareholders to take an active role in protecting their planned assets.³ It encourages its members to direct their activism towards boards of directors and managers of listed firms with the purpose of pressurizing them to make changes that are necessary to improve the performance of their firms.⁴ It is true that the rapid and ongoing ongoing share ownership by institutions as opposed to individual investors insisted to have more voice in companies.⁵ Institutional shareholders, especially those that manage manage funds on behalf of their clients have been seen to be soft in attacking management.⁶

Institutional investors in South Africa are also increasingly becoming more demanding of directors, as a number of international investors is increasing.⁷ Institutional investors both in South Africa and internationally are drafting criteria for investment and how they can improve corporate governance in companies in which they invest.⁸ The empirical evidence on the recent wave of shareholder activism reveals that more traditional

1 Haberstroh 2003: 69.

2 Kekana 2005: 26.

3 Song *et al* 2003: 317. See also Smith 1996: 231, where he states that the primary participant in the creation of CII in 1984 was CalPERS. CII serves as a clearinghouse for activist institutional investors and provides information to members on firms with poor stock price performance.

4 Song *et al* 2003: 317.

5 Gupta 1992: 48.

6 Mahabane 2001: 45.

7 Mammatt *et al* 2004: 3.

8 King II: 13.

shareholders, such as institutional investors are actually working with social investors.¹ Institutional shareholders may face a number of challenges, such as conflicts of interests, that may render them ineffective and apathetic.

3.3.1 MARKET DRIVEN ACTIVISTS

Market driven activists are purely focused on market forces and focus mainly on making profits out of their investments. They watch market developments and management of companies closely. They often invest in companies that are showing signs or have a potential to grow and disinvest in companies that are seen to be rather poor performers. They are more risk conscious and cautious. Private equity funds and hedge funds have their focus on what the management style and risk factors associated with their investments. Their activism is based on issues of income statements and the balance sheets.

3.3.1.1 PRIVATE EQUITY FUNDS

Private funds are funds set up by employers to provide for the retirement of their employees. They are commonly run by fund managers and trustees who are top managers or directors of a particular company.² By law, fund managers must accept appointment by signing an appointment form. These should be people who have knowledge of pension fund management and should carry out their duties with duty of skill and care. They should act in the best interests of fellow employees.

Some of the excuses made by fund managers as to why they are passive, range from “we are not in a position to second-guess corporate management” to “there is no need for such a strategy, if we do not like a company we just sell the shares”.³ This is a cause of shareholder passivity by private pension funds, banks and mutual funds.⁴

Allan Gray Asset Management, Coronation and Sanlam have demanded the resignation or insisted on appointments of directors of Kersaf, Primedia and Comparex in startling public displays.⁵ Private equity funds take such drastic steps when their investments are

1 Fairfax 2008: 32.

2 Davis *et al* 1994: 161.

3 McNulty 2001: 67.

4 Davis *et al* 1994: 162.

5 Hasenfuss 2002: 9.

likely not going to make expected profits due to alleged non-performance by directors. In most cases management is put on the spot at a general meeting or through a surprise call by the media. There is however a tendency by fund managers to pressurize directors to resign so that there can be a vacancy and put their candidate(s) on the board. Because fund managers want to get involved in the management of companies, they nominate representatives to the companies in which they have invested.¹

Williams² quotes a Sanlam spokesperson as having said that Sanlam values its relationship with all its shareholders and that Sanlam supports and encourages shareholder activism to protect all shareholders' interests. Implicit in the welcoming of shareholder activism is a notion that large shareholders will look out for the interests of small shareholders.³ However, some people argue that this assumption is unfounded.⁴ Investec Asset Management and BOE Asset Management have focused on shareholder rights by attending annual general meetings and meeting management privately to try to persuade companies with control structures, such as pyramid schemes to abandon such structures.⁵

A pyramid corporate structure is one in which two or more companies own the same underlying asset, the control mechanism of which effectively multiplies the voting power of the controlling shareholder at the top of the pyramid.⁶ Pick 'n Pay Holdings ("PPH") is one example of a pyramid scheme. Through its chairman, it made it clear at an annual general meeting that the Ackerman family, which controls Pick 'n Pay Stores Ltd ("PPS"), wanted to keep the pyramid structure.⁷ PPH is owned and controlled by the Ackerman family, through Ackerman Family Trust. PPH controls PPS. It has no other assets or activities.

1 Hasenfuss 2002: 9.

2 2007: 37.

3 Rock 1999: 466.

4 Rock 1999: 466.

5 Formby 1998: 102. Examples cited by Formby is Anglovaal and Rembrandt Group. Both are family controlled companies.

6 Hasenfuss 2008: 18. Pyramid schemes were used in the 1950's and 1960's as a way for a family to maintain control and effectively thwart hostile takeover bids. Pyramid structures are no longer allowed to list on the JSE.

7 Hasenfuss 2008: 19.

At a Liberty Holdings shareholders meeting, the chairman told shareholders that if Standard Bank were to unbundle its pyramid holding of Liberty, his life would be desperately dull.¹ This was after the PIC told the chairman that they have a problem with the pyramid structure to such an extent that 12% of Liberty Holdings shareholders voted against the reinstatement of Derek Cooper as the chairman.² Opportune Investments also accused Standard Bank of concocting a half-baked excuse for keeping the pyramid.³ Standard Bank is the majority shareholder in Liberty Holdings and Derek Cooper was chairman of both entities. The response from Derek Cooper was an example of arrogance that is normally displayed by directors of companies, who would say, “you are free to sell your shares and leave us alone,” as if they are talking about their own company.

Apart from PPS, Trencor Limited is another example of a pyramid structure as it is controlled by Mobile Industries.⁴ Pyramid schemes have been widely criticized in South Africa and are outdated as a form of a corporate structure and the JSE Ltd does not allow new listings of pyramid schemes.

Rademeyer *et al* states that shareholders find it attractive and advantageous to sell their shares rather than to engage in actions that would ensure compliance with corporate governance.⁵ However many institutional shareholders have grown so big and have such enormous portfolios that selling is not an option.⁶ These institutional shareholders include private equity funds. There are constraints on institutional investors that often preclude them from being able to dump large shares of stock such as:⁷

(a) If an institutional investor jettisoned a sizeable block of stock onto the market, the price of that could drop precipitously, possibly resulting negative repercussions throughout the market;

1 Rose 2008: 72. Standard Bank owns fifty nine percent of Liberty Holdings, Liberty Holdings owns fifty one percent of Liberty Group. Standard Bank effectively owns thirty three percent of Liberty Life.

2 Rose 2008: 72.

3 Rose 2008: 72.

4 Hasenfuss 2008: 18.

5 Rademeyer *et al* 2003: 769.

6 Loring *et al* 2006: 324.

7 Loring *et al* 2006: 324.

- (b) Continued dumping of large blocks of stock could lead to a market crash driving down the value of an institutional investor's overall portfolio even though most institutional investors hold indexed portfolios;*
- (c) Many institutional investors are governed by rules that impose fiduciary restraints on their freedom of action for the benefit of shareholders, members or clients.*

Private equity funds have a major role in making sure that companies do not engineer dubious corporate structures that are not for the benefit of shareholders. There may also be a real potential for conflict of interest as the fund management firms may want to attract or keep the pension fund or the investment banking business of the company in question.¹ Corporate managers can and do pressurise outside money managers to vote for management's proposals and to further management's interests. For example, management may threaten to change banks unless the bank votes the shares it holds in a fiduciary capacity for management.²

Sometimes private funds lack vigour to challenge companies that fail to embrace corporate governance principles. This is because they have to deal with issues of conflicts of interest, and therefore cannot be robust in their approach but would rather employ the approach of quiet diplomacy or be soft in their approach. Corporate managers also have a history of influencing fund managers to vote in their favour.³ Some argue that their activism comes in the form of targeting companies that are underperforming pertaining to shareholder proposals and to promote the so-called good corporate governance practices.⁴

3.3.1.2 HEDGE FUNDS

A hedge fund is a private investment that charges both a performance fee and a management fee to its clients.⁵ They have become critical players in corporate governance.⁶ Hedge fund activism differs from traditional institutional activism in that hedge funds are directed at significant changes in individual companies, entail higher

1 McNulty 2001: 67.

2 Rock 1991: 469.

3 Davis *et al* 1994: 161.

4 O'Connor 2000: 112.

5 http://en.wikipedia.org/wiki/Hedge_fund. Date accessed 23/03/2009.

6 Kahan *et al* 2007: 1022.

costs and they are strategic and *ex ante*.¹ They engage in a variety of investment strategies including investing in distressed securities, illiquid securities, and securities of companies in emerging markets, derivatives and arbitrage opportunities.² They have increasingly tried to influence business strategy and management of corporations.³

Hedge funds are not concerned with long-term success of companies on whose stocks they trade and instead focus on current market price of a company's stock.⁴ They are short-term investors that want to make quick returns on their investments.

The involvement of hedge funds in corporate governance and control raises two potential problems in that their interests diverge from those of the fellow shareholders and they impose substantial stress the regulatory system cannot withstand.⁵ This however should not mean that hedge funds cannot raise their concerns when a need arises. After all, all that is required of companies is to be compliant with corporate governance. The participation of hedge funds in activism should not be seen as less important.

In the USA in 2003, the SEC introduced new rules that required mutual funds to adopt voting policies and to disclose their voting records.⁶ These new rules were viewed to have a potential to increase shareholder activism by mutual funds.⁷ They have a different incentive structure and traditional institutions face regulatory barriers, political constraints and conflicts of interest.⁸

3.3.2 POLITICALLY DRIVEN ACTIVISTS

3.3.2.1 THE STATE

Historically the state sought to achieve its goals for company law through a strategy of “command and control”, through which legislation or judicial intervention would specify what should or should not happen and impose sanctions for failure to observe those

1 Kahan *et al* 2007: 1021.

2 Anabtawi 2006: 580.

3 Kahan *et al* 2007: 1029.

4 Anabtawi 2006: 579.

5 Kahan *et al* 2007: 1021.

6 Brownstein 2004: 29.

7 Brownstein 2004: 29.

8 Kahan *et al* 2007: 1021.

injunctions.¹ In the mid to late 1990's and the early 2000's, the government passed legislation such as the Employment Equity Act, Broad Based Black Economic Empowerment Act and policies that had a direct or indirect impact on companies' policies. To some companies the legislation impacted positively and to others it impacted negatively.

Williams² quotes the former President, Thabo Mbeki, at the re-launch of the PIC in 2005, 2005, as having made it clear that the job of the PIC was no longer merely to get steady returns for state pensioners and said: "I think it would be useful for our fund management industry as well as trustees of our pension funds, to begin to take a more active role in discharging their responsibilities as shareholders on our behalf in transforming these companies. The transformation of our country is a collective effort as part of ensuring rapid transformation. Perhaps what is required is some form of alliance of shareholders among institutional investors so that common standards and rules of engagement can be set".

Owing to South African's past, there is no way that companies can be left alone to implement transformation on their own, as up to now little has changed. State organisations like the PIC had to take a stand and use their powers to facilitate and enforce transformation. Former Minister of Finance, Trevor Manuel told delegates at a shareholder activism conference to be alive to their power, develop a checklist of good corporate citizenship, attend general meetings and understand their rights and obligations.³

This is a clear indication that South Africa cannot escape the hype of shareholder activism and that this phenomenon is growing at an alarming pace. Manuel rightfully stated that shareholders should understand their rights and obligations to be able to more effective. It is a fact that a majority of shareholders in South Africa know little about

1 Grantham, 1998: 585.

2 2007: 34. See also Grantham 1998: 586. Rather than the state through the courts or other officials directly undertaking the approval of irregular transactions, approval of changes in corporate constitution and the pursuit of delinquent directors, may be performed indirectly by vesting rights in suitably motivated groups, both within and outside a company.

3 Walker 2002: 12.

their rights and duties. The statements by both Mbeki and Manuel confirm the view that the state supports activism by the PIC.

3.3.2.2 COMMISSION FOR EMPLOYMENT EQUITY

The Commission for Employment Equity (“CEE”) is a juristic body that was formed in terms section 28 of the Employment Equity Act. The primary purpose of the CEE is to advise the Minister of Labour on issues of employment equity in the work place. The CEE is comprised of nine members including a chairman, two members representing each sector. The sectors represented in CEE are employers, community, labour and government. The CEE is a watchdog of the department of labour to see to it that the provisions of the Employment Equity Act are fully implemented.

The CEE has played an important role in enforcing changes in employment patterns in the public and private sectors. It has been vocal about the lack of employment equity, especially in the private sector. It advocates for black representation in all company structures, from top management downwards to the lowest rank, in order to achieve a demographically representative economic population.

However, it is doubtful whether the CEE’s activism has led to a change in employment policies in companies. The truth is that most companies are still behind on employment equity, as the majority of directors and senior management of both listed and unlisted companies are white males.¹

The attitude adopted by many companies, especially those that do not directly do business with the state or its organs, is that employment equity is not applicable to them and therefore they simply ignore it. To address this the CEE had threatened to name and shame the defaulters through the media. Where companies really have to address employment equity due to links with state business, some resorted to fronting and window dressing their teams in order to boost statistics. Fronting is where black people get employed in positions of power but are not given the authority and influence such positions demand.

1 SASSBI: 2007. Women directors make thirteen comma four percent and previously disadvantaged individuals make about twenty six comma two percent of board representation of companies listed on the JSE.

3.3.2.3 PUBLIC PENSION FUNDS

Shareholder activism by public funds began in the USA around 1987, through the submission of proxy proposals.¹ In the early 1990's they started targeting firms on the basis of their performance rather than on a general approach that was used in the earlier years.² They have truly been the principal players in the recent movement towards greater institutional activism.³

To date in South African leading agents of the shareholder movement are public employee pension funds and union pension funds, but not private pension funds.⁴ Public pension fund managers administer funds for public employees and they do not do business directly with management teams.⁵ This notion has changed in the recent past as the PIC wanted to have one-on-one talks with management on issues of discontent. Public pension fund managers need to be good political operators as well as good money managers.⁶ They may become active shareholders partly to generate good publicity for themselves.⁷ The reason that public pension funds are active is mainly because they are politicized as most of their boards of directors are political appointees.⁸ An example of a political appointment is that of the PIC chairman, which is occupied by the deputy minister of finance.

Public pension funds concentrate on the structure and competence of the board of directors via limits on poison pills, limits on executive compensation, declassification of boards and enhancement of board independence.⁹

Managers of public funds (while less susceptible to pressure from corporate management) do face other conflicts, like being pressured by interest groups within the state that have interests unrelated to, or directly contrary to the maximization of the

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- 1 Gillan *et al* 2000: 278. Those proposals were centered on issues of corporate governance.
 - 2 Gillan *et al* 2000: 278.
 - 3 Black 1990: 598.
 - 4 O'Connor 2000: 111.
 - 5 Davis *et al* 1994: 162. They have by far been the most active institutional investors.
 - 6 Black 1990: 599.
 - 7 Black 1999: 599.
 - 8 Davis *et al* 1994: 162.
 - 9 O'Connor 2000: 112.

value of the fund.¹ They are however faced with fewer direct conflicts of interest in monitoring corporate managers compared to corporate pension funds and bank trust departments.²

Those who are against institutional activism argue that public pension fund managers lack the expertise to advise corporate management.³ However, the fact is that shareholder activists are not there to advise management, but merely there to raise issues of concern and to be the watchdog and to curb director and board excesses.

The PIC, as a major shareholder in most big companies, plays an important role and adopts a harsher attitude in making sure that companies change their policies and transform.

3.4 SOCIAL ACTIVISTS

Companies are increasingly being evaluated on social as well as on financial performance.⁴ Transformation and BEE are social factors that need to be taken into account by companies in making sure that the imbalances of the past are addressed.⁵ Legislation such as the Employment Equity Act, the Skills Development Act, and the BBBEE Act are some of the legal tools used by social activists to enforce transformation in companies. Shareholder resolutions urging corporations to adopt more socially responsible business practices are also on the rise.⁶

Often challengers and groups whose interests are not considered in decision making often resort to social movements to gain support and thus have their interests taken into account.⁷ In the USA, the USAss founded by T Boone Pickens in 1986 for individual shareholders and the Institutional Shareholder Services formed by Robert AG Monks in 1985, were created as social movements to fight for shareholder rights.⁸ In the USA,

1 Rock 1991: 471.

2 Black 1990: 523.

3 Gillan *et al* 2000: 280. They normally argue that pension funds are there to manage money for beneficiaries.

4 Waddock 2000: 324.

5 King II: 122.

6 Guay *et al* 2004: 125.

7 Davis *et al* 1994: 152.

8 Davis *et al* 1994: 153.

investors were challenged to make a response to apartheid and in South African church groups and students advocated this idea even more vigorously.¹

Non-governmental organisations (“NGO’s”) also have opportunities to influence corporate conduct via direct, indirect and interactive influences on the investment community and the overall influence of NGOs as major actors in socially responsible investment is growing.²

3.4.1 CO-ORDINATED GROUPS AND HUMAN RIGHTS ACTIVISTS

Companies are responsible not just to their shareholders but to other stakeholders like workers, suppliers, environmentalists and communities.³ Different groups with different interests can join forces on a specific matter and increase their influence to achieve a specific objective. Shared identity together with social ties increase the ability of a group that share common interests to mobilize towards a common objective.⁴

The Treatment Action Campaign (“TAC”) is one example of a co-ordinated social group. At one stage it joined forces with the Medicines Control Council to oppose an advertisement campaign by Aids dissident scientist Mathias Rath’s foundation, which claimed that anti retrovirals were toxic. The Rath Foundation claimed that it had discovered “natural solutions” to health problems and that multivitamins were a treatment for AIDS.⁵ Rath was reportedly running unregistered medical practices in Cape Cape Town townships and conducted unauthorized, unethical and dangerous experiments on people with HIV.⁶

Due to the activism of the TAC, a number of rulings were made against Rath in South Africa, Europe and North America⁷. Some are as follows:

1 Spratlen 2001: 74.

2 Guay *et al* 2004: 125.

3 Guay *et al* 2004: 128.

4 Davis *et al* 1994: 163. This increases the likelihood that people may join social movements.

5 http://www.tac.org.za/newsletter/2005/ns19_04_2005.htm. Accessed on 29/03/2009.

6 http://www.tac.org.za/newsletter/2005/ns19_04_2005.htm. Accessed on 29/03/2009.

7 http://www.tac.org.za/newsletter/2005/ns19_04_2005.htm. Accessed on 29/03/2009.

- (a) *The Advertising Standards authority of South Africa ordered Rath to withdraw his unsubstantiated claims;*
- (b) *The British Advertising Standards Authority forced Rath to remove his advertising for treatments as they were unsupported by evidence and misled the public;*
- (c) *The Food and Drug Administration in the USA cautioned Rath for advertising some of his products in contravention of USA law;*
- (d) *The South African Medical Association, the Southern African HIV Clinicians Society, Joint United Nations Programme on HIV/AIDS (UNAIDS), World Health Organization (WHO) and United Nations Children's Fund (UNICEF) condemned Rath's misrepresentations.*

In the UK the debate about what constitutes legitimate shareholder activism was sparked by an incident in which Phillips & Drew, which owned 11% of Huntingdon Life Sciences, Europe's leading animal testing company, became a target of harassment by animal rights groups which bombarded it with hate mail and death threats.¹

Social organisations can be able through their activism to change things, as it was the case with Rath, and can even influence international organisations to condemn practices that are seen to be *contra bonos mores*.

3.4.2 COMMUNITIES

Communities are stakeholders in companies that operate within their jurisdictions. They can through their activism influence, consent to or block any proposed initiatives by companies in their communities. Communities in most instances do not welcome companies to develop their areas unless issues such as compensation and the provision of jobs are part of the plan.

The rural community of Macambini on the KwaZulu-Natal north coast expressed unanimously their intention to reject a proposed development in their area by a Dubai based company, Ruwaad and preferred Bukhatir Group, also from Dubai to develop their area as they offered the community a better deal.² Unlike Ruwaad, Bukhatir promised

1 Lascelles 2000: 22.

2 Hlongwa 2008: 30.

the community that they would not have to vacate their land, which includes farms, to make way for the proposed development.

Furthermore, the KwaZulu-Natal provincial government apparently did not consult the community about the proposed development by Ruwaad.¹ Due to community activism the development of Macambini was placed on hold until the community's concerns and demands were addressed properly. That is just one example of what communities can achieve if they used their inherent power as stakeholders.

Communities are always resistant to arbitrary and unilateral decisions made on their behalf, because they normally would not abandon their heritage and traditional practices without a just cause.

3.4.3 ENVIRONMENTAL ACTIVISTS

The Constitution Act 108 of 1996 ("the Constitution") makes it clear that everyone has a right to life,² and everyone is protected under section 24 of the Constitution.³ Companies have a duty to respect and realize universally recognised fundamental rights.⁴ It is difficult to strike a balance between ecological sustainability and promotion of justifiable economic and social development. Normally, those who are interested in developing an area will put forward the argument that the development will enhance the economy and uplift the lives of people. Environmentalists on the other hand may argue that development is harmful and destroys the environment.

With global warming threatening the environment worldwide, companies are required to report on their activities that may have an impact on the environment and what measures are in place to mitigate whatever harm may be posed by such activities.

1 Hlongwa 2008: 30.

2 Section 11.

3 Section 24 of the Constitution states that everyone has a right:
(a) to an environment that is not harmful to their health or well being; and
(b) to have the environment protected, for the benefit of present and future generations, through reasonable legislative and other measures that:
(i) prevent pollution and ecological degradation;
(ii) promote conservation; and
(iii) secure ecologically sustainable development and use of natural resources while promoting justifiable economic and social development.

4 King III: 22.

Investors typically look at the company's internal operating behavior and external practices and policies as well as its product line.¹

To make environmental corporate governance principles effective, they should be integrated with the financial components and other aspects of the business.² Environmental and other legislation impose duties on companies and directors personally.³

The Xholobeni community of Wild Coast in the Eastern Cape, assisted by an environmental group calling itself the Sustain the Wild Coast successfully lodged a complaint with the South African Human Rights Commission over the application by Australian company Minerals Commodities to mine sand deposits in their area.⁴ This case, like that of Macambini, shows that the issue of activism by communities and environmentalists can frustrate plans to develop an area, as the communities hold the keys to access their areas.

3.5 LABOUR ACTIVISTS

Labour unions are important stakeholders in companies. They represent employees on matters that affect them and employees themselves have expectations that have to be fulfilled by the unions. They face strategic choices as to how best to provide the benefits to their constituents.⁵ Many national and international trade unions have research departments and have staff complement of a number of professionals including economists, lawyers, accountants and human resources specialists to assist them in their work.⁶ This shows that labour unions are serious about executing their mandate, which is collective bargaining.

1 Guay *et al* 2004: 126. Examples of internal operating behaviour include employment policies and benefits, examples of external practices and policies include effects on environment and indigenous people and examples of a product line include products such as tobacco, liquor and gambling.

2 King II: 119.

3 King II: 117.

4 Nontshiza 2007.

5 Schwab 1998: 1039.

6 Schwab 1998: 1037.

Recently unions have become the most aggressive of all institutional stakeholders.¹ Where traditional trade union bargaining activities are restricted unions often resort to shareholder activism to achieve their aims.² Sometimes they use their shareholder power simply as a weapon to further unions' traditional organising.³ They use tactics such as the "union corporate campaign" to achieve their aims,⁴ and warlike rhetoric, with management as its enemy.⁵ To achieve their goals, unions strike and picket against recalcitrant firms.⁶

Labour pension assets are USA's largest source of capital amounting to thirty five-percent of equity holdings.⁷ In 1949 Communication Workers of America became the first labour group to use the rights of shareholders to bargain, having been faced with a unilateral decision by the management of American Telephone and Telegraph to cut pension funds. They bought back their stock to bring their demands to the attention of the company's stockholders.⁸

Traditional business unions have three basic functions to achieve their goals:⁹

- (a) *Firstly, they organise workers at non-union firms;*
- (b) *Secondly, once organised they bargain with management;*
- (c) *Thirdly, once collective bargaining agreement is negotiated, they monitor management to ensure that it complies with the agreement, usually by processing worker complaints through a grievance arbitration system.*

In collective bargaining, unions use two methods of obtaining favourable contract for workers:¹

1 Schwab 1998: 1019.

2 Anderson *et al* 2007: 45.

3 Schwab 1998: 1022. See also Bainbridge 1998: 815. He says because of disparities of power in employment, setting self-defence by workers against managerial opportunism requires some form of collective action.

4 Schwab 1998: 1032. At its broadest the term union corporate campaign means any union tactics other than usual traditional strikes and picketing used to pressure management to change some behaviour.

5 Schwab 1998: 1034.

6 Schwab 1998: 1031.

7 O'Connor 1997: 1354.

8 Anderson *et al* 2007: 45.

9 Schwab 1998: 1031.

- (a) *Firstly, unions demand a bigger slice of the pie, arguing that the employers should offer better benefits and better working conditions; and*
- (b) *Secondly, collective bargaining attempts to increase the size of the pie by trading particular items to the highest valued user. This is sometimes called win-win bargaining or value added unionism.*

Unions also assert their rights as stakeholders to influence corporate decision making outside the conventional labour law framework.² It is not clear if the involvement of employees in decision making enhances corporate governance and the performance of the company.³ The free market position states that employees do not play a role in corporate governance because they are protected by contractual mechanisms such as collective bargaining, but O'Connor argues that corporate governance rights for workers are necessary because private contracts are inadequate.⁴

For a number of years labour unions pushed for corporations to adhere to the principles of governance in order to safeguard worker pension assets and to promote ethical, international labour standards.⁵ In recent decades unions have become increasingly frustrated at their lack of influence over basic corporate policy.⁶ Labour shareholder activism has significant symbolic value because it highlights the fact that working people are beneficiaries and it has increased just when leaders in the corporate world are concerned that corporate is facing a legitimacy crisis.⁷

1 Schwab 1998: 1031. See also Bainbridge 1998: 816, where he states that unions provided a variety of permanent structural protections such as employer opportunism, severance packages, grievance procedures and promotion ladders.

2 O'Connor 1997: 1342.

3 Bainbridge 1998: 741 is of the opinion that the long-term economic effects of participatory management are unknown, but this philosophy is gaining momentum in the USA.

4 2000: 97. See also Bainbridge 1998: 741. Bainbridge supports the idea of participatory management, the philosophy of involving employees in corporate decision making. This philosophy has been endorsed by the former USA President Bill Clinton and the late Pope John Paul II. Employee involvement programme in capital owned firms is usefully divided into two basic categories: Operational and strategic involvement. Under operational programmes, employee involvement is limited to day-to-day issues of productivity and working conditions at plant level; whilst strategic involvement refers to programmes in which employees participate in major policy decisions such as those that are traditionally viewed as falling within the realm of corporate governance.

5 Chakrabarti 2004: 46.

6 Schwab 1998: 1023.

7 O'Connor 1997: 1350.

According to O'Connor¹ employees' role in corporate governance can be analyzed at three different levels:

- (a) *At the shop level, workers have access to much information about product production that would benefit managers;*
- (b) *At collective bargaining level workers do not have a right to bargain over plant closings and relocations;*
- (c) *At the strategic decision making level the boardroom culture still resists efforts to include human capital perspectives.*

Although unions do not hold powerful membership presence in the private sector, they have begun to exercise influence over corporate governance practices in new ways.² Within the corporate governance realm, labour and other shareholders have learned to overlook their differences concerning wages and job security to rally around one campaign that unites them.³ Workers want boards to ensure that managers are responding to early market signals in order to avoid major layoffs that accompany long-term mismanagement.⁴

Unions, union pension funds, individual union members and labour-orientated investment funds use the corporate voting processes to push for a wide variety of changes in corporate governance.⁵ It should not be surprising that a system of corporate governance, assuring management accountability to shareholders would provide new vehicles for employees to have a voice in publicly owned companies.⁶

1 2000: 98. See also Bainbridge 1998: 743. Participatory management programmes implicate at least four core labour doctrines:

(a) *the prohibition of company unions;*

(b) *exclusive representations;*

(c) *legal differences between workers and managers and*

(d) *the distinction between mandatory, permissive and illegal bargaining subjects.*

2 Chakrabarti 2004: 45. He states that labour movements have been able to articulate and implement corporate governance reforms at corporations such as Apple Computers, Bank of American and Goldman Sachs.

3 O'Connor 1997: 1346.

4 O'Connor 1997: 1348.

5 Schwab 1998: 1020.

6 Murphy 2003: 101. See also Bainbridge 1998: 744. Some academics propose that there should be tax incentives for companies that embrace participatory management and that the government should adopt a variety of policies designed to encourage participatory management. See also Bainbridge 1998: 745 where he states that proponents of government involvement state that there are two justifications for government involvement. The first justification is economic, typically arguing that participatory

Organised labour can leverage on a listed company's high public profile by exerting pressure through unfavourable publicity to achieve their aims.

The economic crisis in the USA in the last two years revealed serious, systematic flaws in corporate governance that have cost union pension funds billions of dollars and has resulted in labour movements beginning to take charge of governance reform. To do that unions mobilise pension assets, and launching company specific shareholder campaigns.¹ Whilst labour unions seek to adopt the language of corporate social responsibility in a tactical sense and link their union shareholder campaigns with corporate competitiveness and shareholder value, union shareholder activism invariably arises in the context of conventional industrial disputes and weakened union power.² Labour unions also use Rule 14A-8 to make corporate governance proposals.³

Labour unions can be as active as capitalists.⁴ This way labour unions use their influence or representation to shape corporate behavior by insisting amongst other things, that the remuneration of company executives should be tied to the performance of the company and that benefits such as share options be spread amongst all employees.⁵ They focus most of their resolutions on issues pertaining to executive compensation, staggered boards, board independence and poison pills.⁶ Poison pills are corporate strategies that seek to prevent a hostile takeover by making an acquisition too expensive and by issuing a special dividend in the form of a right to purchase additional shares of the issuing firm's common stock.⁷ There are three political features of labour

management is an efficient system of organising production of nevertheless thwarted by various market failures requiring government correction and that employees have a right to participate in corporate governance. He is however of the opinion that government-mandated employee involvement cannot be justified on economic grounds.

1 Chakrabarti 2004: 45.

2 Anderson *et al* 2007: 51.

3 Schwab 1998: 1345.

4 Schwab 1998: 1019.

5 Weller *et al* 2001: 49.

6 O'Connor 1997: 1346.

7 Loring *et al* 2006: 326. See also Anabtawi 2006: 568 where describes poison pills as a plan by which shareholders receive the right to be bought out by a corporation at a substantial premium on the occurrence of a stated triggering event. Ross *et al* 2005: 903 defines poison pills as a strategy by a takeover target company to make a stock less appealing to a company that wishes to acquire it.

shareholder activism that facilitate union endeavors to increase membership, even when those efforts are not part of corporate campaigns.¹

- (a) Firstly, labour shareholders innovative corporate governance reforms receive favourable media attention which portrays organised labour as a potent force to confront managerial power;*
- (b) Secondly, labour shareholder activism destroys the perception created under Taylorism that workers are not competent to make strategic business decisions;*
- (c) Thirdly, exercise of labours' shareholder rights is politically acceptable because it is consistent with both shareholders supremacy and democracy in corporate governance.*

Schwab² is of the view that shareholder activism by unions requires a major realignment of the traditional ideologies of shareholder, worker, and manager. To be successful, union stakeholder activism must gain support of other stakeholders,³ such as the state, the public as well private pension funds. Lasting changes in corporate governance can occur if unions develop a more strategic model of their role in corporate governance, which would require them to concentrate on where their interests coincide with other shareholders and where they can demonstrate that their actions will increase stakeholder value.⁴

If labour can demonstrate to other shareholders that it is using its monitoring advantages to take actions to increase stakeholder value by policing management and reducing agency costs of equity, then other shareholders will be more willing to follow its lead in future voting initiatives.⁵

3.5.1 LEGISLATION

South Africa as a global player in world affairs is also a signatory of the International Labour Organisation. As such, South African laws must be on par with best labour

1 O'Connor 1997: 1381.

2 1998: 1020. Managers traditionally are thought to represent shareholders interests and unions are thought to represent workers.

3 Schwab 1998: 1035.

4 Schwab 1998: 1090. See also Bainbridge 1998: 811, where he says that central to many proposals mandating employee involvement is the proposition that employees have a right to participate in corporate decision making to protect themselves from oppression by opportunistic managers and shareholders.

5 Schwab 1998: 1090.

practices in the world in protecting workers' rights. Since 1994, a number of statutes that seek to protect the interests of workers have been promulgated in South Africa.

3.5.1.1 THE CONSTITUTION

In South African workers' rights are enshrined in the Constitution Act 108 of 1996 ("the Constitution"). The Constitution is the supreme law of the country¹. It guarantees workers the right to fair labour practices² and a right to engage in collective bargaining through their trade unions³.

3.5.1.2 LABOUR RELATIONS ACT

The purpose of the Labour Relations Act 66 of 1995 ("LRA") is to advance economic development, social justice, labour peace and the democratisation of the work place. The LRA requires employers to consult with trade unions through work place forums on specific matters⁴. Trade unions have a role to play in decision making in companies. That is why trade unions have increasingly become contributors to corporate governance. Therefore, employees have a right to call management to account if good corporate principles are flouted.

3.5.1.3 EMPLOYMENT EQUITY ACT

The labour unions also advocate for employment equity in the work place. They use the Employment Equity Act ("EEA") to achieve their goals. Similar to South Africa, in the USA in 1991, the Amalgamated Clothing and Textile Workers Union asked Dayton Hudson Corporation to report on its equal employment opportunity initiatives and the

1 S 2.

2 S 23 (1).

3 S 23 (5).

4 S 84 (1) lists specific matters for consultation as:
(a) restructuring of a work place;
(b) changes in the organisation of work;
(c) partial or total plant closures;
(d) mergers and acquisitions;
(e) dismissal of employees based on operational requirements;
(f) job grading;
(g) merit increases;
(h) education and training;
(i) product development and
(j) export promotion.

purchases on minority and female owned small enterprises.¹ This explains the influence of USA activism on South Africa.

3.5.1.4 COMPANIES ACT 2008

The Companies Act 2008 makes a provision that a trade union representing employees of a company may take proceedings to restrain a company from doing anything that is inconsistent with the Act.² This shows that companies have to recognize the rights of trade unions. Where employees are shareholders in a company through employee share ownership schemes, they should have equal rights as those shareholders who bought their shares in an open market.

3.6 BUSINESS ASSOCIATIONS

Shareholder associations are essential to ensure that corporate governance levels that are necessary to attract foreign capital are established and maintained. For example in the UK, they have the Association of British Insurers and National Association of Pension Funds.

Mfundu Vundla, the chairperson of the Presidential Black Business Working Group ("PBBWG") in South Africa, encouraged activism from the PIC because it understands the transformational needs of the country³. He stated that the kind of shareholder activism that comes from the PIC is most welcome and should send a strong message to other companies that are not playing ball.⁴

Companies that have the PIC as a shareholder have to learn from Sasol and Barloworld as examples, so that if there is disagreement and public hostility it is not a result of arrogance and poor management of the relationship.⁵ The PIC forced BEE and good corporate governance by encouraging the independence of company boards and director remuneration that is on par with black executive representation, employment equity and black ownership in companies.⁶

1 Dhir 2006: 380.

2 S 20 (4) of the Companies Act 2008.

3 Williams *et al* 2007: 36.

4 Williams *et al* 2007: 36.

5 Williams *et al* 2007: 37.

6 Radebe 2008: 44.

Other than the PIC and the PBBWG, there are other business organisations that are at the fore front of transformation and have made their voices heard. Due to their limited resources and financial power, they have not yet been robust to the same level as the PIC.

3.6.1 BLACK MANAGEMENT FORUM

The BMF¹ is a non-racial, thought leadership organisation founded in 1976. It has amongst others taken interest in socio-economic transformation of South Africa, in pursuit of socio-economic justice, fairness and equity.

The BMF continues to be vocal on issues of transformation, corporate governance and BEE and has been putting corporate South Africa in the spotlight and talks about (doing nothing tangible) encouraging broader black economic participation.

The organisation stands for the development and empowerment of black management capacity, primarily within large corporate organisations to reflect the demographics of the wider South African population. At its national conference in 1997 the BMF established the Black Economic Empowerment Commission, under the auspices of Black Business Council and proposed that there should be an integrated national broad-based BEE strategy.²

3.6.2 BUSINESS UNITY SOUTH AFRICA

Business Unity South Africa ("BUSA")³ was created in October 2003 through the merger of the Black Business Council and Business South Africa. The merger created the first truly unified business organisation in South Africa.

The function of BUSA is to ensure that business plays a constructive role in the country's economic growth, development and transformation and to create an environment in which businesses of all sizes and in all sectors can thrive, expand and be competitive.

1 www.bmfonline.co.za. Accessed on 23/04/2009.

2 Balshaw *et al* 2005: 67.

3 www.busa.org.za. Accessed on 23/04/2009.

3.6.3 ASSOCIATION OF BLACK SECURITIES AND INVESTMENT PROFESSIONALS

Association of Black Securities and Investment Professionals (“ABSIP”)¹ was established in 1995 to address the apparent lack of black professionals in the securities and investment industry. It was also conceived as a platform to address the aspirations of those in the industry and to create a forum for black professionals to exchange information and ideas.

The mandate of ABSIP has evolved to encompass the empowerment of black professionals across the financial industry. It has become widely recognised as an influential force in the transformation of the financial sector as evidenced by its participation in drafting the landmark Financial Sector Charter. ABSIP is an affiliate member of BUSA.

3.6.4 SHAREHOLDER’S ASSOCIATION OF SOUTH AFRICA

Shareholders Association of South Africa (“SASA”) is a body that represents shareholders, but it has up to now not been robust and has not lived up to expectations. It has not yet gained any demonstrable influence in SA’s corporate landscape. The objectives of the association which primarily concerns itself with public companies registered in South Africa since inception have been:²

- (a) To protect and further the rights and interests of shareholders;*
- (b) To make presentation to the boards of directors with regards to shareholder interests;*
- (c) To act as a proxy and attend special and general meetings of companies;*
- (d) To make presentations to government or authorities or bodies for enactment, repeal, amendment, or variation of legislation affecting the rights of and interests of shareholders;*
- (e) To make such actions as may be deemed advisable in the interests of the public or any particular group of shareholders.*

It is not clear what SASA stands for, as it has not committed itself to fighting for good corporate governance and transformation. It says it looks after the interests of

1 www.absip.co.za. Date accessed 24/03/2009.

2 www.profile.co.za/fmd/data/M00233.ASP. Date accessed 24/03/2009.

shareholders who in many cases are only profit driven. How that is to be achieved without pushing for either good corporate governance or transformation remains unclear. The chairman of SASA described corporate governance recommendations in South Africa as utterly ineffectual,¹ which explains why corporate governance is not part of its mission statement. However, there is evidence for the development of good corporate governance compared to ten years ago in.

3.7 COMPANIES AS ACTIVISTS

With the introduction of the Codes of Good Practice in South Africa, companies have begun to be activists amongst themselves. While some companies would like to apply the “we do not do business with the state” attitude and therefore do not take transformation seriously, they are forced to transform by their counterparts who do business directly with state-owned enterprises as they themselves are required to procure from transformed companies.

State owned enterprises such as Eskom, Telkom, Armscor, Transnet *etc*, insist on transformation and their suppliers are required to be compliant with transformation objectives. This forces companies in the supply chain to transform, not out of their own will but because they might lose business as companies are required to be transformed and empowered.

3.8 TYPES OF SHAREHOLDERS

Shareholders are divided into different types, depending on their interests.

3.8.1 BENEFICIAL SHAREHOLDERS

Beneficial shareholders are true owners of shares and they may have shares registered in another person or entity's name.² They can be direct or indirect beneficiaries who

1 Theobald 2001: 39.

2 S 140A of the Act, defines beneficial interest with relation to shares as the right or entitlement to receive any dividend or interest payable in respect of the shares or the right to exercise or cause to be exercised in the ordinary course any or all of the voting, conversion, redemption or other rights attaching to such shares. Beneficial does not include any interest held by a person in a unit trust. See also the definition of beneficial interest in the Companies Act 2008, where it is defined as a right or entitlement of a person through ownership, agreement, relationship or otherwise, alone or together with another person:
(a) receive or participate in any distribution in respect with the company's securities;

sometimes hold their shares through nominee companies.¹ In this instance, financial institutions act as agents of the true shareholders. A nominee shareholder does not have authority to do as he pleases with the shares registered in his name and must always consult the beneficial owner for authorisation.²

The JSE Listings Requirements define a beneficial owner in relation to shares as a person or entity with any one or more of the following:³

- (a) *The de facto right or entitlement to receive a dividend or interest payable in respect of a share; or*
- (b) *The de facto right to exercise or cause to be exercised in the ordinary course of events, any or all the voting, conversion, redemption or other rights attached to such a share.*

It is clear that a beneficial shareholder is the only person who derives benefits and proceeds out of share ownership.⁴ The benefits and proceeds can be direct or indirect.

3.8.1.1 DIRECT BENEFICIARIES

A direct beneficiary is a shareholder on his name the shares are held and registered. The benefits and the proceeds of the shares accrue to them directly. They can trade with their shares as they wish, without contacting a nominee or another third party.

3.8.1.2 INDIRECT BENEFICIARIES

Indirect beneficiaries are found in instances whereby shares are registered and held in the name of a third party, for example shares that are held by a trust on behalf of its beneficiaries. The Companies Act 2008 provides for the registration of shares in the

(b) *exercise or cause to be exercised in the ordinary course any one all of the rights attaching to the company's securities or*
(c) *dispose or direct the disposition of the companies securities or any part of a distribution in respect of the securities but does not include any interest held by a person in a unit trust or collective investment scheme in terms of the Collective Investment Schemes Act 45 of 2002.*

1 Cilliers *et al* 2000: 242.
2 Cilliers *et al* 2000: 242.
3 See definitions in the JSE Listings Requirements
4 See also Grantham 1998: 562. In the past shareholders were treated as the beneficial owners of the assets with the company holding the assets in trust for the shareholders, but from the early 19th century the courts began treating shareholders as having no direct, severable interest in the company's assets. By the beginning of the 20th century this idea was well established.

name of other person for the benefit of another person.¹ When shares are traded on the JSE, the sellers or buyers are required to identify themselves if they are direct or indirect beneficiaries of the traded shares.

3.8.2 PUBLIC AND NON-PUBLIC SHAREHOLDERS

A listed company on the JSE is a public company and all its shareholders are public shareholders. However, there are some individuals in terms of paragraph 4.25 of the JSE Listings Requirements that are not regarded as public shareholders even though they may be shareholders in a public company.

According to the JSE Listings Requirements the following suit the criteria of non-public shareholders:

- (a) The directors of the company or any of its subsidiary;*
- (b) Associate of a director of the company or any of its subsidiaries;²*
- (c) Trustees of employee share scheme or pension fund established to benefit the directors or employees of the company and its subsidiaries;*
- (d) Any person who by virtue of an agreement has a right to nominate a person to the board of directors of a company;*
- (e) Any person that is interested in holding ten percent or more of the securities in issue;*
- (f) Employees of a company where restrictions on trading on the company's listed shares is imposed by the company on the employees.*

Public shareholders are shareholders that have no connections with a company or its directors and as such trade their shares in the open market without announcing on Securities Exchange News Service ("SENS"), whereas non-public shareholders are required to make an announcement.³

1 S 56 (1) of the Companies Act 2008.

2 Associate with regard to individual means that individual's immediate family member, trustees of the trust in which the individual or the individual's immediate family members are beneficiaries, any company or close corporation in which the individual holds thirty five percent or more of the voting rights and in relation to the company associate means, any other company that is its subsidiary or holding company, any company whose directors are accustomed to act in accordance with the company's instructions and directions.

3 JSE Listings Requirements: 3.44.

3.8.3 MAJORITY SHAREHOLDERS

A majority shareholder is a shareholder that has a majority stake in a company. The JSE Listings Requirements does not define what a majority shareholder is. It only refers to a material shareholder. A material shareholder is any person who is, or within 12 months preceding the date of transaction was entitled to exercise or control the exercise of 10% or more of the votes able to be cast on all or substantially all matters at a general meeting or annual meetings of a listed company or any other company that is its subsidiary or holding company or is a fellow subsidiary of its holding company.¹

The JSE Listings Requirements refers to a controlling shareholder as any shareholder owns an overall majority of shares in a company.

Shareholder activism only empowers majority shareholders.² Sometimes majority shareholders abuse their status to the detriment of other shareholders. Possible abuse of power may entail major shareholders practicing unfair means by concealing certain information from other shareholders. They bear the burden of paying for all the costs relating to their involvement in corporate governance issues and the small shareholders benefitting from that.³ Shareholder proposals may not be voted if they only serve a section of the majority shareholders, which may lead to a proposed vote not gaining majority support, which is why sometimes shareholder proposals are not adding value to the creation of shareholder wealth.⁴

While directors may resist adoption of shareholder proposals, it is noted that the changed corporate governance climate makes it essential for companies and their directors to treat majority vote resolutions seriously and to enhance their procedures for considering and acting on such resolutions.⁵ In the USA on average half the ownership of large corporations is owned by institutional investors and most of these are in the hands of College Retirement Fund and CalPERS.⁶ In South Africa the PIC is one of the majority shareholders.

1 See definitions on the JSE Listings Requirements.

2 Camara 2005: 223.

3 Maug 1998: 67.

4 Camara 2005: 223.

5 Brownstein 2004: 24.

6 Davis *et al* 1994: 144.

3.8.4 MINORITY SHAREHOLDERS

Minority shareholders are shareholders who own a minor stake in a company. Between 1986 and 1993 in the USA, the USAss provided a channel through which small shareholders could unite and attempt to influence the governance of large USA corporations.¹ The USAss wanted to have an input on governance and policy issues in corporations and the monitoring by minority shareholders was proven to be possible and successful.²

Minority shareholders are in all likelihood not able to vote or oppose a proposal based on the obstacles that may hinder effective shareholder activism and majority or institutional shareholders are likely to overcome these obstacles.³ Minority shareholders may feel that it is pointless venting frustrations on any decisions taken by directors and hope that institutional investors will take up the cudgel on their behalf.⁴ They should be protected against abusive actions by or in the interests of majority shareholders.⁵

3.8.5 CONTROLLING SHAREHOLDERS

Control is a *de facto* holding or aggregate holding of shares or other securities in a company entitling the holder to exercise or cause to be exercised more than twenty percent or more of the voting rights at a general meeting of a company.⁶

The JSE Listings Requirements refers to a controlling shareholder and any shareholder that together with its associates and any other party with whom the shareholder has an agreement relating to any voting rights attached to any shares in a company, can exercise or cause to be exercised the specified percentage or more of the voting rights

1 Strickland *et al* 1996: 319. The United Shareholders Association was a non-profit advocacy organization formed in August 1986 by T. Boone Pickens and was disbanded by its board in October 1993.

2 Strickland *et al* 1996: 320.

3 Camara 2005: 225. Camara lists seven principal obstacles to effective shareholder activism:

(a) *shareholders inadequate incentives to investigate the quality of corporate actions;*

(b) *externalities of voting;*

(c) *bounded rationality;*

(d) *campaign costs;*

(e) *costs of redundant decision making;*

(f) *costs of inconsistency and*

(g) *the need for fiduciary duties between shareholders.*

4 Mahabane 2001: 45.

5 King III: 103.

6 JSE Listings Requirements.

at a general or annual general meeting or can appoint or remove directors exercising the specified percentage or more of the voting rights at directors meeting of a company.¹

At common law majority or controlling shareholders are free and have a right to dispose of shares as they please without regard to the interest of minority shareholders and to sell their shares at a premium as long as they do not act to defraud the minority.²

3.8.6 PREFERENCE SHAREHOLDERS

Preference shareholders are shareholders that have preferential rights to a class of shares. They hold preference shares and they usually enjoy preferential rights to dividends.³ Preference shares were designed for investors who desired a fixed income coupled with a reasonable degree of security but they are only allowed to claim preference dividend if sufficient profits are made to warrant distribution and the dividend is allowed by the articles of the company.⁴

3.9 CONCLUSION

Shareholder activism should not be about hate mail and threats. It should be about direct engagement of company management on issues of corporate governance and sustainability. The lack of robust shareholder activism in South Africa seriously undermines good levels of managerial compliance and corporate governance. Shareholder apathy should be a thing of the past and shareholders must unite in fighting for their rights and protection of their investments. Shareholders should be able to keep directors to account by asking relevant questions and offering suggestions in the interests of sustainability and good corporate citizenship.

Shareholder activism by both individual and institutional shareholders is certainly developing in South Africa. We have seen both public funds and private equity funds questioning boards of directors on issues of corporate governance. The PIC together with other private funds such as Allan Gray, Coronation, Sanlam *etc* should continue making sure that they keep directors of companies accountable. Conflicts of interests

1 Specified percentage in terms of S 440A of the Act means that a shareholder must hold shares of not less than twenty percent to be regarded as a controlling shareholder.

2 Pretorius *et al* 1999: 404.

3 Cilliers *et al* 2000: 227.

4 Cilliers *et al* 2000: 227.

should be managed in such manner that they do not out-weight their duties of ensuring good governance and business ethics.

Actions of the organisations such as TAC and the communities of Xholobeni and Macambini should be applauded. Their actions show that passivity by communities might be a thing of the past and companies cannot do as they wish. Businesses and business associations must come into party and increase their activism in the interests of a sustainable and prosperous economic future. SASA, just like the USAss needs to be visible and be seen to be a serious association addressing issues that affect shareholders across the board.

Shareholders, whether majority, minority or preference shareholders, from private and public funds to co-ordinated groups, business associations and communities should stand up against companies that fail to enhance the spirit of good corporate governance. Good corporate governance by companies is good for South Africa as it has the potential to attract more investment. More importantly, however, good corporate governance should benefit sustainability and help protect the environment for future generations.

CHAPTER 4

RIGHTS, POWERS AND DUTIES OF SHAREHOLDERS AND DIRECTORS

4.1 INTRODUCTION

Shareholders in every company have rights, duties and powers provided and guided by the Companies Act 61 of 1973 ("the Act") and the articles and memorandum of association ("the articles") of the company in question. The Act and the articles serve as a constitution of a company and they manage the relationship between the shareholders and the directors. The provisions of the articles must not conflict with the provisions of the Act. In case of a conflict, the provisions of the Act prevail.

The new companies act, the Companies Act 71 2008 ("the Companies Act 2008") will come into effect in 2010. Its purpose is to balance the rights and obligations of shareholders and directors¹ and to encourage efficient and responsible management of companies.² The various King reports on corporate governance in South Africa also provide for guidance on the rights, duties and the powers of shareholders in a company.

There are different views and opinions on what shareholders rights and powers are. There are also different views on whether shareholders should be involved in the management and decision making of companies or they should delegate their powers to directors to manage companies on their behalf. There are also opposing theories on whether shareholders or directors are supreme in a company.

4.2 PRIMACY THEORIES

There are different views on who is supreme in a company. Bainbridge³ believes that any model of corporate governance must answer two basic sets of questions:

(a) Who decides? In other words which corporate constituency possesses ultimate decision-making power? and

1 S 7 (h) of the Companies Act 2008.

2 S 7 (i) of the Companies Act 2008.

3 2003: 605.

- (b) *When the ultimate decision maker, whoever it may be, is presented with a zero sum game in which it must prefer the interests of one corporate constituency over those of all others, whose interests prevail?*

These questions may be explained through different primacy theories. These are different primacy theories with regard to corporate governance:¹

- (a) *Shareholder primacy model - this theory assumes that shareholders both control a corporation and are the appropriate beneficiaries of director fiduciary duty;*
- (b) *Managerialist model - assumes that top management controls the corporation, but differ as to the interests managers should pursue;*
- (c) *Stakeholderist model - rarely focus on control issues, but instead emphasize that shareholders should not be the sole beneficiaries of director and officer fiduciary duties;*
- (d) *Director primacy model - as to the “means axis” theory neither the shareholders nor the managers control corporations and as to the “end axis” director primacy claims that shareholders are the appropriate beneficiaries of director fiduciary duties.*

In the shareholder power debate over how best to apportion decision making between officers and directors on the one hand and shareholders on the other hand, shareholder primacists are gaining momentum.² According to Licht³ every theory of corporate governance is at heart a theory of power. Grossman⁴ is of the opinion that shareholder primacy theory is outdated as it fails to acknowledge the business case for adopting socially responsible practices. Any primacy theory depends on who amongst a company's shareholders wields more power. It can be dangerous if only one group of

1 Bainbridge 2003: 550. According to Smith 1998: 277, managers manage corporations on behalf and in the interests of shareholders. He says that this shareholder-centric focus of corporate law is often referred to as shareholder primacy. Although shareholder primacy manifests itself in the structure of corporate law, it is within the law relating to fiduciary duties that shareholder primacy finds its direct expression. Bainbridge 2006: 1725 believes that much of the business law acts to limit shareholder in corporate governance, taken together. He refers to this as director primacy.

2 Anabtawi 2006: 562.

3 Licht 2004: 653.

4 2005: 573. Given that social factors now play an important role in the quest for profit maximization, the hypotheses that social engagement should be considered *ultra vires* from business activities is contradictory.

shareholders can be supreme to others and take a lead in everything. All shareholders must be actively involved so as to ensure effective governance.

4.3 DEFINITION OF A SHAREHOLDER¹

The Act does not give a specific definition of a shareholder, instead throughout its content it refers to “members”. Therefore, the terms shareholder and member are synonymous and are also used interchangeably. Member is also used in the Close Corporations Act of 1984 to define an owner of an interest in a close corporation. According to the Act, a member is a subscriber to the memorandum of a company,² and every person who agrees to be a member of a company and whose name is entered in to the register of members.³ However, a holder of a share warrant is a shareholder but not necessarily a member.⁴ Members of a company are subscribers to the memorandum of the company and have their names entered into the register of members.⁵

A member of a company has an interest in the company entitling him *inter alia* subject to a company’s constitution, to share in the profits of a company; to attend and vote at the meetings of a company and to share in the surplus assets if there are any when a company is wound up.⁶

The Companies Act 2008 defines a shareholder as a person who is entitled to exercise any voting rights in relation to a company, irrespective of the form, title or nature of the securities to which those voting rights are attached.⁷ It further states that it is also a holder of a share issued by a company who is entered as such in the certificated or uncertificated securities register.⁸

1 See also paragraph 1.4 above.

2 S 103 (1) of the Act.

3 S 103 (2) of the Act.

4 Pretorius *et al* 1999: 175.

5 S 103 (1) of the Act.

6 Pretorius *et al* 1999: 175.

7 Section 57 (1) of the Companies Act 2008.

8 See definitions in the Companies Act 2008. A share means one of the units into which a proprietary interest in a profit of a company is divided. In terms S 29 of the Securities Services Act 2004, certificated securities mean securities evidenced by a certificate or written instrument, whilst uncertificated is not evidenced by a certificate or a written instrument.

A shareholder is a person who has a beneficial or non-beneficial interest in a company. The primary motive of a shareholder is profit making or to receive a return on investment, hence the beneficial interest. The structure of corporate law ensures that corporations operate in the interests of shareholders.¹ The JSE Listings Requirements does not provide the definition of a shareholder and refers to a beneficial owner.² It is clear that shareholder, member and beneficial owner are interpreted to mean the same thing.

A shareholder can be a natural person or a juristic person. Natural and juristic persons become shareholders by investing in buying shares in companies and expect good returns or dividends at the end of the month, a quarter, or a year depending on whether that particular shareholder is a passive or an active investor.³ A shareholder should be a person who makes sure that a company is properly managed and does business morally and ethically. It is a person who is not shy or afraid to raise pertinent issues regarding the affairs of a company or to make proposals.

4.4 POSITION OF A SHAREHOLDER IN A COMPANY

Shareholders are owners of companies and have given directors a role to maximize wealth of the shareholders and to facilitate shareholders financial interests.⁴ The various ways by which shareholders can be characterised within a corporate structure have two important implications concerning the role of shareholders in a corporation.⁵

1 Smith 1998: 277.

2 The JSE Listings requirements define a beneficial owner as a person or entity that has a *de facto* right or entitlement to receive any dividend or interest payable in respect of a security or having a *de facto* right to exercise or cause to be exercised in the ordinary course of events, any or all of the voting, conversion, redemption or other rights attached to that security.

3 These are my own terms to illustrate types of investors. Passive investors are investors who buy shares and expect no returns within a year and active investors are investors who expect returns every month, quarter or year and are making a living out of trading in shares. See also Anabtawi 2006: 579. He makes a difference between short-term shareholders and long-term shareholders. According to him, a short-term shareholder is one who seeks to buy and sell shares with high frequency in an endeavour to profit from market movements, on the other hand a long-term shareholder is seen as buying and holding stocks, usually without regard to short-term developments.

4 Dhir 2006: 369. See also Licht 2004: 653. According to him the corporate governance problem is not one of maximizing over a single factor, rather it calls for optimizing over several factors simultaneously.

5 Hill 2000: 42. Firstly, the appropriate level of shareholder participation in corporate governance and secondly, the status of shareholder interests, specifically whether they should be treated as paramount within the corporate structure.

The shareholders exclusive right to benefit from company activities is thus in law as a consequence of their ownership of the business.¹

According to Bainbridge² shareholders initially provide equity capital and subsequently bear the risk of losses and monitor the performance of a company. As such, shareholders are beneficiaries of corporate fiduciary duties because the shareholders' investment in the firm is a transaction specific asset.³

As the Act stands, it is not clear what the directors' and shareholders duties are. Schedule 2 to the Act only provides a comprehensive list of the powers of a company.⁴ The shareholders supposed duty is to police management and to make sure that management implement company policies. That is why each shareholder is entitled to a copy of the annual report and every circular and to ask questions on matters that warrant clarity.

Limitation of shareholder powers is created by statutory assignment of decision making authority to the board,⁵ resulting in shareholders being spectators. Shareholders essentially have no power to initiate corporate actions. Moreover they are entitled to approve or disapprove only a very few board decisions and shareholder rights are so weak they scarcely qualify as part of corporate governance. Bebchuk⁶ is of the view that shareholders should be allowed to initiate and vote to adopt changes in the company's basic corporate governance arrangements. Shareholders as the owners of a company

1 Grantham 1998: 567.

2 1993: 1427. On the other hand management monitors the performance of employees and coordinate the activities of all the firm's inputs.

3 Bainbridge 2003: 586. See also Grantham 1998: 578. The shareholders' status as the ultimate proprietors of the company, entitles them by virtue of their ownership to have the company operated for their benefit and to have their will prevail.

4 For a comprehensive list of the common powers of companies, see Schedule 2 of the Act See also Hill: 44. The traditional corporate theory assumed that the role of directors was to carry out the will and implement the interests of shareholders and that within standard principles of agency law shareholders had a formal right to control their agents.

5 Bainbridge 2006: 616. See also Grantham 1998: 566, shareholders lack of control over management thus does not arise because they have delegated that right to the directors.

6 2005: 836. Bebchuk 2005: 836 states that shareholder power to adopt governance arrangements should include the power to adopt provisions that would allow shareholders to initiate and vote on proposals regarding specific corporate decisions. He further argues that increasing shareholder power to intervene would improve corporate governance and enhance shareholder value by addressing important agency problems that have long afflicted publicly traded companies.

must be at the forefront of making sure that companies adhere to corporate governance principles.

4.5 THE RIGHTS OF SHAREHOLDERS

A company acts through two bodies namely, the general meeting and the board of directors.¹ Shareholders retain a privileged position among corporation's constituencies, enjoying a contract with the firm granting shareholders ownership-like rights, such as the vote and the protection of fiduciary obligations by directors and officers.²

Every shareholder has a right to be notified well in advance of all shareholders meetings and the agenda of such meetings. The Companies Act 2008 states that a company must deliver a notice of each shareholders' meeting fifteen days before the meeting and ten days before any other meeting.³ The memorandum of a company may provide for longer minimum notice periods.⁴

Members can by special resolution agree to a notice period of less than twenty-one days and that consent should on a prescribed form be submitted to the registrar of companies.⁵ Members can by consent propose a special resolution at a general meeting where a proper notice for that meeting was given and such consent should be submitted to the registrar of companies.⁶

If the required quorum in terms of S199 (1) of the Act, is not achieved, the meeting should be postponed to a date not earlier than 7 days or not later than 21 days after the original meeting and if no quorum is reached at such a postponed meeting, then the members present can vote.⁷ Members present will form a quorum and any decision may be regarded as a special resolution.⁸

1 Pretorius 1999: 336.

2 Bainbridge 2003: 548.

3 S 62 (1) of the Companies Act 2008.

4 S 62 (2) of the Companies Act 2008.

5 S 199 (3) of the Act.

6 S 199 (3A) of the Act.

7 S 199 (2) (a) and (b) of the Act. See also S 64 (4) of the Companies Act 2008.

8 S 199 (2) (a) and (b) of the Act. See also S 64 (4) of the Companies Act 2008.

Shareholders holding an aggregate of one-fourth or more of the total votes and are entitled to vote, must be present at a meeting in person or by proxy.¹ If they cannot attend, shareholders have a right to be represented by a person of their choice to be their proxy and to attend, speak and vote.² A proxy appointment must be made in writing and it is valid for one year or any period stated in the appointment.³

A proxy form must be signed by the shareholder with all the information about the appointee and the resolutions in favour of or against and at least three nominees must be appointed in case the others fail to attend a meeting.⁴ If every shareholder in a company is also a director, any matter that would be referred to the shareholders may be decided by the shareholders without notice or internal compliance formalities.⁵

The Companies Act 2008 states that shareholders rights include:⁶

- (a) to receive notice of shareholders meeting;*
- (b) to participate and vote in the shareholders meeting;*
- (c) to decide any matter by written consent or electronic communication;*
- (d) to exercise pre-emptive rights;*
- (e) receive distribution; or*
- (f) to be allotted or exercise other rights.*

In the USA during the hearings of the Senate Judiciary Committee's Subcommittee on Citizens and Shareholder Rights and Remedies, the subcommittee considered the shareholders role in the corporate world.⁷ The subcommittee proposed to the Securities and Equities Exchange ("SEC") to guarantee shareholder rights reviewing management objections to shareholder proposals or the right to communicate freely with other shareholders, so as to promote shareholder democracy.

1 S 199 (1) (a) and (b) of the Act. The difference between these two subsections is that the other requires a total number of votes and another requires a total number of members. S 64 (1) of the Companies Act 2008 requires that at least an aggregate of twenty-five percent of people with voting rights should be present.

2 S 58 (1) (a) of the Companies Act 2008.

3 S 58 (2) (a) and (b) of the Companies Act 2008.

4 Article 52 of Schedule 1 to the Act.

5 S 57 (4) (a) of the Companies Act 2008.

6 S 59 (1) of the Companies Act 2008.

7 Regis 2001: 76.

During the hearings one witness, Timothy Smith, described the system then as favouring management, in that shareholders' duties were limited to monitoring fiduciary duties of directors and appointment of outside directors. He proposed that the reforms should include increased shareholder input on social and financial matters and such reforms permit shareholders to have a say in proposing alternative candidates for board appointments and easing restrictions on submission of shareholder resolutions.¹

The Delaware General Corporation Law granted shareholders the right to:²

- (a) *Nominate and elect directors;*
- (b) *Adopt, amend and repeal bylaws;*
- (c) *Approve fundamental corporate changes such as mergers, sales of all or substantially all of the firms' assets, dissolutions, and amendments to the firms certificate of incorporation and*
- (d) *Request board action through shareholders resolutions included in a company's proxy statement.*

There is an opinion that shareholders should also receive transactional rights.³ At a Sasol annual general meeting a portion of new shareholders turned up and wanted to know whether they'd have to pay for the R4 billion fine Sasol faced and also wanted chief executive Pat Davies to resign.⁴

The fine that Sasol paid was after it was found guilty of price-fixing and that happened before the Sasol Inzalo scheme came into being. The Inzalo shareholders felt that it would be unfair to them if their money were to be used to pay the fines as it may have a negative impact on their dividends.

1 Regis 2001: 76. See Bebchuk 2003: 44. In theory if directors fail to serve the shareholders or if they appear to lack qualities to do so, shareholders have a power to replace them. Accordingly this shareholder power provide incumbent directors with incentives to serve shareholders well, making directors accountable. See Bebchuk 2003: 45. Although shareholder power to replace directors is supposed to be an element of corporate governance, it is largely a myth. Attempts to replace directors are extremely rare even in firms that systematically underperform over a large period of time.

2 Anabtawi 2006: 569.

3 Black *et al* 1996: 1917. These include pre-emptive rights when a company issues new shares, appraisal rights for shareholders who do not approve major transactions and takeout rights when a controlling stake in a company is being acquired. See Smith 1998: 278 who is of the opinion that shareholders exercise control over the control of the corporation by amongst others approving fundamental transactions.

4 Ashton 2008: 1.

4.5.1 VOTING RIGHTS

Shareholders have a right to vote for directors but, sometimes it becomes difficult to vote as they may not have full details about directors that are up for election, which may lead to shareholders complaining. One shareholder at a Sasol annual general meeting was quoted as having said: "You ask us to vote for or against directors, but you fail to even provide us with a picture or introduce the directors we are voting for."¹ It is important that directors that are up for election are introduced to shareholders, so that shareholders can at least put the face to the curriculum vitae.

4.5.1.1 METHODS OF VOTING

Normally at a general meeting shareholders choose which method of voting will be appropriate. The common methods of voting are voting by show of hands or by a poll. An important dimension of shareholder voting is agenda control as most of the time manager's control what shareholders vote on, how proposals are packaged, when shareholders vote and when shareholders find out what they are voting on.²

4.5.1.1.1 VOTE BY SHOW OF HANDS

Any person who is present and entitled to vote by show of hand as a member or proxy shall have only one vote irrespective of the number of shares he holds.³ A vote by show of hands is a common method of voting in South Africa.

4.5.1.1.2 VOTE BY MEANS OF A POLL

Voting by a poll at any meeting, a member or his proxy shall be entitled to exercise all his voting rights, but shall not be obliged to use or cast all his votes in the same way.⁴ This method is commonly used when shareholders want to vote in secretly.

1 Ashton 2008: 1.

2 Black 1990: 524. See also Black 1996: 1933. Good voting decisions require good information.

3 S 197 (1) of the Act. See also Black 1996: 1933. One share one vote rule prevents insiders from acquiring voting power disproportionate to their economic interest in a company. See Black 1996: 1946. The one share one vote principle is widely accepted across jurisdictions. It is dominant in the USA, the UK and Japan.

4 S 197(2) of the Act; S 198 makes provision for members to demand a poll by not less than five members entitled to vote at such meeting or by a member or members representing not less than one-tenth of the voting rights or members representing not less than one-tenth of the issued share capital of a company.

4.5.2 ELECTION AND APPOINTMENT OF DIRECTORS

It is the duty of shareholders to elect and remove directors, but in practice the board is responsible for selecting its board members.¹ Appointment of directors should be formal and transparent and should be a matter of the board assisted by the nominations committee, subject to shareholder approval.² The Act does not clearly state whose prerogative it is to nominate a director for appointment. It simply states that every subscriber to the memorandum shall be deemed to be a director.³ It does not state in the first instance the procedure to be followed when a director is appointed. However different companies have their own nomination methods, all of which allow shareholders to nominate.

Directors are appointed either by being named in the articles of the company or by subscribers to the memorandum and subsequently at a general meeting by the shareholders or by the board if the articles of the company prescribe as such.⁴ Directors who are appointed to a board of a company listed on the JSE must complete the Schedule 21 declaration and submit it to the JSE.⁵

Legal rules could, but do not make it easier for shareholders to set their own agenda.⁶ Shareholders otherwise participate only in fundamental corporate actions such as mergers.⁷ Shareholders do not take time to consider particular proposals and instead adopt a crude rule of thumb like vote with management.⁸

But things seem to be changing as shareholders want to have a voice in the appointment of directors as has been the case at Sasol Ltd and Barloworld Ltd. The PIC put pressure on both Barloworld and Sasol to appoint black directors. It is a rare occurrence whereby directors' appointment is rejected by the shareholders at an annual general meeting. Shareholders usually approve or rubberstamp what the directors have proposed to them. Employees who hold shares under employees ownership schemes

1 King II: 65.

2 King III: 40.

3 S 208 (2) of the Act.

4 Van der Merwe *et al* 1995: 15-4.

5 Listings Requirements 2.9 (a).

6 Black 1990: 524.

7 Thompson 1993: 701. A majority shareholder has the power to elect all or most of the board and the board normally act by majority rule.

8 Black 1990: 527.

may appoint directors to the board, presumably to look after employee interests.¹ However shareholders can nominate directors, deciding factor is the number of votes they pull through at an annual general meeting.

The following factors with regard to the appointment of directors should be taken into consideration:²

- (a) evolving circumstances, the needs of the company and the nature of its business;*
- (b) the need to achieve an approximate mix of executive and independent non-executive directors;*
- (c) the need to have sufficient directors to structure board committees appropriately;*
- (d) potential difficulties of raising a quorum with a small board;*
- (e) regulatory requirements; and*
- (f) the skills and knowledge needed to make business judgment calls on behalf of the company.*

4.5.3 MONITORING

Monitoring and supervision across the entire spectrum of economic and commercial enterprise is impossible by any measure.³ Effective monitoring requires that information be accessible, intelligible, up-to-date and relevant.⁴ Shareholders should have unrestricted access to company records to be able to exercise monitoring and supervision. Where the board has delegated some of its powers to management, the powers so delegated should be monitored and evaluated on a regular basis.⁵

In recent years major shareholders have assumed a more proactive role in their capacities as owners and to offer unsolicited advice to management.⁶ The divergence of

1 Murphy 2003: 111.

2 King III: 39.

3 King II: 19.

4 Al-Hawamdeh 2005: 493. See also King III: 103.

5 King II: 21.

6 Akhigbe *et al* 1997: 567.

of interest between managers and shareholders results in monitoring costs.¹ Generally, it is the majority shareholders that have to carry the costs of monitoring.²

4.6 THE DUTIES OF SHAREHOLDERS

Originally, shareholders' duties were to elect directors and approve major corporate decisions proposed by the board.³ Shareholders are not trustees for one another and unlike directors do not occupy any fiduciary position.⁴ Disciplining management by shareholders, remains necessary to ensure that managers manage the corporation effectively and in their interests.⁵

Camara⁶ suggests that shareholders' duties should be limited to approving or disapproving directors' proposals. He contends that it is not necessary to have shareholders involved, as directors are appointed to manage the business. If Camara's suggestion is taken into consideration, it will mean that shareholders duty will only be to rubberstamp the decisions of the directors, whether they are flawed or not. This view may perpetuate the director primacy theory and shareholder apathy.

It is the duty of shareholders to hold directors accountable for their failure to monitor compliance with the laws that prohibit discrimination.⁷ In theory, shareholders of public companies elect directors, who watch corporate officers, who manage/watch the

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- 1 Ramsay 1992: 151. Monitoring costs are incurred by shareholders in making sure that managers act in the interests of shareholders. See Ramsay 1992: 152. The American Law Institute has argued that the shareholder derivative action reduces agency costs:
(a) it operates to deter mismanagement and therefore aligns the interests of managers and shareholders and
(b) it can reduce one part of agency fees, namely monitoring costs incurred by shareholders.
 - 2 Gillan *et al* 2000: 279. See Admati *et al* 1994: 1099. Monitoring by large shareholders typically involve identifying companies whose actions are in conflict with shareholders' interests. See also Hill: 44. The traditional corporate theory assumed that the role of directors was to carry out the will and implement the interests of shareholders and that within standard principles of agency law shareholders had a formal right to control their agents.
 - 3 Camara 2005: 219. He contends that this is fundamental to corporate law.
 - 4 Pretorius *et al* 1999: 226.
 - 5 Rock 1991: 454. Rock uses the term "discipline" rather than the more common term "monitoring" because effective oversight requires more than monitoring management's performance.
 - 6 2005: 225
 - 7 Wade 2003: 214.

company on behalf of shareholders.¹ Nowadays shareholders' duties should be to exercise an oversight role and to make sure that directors are accountable and that companies are transparent enough.

4.7 THE POWERS OF SHAREHOLDERS

The powers of shareholders are usually outlined in the articles. Articles contain regulations for the internal affairs of a company,² and are also its constitution. They bind a company and its members to the same extent as if they had been signed by each member.³ They serve as a contract between the company and its members as well as between the members *inter se*.⁴ Articles and memorandum are not allowed to be in contravention of the Act or other statutory regulations and common law.⁵

Shareholders essentially have no power to initiate corporate actions and moreover are entitled to disapprove limited set of board actions.⁶ Shareholders exercise their power through voting. They can vote for an ordinary or a special resolution. For a special resolution to pass, it has to meet at least a 75% shareholder approval, in terms of the Act. The company must give twenty-one days clear notice to shareholders of the proposed resolution.⁷

Matters on which shareholders vote under state law typically include electing directors, amending corporate charter, reincorporating in another state, merger with another company, sale of substantially all the assets and liquidation.⁸ Hereunder are some of the the statutory powers of shareholders.

4.7.1 CONVERSION FROM ONE TYPE TO ANOTHER

It is only through a sanction of a special resolution passed by shareholders that a company can be converted from being a public company to a private company and *vice*

1 Black 1990: 521.
2 Pretorius *et al* 1999: 68.
3 Pretorius *et al* 1999: 68.
4 Pretorius *et al* 1999: 68.
5 Pretorius *et al* 1999: 68.
6 Bainbridge 2003: 559.
7 S 199 (1) of the Act.
8 Black 1990: 534.

versa.¹ A special resolution is also required for a conversion of a company into an incorporated association not for gain or into a company limited by guarantee,² and converting a company limited by guarantee into a company having a share capital.³ The same principle applies when a company delists from the JSE.

It is within the powers of shareholders to approve or disapprove such a move. Section 26 of the Act requires that a company intending to convert from any form to another, to give notice of the intended conversion in the government Gazette three weeks before the meeting. The notice should specify the details of a proposed conversion and if the conversion is by a public company, creditors should be given three weeks' notice before the meeting. Creditors are important stakeholders in a company, hence they should be notified.

4.7.2 CHANGE OF COMPANY NAME

Any company intending to change its name shall by special resolution change its name if it is a proper and desirable name agreed to by the registrar of companies.⁴ An example of a name change is that of Johnnic Communications Ltd, changing its name to Avusa Ltd. Shareholders were given a chance to resolve to approve or disapprove the name change.

4.7.3 ALTERATION OF MEMORANDUM TO OBJECTS AND POWERS

Subject to the provisions of the Act, a company can in terms of section 55 alter, amend or make additions to the provisions of its memorandum, with regard to the powers and objects of the company. The Act allows a company to amend the memorandum and articles by special resolution to bring it to conformity with the Act. This can only be possible if shareholders have consented thereto.

A special resolution is not a requirement to alter a memorandum in terms of the Companies Act 2008 as long as the alteration is done by the board or an individual

1 S 22 of the Act.
2 S 23 of the Act.
3 S 24 of the Act.
4 S 44(1) of the Act.

authorized by the board¹ and the procedure of effecting such an alteration is followed.² The procedure is a 75% shareholder approval and then registered with the company's registrar. A company's memorandum may also be amended if authorized by a court or by a special resolution proposed by the board or shareholders entitled to exercise 10% of the voting rights.³

A consolidated revision of a memorandum must be accompanied by a sworn statement by a director or a statement by an attorney or notary stating that the consolidated revision is a true, accurate and complete representation.⁴ A director or a shareholder can approach the Companies Ombudsman if they feel that the alteration exceeded the authority to correct a patent error or defect.⁵ The alterations suggested by section 17 of the Companies Act 2008 are only "cosmetic" alterations and it is quiet as to the "material" alterations.

4.7.4 ALTERATION OF ARTICLES

Articles specify how a company's internal functioning is to take place and how its internal management is to be structured and they impose certain duties on directors.⁶ A company may by special resolution alter or make addition to its articles. The alteration or addition made should be as valid as if originally contained therein.⁷ The altered memorandum should be lodged with the registrar of companies within fourteen days after the resolution was taken.⁸ The altered articles must not contain anything illegal, must not go outside the powers given by the memorandum of association and must not constitute fraud on the minority.⁹

Even if a company has unlimited power to alter its articles, this power must be exercised *bona fide* for the benefit of the company.¹⁰ The courts have no general power to alter

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- 1 S 17(1) of the Companies Act 2008. The alteration may be a patent error in spelling, punctuation, reference, grammar or similar defect on the face of the document.
 - 2 S 17 (1) (a) and (b) of the Companies Act 2008. It is required that the alteration be published and filed with the registrar.
 - 3 S 16(1) (a) and (c) of the Companies Act 2008.
 - 4 S 17 (6) of the Companies Act 2008.
 - 5 S 17 (2) of the Companies Act 2008.
 - 6 Mammatt *et al* 2004: 26.
 - 7 S 62 (1) of the Act.
 - 8 S 58 of the Act.
 - 9 Pretorius *et al* 1999: 72.
 - 10 Pretorius *et al* 1999: 72.

articles unless under an order issued under section 252 of the Act. Other amendments to the articles can be in conformity to current laws, such as the Constitution Act 108 of 1996 and the Promotion of Equality and Prevention of Unfair Discrimination Act 2000, which are against the discrimination of women. Below is an example of an extract of a proposed special resolution at an annual general meeting:

“as a special resolution to resolve to remove a sentence in clause 1(a), in the articles of association of the company, in terms of section 56 of the Companies Act 61 of 1973, as amended, that refers to “legal incapacity” as meaning a marriage of a female member subject to the marital power (whether in or out of community of property).”

This is an example of an extract out of the memorandum of association that was drafted when the laws were still discriminatory against women. Women were regarded as incapacitated when they got married.

4.7.5 ALTERATION OF THE SHARE CAPITAL

Any company subject to the provisions of the Act may change its share capital and shares if the move is sanctioned through a special resolution.¹ A company which is not authorized by its articles to alter its capital must first alter its articles by special resolution so as to give itself this power and both the special resolutions can be passed at the same meeting.²

The authorization and classification of shares, the number of authorized shares of each class and the preferences rights, limitations and terms associated with each share may only be changed by special resolution of shareholders,³ or by the board if authorized by the memorandum.⁴

1 S 75 of the Act.

2 Pretorius *et al* 1999: 147.

3 S 36 (2) (a) of the Companies Act 2008.

4 S 36 (2) (b) of the Companies Act 2008 states that the board may if authorized by the memorandum:

(a) increase or decrease the number of authorised shares of any class of shares;

(b) reclassify any classified shares that have been authorised but not issued;

(c) classify any unclassified shares that have been authorised but are not issued;

(d) determine preferences, rights, limitations or other terms of shares in class.

In terms of S 47 of the Companies Act 2008, the board may by resolution issue recapitalisation shares to the shareholders of one or more class of shares.

An increase of share capital concerns only the authorised share capital and involves the creation of new shares either of a class which already exist or of a new class different from the existing shares.¹ A company is required to also lodge an application with the JSE, to inform the JSE that the alteration has been approved by the registrar of companies.

4.7.6 AUTHORISING PAYMENT OF INTEREST

Where a company issues shares for the purposes of raising money for capital expenditure purposes, which cannot be made profitable for a lengthy period, the company may pay interest on the share capital for that period. No such payment shall be made, unless it is authorized by a special resolution and approved by the Minister of Trade and Industry.²

4.7.7 AUTHORISING ISSUE OF SHARES AT A DISCOUNT

A company shall by special resolution issue shares at a discount of the class of shares already in existence.³ In terms of section 221 of the Act, directors of a company are not allowed to issue shares of a company without prior approval of a company in a general meeting.

The approval may be in the form of specific authority or general authority and if it is a general authority, it shall be valid until the next annual general meeting of a company but may be revoked by any general meeting prior to the next annual general meeting.

4.7.8 AUTHORISING ISSUE OF SHARES BELOW BOOK VALUE

No company shall be allowed to issue shares having no par value of a class of shares already issued if it is not sanctioned by a special resolution.⁴

4.7.9 CONVERSION OF SHARES

A company can only convert its shares if it is empowered to do so through its articles and through a special resolution.¹ The Companies Act 2008 requires that a special

1 Cilliers *et al* 2000: 338.

2 S 79 of the Act.

3 S 81 of the Act. Other requirements for the issue of shares at a discount is that the discount should be done within one year of the company having commenced business and that the discount should be sanctioned by the court.

4 S 82 of the Act.

resolution should be passed for issue of shares, a grant of options and any rights exercisable for securities.² The authorization and classification of shares, the number of authorized shares of each class and the preferences rights, limitations and terms associated with each share may only be changed by special resolution of the shareholders,³ or by the board if authorized by the memorandum.⁴

An increase of share capital concerns only the authorised share capital and involves the creation of new shares either of a class which already exist or of a new class different from the existing shares.⁵

4.7.10 CONVERSION OF SHARES INTO STOCK

A company having a share capital, if so authorized by its articles may by special resolution convert all or any of its shares into stock and reconvert such stock into any number of paid up shares.⁶

4.7.11 APPROVAL OF A SHARE INCENTIVE SCHEME FOR DIRECTORS

Shareholders have a right and responsibility to vote on directors' remuneration, including incentive schemes once a year. No right or option shall be given to a director directly or indirectly in terms of any scheme or plan, for any shares in that company or to take up debentures convertible to shares of a company unless authorized as such by a special resolution.⁷

4.7.12 MAKING OF A LOAN TO A DIRECTOR

The making of a loan by a company to its director shall require authorization by shareholders through a special resolution.⁸ A board may authorize a company to provide

1 S 98 (2) of the Act.

2 S 41(1) of the Companies Act 2008.

3 S 36 (2) (a) of the Companies Act 2008.

4 S 36 (2) (b) of the Companies Act 2008 states that the board may if authorized by the memorandum :

(a) *increase or decrease the number of authored shares of any class of shares;*

(b) *reclassify any classified shares that have been authorised but not issued;*

(c) *classify any unclassified shares that have been authorised but are not issued;*

(d) *determine preferences, rights, limitations or other terms of shares in class.*

5 Cilliers *et al* 2000: 338.

6 S 100 of the Act.

7 S 223 of the Act.

8 S 226 (2) (a) of the Act.

direct or indirect financial assistance to a director of a company or inter-related company,¹ provided that shareholders have by special resolution authorized such a payment and/or is part of an employee share scheme.² The board must be satisfied that after making such a loan, the company will be solvent and liquid and that the terms of the loan are reasonable and fair.³

4.7.13 APPROVAL OF PAYMENTS TO DIRECTORS FOR LOSS OF OFFICE

Shareholders have a right to have a say on the payment of the directors' remuneration and have a right to bring and have *locus standi* to bring an application to court where they can allege that a company paid remuneration to its directors without due consideration of the articles of a company or the terms of a contract.⁴

In terms of the Act, a company is not allowed to make any payment or grant to any of its directors or past directors of its subsidiary or holding company by way of compensation for loss of office or in connection with retirement from office or with regard to any scheme of arrangement, unless authorized by a special resolution.⁵

Shareholders in a general meeting may fix a global amount as the directors' fees and leave it to the directors to decide how to distribute it amongst themselves.⁶ Directors' fees may be paid as a percentage on the profits of the company.⁷ A director is only entitled to compensation for *bona fide* expenses incurred on behalf of a company and not for traveling expenses to board meetings, unless that is provided for in the articles.⁸

The determination of the remuneration for executive directors is entirely left in the hands of a board to decide.⁹ Managing directors customarily receive "golden handshakes" or

1 S 45 (3) (a) of the Companies Act 2008.

2 S 45 (3) (b) of the Companies Act 2008.

3 S 45 of the Companies Act 2008.

4 *Brown v Nanco* 832. The court in this case held that there were reasons for a cause of action for the recovery of management commission paid to the directors.

5 S 227 of the Act.

6 Pretorius *et al* 1999: 276.

7 Pretorius *et al* 1999: 277.

8 Pretorius *et al* 1999: 277.

9 Pretorius *et al* 1999: 277.

“golden parachutes” on retirement or if they lose office on the takeover of their company by another company.¹

4.7.14 INVESTIGATION OF COMPANY AFFAIRS

A company may by special resolution resolve that the company ought to be investigated or a court may by order declare that the affairs of the company be investigated.² That is why shareholders have a responsibility to make sure that a company is well managed in the interest of all the shareholders.

4.7.15 WINDING-UP BY COURT

A company may be wound up by court if a company has resolved by special resolution that it be wound up by a court.³ A company is usually wound-up when it is insolvent *i.e.* it cannot pay its debts or when its liabilities exceed its assets.

4.7.16 VOLUNTARY WINDING-UP

A company may be voluntarily wound-up if it has by special resolution resolved to be wound up.⁴ Directors cannot on their own wind-up or put an end to the existence a company without the consent of the shareholders.⁵ This means that directors cannot on their own resolve to terminate the existence of a company.

1 Pretorius *et al* 1999: 278. Ross *et al* 2005: 898 defines a “golden parachute” as compensation paid to top level management by a target firm if a takeover occurs.

2 S 258 of the Act. The reasons for such an investigation may vary. The Act under Ss 2 states that the Minister of Trade and Industry may appoint an inspector if there are reasons to believe that:

(a) the company is being conducted with the intention to defraud its creditors or in a manner that is oppressive or unfairly prejudicial or unjust or inequitable;

(b) if any person involved in the formation or management has been found guilty of fraud, delict or misconduct towards the company members;

(c) if the company has not given the members all the information that the members reasonably expect. This section can be used hand in hand with S 252.

3 S 344 (1) (a) of the Act. See also S 81 of the Companies Act 2008 which states that a court may wound up a solvent company if the shareholders resolved by special resolution or an application is made to court for to have voluntary winding-up continued by the court.

4 S 349 of the Act. See also section 80 (1) of the Companies Act 2008 which also state that a solvent company cannot be wound up voluntarily unless a special resolution to do so has been adopted.

5 *Ex Parte Screen Media Ltd* 1991: 462.

4.7.17 SANCTIONING AGREEMENT

Any agreement entered into between a company able to pay its debts or about to be wound-up shall be binding on the company if sanctioned by a special resolution and if the majority of the creditors accede to such an arrangement.¹

4.7.18 SANCTIONING ACCEPTANCE OF SHARES

A liquidator of a company can only accept a share for the assets of a company if authorized to do so by a special resolution.²

4.7.19 DISPOSAL OF COMPANY RECORDS

Disposal of the records of a company that was wound-up voluntarily shall be disposed of in such a way as the company by special resolution may direct.³

4.7.20 PRELISTING APPROVAL

Shareholders are required to approve the issue of shares, as the pre-listing statement is made conditional upon the approval of the shareholders.⁴

4.7.21 DISPOSAL OF COMPANY ASSETS

Less frequently noted but by no means infrequently occurring are problems generated by the diversion of corporate assets to majority or controlling shareholders at the expense of other shareholders of the same class.⁵ Shareholders have a right to have a say in the way company assets are disposed of.

Directors have no power to dispose of the whole or greater part of the undertaking or the whole or greater part of the assets of the company without a special resolution by shareholders.⁶ The same rules apply to a disposal by a subsidiary of a company if the financial statements record it as such.⁷ The undertaking or the assets shall be calculated

1 S 389 of the Act.

2 S 390 of the Act.

3 S 422 (1) (b) of the Act.

4 Listings Requirements: 6.10.

5 Brudney 1983: 1073.

6 S 228 (1) of the Act. See S 112 (2) (a) of the Companies Act 2008. A special resolution is a requirement to dispose the greater part of the assets or undertaking of the company.

7 S 228 (2) of the Act.

calculated at fair value as required by the financial reporting standards,¹ and the rules shall not apply to a disposal between a wholly owned subsidiary and its holding company or between two wholly owned subsidiaries.²

4.8 LEGAL POSITION OF A COMPANY

A company is a means of achieving economic and social benefits.³ It is an economic institution and also a corporate citizen.⁴ It is a juristic person that is endowed by law with the capacity to have rights and duties apart from its members and it is incorporated under the Act, its predecessors or the General Enabling Act.⁵ This means that a company can sue and be sued in its own name and has reputation and goodwill. It has the same legal status as a natural person, although it is represented by a legal person in all its actions. To some a company is seen simply as a legal fiction representing the complex set of contractual relationships between inputs.⁶

It is a juristic person and exists continuously until it is removed from the companies register.⁷ It can also be a body corporate, wherever incorporated or established, including any other legal person, undertaking, association of persons or entities and any trust or similar device, wherever established, that issues securities, which are capable of being listed by the JSE Limited.⁸

1 S 228 (4) of the Act.

2 S 228 (4) of the Act.

3 S 7 (c) of the Companies Act 2008.

4 King III: 22.

5 Pretorius *et al* 1999: 7. See also Grantham 1998: 587. A company has been recognised by the House of Lords over 100 years ago as a legal right-and-duty bearing entity distinct from the natural persons involved with it. King III introduces the concept of corporate citizenship, which means that a company is a person and should act in a sustainable manner.

6 Bainbridge 1993: 1427. In other words the firm is not treated as a thing but rather as a *nexus* or web of explicit and implicit contracts establishing rights and obligations among various inputs making up the firm.

7 S 19 (1) (a) of the Companies Act 2008.

8 The definition as per the JSE Listings Requirements. The JSE Listings requirements also refer to a cash company or a cash shell as a listed company other than an investment entity whose assets consist wholly or mainly of cash. The word “securities” is a synonym of shares or stock. In the past the South African stock exchange was called Johannesburg Stock Exchange and later changed its name to Johannesburg Securities Exchange and now it is called JSE Limited as it was incorporated into a public company and is itself listed on its own exchange, licensed as such under the Securities Services Act of 2004.

The Companies Act 2008 define a company as meaning a juristic person incorporated in terms of this Act or a juristic person that immediately before the effective date –
was registered in terms of the-

- (b) Companies Act, 1973 other than as an external company as defined in the Companies Act; or*
- (c) Close Corporation Act, 1984 if it has been subsequently converted in terms of Schedule 4;*
- (d) was in existence and recognized as an “existing company” in terms of the Companies Act 1973;*
- (e) was deregistered in terms of the of the Companies Act 1973 and has subsequently been reregistered in terms of this Act .*

A company is a person in law and the directors stand in a fiduciary relationship towards it.¹ Owing to its artificial existence it conducts its activities through natural persons - the directors.² It has all the legal powers and capacity of an individual, but it is incapable of exercising any power or have any capacity to act on its behalf without the assistance of its directors or shareholders.³

According to Balshaw⁴ because a company has a separate legal *persona* the following are consequences of that status:

- (b) Shareholders have no legal interest in the property or assets of the company;*
- (c) Shareholders are not personally liable to pay company debts and to meet its obligations;*
- (d) A shareholder can be a creditor or debtor of the company;*
- (e) Shareholders have no right to participate in the company management or bind the company contractually in their capacity as the shareholders;*
- (f) Shareholders generally have no right to inspect company books and records;*

1 S v Hepke: 484.

2 Mammatt *et al* 2004: 5.

3 S 19(1) (b) (i) of the Companies Act 2008.

4 2005: 161. There is however a dissenting view by Grantham 1998: 558, where he states that members as partners are jointly and severally liable for the debts of the company and have all the rights and powers which ownership imply. Their entitlement to the control and benefit of the company is therefore an incident of their legal ownership of the company. Again see Grantham 1998: 587. The suggestion that shareholders do not own a company may strike some radical proposition; the company after all exist by virtue of the will, enterprise and capital of shareholders.

Companies operate under an act of parliament. They are required to uphold the laws under which they operate. A company must be registered with the registrar of companies and must have a certificate to commence business. The certificate is issued after all the necessary forms and documentation has been submitted to the satisfaction of the registrar.

Any entity that is not registered as a company but conducts itself under the style of a company is breaking the law. Companies carry a public purpose in that they are born and operate as legal constructs only with the approval of the government. They must promote social welfare and provide meaningful employment, satisfying consumer desires and contributing to community life.¹ Companies cannot have a meaningful contribution whatsoever if they do not comply with principles of corporate governance.

4.9 TYPES OF COMPANIES

Companies come in different types, from publicly listed multinational to *quasi*-partnerships.² There are two types of companies in the South African context namely those that have a share capital and those that do not have a share capital and having the liability of its members limited by guarantee.³ A company with a share capital may be a public company or a private company having shares of par value or of no par value. A private company limits the number of its members to fifty.⁴ A public listed company does not have a limitation on its membership.

However, under the Companies Act 2008 there two types of companies that may be incorporated, namely profit and non-profit companies.⁵ There are four categories of a profit company, namely a state-owned enterprise,⁶ a private company,⁷ a personal

1 Dhir 2006: 370.

2 Grantham 1998: 556.

3 S 19 of the Act.

4 S 20 (1) (b) of the Act.

5 S 8 (1). A non-profit company that has no purpose of carrying business for gain.

6 S 8 (2) (a) of the Companies Act 2008. See definitions: a state owned enterprise mean means a company that is registered in terms of this Act or falls under the meaning as stated in the Public Finance Management Act 1 of 1999.

7 S 8 (2) (b) of the Companies Act 2008. A company is private if it is not a state-owned enterprise and it is not offering its shares to the public and restricts the transferability of its shares.

liability company,¹ or a public company.² There are advantages for separate regimes of companies.³

4.10 THE INDEPENDENCE OF A COMPANY

As a rule, the policy of the courts has been not to interfere with the internal domestic affairs of a company, where a company ought to be able to adjust its affairs itself by appropriate resolutions of a majority of shareholders.⁴ A company is constituted on democracy principles and therefore majority rule, only in terms of ownership votes, applies.

4.10.1 THE RULE IN *FOSS V HARBOTTLE*⁵

The rule in *Foss v Harbottle* is based on two principles, that a company has separate legal personality and that majority in a company rules.⁶ This rule is also known as the proper plaintiff rule.⁷ Generally, the minority must subject itself to the wishes of the majority.⁸ However, that does not mean the majority is always right. According to this rule when a wrong is done to a company, the company itself must institute legal action, and if the company fails to do so, any other member can under certain circumstances institute a legal action on behalf of the company, if simply majority condones or ratify the action.⁹

There is an exception to this rule both at common law and in statute, as shareholders can bring an action under common law where officers or directors of a company acted *ultra vires* the company or defrauded the minority.¹⁰ A court can only interfere at the

1 S 8 (2) (c) of the Companies Act 2008. A personal liability company is a company that is a private company and its memorandum of incorporation states that it is a public liability company.

2 S 8 (2) (d) of the Companies Act 2008. A public company is a company that has its shares publicly listed.

3 Grantham 1998: 557.

4 *Yende v Orlando Coal Distributors*: 316.

5 Cilliers *et al* 2000: 297.

6 Cilliers *et al* 2000: 297.

7 Pretorius *et al* 1999: 382.

8 Cilliers *et al* 2000: 296.

9 Cilliers *et al* 2000: 296. See also Ramsay 1992: 150. Shareholder litigation may involve a number of bodies such as the plaintiff shareholder, other shareholders, the directors and the courts. See also Ramsay 1992: 167.

10 Pretorius *et al* 1999: 382. See also Ramsay 1992: 158. Four exceptions to the rule are:
(a) if the transaction is illegal or *ultra vires*;
(b) requires the sanction of special majority;

instance of aggrieved shareholders or other stakeholders in the internal affairs of the company if the problem cannot be resolved by means of an ordinary resolution.¹ The rule in *Foss v Harbottle* has no bearing in the enforcement of rights pertaining to a person in his private capacity, which do not relate to his capacity as a member.² The main problem with *Foss v Harbottle* has always been that where directors are wrongdoers they may decide not to have the company commence litigation and therefore may go unpunished.³

This rule falls under section 266 of the Act. This section deals with shareholder derivative actions. It empowers shareholders to institute legal proceedings against any wrong, breach of trust or breach of faith committed by past or present director or officer of a company and a company has not instituted a legal action for the recovery of damages, loss or benefit. Notwithstanding that, the company has in anyway ratified or condoned any such wrong, breach of trust or breach of faith or any act or omission.⁴ Derivative actions are going to be outlawed by the Companies Act 2008⁵. Shareholder derivative litigation had sparked controversy since its inception 150 years ago.⁶

4.11 POWERS OF COMPANIES

Subject to any limitations imposed by the Act, every company shall have plenary powers, including common powers as stated in schedule 2 of the Act, unless such powers are expressly excluded or qualified by the memorandum of a company.⁷ The Companies Act 2008 provides that no limitation, restriction or qualification may render the actions of a company void,⁸ and if the memorandum of incorporation limits the

(c) *infringes on the personal rights of a shareholder or*
(d) *amounts to fraud on the minority.*

1 Pretorius *et al* 1999: 387. See the Companies Act 2008 S 65 (7), for an ordinary resolution to be approved by shareholders, it must be supported by more than fifty percent of the voting rights.

2 Cilliers *et al* 2000: 299.

3 Ramsay 1992: 158.

4 S 266 (1) of the Act.

5 S165 (1).

6 Swanson 1993: 1340.

7 S 34 of the Act and see Schedule 2 to the Act for full details.

8 S 20 (1) of the Companies Act 2008.

authority of directors to ratify any action by a company, shareholders may by special resolution ratify any action.¹

A company does things on the direction of its directors. In the recent past, a company was not allowed to purchase its own shares, but now section 85 of the Act allows companies to purchase their own shares subject to liquidity of a company and passing of a special resolution at a general meeting of the company.² The Companies Act 2008 also allows a company to acquire its own shares if it satisfies certain requirements.³

Companies are subjected to the principle of majority rule and the minority is subjected to the will of the majority.⁴ In order for a company to survive, its governance system must allocate authority to make adaptive decisions and define the norms that should guide their chosen decision makers.⁵ Companies have to ensure that all the shareholders who hold the same class of shares and are in the same position and receive fair and equal treatment.⁶

4.11.1 IN RELATION TO PRE-INCORPORATION CONTRACTS

A pre-incorporation contract is an agreement entered into before the incorporation of a company, by a person who purports to act in the name of, or on behalf of a company, with the intention or understanding that a company will be incorporated.⁷ A pre-incorporation contract can be ratified or adopted and made binding and enforceable over the company when it is incorporated as if a contract was concluded when a company

1 S 20 (2) of the Companies Act 2008. See definitions: special resolution means a resolution adopted at a shareholders' meeting with the support of at least seventy five percent of the voting rights exercised.

2 Under Ss 4, the circumstances whereby a company is allowed to purchase its own shares is when it can prove that after the payment for its own shares it shall be able to pay its debts when they become due in the ordinary course of business or if the consolidated assets of the company when fairly valued would be more than the liabilities of the company.

3 S 48 (2) (a) of the Companies Act 2008.

4 Pretorius *et al* 1999: 381.

5 Bainbridge 2003: 552.

6 Listings Requirements 3.27.

7 Definition in terms of the Companies Act 2008.

was incorporated, provided the memorandum of a company makes provision for such ratification or adoption.¹

If a memorandum does not provide for such ratification or adoption, the company agent would have acted *ultra vires*. A company has the powers to reject or accept any pre-incorporation agreement if it deems necessary to do so.

The Companies Act 2008 sets out requirements for pre-incorporation contracts to be valid. It states that a person who contracts on behalf of a company that is not yet incorporated is liable if a company is not subsequently incorporated and/or if a company rejects any part of the agreement.² The board has to reject to ratify or reject such a contract within three months after a company was incorporated, failing which it will be taken as being ratified.³ The decision to enter into contracts to which a corporation is a party is a decision made by the board or its subordinates acting pursuant to properly delegated authority and as a result the board is *nexus* of the set of contracts among the factors of production making up the firm.⁴

4.11.2 IN RELATION TO *ULTRA VIRES*

Shareholders have a right to take directors to account for their actions. In terms of section 36 of the Act, directors or any representative of the directors cannot plead ignorance to the fact that they never knew that the company was represented without authority or power. If an *ultra vires* action does not benefit shareholders, they have a right to take directors to task.

4.12 DIRECTORS

Companies are managed by a group of men and women referred to as directors. They give direction to a company with regard to strategy and policy formulation. King III⁵ also states that the first responsibility of the board of directors is to determine the company's strategic direction and secondly, to take control of a company.

1 S 35 of the Act requires that two copies of the contract, one of which shall be signed by a notary public should be lodged together with the lodgement of the memorandum and articles of the company. See also S 21 (1) of the Companies Act 2008.

2 S 21 (2) of the Companies Act 2008.

3 S 21 (5) of the Companies Act 2008.

4 Bainbridge 2003: 559.

5 King III: 20.

4.12.1 THE LEGAL DEFINITION OF A DIRECTOR

By law¹ a director is defined as including any person occupying the position of a director or alternate director of a company, by whatever name he may be called. A director is any natural person who has accepted an appointment as a director of a company by signing the CM27 form in terms of section 211 of the Act and whose name appears on the CM29 form, which is registered with the registrar of companies. A director of a public company must sign schedule 21 of the JSE Listings Requirements.² The Companies Act 2008 states that a director is a person that has been appointed or elected and has consented to serve as a director.³ A director is any person that occupies the office of director even if his job title does not include the word director.⁴

Directors make up the board of a company and are assigned to undertake its management. Sometimes directors are called trustees, or commercial trustees or managing partners.⁵ It does not matter what they are called so long as they understand their true position, which is that they are really commercial men managing a trading concern for the benefit of themselves and all other shareholders in it.⁶

The business and affairs of a company are managed by its board, which has authority to exercise all of the powers and perform any of the functions of a company.⁷ They are a

1 According to Kleyn *et al* 1996:13, law is a set of norms distinguishing good from bad. At 12 Kleyn states that law is a body of rules or regulations facilitating and regulating human interaction; orders society and gives certainty and are rules applied or interpreted by institutions of state. See also Bainbridge 1998: 749 where he states that law consists in the first instance a set of doctrinal propositions i.e. the legal rules derived from statutes, judicial precedents and *opinio juris*. The doctrinal propositions rests on tripod whose legs are:

(a) *moral norms which characterise conduct as right and wrong;*

(b) *policy which characterise state of affairs as good or bad in light of general welfare of the society and*

(c) *experience which teaches us the way the world works.*

2 JSE Listings Requirements 2.9 (a).

3 S 66 (7).

4 Van der Merwe *et al*: 15-1.

5 *Re Forest of Dean Coal Mining Co. 1878 10 Ch.D.450*. See also Hill 2000: 46. In the United Kingdom terminology describing directors as “trustees” dates back to mid-18th century.

6 *Re Forest of Dean Coal Mining Co. 1878 10 Ch.D.450*. See also Hill 2000: 46. In the United Kingdom terminology describing directors as “trustees” dates back to mid-18th century.

7 S 66 (1) of the Companies Act 2008.

controlling mind of the company.¹ A board of directors is headed by a chairperson who presides over all the meetings of both the board and the shareholders. Directors are divided into three categories, namely, executive directors, non-executive directors and independent non-executive directors.²

4.12.2 QUALIFICATION FOR A DIRECTORSHIP

Section 218³ of the Act, states that only natural persons who are not minors or under legal disability or disqualified, unrehabilitated insolvents, or persons who have been removed from an office of trust due to misconduct or any person that has been convicted of theft, perjury fraud, or forgery do not qualify to be directors. Directors are appointed individually by a motion passed at a general meeting, in terms of section 210 of the Act. A person accepting appointment before a company commences business is required to lodge with the registrar of companies a written consent that he accepts such an appointment.⁴

A director who is appointed after the certificate to commence business has been issued is required to inform the registrar of companies of his appointment.⁵ Sometimes companies use the title of a director, whereas they are not appointed to the board of directors, for example marketing directors.⁶ A person qualifies to be a director after accepting appointment and his name appear on the CM29 form.

In the face of legal uncertainty over binding law amendments, some shareholder activists have suggested a new tactic of using a binding law amendment that focuses on establishing director qualification.⁷

4.12.3 TERMINATION OF A DIRECTORSHIP

The Act does not specify the period for directors' appointment, hence some directors are directors for many years or decades. The articles usually provide for a period within

1 Pretorius *et al* 1999: 336.

2 King II: 24.

3 See also S 69 (8) of the Companies Act 2008. There is not much difference in content between these two Acts.

4 S 211(1) (a) of the Act.

5 S 211 (3) of the Act.

6 Mammatt *et al* 2004: 14.

7 Brownstein 2004: 59.

which a director has to retire or be re-appointed. The period is normally three years and they retire in rotation. The re-appointment of a director is done through a shareholder vote at the annual general meeting and shareholders may not re-appoint a director if they feel that he does not deserve to be re-appointed.

A director can be removed from office by a resolution of the company before the expiry of his term of office.¹ The company has a right to dismiss a director whose character is questionable or brings the company into disrepute. The JSE can also disqualify a director for the contravention of the JSE Listings Requirements for any period of time.² Directors may also be removed from office by disgruntled shareholders.³

Any person who proposes the removal of a director should give special notice to the company proposing a resolution to remove a director or appoint another person in the stead of the director to be removed and the director to be removed should be given a chance to be heard on the resolution so proposed.⁴ If the director proposed to be removed makes presentations to the company with respect to his removal, a company shall, if the presentations are not received late, make a copy of the representations available to other members of the company.⁵

No presentations shall be sent out or read out in a meeting if the company or any person feels aggrieved and has approached the court and the court is satisfied that the provisions of the Act are abused to secure needless publicity.⁶ A director's term of office can be terminated by death or resignation or non-reelection or under the provisions of section 218 (1) (d) of the Act or if the director is declared by court as an unrehabilitated insolvent, or removed from a position of trust due to misconduct or has been convicted of fraud, theft, forgery or dishonesty.

1 S 220 (1) (a) of the Act.

2 Listings Requirements: 1.20 (d).

3 Mammatt *et al* 2004: 1.

4 S 220 (2) of the Act.

5 S 220 (3) of the Act.

6 S 220 (5) of the Act.

A director may also be removed through an ordinary resolution adopted at a shareholders meeting by persons entitled to exercise voting rights.¹ A listed company is required through its sponsor to notify the JSE on any changes to a board including the resignation, removal or retirement or death a director or company secretary.² It is a rare occurrence to find a director fired at shareholders meetings. In the USA much attention had been given to the possibility of making it easier for shareholders to replace directors.³

4.12.4 BLACKLISTING OF DIRECTORS

The Department of Trade and Industry has established a register for disqualified directors in terms of section 218(1A) (b) of the Act. The objective is to “blacklist” persons who have been disqualified from being appointed or acting as directors of a duly registered company.

4.12.5 TYPES OF DIRECTORS

Except for the different levels of care and skill arising from the level of involvement in a company’s daily management, there is no difference between the duties and liabilities of executive and non-executive directors.⁴ Although non-executive directors are not involved in daily operations of the company, they are nevertheless accountable for its actions. A different degree of care is expected from both executive and non-executive directors.⁵

4.12.5.1 EXECUTIVE DIRECTORS

Executive directors are fully salaried employees who are involved in day-to-day management of a company and its subsidiaries.⁶ In addition to their normal salary, they are normally entitled to target based benefits set by the board, such as performance

1 S 71 (1) of the Companies Act 2008. This can be done by agreement between directors or between directors and shareholders.

2 Listings Requirements: 3.59 (b).

3 Bebchuk 2005: 836. In particular, a heated debate has taken place over a SEC proposal to provide shareholders with the power to place director candidates on the corporate ballot in some circumstances. While she supports making shareholders power to replace directors more viable, it is important to increase shareholder power with respect to other issues as well.

4 Mammatt *et al* 2004: 13.

5 *Fisheries Development Corporation of South Africa (Pty) Ltd v Jorgensen; Fisheries Development Corporation of South Africa (Pty) Ltd v AWJ Investments (Pty) Ltd*: 163.

6 King Report III: 53; Jack 2007: 229.

bonus, share options, and fringe benefits such as car allowance, housing benefits and medical scheme benefits.¹

They are a link between the company and the board. They are also referred to as “inside shareholders” in a company.² Their duty is the day to day running of the company and the execution of the board strategy and to enhance shareholder value and profits.

Executive directors usually have a service agreement under which they work, unlike non-executive directors who do not have such an agreement.³ A service contract usually has targets that a particular director must achieve within a set period of time.

As a minimum two executive directors should be appointed to the board, those being the chief executive and the finance director in a listed or public company.⁴ Examples of executive directors include, but are not limited to, chief executive officers, managing directors, financial directors, sales directors, marketing directors *etc.*

4.12.5.2 CASUAL DIRECTORS

These are directors that are appointed when a vacancy occurs as a result of a death or resignation of a director or when an elected director fails or refuse to accept office.⁵ Causal directors are usually non-executive directors.

4.12.5.3 NON-EXECUTIVE DIRECTORS

Non-executive directors are the opposite of executive directors. They are also referred to as outside directors. They are not fulltime salaried employees of a company or its subsidiaries and are not involved in day-to-day management.⁶ They play an important role in providing independent judgment⁷ and providing strategic direction and supervision of management. These are individuals that are sometimes directors in other companies or have fixed employment in other companies. They are expected to attend

1 Jack 2007: 229.

2 Anabtawi 2006: 586.

3 Pretorius *et al* 1999: 240.

4 King III: 39. Executive that should be appointed include the chief executive officer and the finance director.

5 Van der Merwe *et al* 1995: 15-31.

6 King II: 24.

7 King III: 53.

board meetings and board committees meetings and to acquire knowledge relevant to the business of the company.¹

A non-executive director is not bound to give continuous attention to the affairs of a company as his duties are of intermittent nature performed at board meetings.² It is however advisable for non-executive directors to be involved, without usurping the powers of executive directors. This will keep them advised of company operations.

They should remember that there is no distinction made between executive and non-executive directors, when it comes to director liability. A non-executive director is expected to exercise care which is reasonably expected from a person of his knowledge and experience.³

4.12.5.4 INDEPENDENT NON-EXECUTIVE DIRECTORS

Independence of directors has been described as perhaps the most effective stockholder protection device available.⁴ A director becomes independent if they satisfy the following criteria.⁵

- (a) *If he is not a representative of a shareholder who has the ability to influence and control management or the board;*
- (b) *Does not have a direct or indirect interest in the company (including any parent or subsidiary in a consolidated group with the company) which exceeds 5% of the group's total number of shares in issue;*

1 King III: 41.

2 *Fisheries Development Corporation of South Africa v Jorgensen; Fisheries Development Corporation of South Africa v AWJ Investments (Pty) Ltd*: 165.

3 *Fisheries Development Corporation of South Africa v Jorgensen; Fisheries Development Corporation of South Africa v AWJ Investments (Pty) Ltd*: 166.

4 Goldman *et al* 2000: 699. Goldman quotes former Delaware Chancellor William T. Allen who explained the virtues of independence as: "Director independence does not assure that a director will make a better contribution on the board than an insider might make. Independent directors may have less information about the firm and may, in fact, tend to make less brilliant decisions over time than those with close financial ties with the firm. Nevertheless, independence offers to investors some further assurance that the governance process has integrity".

5 King III: 38. See also King Report II: 24. There is not much difference between King II and King III. The only major change is that independent directors are should not hold more than 5% of shares in issue or less than 5% but is material to his personal wealth.

- (c) Does not have a direct or indirect interest in the company which is less than 5% of the group's total number of shares in issue, but is material to his personal wealth;*
- (d) Has not been employed by the company in any executive capacity or appointed as the designated auditor or partner in the company's external audit firm or senior legal adviser for the preceding three financial years;*
- (e) Is not an immediate family member of an individual who has been employed by the company in any executive capacity in the past three financial years;*
- (f) Is not a professional advisor to the company other than in a director capacity;*
- (g) Is free from any business or other relationship (contractual and statutory) which could be seen to materially interfere with the individual's capacity to act in an independent manner, such as being a director of a material customer or supplier of the company; or*
- (h) Does not receive remuneration contingent upon the performance of the company.*

An independent director is at best independent of both the shareholders and management and often has no individual economic stake in effectively disciplining management.¹

The position and the definition of independent non-executive directors should be reviewed. Independent non-executive directors should not be allowed to have any relationship with a company whether directly or indirectly through his associates. There is no limit on a number of years a director can be an independent director.² However, independent directors, just like auditors should hold their positions for no longer than five years.³

1 Rock 1991: 449.

2 King III: 40.

3 An individual cannot be an auditor for a period of more than five years. This is done to avoid auditors for auditing a company for many years which may compromise his independence.

Nampak Ltd has been accused of having a board that lacks independence and chairperson Trevor Evans has been singled out as he has been with the company for 41 years and a director since 1990.¹

A lack of available and sufficiently experienced directors should not be a reason for boards not to seek to constitute the majority of the non-executive directors as independent.² Independent non-executive directors should every year undergo independence evaluation by the chairman and the board.³

4.12.5.5 LOCAL DIRECTORS

Local directors are those directors who have been placed to represent a company in a foreign country.⁴ These are usually executive directors.

4.12.5.6 NOMINEE DIRECTORS

A nominee director is a director of a holding company nominated by the board to serve on the board of its subsidiary in order to watch over the interests of the parent company.⁵ A nominee director must place the interests of a company to which he has been nominated above those of a company by which he has been nominated.⁶ A nominee director's duty is to observe with outmost good faith towards a company and in discharging that duty he is required to exercise an independent judgment and to take decisions according to the best interest of the company as its principal.⁷

4.12.5.7 ALTERNATE DIRECTORS

Alternate directors are directors who are appointed to replace other directors who may be absent for a lengthy period. The Companies Act 2008 defines an alternate director as a person who is elected or appointed to serve as the occasion requires, as a member of a board of a company in substitution for a particular elected or appointed director.

1 Bonorchis 2008: 13. See Ramsay 1992: 153 for a dissenting view. Some commentators argue that independent directors increase cost of running a company because of lack of familiarity with the business.

2 King III: 30.

3 King III: 40. This should be done by weighing all relevant factors that may impair independence.

4 Van der Merwe *et al* 1995: 15-31

5 Van der Merwe *et al* 1995: 15-31.

6 Pretorius *et al* 1999: 279.

7 *Fisheries Development Corporation of South Africa v Jorgensen; Fisheries Development Corporation of South Africa v AWJ Investments (Pty) Ltd*: 163.

Nomination of alternate directors is a prerogative of the director wishing to nominate him and the board will have to approve or disprove the nomination.¹ Alternate positions are usually catered for non-executive directors. No executive director can have an alternate.

Articles and memorandum of a company should make provision for appointment of alternate directors. Most companies do not have alternate directors as they rely on a quorum to proceed with a meeting and if no such quorum is reached, a meeting is usually postponed to another date.

The duties of an alternate director are no different from those of any director as he must act on what he *bona fide* considers to be in the best interest of the company and not act on what the director he represents thinks.² Alternate directors are common in South Africa.

4.12.5.8 EX OFFICIO DIRECTORS

An *ex officio* director is a person who holds an office as a director of a particular company solely as a consequence of that person holding some other office, title, designation or similar status specified in a company's memorandum of incorporation.³ *Ex officio* directors are not common in South Africa.

4.12.5.9 LEAD INDEPENDENT DIRECTORS

The appointment of a lead independent director ("LID") is to assist the board in dealing with any actual or perceived conflicts of interest that may arise.⁴ The main function of a LID is to provide leadership and advice to the board, without detracting from the authority of the chairman, when the chairman has a conflict of interest. Such assistance may be provided:⁵

- (a) *at any board meeting (including meetings of committees of the board) or at any other meeting of the company;*
- (b) *at any meeting the chairman may initiate with the LID;*

1 Van der Merwe *et al* 1995: 15-30.

2 Pretorius *et al* 1999: 279.

3 See the definition in the Companies Act 2008.

4 King III: 50 and 34, states that the chairman of the board should be independent and free of conflicts of interests, failing which the board should appoint a LID.

5 King III: 51 and 53.

- (c) *in any consultations that any other director or executive of the company may initiate with the LID;*
- (d) *in any consultation that the LID may initiate.*

A LID should at all times be aware that his role is that of support to the chairman and the board and not in any way to undermine the authority of the chairman.¹ A LID should also chair the board meetings which deal with the succession of a chairman and the chairman's performance appraisal.

The term of a LID's appointment depends on the circumstances of a company and could either be an ongoing appointment or of limited duration for so long as the actual or perceived lack of independence or conflict of interest of the chairman exists.

4.12. 6 DUTIES OF A DIRECTOR

Directors are trusted employees of the company. Their primary duty is to act in the best interests of all the shareholders in a company.² They have both statutory and common-law duties. Under common-law they are required to conduct the affairs of a company with duty of care and skill.³ Directors may make, amend, and repeal any necessary or incidental rules relating to the governance of a company if authorized by the memorandum.⁴ The contemplated changes to the rules must be consistent with the provisions of the Act or the memorandum and any inconsistent rule shall be void.⁵

1 King III: 53.

2 See also Grantham 1998: 570. To act in the "interest of the company" embraces the shareholders, creditors as well as employees. See also Hill: 44. The traditional corporate theory assumed that the role of directors was to carry out the will and implement the interests of shareholders and that within standard principles of agency law shareholders had a formal right to control their agents.

3 Pretorius *et al* 1999: 278. See also Grossman 2005: 576. Primary statutory duties of directors are: to use due care and diligence, act in good faith, not make improper use of a position, and not make improper use of information and the common law duties include: duty to use skill, care and diligence, and the duty to act *bona fide* in the interests of the company.

4 S 15 (3) of the Companies Act 2008. The amendment relates to matters that are not addressed by this Act or in the memorandum. Directors are required to publish a copy of those rules in a manner required by the memorandum and filing them.

5 S 15 (4) (a) of the Companies Act 2008.

Directors are appointed to manage a company on behalf of shareholders. Van der Merwe¹ states that directors are appointed to manage and control the affairs of the company and are required to:

- (a) Decide upon the policy, both present and future, which the company is to pursue and the strategy that it is to adopt;*
- (b) To accept the ultimate responsibility for due compliance with the requirements of Act;*
- (c) To delegate to the managing director or other chief executive officer subject to such conditions that they may impose;*
- (d) To exercise an evaluative role in regard to the performance of the managing director and that of executive directors;*
- (e) Generally to exercise overriding control over the business of the company.*

According to Bainbridge,² there are three functions that are performed by boards of public companies:

- (a) Firstly, and foremost the board monitors and discipline top management;*
- (b) Secondly, while boards rarely involve themselves in day to day operational decision making, most boards perform at least some managerial function, for example broad policy making is the prerogative of the board;*
- (c) Thirdly, the board provides the corporation access to a network of contacts that maybe useful in gathering resources and/or obtaining business.*

The views of both Van der Merwe and Bainbridge point to a similar direction: boards must make policies and manage companies in the best interests of its shareholders. Directors may be authorized to delegate some or all of their duties and powers to a managing director or managers or to a committee of directors and may impose restrictions on the powers so delegated.³

A contract of employment of every director, especially the executive directors should state in no ambiguous terms what their duties are. It is the duty of the board to define

1 1995: 15-1.

2 2003: 599. According to Bebchuk 2003: 44, directors make or approve important decisions among others, the power to block high-premium acquisition offers as well as to set compensation of company's top executive.

3 Mammatt *et al* 2004: 27.

levels of materiality, reserving specific powers to itself and delegating some matters with written authority to management.¹ For example, the board may give the executive directors the powers to bind the company in certain transactions or dealings. A board may have a policy that executive directors may bind the company on dealings less than R1 million per transaction or cumulative in a year and that anything beyond that should be approved by the full board.

A board must apply the tests of fairness, accountability, responsibility and transparency to all acts or omissions and should be accountable to a company and be responsive and responsible to its identified shareholders.² Directors are entitled to accept and rely on the judgment, information and advice of management unless there are reasons for querying it.³ However this may have unintended and undesired results if management is hiding some information that is critical to the company.

Non-executive directors should know that they are the watchdog of the shareholders, as they are a focal point of corporate governance and are ultimately accountable and responsible for the performance and the affairs of a company.⁴ Most South African directors do not protect shareholders' interests, as they are ineffectual or turn a blind eye on actions they know are improper.⁵ This has given credence to the perception that some directors do not participate in meetings and are only interested in retainers.

4.12.6.1 FIDUCIARY DUTIES

Fiduciary duties for directors were first developed by courts as a matter of common law.⁶ A director is both an agent of a company in the execution of its transactions and a trustee that is guarding company assets.⁷ A director is expected to exercise his powers and carry out his duties in a *bona fide* manner and in the interests of the company.⁸ They

1 King III: 36.

2 King II: 19.

3 Mammatt *et al* 2004: 27.

4 King II: 21.

5 Kok 2006: 1.

6 Smith 1998: 287. Smith contends that only in the past few decades have the duties been defined in most corporations' statutes.

7 Mammatt *et al* 2004: 22. See also Bainbridge 2003: 550. Shareholder primacy model theory assumes that shareholders both control a corporation and are appropriate beneficiaries of director fiduciary duty.

8 See Cilliers *et al* 2000: 147. See also Smith 1998: 278. Corporate directors have a fiduciary duty to make decisions that are in the interests of the shareholders.

They are expected to put the interests of a company before their own. They should refrain from binding their companies in transactions that are not profitable and are intended to serve the directors' own ends.¹ In the USA a company's board has a fiduciary duty to make its own determination as to whether adoption of all or any part of a shareholder proposal is in the company's best interests.²

Mammatt³ sums up what is required of a director as follows:

- (a) *They should be faithful to the company;*
- (b) *They should act for the benefit of the company;*
- (c) *They should avoid conflict of interest between themselves and the company;*
- (d) *They should not use company information for their personal gain;*
- (e) *They should not bring the company into disrepute.*

In the USA and Canada high profile corporate scandals have resulted in investors having no confidence and trust in corporate decision making by management and as a result there were mechanisms put in place to achieve corporate governance practices to protect the rights and interests of investors.⁴

The Enron scandal resulted in the promulgation of Sarbanes-Oxley Act 2002 and many strict audit policies such as International Financial Reporting Systems. Fiduciary duties prevent corporate directors and officers from appropriating quasi-rents through opportunistic conduct unanticipated when the firm was formed.⁵

4.12.6.2 DUTY TO ACT *INTRA VIRES*

Directors are expected to act within their powers. That is why it is important for a company to have a policy to guide directors in the performance of their duties. The board should set parameters as to what duties directors can perform jointly or severally.

The general requirements for a company to be bound by the actions of its officers are that company itself must have the capacity to perform a juristic act and that a company

1 *S v Hepke*: 484.

2 Brownstein 2004: 42.

3 2004: 22.

4 Dhir 2006: 365.

5 Bainbridge 2003: 286.

representative should have the necessary authority to bind the company with respect to a particular contract.¹ It is common practice by directors to resolve to give powers to one of their own to act on their behalf.

It is difficult for all directors to negotiate simultaneously on behalf of a company. Let us say company X with twelve directors and company Y with ten directors are interested in concluding a deal. It is impossible for the two teams to meet and negotiate in big numbers. Normally chief executive officers or managing directors or any other director delegated by the board are given mandate to negotiate on behalf of their respective companies. A chief executive officer or any other delegated person should not act *ultra vires* their mandate.

4.12.6.3 DUTY TO EXERCISE CARE, DILIGENCE AND SKILL

Director must execute their duties carefully, diligently and skillfully. The extent of a director's duty of care and skill depends to a considerable degree to the nature of a company's business and on any obligations assigned to him.² A director who does not observe his duties of care and skill towards his company is liable to it in *delict* for damages and in terms of a contract if a contract is in existence.³ When deciding if a director has exercised the required degree of skill and diligence, the actions of a director should be viewed objectively as well as subjectively.

The objective element requires consideration of whether a director acted in a manner in which a reasonable person would have acted and the subjective element looks at imputing the director's knowledge and experience to that of a reasonable person.⁴ A director's duty of care should involve an endeavour to ensure that there is a mechanism to manage disputes and, if disputes arise, to resolve them as effectively, expeditiously and efficiently as possible.⁵ Therefore, directors may be held personally liable for losses or damages to others made on behalf of a company in which they sit as directors.⁶

1 Cilliers *et al* 2000: 179.

2 *Fisheries Development Corporation of South Africa v Jorgensen; Fisheries Development Corporation of South Africa v AWJ Investments (Pty) Ltd*: 165.

3 Cilliers *et al* 2000:148. See also Pretorius *et al* 1999: 283.

4 Mammatt *et al* 2004: 24.

5 King III: 28.

6 Mammatt *et al* 2004: 28.

4.12.6.4 DUTY TO KEEP CONFIDENTIAL INFORMATION

Directors are required to keep price sensitive information and not make it public.¹ There are serious legal consequences if a director is found guilty of contravening the Insider Trading Act. In terms of section 77 of the Securities Services Act 2004 a director can face civil liability for insider trading if it can be proved that he acted unlawfully in disclosing the inside confidential information.²

An insider is a person who for his own benefit or of another person directly or indirectly use or knowingly participate in the use of manipulative, improper, false or deceptive practice trading in listed securities.³ An insider shall not be guilty of an offence if he can prove on balance of probabilities that he was not acting in bad faith in disclosing the inside information.⁴

Section 72⁵ of the Insider Trading Act states that an insider is a person who has inside information:

Through:

- (a) Being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates; or*
- (b) Having access to such information by virtue of employment, office or profession; or*
- (c) Where such person knows that the direct or indirect source of the information was a person contemplated in paragraph (a).*

Company directors, employees and their associates are not allowed to trade in company shares during a closed period. A closed period means:⁶

- (a) The date from the end of the financial year-end up to the date of earliest publication of the preliminary report, abridged report or provisional report;*

1 Section 72 of the Insider Trading Act 1998. The JSE Listings Requirements state that price sensitive information is unpublished information that, if it were made public would be unreasonably likely to have an effect on the price of a listed company's securities.

2 See S 77 for a full discussion.

3 S 75 (1) of the Securities Services Act. See S 75 (3) of the Securities Services Act for a complete list of what constitutes manipulative improper false and deceptive trading.

4 S 73 of the Securities Services Act.

5 See also S 72 of the Securities Services Act 2004.

6 See definitions in the Listings Requirements.

- (b) The date from the expiration of the first six month period of the financial year end up to the date of publication of the interim results;*
- (c) The date from the expiration of the second six month period of the financial year to the date of the publication of the second interim results, where the financial period covers more than twelve months;*
- (d) In case of companies reporting on quarterly basis, the date from the end of the quarter up to the date of the first publication of the quarterly results; and*
- (e) Any period when the company is trading under cautionary announcement.*

In the USA, shareholders or a group of shareholders owning ten percent or more of the shares were subjected to insider trading rules requiring them to make monthly disclosures of their trades in corporations as well as their liabilities.¹

A person also commits an offence whereby they knowingly and unlawfully directly or indirectly publish information that is false deceptive or misleading.² It is a punishable offence for directors or employees to breach section 73 of the Securities Services Act if the person knows and uses that inside information that would likely affect the share price, to his advantage and benefit through his agent or in person.³ Directors must also ensure that statements made by the company secretary relating to statutory records, including statements pertaining to corporate governance are accurate.⁴

4.12.6.5 DUTY TO ACT AS A BOARD

Companies should be headed by an effective board, which can both lead and control a company.⁵ A board has a collective responsibility to provide effective corporate governance that involves a set of relationships between management, its board, its shareowners and other relevant shareholders.⁶ In fact, a board should act as an intermediary for all the shareholders.

1 Davis and Thompson 1994: 148.

2 S 76 (1) of the Securities Services Act.

3 S 73 (1) (a) of the Securities Services Act.

4 Mammatt *et al* 2004: 27.

5 King II: 46.

6 King II: 46.

In South Africa the unitary board structure, which is a combination of executive and non-executive directors, remains the favoured structure.¹ The chairperson of the board should be non-executive and preferably independent. The board should be composed of individuals of integrity who bring a blend of knowledge, skills, objectivity, experience and commitment to the board.²

The average number of board members in listed South African companies is twelve, with the financial services sector having an average of thirteen comma five and the information communication technology sector having an average of ten comma seven board members.³

4.12.6.6 RISK MANAGEMENT

The directors should be responsible for risk management.⁴ Companies should appoint a risk committee for that purpose.⁵ The directors are required to identify key risk areas that that should be monitored regularly.⁶ Some of the risks that directors should continuously address include:⁷

- (a) Physical and operational risks;*
- (b) Human resources risks;*
- (c) Technology risks;*
- (d) Business continuity and disaster recovery;*
- (e) Credit and market risks and*
- (f) Compliance risks.*

The directors should develop and implement a risk policy.⁸ The policy should be reviewed at least once a year⁹. King¹⁰ further suggests that companies should set risk tolerance levels or limits that can be measured quantitatively or qualitatively and both external and internal factors should be taken into consideration. The risks should be

1 King II: 46.
2 King II: 47.
3 Stuart Spencer 2007: 8.
4 King III: 73.
5 King III: 75.
6 King II: 22.
7 King II: 31.
8 King III: 73.
9 King III: 74.
10 King III: 74.

categorised as low, medium, or high. The higher the risk the more attention it should receive.

Other companies include political environment in their list of risks. This is normally a case where a company intends to investment in a country where there is no political stability. For example, some companies would view investing in Iraq, Sudan, Pakistan or Democratic Republic of Congo *etc* as a risk because of political instability. Non-compliance for example with BEE can also be classified as a risk, as more and more companies do not want to associate themselves with companies that are not empowering previously disadvantaged people. Shareholders can hold directors accountable if it is proved that they were negligent or did not pay attention to the risks that a company faced.

4.12.7 MORAL DUTIES

A director should execute the following moral duties.¹

- (a) *Conscience*. Directors should avoid conflicts of interests. They should act with intellectual honesty and independent mind in the best interests of all the shareholders.
- (b) *Inclusivity*. Directors should include shareholders in seeking to achieve sustainability. Also legitimate interests and expectations of shareholders must be taken into account in decision making and strategy.
- (c) *Competence*. Directors should have the knowledge and skills required for effective governance of a company. Competence should be always developed.
- (d) *Commitment*. A director should be diligent in performing their duties and devote sufficient time for in company affairs.
- (e) *Courage*. Directors should be able to take risks associated with directing and controlling a successful, sustainable company. They should also have courage to act with integrity in all board decisions.

4.12.8 LIABILITY OF DIRECTORS

One of the main functions of a company is to make sure that it has more assets than its liabilities. Should a company acquire shares issued by it, contrary to section 85 (4) of the Act, shareholders and directors become jointly and severally liable to the company for

1 King III: 21.

any amount so paid.¹ If a company is a personal liability company directors and past directors are jointly and severally liable, together with a company for any debts and liabilities of a company during the time they were contracted to the company.²

Section 86 of the Act gives only directors' powers to compel shareholders to repay any monies paid and the provisions do not offer shareholders the same rights to force directors to repay any amounts paid unlawfully. Directors can be compelled by liquidators to return any money if it is proved that they traded recklessly and negligently.

By becoming a shareholder in a company a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions are arrived at in accordance with law even if they adversely affect his rights as a shareholder.³ The JSE can order payment of compensation to any person prejudiced by the contravention of the JSE Listings Requirements.⁴

There is a perception that South African directors have for too long been immune from civil liability, when they are alleged to have recklessly destroyed shareholder value.⁵ Examples are Sasol and Tiger Brands directors who have not been sued by any of the shareholders for the involvement of their companies in price fixing.

Nevertheless, shareholders can use section 252 of the Act, if they feel aggrieved by any action of the directors or other members. In this instance, shareholders and directors are required to be more accountable, which to a certain extent is unfair, as the shareholders never make decisions.⁶ These kinds of decisions are taken by directors and are tabled before shareholders for approval or endorsement as a matter of formality. Directors are the ones that know how a company is performing and therefore make decisions based on inside information and may also mislead shareholders to believe that the company is properly managed.

1 S 86 (1) of the Act. S 85 (4) states that a company shall not make any payment to acquire any shares issued by the company unless there are reasonable grounds to believe that the company will be solvent after such a payment.

2 S 19 (3) of the Companies Act 2008.

3 *Sammel v President Brand Gold Mining Co. Ltd*: 678.

4 Listings Requirements: 1.20(e).

5 Kok 2006: 1.

6 See also S 163 of the Companies Act 2008.

Directors or past directors of a company can be jointly and severally liable together with the company for its debts and liabilities.¹ A transaction entered into by a company and approved by directors is binding on a company,² and the consequences thereof must be binding. A shareholder has a number of options to address issues relating to alleged contravention of the Companies Act of 2008, through alternative dispute resolution, approaching Company Ombudsman or by approaching a court.³

4.12.8.1 PERSONAL LIABILITY

A person is not solely by reason of being an incorporator, shareholder or director of a company, liable for any liabilities and obligations of a company except provided for the memorandum of incorporation or by the Companies Act 2008.⁴ Directors can be held personally liable for companies liabilities if found guilty of reckless conduct.⁵ As a general rule a director cannot be held liable for his actions if he entered into a contract with a third party in the name of his company, however there are exception to that rule.⁶

- (a) Where a director has bound himself personally for the liability of the company, for example as a surety or a co-principal debtor;*
- (b) Where a director has breached warranty of authority;*
- (c) Where a director has acted fraudulently or carelessly;*
- (d) Where a director has acted negligently;*
- (e) Where a director wrongfully procured a breach of contract by the company or deliberately committed an act disabling the company from carrying out its duties under a contract;*
- (f) Where a director formed a company with a purpose to doing wrongful acts;*
- (g) Where a director has signed an order or negotiable instrument on behalf or the company without using its name.*

One of the primary goals of shareholder activists is to pressurize the management of poorly performing firms for improved performance and enhancement of shareholder value. Directors who issue any financial statements or circulars to shareholders that are

1 S 53 (1) (b) of the Act.

2 Pretorius *et al* 1999: 347.

3 S 156 (1) of the Companies Act 2008.

4 S 19 (2) of the Companies Act 2008.

5 Mammatt *et al* 2004: 1.

6 Pretorius *et al* 1999: 368.

incomplete or do not comply with the provisions of the Act shall be guilty of an offence.¹ Equally any person who was knowingly party to the preparation, approval, publication or supply of false or misleading financial statement, that are false or misleading in a material way shall be guilty of an offence.²

Directors face a risk of being sued for damages in respect of losses that are as a result of their unlawful conduct.³ If directors make loans or security to a holding company by its subsidiary without the consent of all the shareholders, may be liable to the company for any losses which may arise.⁴ Financial losses as it affects shareholders return, may lead lead to shareholder activism.

A board must exercise its business judgment in making decisions regarding shareholder proposals. Pursuant to the business judgment rule, directors will have no personal liability for a decision made in good faith on an informed basis and with no conflict in loyalty to the company's shareholders.⁵ Directors incur personal liability in contract where they do not specify to the party with whom they are contracting that they are a representative of the company and are not acting in their personal capacity.⁶

Shareholders may institute claims against directors whose behavior cause harm them.⁷ This should apply in cases where directors failed to execute their duties with care and skill required of them.

4.12.8.2 THE TURQUAND RULE

The *Turquand Rule* allows persons who are dealing with a company to assume that all internal company matters have been complied with⁸. But a company becomes bound by

1 S 287 of the Act.

2 S 287A (1) of the Act.

3 Mammatt *et al* 2004: 1.

4 Mammatt *et al* 2004: 1.

5 Brownstein 2004: 43.

6 Mammatt *et al* 2004: 1

7 Van Zyl 2002: 46.

8 The *Turquand Rule* comes out of the case of *Royal British Bank V Turquand (1856) 6E & B 327; 119 ER886*. In this case The Royal British bank sued Turquand as the official manager of a coal mining and railway company on a bond signed by two directors whereby the company acknowledged itself to be bound by the Royal British Bank in an amount of £2 000. Under the constitution of the company, the directors might borrow on

the contract even if all internal matters of management have not been complied with.¹ The Companies Act 2008 includes the *Turquand Rule* in its provisions.²

However, the doctrine of *estoppel* can be used by a third party and a company can be stopped if it is proven that it misrepresented, intentionally or negligently, that an agent concerned had the necessary authority to represent the company and as a consequence the third party was induced into dealing with the agent and as a result the third party was prejudiced.³

A person who enters into a pre-incorporation contract as an agent of the company, unless the contract stipulates otherwise does not incur personal liability if the company is not formed or ratify or adopt the contract.⁴ To avoid unintended consequences, negotiating companies should present resolutions from their directors giving a representative powers to negotiate on their behalf.

4.13 SHAREHOLDER PROTECTION

Generally, a company is governed by the will of the majority, but minority shareholders are protected under common law rule and that majority shareholders may not gain at the expense of a minority.⁵ A minority shareholder whose rights have been unlawfully ignored has a right to approach the court for relief.⁶ Corporate law statutes and judicial interpretations have evolved in the past two or three decades.⁷ Courts are more likely today than in the past to interpret statutory grounds for dissolution in a way that provides

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- bond such sums as should from time to time by a general resolution of the company, be authorised to be borrowed. The defendant argued that there was no such a resolution.
- 1 Cilliers *et al* 2000:192. There are however exceptions to the general rule. A manager or director cannot rely on this rule if he knew that the mandate was defective or that the circumstances surrounding the negotiations were suspect and he had accordingly been placed on his guard.
- 2 S 20 (7) of the Companies Act 2008.
- 3 Cilliers *et al* 2000: 193.
- 4 Pretorius *et al* 1999: 106.
- 5 Mammatt *et al* 2004:10. See also Smith 1998: 311. Since the earliest reported cases the courts have consistently held that the will of the majority of the shareholders govern the business corporations, however courts recognised the possibility that majority rule would lead to unfair results for minority shareholders and imposed the trust metaphor to impose on directors a fiduciary duty to serve all of the shareholder in a corporation, not just a select group.
- 6 Pretorius *et al* 1999: 420.
- 7 Thompson 1993: 707. The formerly narrow involuntary dissolution statutes have given way to much cause of action for oppression.

relief for minority shareholders, particularly by focusing on the reasonable expectations of shareholders.¹

4.13.1 SECTION 252 OF THE ACT

Shareholders can bring to court any action that they believe is unfairly prejudicial to them. Section 252 (1) of the Act states that:

Any member of a company 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 of the company, may subject to the provisions of subsection (2) make an application to court for an order under this section.

In Canada there is a requirement that a shareholder must own 1% of the outstanding voting shares on the date of submission or own shares that have a fair market value of at least \$2,000, before a shareholder can be able to table a proposal at the annual general meeting.² This threshold may be seen as excluding minority shareholders, who own less than 1% of the shares from lodging proposals. This policy may be unfairly prejudicial to minority shareholders.

4.13.2 SECTION 266 OF THE ACT

This section deals with shareholder derivative actions. Section 266 of the Act empowers shareholders to institute legal proceedings against any wrong, breach of trust or breach of faith committed by past or present director or officer of the company if a company has not instituted a legal action for the recovery of the damages, loss of benefit, notwithstanding that a company has in anyway ratified or condoned any such wrong, breach of trust or breach of faith or any act or omission.³

This position is going to change under the Companies Act 2008 as derivative actions will be outlawed. Aggrieved shareholders must give the company a written notice to institute action within one month from the date of service of such notice stating that if the company fails to act,⁴ an application will be made to court for an appointment of a

1 Thompson 1993: 699.

2 Dhir 2006: 386.

3 S 266 (1) of the Act.

4 S 266 (2) (a) of the Act. See also S 165 (2) of the Companies Act 2008.

curator ad litem for the company, for the purposes of instituting and conducting proceedings on behalf of the company against such a director or officer, past director or officer.¹ The court may appoint a provisional *curator ad litem* and direct him to conduct such investigation and report to the court on the return date of the provisional order.²

The court has powers to discharge the provisional *curator ad litem* or appoint the *curator ad litem* and issue directions as to the institution of the proceedings in the name of the company as it may think necessary and may order a resolution ratifying or condoning the wrong, breach of trust, breach of faith or any act or omission in relation thereto.³

In the USA shareholders are allowed to take derivative actions.⁴ Often defendants are corporate insiders who have injured the business, either by intentional abuse of corporate form for personal gain or by negligent “garden variety mismanagement”.⁵ Derivative actions have seen the role for shareholders with the establishment of shareholder litigation committees.⁶ Shareholder litigation is not common everywhere in the world. One study in USA found out of a total of 179 companies that shareholder litigation occurs once in seventeen and half years.⁷

However, a shareholder, director, trade union or any person authorized by the court may serve a demand on a company to commence or continue legal proceedings or related steps.⁸

1 S 266 (2) (b) of the Act.

2 S 266 (3) of the Act. The court may appoint a provisional curator if it is satisfied that the company has not instituted the legal action under Ss (2) (a), that there are prima facie grounds for such proceedings and the investigation into the grounds and desirability of such an action is justified.

3 S 266 (4) of the Act. The *curator ad litem* has the same powers as the inspector appointed in terms of section 260 of the Companies Act 1973, and the court may give the curator additional powers in terms of S 261 (1).

4 Ramsay 1992: 149. A shareholder derivative action is a legal action brought by a shareholder based on a cause of action belonging to the company and not the shareholder. See also Swanson 1993: 1344. Unlike direct actions in which plaintiffs seek redress for injuries they themselves sustained, shareholders in derivative actions sue to redress injuries sustained by the company. See also Smith 1998: 277. Shareholders exercise control over the control of the corporation by amongst others bringing derivative suits on behalf of the corporation.

5 Swanson 1993: 1345.

6 Ramsay 1992: 150. The litigation committees are comprised of independent directors.

7 Ramsay 1992: 155.

8 S 165 (1) of the Companies Act 2008. A trade union means a registered trade union in terms of S 96 of the Labour Relations Act 1995.

4.13.3 SECTION 163 (1) OF THE COMPANIES ACT 2008

Section 163 (1) states that a shareholder or a director may apply to court for relief if:

- (a) any act or omission of the company or related person that is oppressive or unfairly prejudicial;*
- (b) The business of the company or related person is conducted in a manner that is oppressive or unfairly prejudicial;*
- (c) The powers of a director and or prescribed officer are being exercised in a manner that is oppressive and unfairly prejudicial*

Shareholders have a right to bring to court any matter that they deem unfairly prejudicial, unjust and inequitable or if the companies are managed as such. This section is wide enough to accommodate any issues that are relevant in terms of the King Codes, such as accountability, transparency *etc.* There is no minimum limit on the amount of shares a shareholder must own in order for them to bring an application to court.

The high cost of litigation in enforcing minority rights renders minority protection practically ineffective and there is a need to investigate class actions in the South African legal system.¹ Shareholder protection through court proceedings is a rare occurrence.

4.13.4 SECTION 156 OF THE COMPANIES ACT 2008

The Companies Act 2008 affords any person who seeks an address to alleged contravention of this Act or memorandum to resolve the dispute through alternative dispute resolution, or approach the companies Ombudsman, apply to the High Court for appropriate relief or lodge a complaint with the Companies and Intellectual Property Commission or the Takeover Regulation Panel.²

1 Pretorius *et al* 1999: 420. See also Ramsay 1992: 150. The impediment to shareholders contemplating litigation is not deficiencies in common law concerning standing, but lack of incentives to commence, deriving from a number of factors including cost of litigation.

2 S 156 of the Companies Act 2008.

4.14 COMPANY LIABILITY

4.14.1 CRIMINAL LIABILITY

A company as an artificial person cannot commit unlawful conduct intentionally or negligently. It can be penalized for crimes committed by its agents or servants.¹

Section 332(1) of the Criminal Procedure Act 51 of 1977 states:

- (a) For the purposes of imposing upon a corporate body criminal liability for any offence, whether under any law or at common law-*
 - a. Any act performed with or without a particular intent by or on instructions or with permission, express or implied, given by a director or servant of that corporate body; and*
 - b. The omission with or without a particular intent of any act which ought to have been but was not performed by or on instructions given by a director or servant of that corporate body,*
- (b) In the exercise of his powers or in the performance of his duties as such director or servant or in furthering or endeavoring to further the interests of that body corporate shall be deemed to have been performed by that body corporate or as the case may be to have been an omission on the part of that body corporate.*

A company cannot commit criminal activity on its own, as it does not have a mind of its own. It should be liable only if a director was acting on the best interests of the company and if he had authority to make commitments on its behalf and the company consented thereto.

For a director to be criminally liable for offences committed by a company through its directors, he shall only be guilty if intention is proved or he was not aware of the perpetration. If a director is aware of the commission of a crime, but because he is not part of it, fails to report it, he should be guilty of an offence.

4.15 CONCLUSION

Shareholders are owners of a company. They have powers, rights and duties, which they must exercise fully. They should exercise their rights using the provisions of the Act, relevant legislation and in the future the Companies Act 2008. They must use their rights to propose and draft resolutions. They should hold the directors responsible for their

¹ Burchell *et al* 1997: 386.

unlawful actions, which may put the name of a company into disrepute and which may result in disinvestment. They should exercise their right to vote effectively and must not just rubberstamp the aspirations of the shareholders.

The involvement of shareholders should not only be limited to issues requiring special resolutions but should be extended to be watchdogs of the directors and play a role in shaping corporate governance of their companies. For example if the shareholders of Sasol and Tiger Brands were robust in their activism, the directors should have been charged criminally or forced to resign, as one of their duties is to manage risks that the company may face.

Directors are servants of the shareholders. They should manage a company in the best interests of shareholders. They should be held jointly and severally responsible for their unlawful actions. Directors must not be allowed to claim ignorance when they are faced with serious allegations of corporate misconduct. They should be disqualified for failing to promote corporate governance principles. Non-executive directors, just like the executives should go through a rigorous process of interviews before they are appointed. There should also be a clear distinction between the duties of non-executive and independent non-executive directors.

Companies should have only two executive directors, a chief executive or managing director and a financial director. The boards should be constituted by a majority of independent non-executive directors and the chairperson should be an independent non-executive. The status of an independent director should be reviewed annually. They should not hold shares in companies where they are board members.

LIDs are not necessary. The motive for having LIDs a board will not be necessary if the majority of board members are independent. Independent non-executive directors must chair meetings in the absence or recusal by the chairperson.

White-collar crime or fraud is rampant in modern society and companies need to have measures in place to detect and combat such practices. External and internal auditors should work together in making sure that fraud is reported when detected and advise companies of mechanisms that can be used to curb it.

CHAPTER 5

CAUSES OF SHAREHOLDER ACTIVISM

5.1 INTRODUCTION

There are different reasons for shareholders to revolt against management. The reasons vary in nature. They may be political, economical, social or legal. They also vary from company to company and from country to country. Notably across the board, the primary cause of shareholder activism is the lack of compliance with corporate governance. Corporate governance includes issues of policy. A company without clear governance policies is predisposed and amenable to shareholder activism. If a company fails in its strategic decisions, it can be affected by shareholder activism.¹

General corporate governance issues include general governance issues such as ethics, morality, transformation, risk management, sustainability *etc.* Shareholders use different tactics in challenging directors. Some use a soft approach of negotiating whilst others may be robust. A particular approach depends on the issues at hand and the attitude of directors. The more accommodating and listening the directors, the softer the approach and the more arrogant the directors, the robust the approach. For shareholders to be involved in matters of a company depends on whether they believe directors are employed to deal with them or whether they believe they own the company and if their involvement is vital.

The refusal by some companies to adapt to suggested changes, has in turn led some activist shareholders employing pressure tactics against them.² Activist shareholders usually monitor corporate practices in areas of concern and use shareholder resolutions to foster change.³ Shareholder activism is therefore used to maximize shareholder wealth and to advance social welfare.⁴ Advancement of social welfare means that companies should invest in the communities within which they operate.

1 Jayaraman *et al* 1993: 36.

2 Brownstein 2004: 24. Such pressure tactics include running "Vote No" campaigns, submitting binding bylaw amendments, lobbying for regulatory change and engaging in various other forms of public and private persuasion.

3 Waddock: 323.

4 Dhir 2006: 371.

5.2 HISTORY OF CORPORATE GOVERNANCE IN SOUTH AFRICA

5.2.1 KING REPORT ON CORPORATE GOVERNANCE - 1994 (“King Report I”)

After the release of the Cadbury report in 1992 in the United Kingdom (“UK”), the King Committee was formed.¹ It was an initiative of the Institute of Directors in Southern Africa and was supported by the South African Chamber of Business, the Chartered Institute of Secretaries and Administrators, the South African Institute of Chartered Accountants, the Johannesburg Stock Exchange and the South African Institute of Business Ethics.² Mervyn King S.C. was appointed to lead a team of experts in business, which was thereafter referred to as King Committee (“the King Committee”).

In November 1994, the King Committee issued the King Report I. The purpose of King I was to promote the highest standard of corporate governance.³ The King Committee made the following recommendations directed at all listed companies, public companies, banks, financial and insurance entities, large unlisted companies, large quasi-state entities, such as control boards and co-operatives.⁴

5.2.2 KING REPORT ON CORPORATE GOVERNANCE – 2002 (“King II”)

King II was issued in March 2002. It was necessitated by a number of changes in legislation that was enacted after 1994.⁵ Unlike its predecessor the King II moved from single reporting to triple-bottom-line reporting, in that companies should embrace economic, environmental and social factors when doing business.⁶

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- 1 King I: 3. The Cadbury Report’s terms of reference were to investigate
(a) *financial reporting and accountability;*
(b) *good practice concerning the responsibilities of the executive and non-executive directors;*
(c) *the case for audit committees;*
(d) *the principal responsibilities of auditors; and*
(e) *the links between shareholders, boards and auditors.*
- 2 King I: 3. The terms of reference of the King Committee were wider and included those of the Cadbury Committee. The King Committee’s terms of reference included the investigation of the Code of Ethical Practice for business enterprises in South Africa and to look at entrepreneurship by members of disadvantaged communities.
- 3 King II: 5.
- 4 King I: 5. “Large” referred to companies with shareholders’ equity of R50m or more.
- 5 King II: 7. Example of enacted legislation include, the Labour Relations Act 66 of 1995, the Basic conditions of Employment Act 75 of 1997, the Employment Equity Act 55 of 1998, the National Environment Management Act 107 of 1998, the Insider Trading Act 135 of 1998 and the Public Finance Management Act 1 of 1999.
- 6 King II: 9.

There were four primary reasons why King I had to be reviewed. These were:¹

- (a) there were developments in South Africa and elsewhere in the world with regard to corporate governance;*
- (b) to review and clarify the inclusive approach for sustainability of companies;*
- (c) to recognize the importance of reporting on non-financial issues such as social and ethical accounting, auditing, reporting, safety, health and environment; and*
- (d) to recommend how compliance with corporate governance principles can be measured and based on outcomes.*

5.2.3 KING REPORT ON CORPORATE GOVERNANCE – 2009 (“King III”)

From March 2010 King III will be effective and applicable to South African companies. It will apply to all entities regardless of size and form of incorporation.² Key aspects highlighted in King III are effective leadership, sustainability and the concept of corporate citizenship.³ With regard to sustainability, King III encourages companies to have an inclusive shareholder approach, integrated reporting and integration of social, environmental and economic factors.⁴

As King III is founded on the Companies Act 71 of 2008, a number of provisions in the Act are included in King III.⁵ The report also outlines information technology as a major risk that companies should work hard to mitigate.⁶

5.3 SHAREHOLDER APATHY

There are different reasons for shareholders to be apathetic or passive. The reasons in the United States of America (“USA”) were as a result of a lot of complex legal rules that made it difficult, expensive and risky to own large percentages of shares in corporations, for instance, until 1992 communication that was aimed at influencing the votes of more

1 King II: 15.

2 King III: 17.

3 King III: 10.

4 King III: 12. Inclusive approach means that directors should consider the legitimate interests and expectations of all stakeholders other than shareholders.

5 King III: 14. These are alternative dispute resolution, risk based internal audit, shareholders and remuneration, board and director evaluation and business rescue.

6 King III: 15.

than ten other shareholders had to be scrutinized by the Securities Exchange Commission ("SEC").¹

Sometimes boards have nurtured the image that they are a powerful entity that answers to no one, as shareholders have ceded total responsibility to them.² Shareholders still believe that their only duty is to be "cheque collectors" when dividends are declared. Another reason for shareholder passivity might be the fact that shareholders always argue that they have appointed the board of directors to look after their interests and they believe that directors have a reason to do a good job because their reputation might be at stake.³

Apathy and passiveness by shareholders, particularly the institutional shareholders are responsible for the non-enforcement of the breach of duties by the directors and managers.⁴ Directors can commit criminal offences against a company, perhaps as a result of non-involvement or lack of interest by shareholders.

Both individual and institutional shareholders generally have apathy which is influenced by amongst other things, none incentivisation of shareholders to monitor actions of managers of companies.⁵ They become active or passive depending on the investment strategy of a particular shareholder. Long-term investors tend to be more passive compared to short-term investors.

It is a duty of directors to encourage shareholders to attend annual general meetings and other meetings of the company.⁶ However, it is a difficult task for the directors to encourage shareholders to attend meetings, as the directors themselves do not like to be asked tough questions at meetings. To most directors it is a relief that there is apathy amongst most shareholders. One way of attracting shareholders to meetings has to do with the attitude of the directors when conducting the meetings, as in most instances directors become arrogant and never entertain shareholders' issues.

1 Davis *et al* 1994: 148.

2 Ettorre 1992: 10.

3 Davis *et al* 1994: 149

4 King II: 163.

5 Bolodeoku 2007: 113.

6 King II: 22.

There is however, a view that the days of shareholder passiveness are gone and the era of accountability has arrived, led by shareholder activists, legislators and concerned corporate executives.¹

5.4 DEFINITION OF CORPORATE GOVERNANCE

Corporate governance is a set of proposals for effective management of companies and is not governed by statute. It is a company's expression of ethical standards.² It is a recommended policy for companies to ensure that companies conduct business ethically and morally in the best interests of all their shareholders. It recommends that companies need to take financial as well as non-financial issues when conducting its business.

King³ quotes Sir Adrian Cadbury, who says that corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals, with the aim to align as nearly as possible the interests of individuals, corporations and society.

Balshaw⁴ quotes Bob Garratt who defines corporate governance as the appropriate board structures, processes and values to cope with the rapidly changing demands of both shareholders and shareholders in and around their enterprises. He further quotes Sir Adrian Cadbury who defines corporate governance as a system by which companies are directed and controlled. Corporate governance refers to a relationship between corporate owners and management and is central to the notion of agency.⁵

1 Ettorre 1992: 10.

2 King III: 21. There are four ethical values underpinning corporate governance. These are:

- (a) *Responsibility*. The board should assume responsibility for the assets and actions of the company and be willing to take corrective actions to keep the company on strategic path.
- (b) *Accountability*. The board should be able to justify its decisions and actions to shareholders and other stakeholders.
- (c) *Fairness*. The board should ensure that it gives fair consideration to the legitimate interests and expectations of all stakeholders of the company.
- (d) *Transparency*. The board should disclose information in a manner that enables stakeholders to make an informed analysis of the company's performance and sustainability.

3 King II: 5.

4 2005: 160.

5 Guay et al 2004: 128.

5.4.1 SYSTEMS OF CORPORATE GOVERNANCE

There are four systems of corporate governance, namely: insider-dominated, outsider dominated, “comply or else”, “comply or explain”. For successful corporate governance, companies should adopt an inclusive rather than an exclusive approach.¹ A shareholder inclusive corporate governance approach recognises that a company is made of many shareholders that can affect a company in the achievement of its strategy and long-term sustainable growth.²

5.4.1.1 INSIDER-DOMINATED SYSTEM

The insider-dominated system of governance has its origins in the UK.³ This type of governance refers to a system of corporate governance whereby most companies are controlled by one or more shareholders including families.⁴ This system is akin to the corporate structures of pyramid schemes. Pick n’ Pay Stores Ltd and Pick ‘n Pay Holdings Ltd are examples of insider-dominated system as they are controlled by a family.⁵ This is a paradigmatic corporate governance system that characterised large USA firms and it is that of “strong managers” and “weak owners”.⁶ In this type of a system, corporate power is centralised and in the hands of few individuals.

5.4.1.2 OUTSIDER-DOMINATED SYSTEM

The outsider system of governance also has its origins in the UK.⁷ It is therefore more relevant to UK companies because of their Anglo-Saxon culture.⁸ This system refers to instances where large companies are controlled directly by their managers but indirectly

1 King II: 19. By inclusive approach King means that:
(a) *the company must be open to institutional activism and there must be greater emphasis on the sustainable or non-financial aspects of its performance;*
(b) *boards must apply the tests of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also be responsive and responsible towards the company’s identified stakeholders;*
(c) *the correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this should be specific to each company.*

In King III: 13, King refers to stakeholder inclusive model of corporate governance. This means that directors should also consider the legitimate interests and expectations of stakeholders other than shareholders.

2 King III: 100.

3 Solomon and Solomon 1999: 289.

4 Solomon *et al* 1999: 289.

5 Source: www.pnp.co.za. Accessed on 20/03/2007.

6 Anabtawi 2006: 565.

7 Solomon and Solomon 1999: 289.

8 Solomon and Solomon 1999: 289.

through the actions of outsiders such as financial institutions.¹ A majority of companies prefer this system as power is decentralised and principles of democracy are applied.

5.4.1.3 “COMPLY OR ELSE” SYSTEM

This form of governance has been adopted in the USA since the Enron scandal. Companies are required to comply with the Sarbanes-Oxley Act 2002 to avert re-occurrence of Enron like scandals.² This means that there are legal consequences for not complying, as companies are required to comply line by line with this statute. However, the Sarbanes-Oxley Act with all of its statutory requirements for rigorous internal controls has not prevented the collapse of many of the leading names in USA's banking and finance sectors.³

5.4.1.4 “COMPLY OR EXPLAIN” SYSTEM

The South African governance model is on a “comply and explain” basis.⁴ This system affords companies who fail to comply with corporate governance an opportunity to explain their reasons for non-compliance. An explanation may exonerate a company from being dealt harshly by its shareholders. This system is stronger if its implementation is overseen by institutional investors.⁵

For example Sasol provided an explanation after the PIC criticized the appointment of Hixonia Nyasulu as the chairperson, saying the move undermined good corporate governance as Nyasulu held 1.275% interest in Sasol Oils, a subsidiary of Sasol.⁶ Sasol's chief executive officer Pat Davies, responded to the allegation by saying that the board appointed Juergen Schrempp as a lead independent director to deal with issues of conflicts of interests.⁷

Other examples whereby companies explained their actions are Barloworld and Alexander Forbes. Barloworld appointed Trevor Munday as the deputy chairperson to Dumisa Ntsebeza, a position that was suspended for a number of years. Alexander

1 Solomon *et al* 1999: 289.

2 King III: 7.

3 King III: 9.

4 King III: 8.

5 King III: 10.

6 Njobeni 2008: 2.

7 Njobeni 2008: 2.

Forbes on the other hand appointed Bruce Campbell as the executive chairperson.¹ The Public Investment Commission (“PIC”) viewed these actions as patronising and racist. Both companies explained their motives and moved on.

5.5 CAUSES OF SHAREHOLDER ACTIVISM

5.5.1 LACK OF CORPORATE GOVERNANCE

Several studies found that firms that are targets of shareholder activism are poor performers or have poor corporate governance.² Guay³ states that under bad or poor corporate governance either of these or a combination of these may happen:

- (a) managers may take actions that are not in the best interests of the shareholders;*
- (b) the board not adequately monitor management’s activities;*
- (c) shareholders may not pay close enough attention to the company’s performance.*

Management and boards in recent corporate failures were allowed to operate unchecked for many years and the results have been catastrophic for shareholders.⁴ Jack⁵ states that corporate governance is a critical ingredient of success of any entity, whether a company, a non-profit organization or a government department.

5.5.1.1 LACK OF ACCOUNTABILITY

It is consistent with shared democratic traditions to hold corporations accountable, to the extent practical to the groups most affected by its activities.⁶ Under good corporate governance managers are held accountable for the performance of the company by a board of directors, whose job is to represent the interests of shareholders.⁷ Directors in turn are accountable to the shareholders. Holding someone accountable means dismissing them for incompetence and mismanagement. The sporadic efforts by the

1 Njobeni 2008: 2.

2 Romano 2001:183. See Romano 2001: 184, for example California Public Employees’ Retirement System (“CalPERS”) had chosen its targets among poor performers whereas the Teachers Insurance Annuity Association-College Retirement Equities Fund targeted companies with poor corporate governance.

3 2004: 128.

4 Kekana 2005: 26.

5 2007: 458.

6 Murphy 2003: 67.

7 Guay *et al* 2004: 128.

investment community to rein in the management of listed companies over corporate governance and strategy gel into a concerted programme of shareholder activism.¹

According to King II, companies should make a distinction between responsibility and accountability. Companies are required to be responsible to shareholders that have been identified as relevant to the business and directors are required to be accountable to the company both in common law and statute.²

A group of shareholders wanted to know at the annual general meeting of Sasol if they will be liable for the payment of R4-billion fine imposed on Sasol by the European Commission regarding Sasol's position as a leader of wax paraffin cartel.³ The shareholders felt that it would be unfair of Sasol to pay the fine out of the dividends because of Sasol's failure to adhere to good corporate governance.

5.5.1.2 LACK OF LEADERSHIP

Corporate governance is essentially about leadership.⁴ The board, who are the leaders, should lead by example in enforcing corporate governance. King⁵ states that there should be leadership efficiency to compete effectively in the global economy and to create jobs; leadership probity, as investors require confidence and assurance that management is honest and has integrity. Leadership responsibility is needed as companies should be able to address legitimate concerns relating to their activities and leadership transparency and accountability as the leaders should be trusted to build the company and the country's economy.

Responsible leaders:⁶

- (a) build sustainable businesses;*
- (b) they reflect on the role of business in society;*
- (c) they do business ethically;*

1 Hasenfuss 2002: 9.

2 King II: 5.

3 Ashton 2008: 1.

4 King II: 18. See also King II: 10.

5 King II: 18. King III: 10 and 20 states that leadership should be characterised by ethical values of responsibility, accountability, fairness and transparency and based on moral duties to find the expression in the concept of Ubuntu.

6 King III: 20.

- (d) do not compromise the natural environment and the livelihood of future generations; and*
- (e) embrace a shared future.*

5.5.1.3 LACK OF DIALOGUE

Corporate disclosure and dialogue with market participants in general and shareholders in particular are important in retaining good and sound corporate governance system.¹ Dialogue with corporate managers is popular among investors as they could use dialogue to monitor corporate management.² There are two channels in a corporate dialogue namely, the formal channel also called periodic reporting and informal channel also known as the selective briefing or private briefing.³ Depending on the method of execution, dialogue potentially has great advantages to companies and investors.⁴

A dialogue between the shareholders and the directors depends on the character of the directors. Some directors resort to arrogance instead of engaging in constructive dialogue. The chairperson of Liberty Holdings told Chris Logan of Opportune Investments, that if he was not happy with Liberty's performance, to sell and buy Sanlam shares. This was after Logan was making a comparison between the performance of these two companies.⁵

5.5.1.3.1 FORMAL DIALOGUE

Listed companies communicate with their shareholders through the Securities Exchange News Service ("SENS"), annual reports, trading statements, circulars and print media. Circulars, prelisting statements and announcements should be published in English in a daily English newspaper and in one of the official languages. Announcements on the internet can be made only after the publications has been released on SENS.⁶ Company Company circulars and pre-listing statements should be distributed by the company to all certificated shareholders and to the dematerialized beneficial shareholders.⁷ All share

1 Al-Hawamdeh *et al* 2005: 489.

2 Al-Hawamdeh *et al* 2005: 493.

3 Al-Hawamdeh *et al* 2005: 490.

4 Al-Hawamdeh *et al* 2005: 494.

5 Rose 2008: 72.

6 Listings Requirements: 3.46.

7 Listings Requirements: 3.49.

certificates have to be sent to the shareholders through registered post.¹ An important forum for communicating with shareholders is at the annual general meeting, where shareholders are able to ask questions and raise concerns.

In South Africa there is no platform for shareholders to communicate amongst themselves to prepare to come to a meeting as one voice. If there was such a platform, shareholders would be able to engage with the management effectively as they would appoint a representative amongst themselves to liaise between themselves and management. The formation of shareholders committees is something that South African shareholders need to consider to enhance corporate governance.

King² encourages companies to develop and adopt a strategy and policies for managing relations with shareholders.

According to Marens,³ the SEC had acknowledged that shareholders had a right to communicate to each other and with management. SEC Rule 14A-8 establishes the conditions needed for a proposal to be placed on a company's proxy statement to ensure shareholder participation in important company decisions.⁴

A company must ensure that there are necessary facilities to be able to communicate with shareholders, in order to inform them of the meetings that they are entitled to attend, to be able to vote and to be able to release announcements and distribute circulars.⁵

5.5.1.3.2 INFORMAL DIALOGUE

Private briefings may result in institutional investors and investment managers to become involved in corporate governance and monitoring corporations' management.⁶

1 Listings Requirements: 3.53.

2 King III: 101. King encourages management to engage in constructive engagement with its stakeholders.

3 2002: 370.

4 Loring *et al* 2006: 321.

5 Listings Requirements: 3.44.

6 Al-Hawamdeh *et al* 2005: 490.

The practice of companies to favour significant shareholders, particularly institutional investors and investment managers has caused a great deal of controversy and has raised the arguments:¹

- (a) it is often stated that companies could not practically arrange to meet all the investors to discuss company affairs, particularly in listed companies that have thousands of shareholders;*
- (b) selective briefing as a form of disclosure decreases the volatility of the share price;*
- (c) it is argued that other shareholders have the statutory right to express their opinion and voice their views in the company general meeting;*
- (d) some might argue that institutional investors and individual investors have the same interests anyway;*
- (e) restricting informal relations between institutional investors and companies does not seem to go in harmony with the government's line of encouraging shareholders to make corporate managers accountable;*
- (f) it might be argued that early briefing of analysts on complex issues may be needed to give the analysts in particular time to absorb and understand it.*

Others might even argue that institutional investors should be rewarded for conducting dialogue with corporate management. Unfortunately the JSE Listings Requirements and both the Companies Act 61 of 1973 ("the Act") and the Companies Act 71 2008 ("the Companies Act 2008"), do not have provisions that compel directors to listen or to engage in a dialogue with shareholders.

Directors should consider other informal ways of engaging shareholders such as direct contact, websites, adverting or press releases.² If a disclosure of information does not benefit the shareholders equally, prejudiced shareholders may resort to courts or activism to raise their concerns.

1 Al-Hawamdeh *et al* 2005: 490.

2 King III: 102.

5.5.1.4 MISMANAGEMENT

Shareholder activism occurs when disgruntled shareholders loudly complain that management is not acting in their best interests and threaten to do something about it.¹ Mismanagement is broad and is inclusive of poor business judgment calls.

Dhir² quotes Professor Adolph Berle who said: “All powers granted to a corporation or to the management of the corporation are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears”. He also quotes a dissenting view of Professor Merrick Dodd, who argued that “managerial powers are held in trust for the community not just for shareholders but, also public opinion, which ultimately makes law and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as profit making function”.

It is clear that Berle supports the view that directors are servants of the shareholders and act for their economic benefit. Contrary, Dodd is of the view that directors must not only manage a company in the best interests of the shareholders but of all the shareholders taking social issues and economic issues in to account.

Shareholders are likely to become more involved in the management of companies taking into consideration King II's proposals to protect shareholders more effectively from poor management, by making directors take responsibility for bad decisions, unethical behavior or illegitimate corporate actions.³

5.5.1.5 SUSTAINABILITY

Sustainability is the primary moral and economic imperative of the 21st century.⁴ Sustainability is derived from “sustainable development” and it means development that meets the needs of the present without compromising the ability of the future

1 Guay *et al* 2004: 129.

2 2006: 370. See also Licht 2004: 652. A seminal debate between Adolf Berle and E.Merrick Dodd shows that there is some disagreement on the maximands of corporate governance.

3 Van Zyl 2002: 46.

4 King III: 11. King stresses that nature society and business are interconnected in a complex ways that should be understood by decision makers.

generations to meet their own needs¹. Sustainability focuses on non-financial matters of a company that influence a company to survive and prosper in communities from where they operate. Directors are required to issue an integrated report on its economic, social and environmental performance.²

Under the United Nations Environmental Program, Ceres started and spun off the Global Reporting Initiative, an effort establish common guidelines for triple bottom line reporting of economic, environmental and social issues.³ In Europe sustainability is being taken seriously by some countries.⁴In South Africa, there is Socially Responsible Index, under the auspices of the JSE.⁵

5.5.1.5.1 ENVIRONMENTAL ISSUES

Global warming is a threat to the environment and its sustainability. Companies are constantly reminded to bring down the volumes of toxic emissions during production. Directors have an individual and collective responsibility for companies' performance and compliance with health, safety and environmental issues.⁶ Sustainability requires companies not to destroy the environment or communities from which they operate. Companies are required to practice and encourage environmental responsibility and support a precautionary approach to environmental challenges⁷.

There should be shareholder advocacy and corporate engagement influence to help bring about corporate social and environmental change, through proxy voting, shareholder resolutions and divestment.⁸ For example in the USA, in March 2004, Tyco management advised its shareholders to support a resolution to report on environmental issues to reduce emissions of toxins like lead and dioxin.⁹

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- 1 King II: 96. Companies must balance the need for long-term viability and prosperity of the company and the societies and the environment.
 - 2 King III: 22. This means that companies should protect, enhance and invest in the wellbeing of the economy, society and natural environment.
 - 3 Rogers 2008: 100.
 - 4 King III: 11. Sweden, United Kingdom, Germany, Norway and Denmark have laid down rules with regard to sustainability.
 - 5 King III: 12. SRI index is a tool used for investors to identify companies incorporating sustainability practices in their business practices.
 - 6 King II: 115.
 - 7 King II: 97.
 - 8 King II: 126.
 - 9 Dhir 2006: 383.

In South Africa, companies are under pressure in that King requires companies to invest in corporate social investment programmes and to report on their safety, health and environment issues.¹ King encourages the promotion of collaborative partnerships between companies and communities, recognizing the modality and two-way nature of such relationships². As witnessed in Xholobeni³ stakeholders can raise issues of environment and biodiversity and oppose any action perceived to destroy the environment. Governments around the world are also taking issues that affect the environment seriously.

5.5.1.5.2 HEALTH AND SAFETY ISSUES

Corporate governance practices should reflect a commitment to prevent work place injuries and fatalities.⁴ Companies are required to value the lives of their employees. The directors especially chief executive officers, should be held personally liable for failure by companies to comply with safety requirements at a work place.⁵

Every employer is required by law to provide and maintain a working environment that is safe and without risks to the health of employees.⁶ The advantages associated with adopting a corporate social investment programme are identified in the specific programmes such as those relating to Occupational Health and Safety.⁷

In the USA Coca-Cola supported a resolution under which management would prepare a report on the economic impact of HIV/AIDS on its employees.⁸ Directors should take into consideration all the threats that are material to the health of the shareholders and should reflect a commitment to prevent occupational diseases. Safety and health issues have raised activism by employees that have resulted in strikes and lockouts especially in the mining industry. The pressure put by the departments of Labour and Minerals and Energy resulted in mining bosses taking the issues of safety and health seriously.

1 King II: 114.

2 King II: 98

3 See also paragraph 3.4.3 above.

4 King II: 115.

5 King II: 115.

6 S 8 of Occupational Health and Safety Act 1993.

7 Grossman 2005: 583

8 Dhir 2006: 380.

In a press statement of 01 May 2008, Cosatu¹ demanded an urgent and thorough investigation to establish the cause of accidents and who was responsible. They advocated for a strong disciplinary action against anyone found to have been negligent. They also demanded that inspections be carried out at all the country's mines, and that if any breaches of safety are revealed, mining operations be halted until they have been rectified. These demands followed the death of nine mine contract workers at Gold Fields's South Deep mine on 01 May 2008, preceded by the death of four workers in Gold Fields' Driefontein mine and the death of one worker at South Deep mine. In South Africa shareholders are yet to see directors' prosecuted and convicted for deaths of employees in the work place.

5.5.1.6 APPOINTMENT OF DIRECTORS

Directors are appointed by shareholders, on the recommendation of the board.² They are appointed to serve for an indefinite period unless stated otherwise in the memorandum.³ They are elected by persons entitled to exercise voting rights.⁴ Election of directors must be conducted by series of votes and the vacancies filled by directors who receive majority votes.⁵ A listed company is required through its sponsor to inform the JSE on the appointment of a new director.⁶

Shareholders who nominate and elect directors must be careful whom they elect.⁷ The institutional investors have increasingly wanted to be involved and insist to be a voice not just in strategic decisions such as acquisitions and divestures but also in the appointment of senior personnel such as the selection of new directors.⁸ Upon appointment, directors are expected to understand fully their role, responsibility and accountability.⁹

1 <http://www.cosatu.org.za/press/2008/may.htm>. Accessed on 10/12/2008.

2 See also Smith 1998: 277.

3 S 68 (1) of the Companies Act 2008. See also S 66(4) of the Companies Act 2008.

4 S 68 (1) of the Companies Act 2008. See also S 60 (3) which states that a director can be elected by shareholder prior to a meeting by written polling.

5 S 68 (2) of the Companies Act 2008.

6 Listings Requirements: 3.59 (a).

7 Black 1990: 532.

8 Gupta 1992: 48.

9 Mammatt *et al* 2004: 1.

Shareholders are ultimately responsible for the composition of the board and it is in their own interests to ensure that the board is properly constituted¹. The board has a right to appoint a person who satisfies the requirements for election as a director, on a temporary basis until a proper replacement is found.²

Although directors of some corporations typically stand unopposed for re-election, shareholders should express their lack of confidence in management's performance by marking proxy cards to withhold authority of corporate boards.³ The campaign for majority in election of directors has become the most high-profile aspect of shareholder efforts to increase their power within USA corporations.⁴

5.5.1.6.1 IRREGULAR BOARD APPOINTMENTS

Black⁵ suggests that probably the most important shareholder task is nominating and electing directors. Reforming corporate elections would improve the selection of directors and the incentives they face.⁶ Shareholders should not only rubber stamp appointments but should also put forward names of possible candidates.

What normally leads to director-appointment shareholder activism is the manner in which these appointments are made. Procedures for appointments to the board should be formal and transparent and a matter for the board as a whole, assisted by the nominations committee, subject to shareholder approval when necessary.⁷

1 King III: 40.

2 S 68 (3) of the Companies Act 2008.

3 Grundfest 1993: 865. See Bebchuk 2003: 45. By and large directors nominated by the company run unopposed and their election is guaranteed.

4 Fairfax 2008: 3.

5 Black 1990: 531.

6 Bebchuk 2003: 44. Some supporters of shareholder access have "shareholder voice" and "corporate democracy" as their objectives. See Bebchuk 2003: 53. Opponents of shareholder access argue that it might deter some potentially good directors from serving in the boards of publicly traded companies.

7 King III: 36. See Bebchuk 2003: 43. SEC considered changes in the proxy rule under certain circumstances to include in their proxy material shareholder-nominated candidates for the board. After this proposal was provided for public comment, most responses received favoured the reform but business organisations, corporate law firms and bar groups all expressed opposition to shareholder access.

The worst problem is the cronyism, the selection of family members and friends as directors.¹ Kahan² quotes Third Point hedge fund managers as having said the following at a meeting: “How is it possible that you selected your elderly seventy-eight year old mom to serve on the company’s board of directors and as a fulltime employee providing employee and unit-holder services? We further wonder under what theory of corporate governance one’s mom sits on a company board. Should you be found derelict in the performance of your executive duties, as we believe is the case, we do not believe your mom is the right person to fire you from your job”. This question was as a result of perceived lack of corporate governance, whereby a chief executive officer appointed his mother to serve on the board of directors.

The same question could be asked by shareholders of Pick ‘n Pay Stores Ltd and Pick ‘n Pay Holdings Ltd, as Gareth, Raymond and Wendy Ackerman are family and directors. In essence, there should be no problem with family members serving on the board as long as they do not compromise corporate governance. And as long as they serve the interests of shareholders and will be tough against each other. But it will be difficult to prove that corporate governance is not compromised. However, increasing shareholder activism has led to the reduction in incumbent chief executive officer’s power to pick their successors unilaterally.³

Directors should be nominated only after a thorough background investigation into their ethical conduct, conflict of interest and exercise of independence and those candidates should be supported when they are fit and proper for the role.⁴ An example of irregular appointment was that of Absa, that appointed Danisa Baloyi to the board without verifying her qualifications. This matter was an embarrassment to Absa and a lesson to most companies to make sure that persons they appoint to their boards are beyond reproach. There are many risks to holding the office of a director in today’s corporate environment.⁵ That is why directors’ integrity should not be questionable.

1 Kok 2006: 1. See also Gupta 2006: 49

2 2007: 1030.

3 Gupta 2006: 49.

4 Greenblo 2008: 4. See also King III: 41.

5 Mammatt *et al* 2004: 1.

The legal and institutional structure of shareholder voting severely hinders shareholders' ability to nominate alternative director candidates, as the Rule 14A-8(i) (8) of the SEC regulations allows management to exclude shareholder proposal relating to specific elections.¹ Admission to the boardroom has become the hottest ticket in companies, looking at the shakeup that happened at General Motors and the unceremonious departure of the founder of Digital Equipment Corporation, Ken Osten, allegedly prompted by outside directors.²

Directors should be individuals of integrity and courage, and must have the relevant skill and experience to bring judgment to bear on the business of that company.³ The qualifications and experience of the appointed directors should be made available to the shareholders.

Electing good directors is especially important for diversified institutions who cannot watch any one company closely.⁴ Corporate USA is now governed by directors who are largely impervious to capital market or electoral challenges.⁵

Shareholders agreement providing for groups of shareholders can allow shareholders and each group having right to appoint, remove and replace directors and alternate directors and fill any vacancy in any such appointment and a director cannot be disqualified by resorting to the provision of the articles of association.⁶ This is normally a practice in BEE deals, whereby majority shareholders demand to have a representation. Sometimes managers are elected by the beneficiaries.⁷

5.5.1.6.2 BOARD STRUCTURE AND COMPOSITION

Activists have focused on symbolic issues that brought out public awareness and turned their attention to the role and the structure of the board.⁸ The board should comprise a balance of executive and non-executive directors, with majority being independent non-

1 Joo 2003: 758.

2 Ettorre 1992: 10.

3 King III: 31.

4 Black 1990: 531.

5 Grundfest 1993: 864.

6 *Delfante and Another V Delta Electrical Industries Ltd and Another*: 221.

7 Murphy 2003: 73.

8 Ettorre 1992: 11.

executive to make sure that the interests of shareholders are protected.¹ The theory is that the chief executive officer leads the management team in long and short-range corporate strategy and operations, while the chairperson of the board heads up the entity to which the chief executive officer must answer,² also leads the board in several key areas such as compensation, shareholder rights, outside offers for control of the company and stock issuance.³

The unitary structure with both executive and the non-executive directors remains appropriate for South African companies.⁴ South African boards are classified or staggered. Classified or staggered boards are boards where shareholders elect only a portion of the directors each year, generally one third of the board, where board members do not come up for re-election every year and have multi-year terms.⁵ In the USA, shareholders have put corporations under pressure to abolish classified boards, and most companies acceded to and ended classified boards. This means that directors serve annual terms on the board.⁶

Diversity management is an important constituent of transformation, especially with regard to employment equity.⁷ Every board should consider whether its size, diversity and demographics make it effective. Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age, race and sex.⁸ Some people feel that organisations are perfecting the ploy to appoint smooth and/or eloquent and conformist black people who do not only delay transformation but reverse it as well.⁹

South African shareholder activist Theo Botha is not a favourite of some of the black executives, as he asks questions like: “what are black directors doing in these boards, are they stonewalled or are they just happy to be there?”¹⁰

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- 1 King III: 38.
 - 2 Ettorre 1992: 11.
 - 3 Ettorre 1992: 13.
 - 4 King II: 21.
 - 5 Fairfax 2008: 9.
 - 6 Fairfax 2008: 10.
 - 7 King II: 125.
 - 8 King III: 31 and 39.
 - 9 Mncane 2008: 18.
 - 10 Radebe 2008: 15.

The representation of previously disadvantaged individuals in the boards' falls short of the required levels, with only 26% black and 13.4% female representation.¹ Non-executive directors make up two-thirds of all boardroom seats and are in the majority on most boards and 44% are independent directors.²

There has always been a question as to whether the position of a chairperson and that of a chief executive officer should be separate. King recommends that there should be a division of responsibility between a chief executive officer and a chairman, and the chairman should preferably be independent non-executive.³ Splitting chief executive officer and chairman roles is a company specific issue and not governed by any law.

5.5.1.7 DIRECTOR REMUNERATION

Annual retainers are frequent means of compensation to the chairperson and the non-executive directors.⁴ Shareholder activism and executive compensation have beleaguered corporate USA's boards.⁵ As a rule, directors' remuneration should be determined by the shareholders at a general meeting.⁶

Companies should have remuneration policies and practices for executives,⁷ and the policies should be tabled to the shareholders every year at annual general meetings to enable shareholders to express their views on the policies.⁸ As a general rule a director has no right to remuneration unless such a right is given to him by the articles or a contract.⁹ Unless the memorandum states otherwise a company may pay remuneration to its directors for their services as directors.¹⁰

Director compensation is not approved by shareholders in advance for the following year, but retrospectively after payment has already been made, whether they have performed to meet expectation of shareholders or not. In practice, directors decide what

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- 1 Spencer Stuart 2007: 4.
 - 2 Spencer Stuart 2007: 9.
 - 3 King II: 23.
 - 4 Spencer Stuart 2007: 4.
 - 5 Ettorre 1992: 10.
 - 6 Van der Merwe *et al.* 1995: 15-23.
 - 7 King III: 48.
 - 8 King III: 52.
 - 9 Pretorius *et al* 1999: 272.
 - 10 S 66 (9) of the Companies Act 2008.

is “fair and reasonable” compensation for themselves. A new development is that directors’ remuneration must be approved by shareholders through a special resolution approved by shareholders within two previous years.¹

Prior to 1990, shareholder activism had little influence on determining executive pay, but thereafter there were changes due to shareholder pressure.² Continuing and glaring publicity highlighting such issues as amongst others overblown executive compensation have confirmed suspicions that little happens behind the highly polished closed doors of corporate board rooms³. Significant beneficiaries are white men who as senior executives and board members hold significant amounts of stock and options as part of the highly generous compensation packages.⁴

Dramatic increases in executive pay levels in the USA made them an easy target of shareholder activism. Shareholders’ efforts have also extended to seeking a voice on the compensation of corporate officers and directors.⁵ In the 1980’s institutions submitted hundreds of shareholder proposals consisting amongst others proposals to restrict executive compensation.⁶

From about 2001 companies were expected to answer tough question from shareholders on how much they paid their executive directors.⁷ A company policy of remuneration should be approved by shareholders in a general meeting and the board is responsible for determining the remuneration of executive directors and those decisions need not be approved by shareholders.⁸ The JSE has taken a decision that listed companies should be more transparent and reveal remuneration of executive

1 S 66 (10) of the Companies Act 2008.

2 Davis *et al* 1994: 168.

3 Ettorre 1992: 11.

4 Wade 2003: 220.

5 Fairfax 2008: 2. See also Davis *et al* 1994: 141. Activist shareholders overtime extended their demands and wanted to be involved in the appointment of executives and their pay Romano 2001: 175. See also Mammatt *et al* 2004: 3. Directors’ remuneration is being subjected to scrutiny with emphasis that remuneration should be linked to performance of the company and this is necessary to prevent to a large extent excessive increases being awarded to the directors whilst the company itself is underperforming

7 Gleason 2001: 50. This was apparently sparked by the R24m Alexander Forbes, paid to its executive directors.

8 King III: 48

management.¹ King² also encourages companies to be transparent to enable shareholders to make informed decisions with regard to remuneration of directors and other issues.

Massive and costly boards such as Standard Bank, FirstRand, AngloGold, and Sanlam need to account for such high costs.³ Greater account needs to be kept of chief executives and executive directors who have pay packages of R5 million and more.⁴

Shareholder efforts have also extended to seeking a voice on the compensation of corporate officers and directors.⁵ Because of perception of excessive executive salaries, salaries, shareholders and legislators have launched many efforts to curb executive pay.⁶

Labour unions and pension funds have also devoted significant effort to combating excessive executive compensation.⁷ Labour unions use the corporate voting process to push for a variety of changes in corporate governance.⁸ At a Nedbank annual general meeting, shareholder activist Theo Botha put the directors on the spot by asking why the directors were given lump sum money instead of being paid according to their attendance.⁹ Management defended its decision.

5.5.1.8 MARKET ABUSE AND INSIDER TRADING

Unethical business practices are not acceptable anywhere in the world. No person may, for his own account or on behalf of another person directly or indirectly participate in the

1 Van Zyl 2002: 46.

2 King III: 41.

3 Kok 2006: 1. The annual board costs for Standard Bank was around R75 million, FirstRand, was about R42 million, AngloGold was R36 million and Sanlam was about R20 million.

4 Kok 2006: 1. Jacko Maree (Standard Bank); Tony Trahar (AngloGold); Phuthuma Nhleko (MTN), Tom Boardman (Nedbank) are amongst chief executives who earned more than R5 million for the 2004 financial year.

5 Fairfax 2008: 2.

6 Fairfax 2008: 10.

7 O'Connor 2000: 119. See Schwab 1998: 1021 Labour is also seen to be active in seeking changes to executive pay, an area a bit closer to labour interests and one in which institutional shareholder interest has been increasing recently.

8 Schwab 1998: 1020. These changes range from redemption of rights to implement confidential shareholder voting to cap executive pay.

9 Mamise 2007: 1.

use of manipulative, improper, false or deceptive practice of trading in listed securities.¹ That is why directors should be individuals of integrity, so that they will not abuse their position of having access to inside information for their sole benefit.

The issue of communication between outside directors and the shareholders may be discriminating against smaller individual shareholders and may be a perfect breeding ground for divulging inside information the outside directors may be privy to, inadvertently so.² There are two channels of company disclosure namely, the formal disclosure also called periodic reporting and informal disclosure also called selective briefing or private briefing.³

In the USA the Securities and Exchange Act 1934 ("SEC Act") requires that officers, directors and ten percent beneficial owners of public companies report purchases and sales to the SEC and prohibits anyone from trading while in possession of material non-public information that the person has a duty not to disclose or trade on.⁴

According to the JSE Listings Requirements and the Securities Services Act 2004 insider trading is prohibited and is a punishable offence.⁵ Inside information relates to specific or precise information that has not been made public by a listed company, which if it were made public would influence the share price of the listed company.⁶

Insider trading has four elements:⁷

- (a) the use of information;*
- (b) which is price sensitive;*
- (c) not yet published information and*
- (d) by virtue of insider trading.*

The use of insider information to buy or sell shares constitutes insider trading.¹ An insider can be a director, shareholder or an employee of the company who has access

1 S 75 and 76 of the Securities Services Act 2004.

2 Ettorre 1992: 14.

3 Al-Hawamdeh *et al* 2005: 496

4 Black 1990: 545.

5 S 73 of the Securities Services Act.

6 S 72 of the Securities Services Act. See also Al-Hawamdeh 2005: 496. Insider dealing is trading on sensitive information by company employees or others closely connected with the company which, has not been disclosed to other market participants.

7 Al-Hawamdeh *et al* 2005: 496.

to information by virtue of being employed or by profession is the direct source of such information.² If a company listed on the JSE or any of its directors, contravenes or fails to adhere to the provisions of the JSE Listings Requirements, the JSE may on its discretion publish full details of an imposed fine or order an investigation.³

The JSE wanted the Financial Services Board (“FSB”) to investigate possible insider trading by Sentula Ltd, relating to a burst of trading before an announcement was made on SENS.⁴ Shareholders were angered by the timing of sale selling the shares by major shareholders, Coronation Capital and Jonah Capital.⁵ A Sentula shareholder wanted the FSB to investigate the R680 million book that Jonah Capital and Coronation Capital had, to see if they used insider information to sell shares to the detriment of other shareholders.⁶

If confidential information has been leaked to the market, the company must release a cautionary statement providing particulars of any development in the company’s sphere of activity.⁷ Companies are required to provide price sensitive information under very strict conditions to their sponsors, advisors or any other person, and inform them in writing that the information is price sensitive.⁸ Companies usually enter into non-disclosure and confidentiality agreements to make sure that the inside information remains confidential.

1 Mammatt *et al* 2004: 35.

2 S 72 of the Securities Services Act. See Al-Hawamdeh 2005: 496. He differentiates between primary and secondary insiders. A primary insider is a person who because of his/her position in a company possesses price sensitive information and deals with company’s shares relying on that information. In this context an insider can be a director an employee, a shareholder or anyone who holds inside information by virtue of their position in the company. A secondary insider is legally referred to as the “tippee”. This may be any individual other than primary insiders who has information from a primary insider or from a source that can be traced from the insider. See also S 73 of the Securities Services Act 2004.

3 Listings Requirements: 1.21.

4 Ryan 2008: 29.

5 Ryan 2008: 29.

6 Brown 2008: 17.

7 Listings Requirements: 3.6.

8 Listings Requirements: 3.6.

Public companies are encouraged to have a policy of prohibiting in securities by directors, officers and other selected employees for a specified period before the announcement of its financial results or in any other period considered sensitive.¹

5.5.1.9 FRAUD AND CORRUPTION

Fraud consists of unlawfully making, with intent to defraud, a misrepresentation which causes actual prejudice or which is potentially prejudicial to another.² If at any stage during winding-up or judicial management, it is found out that a company was managed or operated recklessly with the intention to defraud its creditors or any other person, the liquidators or the master of the high court or creditors or members or judicial manager may apply to court to have any person who knowingly committed that fraud to be responsible for the debts and other liabilities of the company.³ And every person who knowingly was party to that shall be guilty of an offence.⁴

It is not permissible for a company to carry on its business recklessly with intention to defraud any person or for any fraudulent purposes.⁵ One of the major themes of corporate law concerns tensions between control and accountability⁶. Boards that are dominated by the firm's managers are likely not going to be able to assert their legitimate roles as managers, and have been accused as defeating the ends of checks and balances in corporations.⁷ It is advisable for companies to have more non-executive directors so that checks and balances are not compromised.

Accounting fraud, greedy chief executive officers and plummeting stock prices have hurt the reputation of most companies.⁸ The SEC Act in the USA was enacted to curb fraud and stock manipulation.⁹ Similarly in South African there is legislation like Securities

1 King III: 32.

2 Burchell *et al* 1997: 579.

3 S 424 (1) of the Act.

4 S 424 (3) of the Act.

5 S 22 (1) (a) of the Companies Act 2008.

6 Ramsay 1992: 151.

7 Baliga *et al* 1996: 42. This is because of their ability to influence board composition and tenure, set board agenda and control information flow, influence the development of corporate strategy, promote convergence on an established strategic direction and resist executive change despite performance decline or instability

8 Pedersen 2004: 24.

9 Marens 2002: 369.

Services Act, Insider Trading Act and Prevention and Combating of Corrupt Activities Act 2004.

When the Enron and other scandals erupted in 2002 shareholders brought 802, proposals compared 1 082 in 2003 and 1 147 by mid 2004, to vote at shareholders meetings.¹ This shows that shareholders were becoming interested in the management of companies in which they invest. In the aftermath of these scandals, the governments increased regulatory focus on issues relating to corporate accountability.²

Randgold & Exploration alleged that it was the victim of widespread fraud and theft of its assets during the Brett Kebble era. That resulted in the company being stripped of the majority of its assets and based on forensic investigations, legal assessments and the opinion of counsel, R&E embarked on a process of attempting to recover damages in respect of the alleged misappropriation of its assets.³ This is an example of directors who did not perform their duties with skill and care and should be prosecuted if they were aware of the alleged commission of fraud by Kebble.

5.5.1.10 ANTI-COMPETITIVE BEHAVIOUR

Companies big and small are required to promote and maintain competition in South Africa by promoting efficiency, adaptability and development of the economy. They must provide consumers with competitive prices and product choice; promote employment and advance economic and social welfare, to ensure that small and medium enterprises have equitable opportunities in the market and to increase the ownership of historically disadvantaged persons.⁴ Sometimes companies, especially monopolies usually enter into agreements in terms of which they prevent or lessen competition in the market by directly or indirectly fixing a purchase or selling price, by dividing markets or allocating customers, suppliers, territories or through collusive tendering.⁵

1 Pedersen 2004: 25. The most popular proposals were CEO pay and non-discrimination.

2 Brownstein 2004: 24.

3 www.randgold.co.za. Accessed on 10/02/2009. Randgold & Exploration is a mining company that has its listing suspended on the JSE after it failed to submit its financial results after allegations of fraud.

4 S 2 of the Competition Act.

5 S 4 (1) of the Competition Act.

For example two units of Tiger Brands Ltd, namely the bakery division and Adcock Ingram Critical Care, were fined by competition authorities for price fixing. Their fines were R99 million and R53,5 million respectively.¹ Sasol is another company that was found guilty of price fixing and collusion. In both cases shareholders lost out on dividends and the enhancement of shareholder value diminished.

Cosatu issued a press statement on 12 February 2008,² in which it noted with anger that the Competition Tribunal was to prosecute several pharmaceutical companies for price fixing. It stated that following the conviction of Tiger Brands for bread price fixing, and the forthcoming prosecution of eight companies on charges of fixing the price of milk, a pattern is emerging of widespread collusion throughout South Africa business. It said that it would demand that if these pharmaceutical companies were found guilty, the directors be prosecuted as well. It was not sufficient punishment to fine companies, since that cost is absorbed into their operating costs and passed on to the very consumers they have been fleecing, but also directors individually and collectively must be held accountable. As long as directors are not prosecuted for these acts, they are likely to continue unabated.

5.5.1.11 SUSPENSION OR TERMINATION OF A LISTING

The JSE has general powers subject to the JSE Listings Requirements to grant, review, suspend or terminate a listing of securities,³ and to prescribe under which circumstances a listing of securities shall or may be suspended or terminated.⁴ If a company requests the JSE to remove its listing that has been suspended, the request must be approved by shareholders in a manner specified by the JSE, taking into account on reasonable grounds the interests of minority shareholders.⁵

A company listing its shares on the JSE can be suspended or terminated if it is in the public interest to do so or if the company has failed to comply with the JSE Listings Requirements and it is the public interest to do so.⁶ What public interest in this context means is not defined nor explained in the JSE Listings Requirements. The provisions of section 2 of Securities Services Act, requires that companies offer shares in a fair,

1 Khanyile 2008: 1

2 <http://www.cosatu.org.za/press/2008/feb.htm>. Accessed on 21/01/2009.

3 S 1.1 (a) of the JSE Listings Requirements.

4 S 1.1 (f) of the JSE Listings Requirements.

5 S 13 (5) of Securities Services Act.

6 S 1.6 and S 1.11 of the JSE Listings Requirements.

efficient and transparent manner so as to boost investor confidence in the South African financial markets and to also protect regulated persons and reduce risks.

Before the JSE Ltd suspends and terminate the listing it should inform the issuer or the listed company of its intention and reasons to remove or suspend a listing and should call the issuer to show good cause why the listing should not be suspended, within a time limit that will be set by the JSE.¹

There are different reasons for a company to be suspended. Here are some of the examples of companies and reasons for suspension:²

Afgem Ltd - at the request of directors;

Aludie Ltd - failed to submit financials timeously;

Amlac Ltd - failed to submit provisional annual financial statements;

Aps Technologies - only one director and possible liquidation;

CCI Holdings Ltd - in liquidation;

Consol Ltd - scheme of arrangement;

Saambou Ltd - placed under curatorship;

Tigon Ltd - at the request of the JSE.

Shareholders revolt against the directors when their shares are suspended. They may want reasons and details of a suspension. For example failure to submit financial statements rests with the directors as a result of negligence or failure to exercise their duties with care and skill.

5.5.1.12 AUDITORS COMPENSATION

A company to be incorporated lodges the memorandum and articles of association together with a written consent by an auditor.³ Auditors are appointed by a company at the annual general meeting and should hold the office until the next annual general meeting.⁴ In terms of section 275¹ of the Act, no person shall be qualified as an auditor if he is one of the following:

1 S 13 (2) of the SSA.

2 Who Own Whom's: 34.

3 S 269 (1) of the Act.

4 S 270 (1) of the Act.

- (a) *Director or officer or employee of the company;*
- (b) *A director or officer or employee of any company performing secretarial work for the company;*
- (c) *A partner or employer or employee of a director or an officer of the company;*
- (d) *A person who by himself or his partner or employee habitually or regularly performs duties of secretary or bookkeeper of the company;*
- (e) *A person who at any time during the financial year was a director or officer of the company;*
- (f) *Disqualified under the Public Accountants and Auditors Act 80 of 1991.*

An auditor plays an important role in certifying that financial statements provided by the board present a true and fair overview of the company's financial affairs. Large amounts of money paid to auditors may, in the same vein as the directors' remuneration, spark shareholder activism. At a Nedbank annual general meeting, Theo Botha again put the directors on the spot by asking why the auditors were paid more than they were paid the previous year.²

Unlike the Act, the Companies Act 2008 gives auditors powers to approach a court to enforce its rights set out in the Act.³ In this way auditors are empowered to make sure that companies comply with every law in the book and that auditors cannot claim ignorance when scandals are uncovered.

5.5.1.13 TAKEOVERS

Shareholder activism has to a certain extent been stimulated by takeover abuses that provoked a continuing cynicism that managements are not looking after shareholders interests.⁴ One method by which external market can impose discipline on managers is through the threat of takeovers.⁵ Shareholders may raise their concerns when a takeover is proposed and when directors invoke poison pills.

5.5.1.14 FRONTING

1 See also S 90 of the Companies Act 2008. There is not much difference in the contents of these two sections.

2 Mamise 2007: 1.

3 S 93 (2) of the Companies Act 2008

4 Ettorre 1992: 11.

5 Akhigbe *et al* 1997: 568.

Fronting is a deliberate misrepresentation of the true BEE status of a company, which results in a false or favourable BEE status being conferred or claimed.¹ It is a practice of making unsubstantial Broad Based Black Economic Empowerment claims, where a black person has no real claim to commensurate benefits claimed to have been given by a company and can also be defined as any action that goes against the spirit of BEE.²

Fronting, window dressing and special purpose vehicles created to profit opportunistic “predators” through smoke-and-mirror empowerment schemes have created unsustainable token empowerment entities.³ There are companies that make non-executive director appointments purely for compliance purposes and accept a yawn in a board meeting to undermine black economic participation.⁴ Real or perceived fronting has sparked reaction from shareholders who feel that it is racist and opportunistic in nature.

5.5.1.15 OPPORTUNISTIC INTERMEDIARIES

This refers to a company or a person whose purpose is to fill an agency role that has no real substance, such as black companies winning tenders and the actual work done by a unempowered company.⁵ Black businesses usually use their empowerment status to solicit business under the false pretences that all the benefits will accrue solely to them. With the introduction of the Codes of Good Practice (“the Codes”) as issued by the Department of Trade and Industry, many companies that perpetuate this practice will be exposed.

5.5.1.16 WINDOW DRESSING

Window dressing involves appointing black people into senior positions where there is no substance attached to that position,⁶ and it is exactly the same as BEE fronting. This is a common practice as companies are under pressure from shareholders to meet employment equity targets. This may falsely create an impression to outsiders that a company is transformed.

1 Balshaw *et al* 2005: 199.

2 Jack 2007: 470.

3 Balshaw *et al* 2005: 23.

4 Jack 2007: 421.

5 Jack 2007: 473.

6 Jack 2007: 474. For example appointing a black person with no responsibility or authority, no budget and no one reporting to him or are paid less than others in equivalent position.

The appointment of Raisibe Morathi at Nedbank as the chief financial officer raised a few eyebrows because she had allegedly been “stripped” of the powers that previous chief financial officers’ had.¹ Nedbank and most corporates are seen as reluctant to introduce radical changes that will give black people a meaningful participation in management positions.² Companies must deal with issues of window dressing, whether real or perceived.

5.5.1.17 DUALITY

The failure by companies to adhere to corporate governance and duality led to poor corporate performance, a drop in shareholder value and rekindled shareholder activism.³ Duality is a traditional model common in Europe particularly in England.⁴ In South Africa, Africa, duality does not feature prominently now as many companies have heeded the recommendations by King II, that the positions of chairman and chief executive officer should be separated.

Duality and lack of good corporate governance have led to the decline of some major USA corporations such as Westinghouse, Sears, General Motors and IBM.⁵ General Motors’ failure was also caused by amongst other things duality because it’s chairman and chief executive officer restricted board oversight and the adoption of new strategies.⁶

It is believed that boards are not fully doing what they are legally, morally and ethically supposed to do, because of duality and that boards are dominated by the firms’ managers, who normally defeat the system of checks and balances.⁷ Proponents of chief executive officer duality argue that non-duality would:⁸

1 Rasethaba 2009: 7.

2 Rasethaba 2009: 7.

3 Baliga *et al* 1996: 41. Duality is a term used when a chief executive officer and the chairman of the board is the same person.

4 Ettorre 1992: 11.

5 Baliga *et al* 1996: 42.

6 Baliga *et al* 1996: 42.

7 Baliga *et al* 1996: 41. See Baliga 1996: 42. In cases of duality, the chief executive officer of the firm wears two hats- a chief executive officer hat and a chairperson of the board hat. Duality can mean the filling of the positions of a chief executive officer and chairman by the same person.

8 Baliga *et al* 1996: 42.

- (a) dilute their power to provide effective leadership of the company by increasing the probability that actions and expectations of management and the board are at odds with each other;*
- (b) create the potential for rivalry between the chairman and chief executive officer;*
- (c) create confusion as a result of the existence of two public spokesmen; and*
- (d) limitation of innovation and entrepreneurship if the chief executive officer feels that the board will perennially second guess his actions.*

Whilst the opponents of duality maintain that it:

- (a) constrains board independence and reduces the possibility that the board can properly execute its oversight and governance roles;*
- (b) signals the absence of separation of decision management and decision control; and*
- (c) makes it difficult for insecure directors to be honest when evaluating firm performance, which in turn leads to long-term organizational drift.*

5.5.1.18 PYRAMID SCHEMES

A pyramid corporate structure is one in which two or more companies own the same underlying asset, the control mechanism of which effectively multiplies the voting power of the controlling shareholder at the top of the pyramid.¹ Pick 'n Pay Holdings and Mobile Industries have been under pressure to collapse archaic and costly pyramid structures, which if removed could earn renewed market respect for adhering to modern corporate governance standards.²

Investec Asset Management and BOE Asset Management have focused on shareholder rights by attending annual general meeting and meeting management to try to persuade companies with control structures, such as pyramid schemes to abandon such structures.³

1 Hasenfuss 2008: 18. Pyramid schemes were used in the 1950's and 1960's as a way for a family to maintain control and effectively thwart hostile takeover bids. Pyramid structures are no longer allowed to list on the JSE.

2 Hasenfuss 2008: 18.

3 Formby 1998: 102. Examples cited by Formby is Anglovaal and Rembrandt Group. Both are family controlled companies.

At Liberty Holdings the PIC told the chairman of Standard Bank, that they have a problem with the pyramid structure and Opportune Investments accused Standard Bank of concocting a half baked excuse for keeping the pyramid, to such an extent that twelve percent of Liberty Holdings shareholders voted against the reinstatement of Derek Cooper as chairman.¹

5.5.1.19 BOARD INDEPENDENCE

The independent director requirement can reinforce the norm that board of directors is substantially a watchdog institution charged with monitoring management on shareholders behalf.² Good corporate governance is a means to an end and it adds value only if it is of substantive management quality and thus the acid test of the corporate governance process and of boards' independence.³ Directors need to understand the mechanisms underlying the maximands of corporate governance principles.⁴

The PIC criticised Sasol's appointment of Hixonia Nyasulu as the group's chairperson saying the move undermined good corporate governance as Nyasulu has 1.275% interest in Sasol Ltd Oils, a subsidiary of Sasol.⁵ The PIC was of the view that Sasol cannot claim Nyasulu was independent if she held shares in a Sasol subsidiary.

Hasefuss⁶ quotes Oasis Asset Management head, Adam Ebrahim as having said the following at a general meeting: "we need strong independent non-executive directors on boards who are able to cope with flamboyant, headstrong chief executive officers." On the other hand, Theo Botha asked Liberty Holdings chairman, Derek Cooper, who is also chairman of Standard Bank if he could profess to be an independent chairman of both

1 Rose 2008: 72.

2 Black *et al* 1996: 1949. See also Ramsay 1992: 153. It is claimed that independent directors are effective means of ensuring management accountability to shareholders.

3 Grundfest 1993: 877.

4 Licht 2004: 657, states that firms and countries alike both the developed and developing are urged to improve corporate governance. There is a perception though that this injunction is narrowly construed as a call for improving public/minority shareholder protection from the opportunism of managers and controlling shareholders.

5 Njobeni 2008: 2.

6 2002: 11.

companies.¹ Botha asked the same question at SABMiller annual general meeting.² He was not happy with the SABMiller's categorization of the board.

A director holding shares in a company should not be classified as independent, no matter how small the stake might be. Companies should have majority of independent non-executive directors. Some companies like Gold Reef Resorts Ltd had only two independent non-executive directors, appointed as recent as July 2008, a practice totally opposite the recommendations of King II.

Ettorre³ quotes Ralph Whitworth of the United Shareholder Association ("USAss") as having said that the concept of an independent board in corporate USA is fallacious. Whitworth's definition of independent is that a director should be nominated and elected by the shareholders. It is believed that the selection of directors in most USA companies is in line with an Albanian election: nomination by management which then counts the votes and shareholders are merely allowed to endorse the appointment.⁴

Board independence is becoming a reality in South African companies, as 44% of all directors are now independent.⁵ But the independence of directors in certain instances is questionable, as some independent directors might have established the companies or have served them for many years. In some instances, independence is just a title as directors may not be independent in the true sense of the word.

In the aftermath of corporate scandals of the recent past in the USA, Congress, the SEC and the self-regulatory organizations adopted enhanced rules and standards of corporate governance requiring companies to adopt many measures such as board independence requirement.⁶

5.5.1.20 BAD RELATIONS

1 Mamise 2007: 1.

2 Crotty 2009: 20. Botha asked if Robert Fellowes who joined SABMiller in 1999, Cyril Ramaphosa who joined in 1997 and Miles Morland who joined in 1999 were independent. The board was also satisfied with continued independence of judgement of Meyer Kahn, the chairman who joined the group in 1966 and was appointed to the board in 1981.

3 1992: 13.

4 Ettorre 1992: 14.

5 Spencer Stuart Board Index 2007: 4.

6 Brownstein 2004: 29.

Things have changed compared to the 1980's and boardroom issues go beyond corporate performance and have extended to issues such as the relationship among the board, shareholders and management.¹ Bad relations between shareholders and management can lead to shareholder activism.

5.5.1.21 SHAREHOLDER EXCLUSION FROM DECISION MAKING

In the USA the USAss and Institutional Shareholder Services were founded because these movements believed that the system of corporate governance had lost its legitimacy and they demanded a right to have a greater voice in decision-making.² As owners of a company they believe they deserve to be informed of certain decisions. Decision-making can be wide and can include shareholders usurping the powers invested in directors.

The big question is whether shareholders should be involved in policy formulation or in operational affairs³. Camara⁴ is of the opinion that there are academics that are in favour and those against shareholder involvement in operational affairs of companies. In recent years as investor groups have gained sharper ability to separate feel-good proposals from serious value builders, management and boards have grown more willing to view investors as someone other than just another barbarian at the portcullis.⁵

Those that are in support of shareholder involvement argue that this initiative would allow shareholders to vote effectively and that their actions would increase shareholder wealth.⁶ Shareholders can make informed decision when they have access to all the information they need.

5.5.1.22 TRANSFORMATION AND AFFIRMATIVE ACTION

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- 1 Ettorre 1992: 11. Corporate performance questions: will there be a dividend this quarter? Is my stock worth more this year than last?
 - 2 Davis *et al* 1994: 153. See also Licht 2004: 651, prominent international bodies and numerous national ones have promulgated codes of principles for optimal corporate governance.
 - 3 Policy issues for example may include: Appointment of directors, remuneration of directors, sustainability, transformation, black economic empowerment, employment equity, risks *etc*. Operational issues for example may include: promotions, discount offers, new markets, buying new machinery, offering sponsorships *etc*.
 - 4 Camara 2005: 221.
 - 5 Ward 1997: 9.
 - 6 Camara 2005: 221.

The terms transformation and affirmative action are used in a similar context. Transformation is about giving previously disadvantaged people equal opportunities that they would not have had prior to 1994. The idea of affirmative action originated from the USA and has been raised as an important issue in the way companies should be managed including racial discrimination.¹ For example, the Amalgamated Clothing and Textile Workers Union asked Dayton Hudson Corporation to report on its equal employment opportunity initiatives and purchases it made from minority and female owned sellers.²

Transformation encompasses BEE, employment equity and affirmative action. By its very nature it has to influence an organisation's culture, processes and belief systems.³ While USA's workforce was becoming browner, boardrooms and executive suits were not and a study conducted by Conference Board found out that corporate executives and investors alike claimed to believe that diversity is a key part of good corporate governance.⁴

Transformation from top to bottom is an imperative, it should start at the board level and filter down to the lowest levels.⁵ It is commonly argued that companies should be more concerned about shareholder value than social justice, but even those who value corporate earnings more than racial fairness should be concerned about executive and board diversity.⁶

Transformation in South Africa is seen as moving at a snail's pace to the detriment of a truly and economically empowered South Africa.⁷ Allied Technologies, Ltd was criticized at a shareholders meeting for a slow pace of transformation.

1 Dhir 2006: 382.

2 Dhir 2006: 380. In South Africa, the same approach is used through the broad-based black economic empowerment legislation. Companies are required to report on their employment equity, procurement etc.

3 Mncane 2008: 18.

4 Joo 2003: 738.

5 Kekana 2005: 26; states that if you looked at some of these companies' annual reports you would think you were in Europe. This is an acknowledgement that white people dominate boards of directors.

6 Joo 2003: 739.

7 Mncane 2008: 18.

The PIC which owned 10,3% of Altech, indicated that it was losing patience.¹ The pace of transformation at Altech was very slow despite the PIC having held meetings with Altech to address these issues.² Most companies use the “comply or explain” system of corporate governance even in addressing issues of transformation.

5.5.1.22.1 BLACK ECONOMIC EMPOWERMENT

Broad-based black economic empowerment policy is aimed at redressing continued unequal distribution of ownership, management and control of South Africa’s financial and economic resources.³ It has initiated some form of activism by the state and state owned enterprises. Shareholders become active when companies seem to be getting in the way of returns and BEE.⁴

There are many instances whereby shareholders, especially the PIC have raised the issue of BEE with companies in which they invest. The PIC was also unhappy with Barloworld’s lack of progress with empowerment, governance, strategy and returns.⁵ Shareholder activism is not about compliance with the Codes but it is where shareholders use unique powers as company owners to facilitate change. It is essentially a mechanism by which asset owners can hold the boards of companies accountable to shareholders.⁶

PIC’s attack on Barloworld has certainly received support from BEE proponents, who saw it as justified pressure on “conservative white corporations”, which they have repeatedly accused of frustrating transformation.⁷ White males are generally threatened by the policy of BEE, with the major fear being that there will be no opportunities for them after graduating from university, as most jobs are reserved for black people.⁸

1 Rose 2008: 21.

2 Rose 2008: 21.

3 King II: 125.

4 Theobald *et al* 2007: 31.

5 McNulty 2007: 40

6 <http://www.busrep.co.za/index.php?fArticleId=3648334>. Accessed on 24/11/2008.

7 Williams *et al* 2007: 36

8 Jack 2007: 55.

On the other hand trouble between the PIC and Sasol started in 2003, when Sasol listed BEE as a risk to its shareholders.¹ Brian Molefe of the PIC argued that non-empowerment must be seen as a business risk and that transformation activism must be seen as business imperative rather than a political one.² Sasol and others that have had a run with the PIC over corporate governance could not simply choose to embrace transformation when it suited them.³ Only a tiny percentage of directors and senior executives were women or people of color and the overwhelming majority are white and male.⁴

A number of black executives become uncomfortable with the role played by shareholder activists such as Theo Botha, PIC's Brian Molefe and to a certain extent Black Management Forum president, Jimmy Manyi.⁵ The reasons for directors being uncomfortable may be that directors themselves are perceived to be not doing enough to transform companies they serve and therefore feel exposed and embarrassed.

The government had numerous reasons why the BEE Codes were necessary. It stated that in the past BEE failed because of the following obstacles.⁶

- (a) Lack of uniform framework for the recognition and measurement of BEE. This created confusion as the same BEE initiatives or transactions may have received different BEE recognition levels by organs of state, business entities and verification agencies;*
- (b) Extension delays in BEE implementation due to differences in interpretation. Industry sectors were often locked in contentious debates around certain aspects of BEE , thereby delaying the implementation of the broad based BEE initiatives;*
- (c) Disparity in definitions and targets in charters and other BEE requirements. Different charters introduced definitions, targets and processes which may have diluted or negated the impact of the strategy and circumvented the principles of the BEE legislation;*

1 Smith 2007: 39.
2 Williams *et al* 2007: 36.
3 Kekana 2005: 26.
4 Wade 2003: 220.
5 Radebe 2008: 15.
6 Codes: 6.

- (d) *The status of transformation charters was unclear. Confusion and delays in BEE implementation resulted since companies were uncertain as to the status and application of charters;*
- (e) *Lack of underlying substance to many BEE transactions many BEE transactions boasted high percentage levels of legal black ownership, but often the actual economic benefits accruing to the black shareholders proved to be significantly lower;*
- (f) *Fronting due to lack of implementation guidelines. Lack of understanding of BEE and its elements often resulted in fronting and meant that fronting was more difficult to detect;*
- (g) *Very little transformation within management levels. Despite various attempts at transformation within entities there is still a lack of sufficient representation of black people within management levels;*
- (h) *Uncertainty as to what type of skills development initiatives could be counted towards skills development spend. Skills spend may not necessarily have been aligned to a particular learning outcome;*
- (i) *Narrow-based recognition tended to benefit a limited number of black people with access to capital. Only a limited number of black people have tended to benefit from black economic empowerment to date;*
- (j) *Lack of awareness of enterprise development in and of itself as well as lack a lack of awareness of what constitutes enterprise development. Unlike corporate social investment, enterprise development is a fairly new concept and fairly specific to broad based BEE. For this reason the lack of documentation with examples of what constitutes enterprise development has made enterprise development one of the least implemented elements on the scorecard;*
- (k) *Corporate social investment initiatives were not necessarily linked to the objective of bringing their beneficiaries into mainstream economy. The black majority remain largely outside of the mainstream economy;*
- (l) *BEE was seen as an obstacle to small business development due to increase in the regulatory burden. Small business tended to ignore BEE or resort to fronting techniques to maintain clients for business purposes.*

To this effect, the state through the Department of Trade and Industry, as the custodian of the government policy on BEE and transformation, drafted the Codes under section 9 of the BBBEE Act.

Unlike before, BEE is going to be measured on seven elements namely, ownership, management control; employment equity; skills development; preferential procurement; enterprise development and corporate social investment.

The Codes focus more on empowerment of black and other previously disadvantaged people, as does the Employment Equity Act. Resilience, dogged determination, boldness, creativity and enthusiasm for broad-based BEE need to come from business leaders including owner managers in small white companies.¹

5.5.1.22.1.1 OWNERSHIP

The concept of ownership² is a complex, powerful and controversial idea.³ Historically ownership was the principal explanation and justification for the central role of shareholders in corporate affairs.⁴ Ownership of companies is about the economic share share the knowledge of successful expos active participation in ownership.⁵ The objective of the ownership element in BEE is to increase the number of black people who own, control and manage economic resources.⁶

1 Balshaw *et al* 2005: 24.

2 Van der Walt *et al* 1997: 64: common law description of ownership is that it as an abstract legal relationship, which implies that a legal relationship exists between the owner and a thing, in terms of which the owner acquires certain entitlements, and that a relationship exists between the owner and other legal subjects in terms of which the owner require that others respect his entitlement regarding the object. Ownership is limited by statutory measures, limited real rights, creditors' rights of third parties and the interests of the community.

3 Grantham 1998: 554. In law it explains, justifies and gives moral force to a host of rights and duties as well as serving to legitimise the allocation of wealth and privilege.

4 Grantham, 1998: 554. See also Grantham 1998: 566. The along with the right to control, the right to the exclusive benefit of an asset is a key incident of ownership of that asset.

5 Jack 2007: 116.

6 Jack 2007: 116.

Few black people have outright ownership of companies listed on the JSE. There are two components in ownership.¹ For companies to be empowered they have to meet the following requirements²:

- at least twenty five percent plus one of the exercisable voting rights should be in the hands of black people;
- at least ten percent of exercisable voting rights should be in the hands of black women;
- at least twenty five percent economic interest should benefit black people;
- at least ten percent of economic interest should benefit of black women;
- at least two comma five percent of the economic interest should be hands of black natural people.

Broad-based ownership can be a juristic person, trust or common law association of persons constituted with a view to facilitating participation of natural persons in a company.³ Some companies have structures in place to address the issue of ownership. African Rainbow Minerals (“ARM”) has 13.64% of its shares held by ARM Broad-Based Empowerment Trust.⁴ Vodacom concluded R7,5bn empowerment deal designed to empower its employees and ordinary people as shareholders.⁵ Sasol put in place a R25,9bn Inzalo empowerment scheme for the sole purpose of empowering black people.⁶ The scheme is structured as follows:⁷

Broad-based groups (1,5%);

Members of black public (3%);

Sasol Employees (4%);

Sasol Inzalo Foundation (1,5%).

1 Jack 2007: 118. The two components of ownership are voting rights and economic interest. Voting rights relates to the ability to influence decision making in a company and economic interest relates to the right to share in the economic fruits of the company.

2 The Codes of Good Practice: Interpretative Guide: 19; natural black people means black designated groups, black participants in Employee Ownership Schemes , black beneficiaries of Broad-Based Ownership Schemes or black participants in co-operatives.

3 Balshaw *et al* 2005: 197.

4 Who Owns Whom's: 52.

5 Claasen 2008: 74.

6 De Klerk 2008: 21.

7 <http://www.moneyweb.co.za/mw/view/mw/en/page40?oid=208913&sn=Detail>. Accessed on 10/12/2009.

Employee share ownership could potentially play an important role in corporate governance under a regime of shareholder democracy.¹ But there is little progress made by companies to empower their employees to be shareholders in companies.

5.5.1.22.1.2 MANAGEMENT CONTROL

Previously black people's involvement in companies was limited to menial jobs and seldom extended to running the enterprise actively.² The representation of black people and female directors on companies listed on the JSE falls short of the levels desired by the boards.³

Companies are required to comply with the following:⁴

- at least fifty percent exercisable voting rights should be in the hands of black board members;
- at least fifty percent of black executive directors in a board;
- at least forty percent of black management; and
- at least forty percent of black independent non-executive directors.

Sasol's radical transformation in terms of the racial make-up of its board, senior management, and middle management was perhaps the biggest scalp the PIC has been swinging from its shareholder activism belt.⁵ Glancing across the various sectors and a few selected companies that are household names, it is clear that while some have done better than others in employing black executives, very few can say they have achieved it.⁶

Many representatives appointed through BEE deals have been criticized for being token representatives on boards of listed companies and despite the description of empowered companies, white directors who still represent many of these businesses do all the talking at presentations.⁷

1 Murphy 2003: 105.

2 Jack 2007: 228.

3 Spencer Stuart Board Index 2007: 4.

4 The Codes of Good Practice: Interpretative Guide: 19. The adjusted recognition for gender is used in calculating percentages.

5 Smith 2007: 39.

6 Williams *et al* 2007: 37.

7 Ashton 2008: 1.

Appointment of black managers in most companies is subject to whether an individual is considered to have political connections or not. That is why some black directors have titles such as “Director: Public Sector” or “Director: Government Relations”, so that they can use their political or government connections to lure business and present the company in good light.

5.5.1.22.1.3 EMPLOYMENT EQUITY

Employment equity is borne out of the Employment Equity Act. This Act was the first piece of legislation to promote affirmative action in a work place.¹ It has enjoyed limited success, as companies have set up initiatives to avoid the law and viewing compliance as a problem best avoided as opposed to duty worthy of participation.² The Codes set the following requirements for employment equity:³

- there should at least be two percent (three percent from 2012) of black disabled employees;
- there should at least be forty three percent (sixty percent from 2012) of senior black managers;
- there should at least be sixty three percent (seventy percent from 2012) of black middle management and
- there should at least be sixty eight percent (eighty percent from 2012) of black junior managers.

Employment equity has led to many competent black people being victimised and labelled as “BEE or EE or AA” appointments. This has led to many black people job-hopping, as they are not made to feel accepted and appreciated in traditionally white companies.

5.5.1.22.1.4 SKILLS DEVELOPMENT

The enactment of skills development is to promote transformation within the workplace.⁴

1 Jack 2007: 20.

2 Jack 2007: 20.

3 The Codes of Good Practice: Interpretative Guide: 19. The adjusted recognition for gender is used in calculating percentages.

4 Jack 2007: 20.

Because of the lack of skills in certain sectors, the requirement is that companies should have skills development programmes as required by the Skills Development Act and the Skills Development Levies Act.

Skills development and organisational transformation are at the heart of BEE, as business education will lead to the financial growth of black people.¹ The Codes² require that companies contribute at least three percent of leviable amount or total payroll to skills development. That money would be used to develop skills of black people and 0, 3% to develop skills of black people with disabilities.

Some companies usually complain about lack of skills but are not spending the three percent skills levy stipulated by the law.³ They are therefore required to have a workplace skills plan to address the issue of skills development. Most companies view the skills development levy as “tax” and make no effort to train staff, as a result there is little skills development of black people.⁴

5.5.1.22.1.5 PREFERENTIAL PROCUREMENT

Preferential procurement means buying goods and services from preferred suppliers.⁵ Preferential procurement was borne out of the Preferential Procurement Policy Framework Act 2000. This Act is meant to be used by state organs or state owned institutions in awarding contracts or tenders. The Codes require companies to comply with following requirements when procuring goods and services:⁶

- at least spend fifty percent (seventy percent in 2012) on all suppliers;
- at least ten percent (fifteen percent in 2012) from small and micro enterprises;
- at least nine percent (twelve percent in 2012) from companies that are more than fifty percent owned;
- at least six percent (8 percent in 2012) from companies that are more than thirty percent black women owned.

1 Jack 2007: 272.

2 The Codes of Good Practice: Interpretative Guide: 19. The adjusted recognition for gender is used in calculating percentages

3 Mncane 2008: 18.

4 Jack 2007: 20.

5 Jack 2007: 295.

6 The Codes of Good Practice: Interpretative Guide: 20.

5.5.1.22.1.6 ENTERPRISE DEVELOPMENT

The purpose of enterprise development is to encourage business, to develop small business through preferential procurement. Companies are required to spend at least three percent of their annual net profit after tax on enterprise development initiatives. Enterprise development is not meant to help companies to score better on their scorecard but to assist in the promotion and development of black business.¹

5.5.1.22.1.7 CORPORATE SOCIAL INVESTMENT

Social investment is a term that currently covers four types of activities.² Social responsibility is increasingly becoming an accepted part of the corporate mandate and the key objective of contributions to socio economic development is the promotion of sustainable access to economy.³

The impact of recent corporate scandals and the entrenched culture of profit maximization resulted in the development of hostile corporate social movement against big business.⁴ The notion that managers and directors should be more directly accountable to shareholders has also helped bolster efforts to increase corporate social responsibility.⁵ For many companies there is a considerable gap between corporate rhetoric and the reality of doing business in a more socially alert and sustainable way.⁶

Companies are required to spend at least one percent of their net profit after tax on socio economic development. The notion that managers and directors should be more directly accountable to shareholders has also helped bolster efforts to increase

1 Jack 2007: 321.

2 Waddock 2001:326.The four types of activities are:

(a) *set of social screens related to issues of interest i.e. investors in either investing proactively in companies that exhibit positive qualities or avoiding certain practices;*
(b) *shareholder activism;*
(c) *financial commitment by investors to development of disadvantaged areas and*
(d) *provision of venture capital to small capitalization firms or even micro-enterprises particularly in disadvantaged areas or disadvantaged groups.*

3 Jack 2007: 342. See Grossman 2005: 573. Given that social factors now play an important role in the quest for profit maximization, the hypotheses that social engagement should be considered *ultra vires* from business activities is contradictory.

4 Grossman 2005: 579. According to Grossman this has resulted in companies engaging communities to avoid consumer backlash and to continue to maximise profits.

5 Rogers 2008: 99.

6 Grossman 2005: 579. An “insincere” corporate social responsibility began as no more than means by directors to exploit the community by appearing responsible in order to maximise profits.

corporate social responsibility.¹ For many companies there is a considerable gap between corporate rhetoric and the reality of doing business in a more socially alert and sustainable way.²

5.6 CONCLUSION

Causes of shareholder activism range from financial to non-financial issues. At the centre of all activism is corporate governance in its widest sense. Companies must comply with the recommendations of the King Reports to make sure that they are compliant with basic principles of corporate governance.

The systems of “*insider dominated*” and “*comply or explain*” should not be encouraged to form part of our corporate governance culture. If South Africa were to prosper, companies should be subjected to strict and uncompromising rules of governance, otherwise it will be a huge task to get companies to account. But as the King III states in the USA with the Sarbanes-Oxley Act has not prevented the collapse of many leading names in USA banking and finance³. The systems of duality and pyramid schemes should not be allowed to form part of our system, as they are both flawed and against good governance.

Companies should be severely punished for fronting, window dressing and using intermediaries. These are acts of dishonesty and should be dealt with harshly. The government must pass legislation to criminalise these acts because as long as they are left unchallenged black people and companies will continue to be used by untransformed companies as tokens.

Companies should adopt remuneration policies and practices that create value for the companies over a long-term. The policies and practices should be aligned with the company's strategy, reviewed regularly and be linked to the executive's contribution to performance. Factors outside the influence of the executives, which affect performance, should not be taken into account in assessing the executive's remuneration.

1 Rogers 2008: 99.

2 Grossman 2005: 579. An “insincere” corporate social responsibility began as no more than means by directors to exploit the community by appearing responsible in order to maximise profits.

3 King III: 9. This argument came after critics argued that South African regulations are light and need to be robust.

Companies should be punished for not endorsing the principles of BBBEE. Companies must not only be made to comply to meet targets, but should do so with a view to addressing issues of inequality and poverty.

CHAPTER 6

THE INFLUENCE OF SHAREHOLDER ACTIVISM

6.1 INTRODUCTION

The question is whether shareholder activism is an effective monitoring mechanism to change corporate behavior. The effect of shareholder activism differs depending on the method of activism and the nature of demands made by shareholders. Pressure applied by shareholders on issues that may paint a company in bad light is likely to achieve the desired outcome as bad publicity can be bad for business. The threat of or actual unfavourable publicity can help a company change its mind and review its policies, particularly if it finds that public opinion is against the practice. Companies can still apply the “comply and explain” principle of corporate governance to keep shareholder activists at bay.

Dalton's view is that shareholder activism had not achieved the desired effects that it was meant to achieve.¹ Based on the current trends Dalton's view may be outdated as his article was written in 1989 when there was not much of shareholder activism happening. Increased concentration of shareholding makes shareholder activism more practical and fruitful, making it easier for shareholders to mount collective action against problems law.² The influence of shareholder activism varies from company to company. Some companies are more resistant whilst some are more compliant.

6.2 OPPONENTS OF SHAREHOLDER ACTIVISM

Many opponents of increased shareholder power believe that it will augment the ability of certain investors to advance their narrow political or personal goals.³ Another criticism of shareholder democracy has been that it will have a negative impact on the ability of corporations to focus on groups, other negative shareholders and issues beyond short-term profits.⁴

1 1989: 2. See also Romano 2001: 187; where he states that there is no evidence that shareholder activism directed at poor performers had any discernible positive impact on corporate governance.

2 Rock 1991: 452.

3 Fairfax 2008: 28.

4 Fairfax 2008: 29.

Some opponents believe that although shareholder activism can allow for an external market discipline, it can also “inhibit managerial abilities” and thus the net effects of activism can be determined empirically.¹ They falsely believe that shareholder activists are there to limit managerial powers or company influence. They believe that a shareholder or a group of shareholders who own five percent or less of the shares in a company, are unlikely to influence any corporate changes.²

6.3 PROPONENTS OF SHAREHOLDER ACTIVISM

Proponents of shareholder activism argue that a number of positive influences do arise from such behaviour, because it makes it possible to have a closer monitoring of management performance.³ A review in the United States of America “(USA)” in 1997 by Thompson and Davis on the effects of shareholder activism, found that shareholder activism encouraged and promoted reforms on corporate governance on behalf of shareholders.⁴ Shareholder voice holds more promise to process and structural issues such as the process by which directors are nominated, dual-class recapitalisations, confidential voting, management compensation and choice of state of incorporation.⁵

One measure of success for shareholder activism is the voting outcomes at general meetings of shareholders.⁶ A company’s success and competitiveness can be influenced by outside factors such as role of suppliers, industry dynamics, buyers and potential entrants.⁷ Shareholder activists have succeeded in moving various governance initiatives from the margins to mainstream, including majority vote policies, board declassification, independent chair policies and advisory votes on executive remuneration.⁸

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- 1 Akhigbe *et al* 1997: 567. See Smith 1996: 228 where he asks if shareholder activism is effective in changing companies’ governance structures or if it increases shareholder wealth.
 - 2 Davis *et al* 1994: 148.
 - 3 Gillan *et al* 2000: 280.
 - 4 Solomon *et al* 1999: 290.
 - 5 Black 1990: 524.
 - 6 Gillan and Starks 2000: 285.
 - 7 Jayaraman *et al* 1993: 36.
 - 8 Rogers 2008: 99. See Loring 2006: 326; declassification of a board refers to shareholders attempts to eliminate classified board structure. Classifieds boards stagger director elections so that only a portion of the board is elected in any year, which prevents fast changes to the boards’ constitution.

Marens¹ reports that a shareholder activist by the name of Lewis Gilbert in the USA had successfully:

- (a) promoted accessibility to meeting sites;*
- (b) published meeting reports;*
- (c) annual election of directors;*
- (d) shareholder approval of company auditors;*
- (e) ending staggered boards;*
- (f) appointing independent outside directors;*
- (g) separating the roles of chief executive and chairman;*
- (h) connecting director pay with performance;*
- (i) requiring directors to own shares in a company and*
- (j) stock options for executives.*

Gilbert also encouraged companies to pursue non-financial issues such as charity, labour relations, racial and gender equality. Marens² further reports that in 1939 Gilbert complained to the Securities Exchange Commission ("SEC") that Bethlehem Steel had not disclosed to its shareholders its statement his intention to present two resolutions at the company's annual meeting. One resolution was seeking to move the annual meeting to New York and the second was seeking to give shareholders the right to approve corporate auditors. The meeting was rescheduled because the SEC felt that Gilbert's proposals were justifiable as they were not communicated to other shareholders prior to the meeting.

6.4 CHANGES IN MANAGEMENT

The increase in shareholder activism has placed chief executive officers and boards of directors under more scrutiny.³ Due to pressure by institutional investors such as the Public Investment Commission ("PIC"), some companies have shaken up their management structures to be in line with the employment equity laws. The board composition of most companies listed on the JSE Ltd ("JSE") has changed in the recent past due to pressure exerted by the PIC and legislation.

1 Marens 2002: 372

2 2002: 370.

3 Akhigbe *et al* 1997: 567.

Examples where shareholder activism by the PIC has had an impact include Sasol¹ and Barloworld,² who were pressurised by the government through the PIC³ to appoint black directors to their boards. The PIC is a major shareholder in these companies and had been vocal about what its expectations are with regard to transformation.⁴ The PIC took a more activist approach after engaging the management of Barloworld and Sasol. According to the latest statistics from Sasol, five out of eight non-executive directors are black, three of the executive directors are black and out of fourteen directors, five are women, compared to a few years back.⁵

However, the PIC though did not succeed in convincing Sasol to change its mind on the appointment of Hixonia Nyasulu as its first black chairperson, although the appointment was seen as controversial. Nyasulu has a stake in a Sasol subsidiary and her appointment and chairman was seen as falling short of the principles of good governance.⁶

In the United Kingdom (“UK”) evidence suggested that some cases where managerial compensation, composition of the board of directors or the continuance in the office of the chair of the board have been influenced by shareholders.⁷

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- 1 Sasol is a South African public company listed on the JSE Limited and the New York Stock Exchange JSE Share Code (SOL). As a result of pressure from the PIC, as a majority shareholder a number of black directors were appointed to the board. (Imogen Mkhize was appointed on 01 January 2005, Hixonia Nyasulu was appointed on 01 June 2006, Christine Ramon was appointed on 01 May 2006 and Nolitha Fakude was appointed on 01 October 2005. Source: www.sasol.com). Black is defined in terms of the Employment Equity Act as African, Coloureds and Indians.
 - 2 Barloworld is a South African public company listed on the JSE Limited, JSE Share Code (BAW). As a result of pressure from the PIC black directors were appointed to the board. (Isaac Shongwe was appointed in January 2007, Hixonia Nyasulu was appointed in January 2007, Dumisa Ntsebeza was appointed in 1999 and was appointed as the chairman in June 2007). Source: www.barloworld.co.za. Accessed on 20/06/2008.
 - 3 PIC is the manager of South African Government Employees Pension Funds. It is a major shareholder in the following public companies listed on the JSE Ltd. 1.Imperial 20,84%; Telkom SA 17.99%; Aveng 20.57%; Steinhoff 16%; Super Group 18.37%; Lewis Group 16.23%; JD Group 15.63%; Sasol 17.18%; Barloworld 16.18%; Ellerines 9.7%; AVI 17.23%; Sanlam 10.37%. (source: Financial Mail Feb 2007).
 - 4 Transformation encompasses all the provisions of the broad based black economic empowerment.
 - 5 Smith 2007: 39.
 - 6 Njobeni 2008: 2.
 - 7 Thompson 2005: 57.

Kahan¹ quotes Third Point, an activist hedge fund which had \$4 billion under its management and targeted Star Gas in which it held a 6% stake and attacked the chief executive officer, Irik Sevin personally. “It is time for you to step down from your role as chief executive officer and director so that you can do what you do best: retreat to your waterfront mansion in the Homptons where you can play tennis and hobnob with fellow socialites,” said Third Point. Sevin resigned a month later.

Key shareholders at Mercantile Lisbon Bank fed up with the poor performance of the company, took action that led to the resignation of half the board. They appointed a new managing director and had radical plans to close down unprofitable parts of the business.²

Agribusiness group OTK felt the sting of Allan Gray and Brait in ousting the board.³ Comparex's five directors including the chairperson Russel Chambers resigned under combined attack by Allan Gray, Investec Asset Management and Sanlam Investment Management.⁴

It is clear that institutional shareholder movement has created new norms of conduct in the boardroom by pushing directors to be more diligent in their efforts to create shareholder value.⁵ On shareholder activism instituted by California Public Employees' Retirement System (“CalPERS”) there was no marked effect on management turnover.⁶

6.5 SUCCESSION PLANNING

Boards must address succession planning, as only 46% of companies say that they discuss chief executive officer succession annually.⁷ Good leaders address succession planning early on and identify possible successors and have them as understudies for a sufficient period of time before their own departure. However, a third of the boards of the surveyed companies revealed that they do not have an emergency succession

1 2007: 1029.

2 Theobald 2001: 50.

3 Thomas 2002: 46.

4 Thomas 2002: 46.

5 O'Connor 2000: 112.

6 Smith 1996: 241. See Smith 1996: 230 CalPERS is the largest public pension fund in the USA with \$72 billion in assets in 1993. CalPERS started organised shareholder campaigns in 1986.

7 Spencer Stuart Board Index 2007: 3.

planning.¹ This indicates that the task of grooming and choosing the next chief executive officer is becoming a major concern for more and more boards.

6.6 TRANSFORMATION AND DIVERSITY

Most companies that do business with government or public enterprises such as Telkom, Transnet, Eskom *etc* had to transform to reflect the demographics of the country as required by the state. Other companies followed suite and required that their suppliers should transform. Diversity is not a racial justice issue but also contributes to better management decision making and greater shareholder wealth.²

Most companies are beginning to set up transformation committees and appointing transformation officers, but the effectiveness of these committees is still questionable.³ At Standard Bank, the transformation committee was formed with Saki Macozoma as its chairman, and rigorous targets to meet transformation targets were set.⁴ It is not clear at the stage if those targets were met.

6.7 CHANGES IN POLICY

The campaign for corporate reforms during the 1990's showed that shareholder activism made a difference in policy outcomes.⁵ On shareholder activism instituted by CalPERS the results of activism on governance structure indicated that activism was reasonably successful in getting governance structure changes adopted.⁶ The United Shareholders Association ("USAss") sponsored proposals were more successful as they increased their influence in underperforming corporations.⁷ The role of USAss was to examine amongst other things how successful its proposals were, how its actions affected firms' value and whether it was successful in improving the governance structure of the target

1 Spencer Stuart Board Index 2007: 5.

2 Joo 2003: 736.

3 Jack 2007: 459.

4 Formby 2007: 37.

5 Davis *et al* 1994: 167.

6 Smith 1996: 241. See Smith 1996: 230 CalPERS is the largest public pension fund in the US with \$72 billion in assets in 1993. CalPERS started organised shareholder campaigns in 1986.

7 Strickland *et al* 1996: 319.

firms.¹ Overall, USAss was found to have had influence in corporate governance and in enhancing shareholder value.²

The pressure of USAss and Institutional Shareholders Service led to the SEC in 1992 making substantial changes in shareholder's ability to engage firm-level collective action.³ A country like South Africa does not need to be reminded what shareholder activism can achieve, as the multinational companies were the reason for its isolation in the later years of apartheid.⁴

The emergence of new players and increased activism of institutional shareholders brought about fundamental changes in corporate law, although they may result in the adoption of some useful reforms and innovations.⁵ In the UK experience with executive compensation suggested that increased shareholder power may have an impact on corporate affairs, as studies showed that compensation of top executives rose between five percent and six percent in 2006 compared to increases of up to fourteen percent in previous years.⁶

6.8 DISINVESTMENT

Generally, investors that are not happy with how a particular company is managed disinvest. If a company does not listen to shareholder activists, shareholders may disinvest. There are no rules, legal or financial rules that forbid investors from taking away their investments. The negative impact of a disinvestment can be huge if the investor is a majority shareholder. In the UK there was an indication of formation of coalitions by institutional investors if companies are deemed to be in trouble, seeking to resolve problems rather than disinvesting and selling their shares.⁷ Anglo American, a shareholder in Western Areas was hoping to disinvest its 15% stake because of alleged corporate malpractices at Western Areas.⁸

1 Strickland *et al* 1996: 320.

2 Strickland *et al* 1996: 321.

3 Davis *et al* 1994: 148.

4 Lascelles 2000: 22.

5 Rock 1999: 452.

6 Fairfax 2008: 27.

7 Solomon *et al* 1999: 290.

8 McKay 2005: 2.

6.9 INFLUENCE ON THE SHARE PRICE

There is always a question as to what effect shareholder activism can have on the share price of a company. A variety of studies have attempted to measure the impact of shareholder corporate governance proposals on firm value, and two studies found little evidence that these proposals had on the firm performance.¹ There is however a belief that institutional shareholder activism and active monitoring can improve investment returns.² According to Ward,³ Robert Pozen of Fidelity Investments wrote in 1994 that activism could be used as a technique for raising stock prices, but only if the right tools are used. There is also evidence that company directors have most of their time taken by meetings between them and institutional investors and find that to a certain extent shareholder activism is a hindrance to company growth.⁴

There is a connection to a certain extent between the way companies deal with social responsibility and the share price, as Dhir⁵ quotes two commentators who agree that there is indeed a connection between the two. It has been established that there is a positive relationship between social responsibility and financial success of a company and that shareholder wealth is decreased when companies act in a socially irresponsible manner⁶. Corporate boards and managers must ultimately be held accountable to shareholders for poor corporate performance.⁷

Institutional shareholders have managed to improve shareholder returns after playing active role in the boardrooms of agribusiness OTK and electronics specialists IST.⁸ An announcement of the chief executive officer's departure can send two signals to the market:⁹

(a) on the one hand it could be interpreted that such announcement as evidence the corporation's performance is worse than the market had anticipated, causing stock prices to decline and

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- 1 Schwab 1998: 1053.
 - 2 Murphy 2003: 74.
 - 3 1997: 9.
 - 4 Solomon *et al* 1991: 288.
 - 5 2006:372.
 - 6 Dhir 2006: 373.
 - 7 Grundfest 1993: 865.
 - 8 Hasenfuss 2002: 9.
 - 9 Grundfest 1993: 878.

(b) on the other hand if the ouster of a poorly performing chief executive officer is interpreted as evidence that management is about to improve, stock prices could increase.

In theory, the simple announcement of a change in the CEO suite could presage either an increase or decrease in stock prices, depending on which effect dominates.¹ Boards of directors at four Fortune 500 Companies - Goodyear Tire & Rubber, Allied-Signal, Tenneco and Snap-on Tools decided to fire their chief executive officers, and except for Snap-on Tools, the chief executive officer terminations increased shareholder wealth by at least \$1.3 billion.²

There is a growing body of evidence that shareholder activism raises share prices even if a takeover is not in the air.³ Also, talking with institutions can do no harm and their ideas might raise the share price.⁴ The principles of stronger corporate governance and shareholder activism can bring about a more vibrant and healthy corporate community, ultimately resulting in higher returns for investors and attract foreign investment.⁵

Adherence to practices of good corporate governance helps improve the confidence of investors and may reduce the cost of capital and may induce more stable sources of capital.⁶ Equally, better corporate governance leads to better performance.⁷ The co-ordinated shareholder activism by the Council of Institutional Investors resulted in improved operating and stock market performance in their listed target firms.⁸ On the other hand, Romano⁹ contends that as shareholder activism became pervasive, financial economists attempted to measure the impact of such activism by both the public pension funds and the unions, although the effect of the two may differ.

With hard evidence that shareholder activism can bring positive results, traditional activists are gaining reinforcements, as major commercial funds are increasingly willing

1 Grundfest 1993: 878.
2 Grundfest 1993: 880.
3 Ward 1997: 9.
4 Ward 1997: 9.
5 Kok 2006: 2.
6 Millson *et al* 2005: 73.
7 Hasenfuss 2002: 9.
8 Song *et al* 2003: 318.
9 2001: 176.

to make their voices heard.¹ Empirical studies showed that in the USA shareholder activism had an insignificant impact on the positive performance of the targeted companies and instead had a negative effect on the share price.² Shareholder activism can have no effect on the value of the firm or can have mixed effects, both negative and positive.³

6.10 CONCLUSION

There are instances where there is evidence that shareholder activism works. Shareholder activism can either change things for the better or worsen them. Its influence can in most cases be measured especially in issues of management and disinvestment. The reasons for companies to bow to shareholder pressure may differ. Some companies bow because they avoid bad publicity, or that shareholders may disinvest *etc.*

When shareholders engage in activism their actions must have an influence in a company. Their activism must bring change to companies. They must continue to put pressure until their demands and concerns are addressed.

1 Ward 1997: 9.
2 Romano 2001: 177.
3 Smith 1996: 242.

CHAPTER 7

THE ROLE OF MEDIA IN SHAREHOLDER ACTIVISM

7.1 INTRODUCTION

Shareholder activists want their activities widely publicised. United States of America (“USA”) shareholder activist groups have proved that boards of directors act differently when heat is applied publicly.¹ Shareholder activism takes a variety of forms from public pressure on a portfolio company to change its business strategy, to running of a proxy contest to gaining seats on the board of directors, to litigation against present or former management.²

The easiest and fastest way to communicate shareholders unhappiness is through the media. It is considered fast and cheap. Media houses are also interested in stories that sell. Shareholder activists may call press conferences to communicate their concerns.

The biggest question is why shareholders opt for media after a fallout with management, instead of going to court. A simple answer is that court processes are regarded as taking a long time to come to conclusion, are expensive and are technical. Another reason might be that shareholders know that there are no prospects of winning in court. Shareholders use different types of media to reach their target audience. They use radio, television, internets, print media *etc.* Media can be used by disgruntled shareholders to settle scores and to defame other companies. Different types of media will be investigated and the influence thereof. Also the role of the courts will be looked at.

7.2 THE ROLE OF MEDIA IN GENERAL

Shareholder activism has to do more with public shaming of companies, as this tactic was used during the era of two well-known activists, Gilbert and Soss as both had backgrounds in journalism and public relations, and they were mentioned in the press more often.³ So shareholder activists opt for an easier solution, that of publicly embarrassing companies that fail to adhere to policies of corporate governance.

1 Thomas 2002: 46.

2 Kahan *et al* 2007: 1029.

3 Marens 2002: 365.

Institutional investors and pension fund managers are encouraged to publicly make their voting policies available, by communicating with their constituencies on a regular basis or by making it accessible to the public at large.¹

The Commission for Employment Equity, supported by the Minister Labour, Membathisi Mdladlana, threatened to name and shame companies that are believed to have pedestrian transformational records, as in its 2006 report listed companies that it alleged did not comply with the Employment Equity Act.²

Labour unions have launched company specific investor campaigns and have also used the media to launch campaigns to publicly shame the abusers of governance policy.³ Many corporate executives who are under pressure to implement corporate social investment programmes usually agree to the concept for the fear of bad publicity.⁴ Bad publicity may have undesired consequences for companies.

The activists also confront management at annual general meetings and through media publicity.⁵ They often file shareholder resolutions related to social or environmental issues at corporate annual meetings or use other measures including media to try to shape corporate actions.⁶ If companies report on the results of all board elections, the resulting negative publicity can sharply reduce the prestige associated with serving on boards, thereby providing impetus for incumbent directors to improve corporate performance.⁷ Many companies and their boards have become more responsive to majority vote resolutions in part to avoid the negative consequences in publicity and shareholder relations that often follow a decision not to adopt the recommended course.⁸ course.⁸

1 King II: 44.
2 William *et al* 2007: 36.
3 Chakrabarti 2004: 49.
4 Guay *et al* 2004: 128.
5 Marens 2002: 365.
6 Guay *et al* 2004: 129.
7 Grundfest 1993: 866.
8 Brownstein 2004: 24.

In an interview in the Financial Mail of 28 June 2002, journalist Itumeleng Mahabane asked Mark Barnes, the representative of Active Value Fund, a shareholder at Primedia who was not satisfied with changes in Primedia, the following questions amongst others:

Question: Why go to the media? Why the public statement?

Answer: Our efforts were not met with the urgency we felt was appropriate. We were told the matter would be attended to in due course. Due course has come and gone.

Question: What do you hope to achieve through the publicity?

Answer: We would be delighted if the publicity resulted in a board or shareholders meeting to resolve the issues.

Alex Romer a shareholder in Sage, who was not happy with how his questions were answered by the chairman of Sage in a board meeting wanted to distribute the recording of the meeting to the media to show how the chairman ducked his views of critical strategic issues.¹ Institutional investors such as Old Mutual, Sanlam and Liberty have often used subtle ways, behind closed doors to address issues with management, but recalcitrant have lead them to waging a concerted media campaign at New Africa Investment.²

Directors are concerned about the reaction of shareholders, especially institutional investors that are large, long-term holders who put pressure on management through things such as phone calls to senior management and letters of criticism as well as more public forms of criticism such as pointing questions on conference calls, critical press releases and postings on internet chat boards.³ Labour shareholders receive positive media attention for shaking up the traditional boardroom culture in order to make executives more accountable to shareholders.⁴ Embarrassment from public disclosure also exerts discipline within management.⁵

Considering a number of corporate governance transgressions, it is no surprise that authoritative market commentators have diagnosed a corporate cancer and the cure is

1 Hasenfuss 2001: 70.

2 Hasenfuss 2002: 9.

3 Brownstein 2004: 66.

4 O'Connor 1997: 1381.

5 Black *et al* 1996: 1927. For example American boards of directors have many times replaced poor CEO's after sharply critical stories appeared in the business press.

likely to be long and painful combining shareholder and public pressure with the criminal justice system.¹

7.3 TYPES OF MEDIA

7.3.1 INTERNET

Internet is a new and fast way of communicating. Bolodeoku² argues that in this day and age shareholder apathy should be a thing of the past as shareholders can use internet to raise their views even if they are not physically present at a meeting. Internet can be used to gunner support for dissident shareholders who may want to know where they stand on matters to be voted on at a general meeting and other shareholders may find it useful whether to support a proposal or not and it can be used to shape shareholder activism.³

Technology has transformed the way companies do business. This view is supported by Goldman⁴ when he said that USA companies use technology to raise capital, to communicate with customers, suppliers and shareholders, which was impossible twenty-five years ago. He further adds that because of modern technology more and more companies are able to send and receive documents from investors online, like wise vote online view annual shareholders meetings online and make investments online. Companies should create a corporate website that would provide for online publication of corporation information, reports and the posting of proposals that would be up for discussion at meetings.⁵

Individual shareholders are likely to benefit from internet related communication as their limitations and challenges are different from those of institutional investors.⁶ Due to increasing popularity of the internet, smaller shareholders have also gained an outlet to voice their opinions.⁷ Internet promises to increase shareholder activism. It is the development and increased accessibility of the internet which has greatly enhanced the

1 Theobald 2001: 39.

2 2006: 111.

3 Bolodeoku 2007: 111.

4 2000: 685. See Bolodeoku 2007: 131. The USA has not mandated the use of corporate websites as a medium of communication between companies and their shareholders

5 Rademeyer *et al* 2003: 771.

6 Bolodeoku 2007: 112.

7 http://en.wikipedia.org/wiki/Activist_shareholder.

ability of shareholders to communicate in support of shareholder proposals.¹ shareholders can now communicate with each other and with management at little cost and without having to comply with onerous proxy filing requirements.²

In the United Kingdom ("UK") fund management of six large insurers disclosed their voting records on their websites.³ South African companies do use internet to a large extent to communicate with shareholders. Annual reports, circulars, management changes, results of meetings and all other announcements are posted on companies' website. The Listings Requirements does give companies permission to make announcements on their websites, only after an announcement has been made on the Securities Exchange News Service ("SENS").

Apart from investing online, methods of voting are not yet in use in South Africa as shareholders are required to be present in person or by proxy to be able to vote. As South Africa is an important player in the global markets, it is necessary to follow international trends and allow its shareholders to vote and communicate online. At the moment companies are required by the Listings Requirements to make available to each shareholder a copy of the notice of the annual general meeting and financial statements, something that could be done online to save costs and disseminate information faster.⁴

The Securities and Equities Commission rules in the USA allows for electronic delivery of information to investors subject to the following requirements:

- (a) There must be a way to ensure that the investor is notified that the data has been sent electronically or can be read electronically;*
- (b) The issuer must make sure that the investor has access to web or email;*
- (c) The investor must be entitled to request and receive a paper copy;*
- (d) That the mail is reliable to give assurance that the delivery requirement is satisfied.*

1 Brownstein 2004: 31.

2 Brownstein 2004: 31.

3 Kok 2006: 1.

4 Listings Requirements: 3.19.

As the number of internet users grows and as shareholders turn increasingly to the internet to communicate with each other, the power of the internet to generate increased shareholder activism by means of shareholder proposals is likely to grow.¹

7.3.2 PRINT MEDIA

Print media is a more popular media channel that shareholders use to make their concerns public. Newspapers and business magazines are tools that are used by shareholders to voice their concerns and to raise awareness on any mismanagement. Press attacks on directors are an unusual shareholder method of voicing displeasure.²

Media in general and print media in particular is usually invited by shareholders to be present in shareholders meetings if there are issues that they feel should be made public. To date most shareholder activism is reported in print media. It is easier to leak information to print media, that is why most breaking stories are reported by print media.

7.3.4 RADIO AND TELEVISION

Television and radio play an equally important role in reporting and highlighting issues of shareholder activism. Most radio and television stations have business slots whereby issues of business are highlighted and debated. In most instances, radio and TV get their news from print media.

7.4 COURTS

Before litigation is filed shareholders should through the submission of shareholder proposals, attempt to inspire directors to adequately perform their functions as monitors.³ Shareholder lawsuits are considered the bluntest instruments in the toolbox of corporate governance.⁴ They can be costly, lengthy and potentially disruptive to a corporation.⁵ The existence of a legal environment that makes legal action against directors easier might just caution those directors not mindful of corporate governance to ensure that their actions are in line with good corporate governance principles.⁶

1 Brownstein 2004: 32.

2 Schwab 1998: 1022.

3 Wade 2003: 230.

4 Joo 2003: 752.

5 Joo 2003: 752.

6 Rademeyer *et al* 2003: 768.

Allan Gray raised a prospect of a legal action if Brett Kebble, then chief executive officer of the suspended Randgold & Exploration had fraudulently sold the company resources in Randgold Resources.¹ Shareholders approach courts when there is a clear deviation from law, not for issues of policy that can be sorted by making relevant noise in the media.

7.5 CONCLUSION

There is no doubt about the role that is played by media in spreading shareholder concerns in a company. Shareholders should continue to use media to raise their issues. Shareholders must use media especially the internet to communicate amongst themselves, so that they can present a united front at shareholder meetings. They must also continue to name and shame companies that flout corporate governance.

The JSE must amend its rules to allow for shareholders to be able to communicate amongst themselves. In addition, with the companies required to go “green”, the JSE must allow companies to post notices, circulars and annual reports on the internet. This will also help in cutting printing and delivery reports.

Media should however not be used to tarnish the image and goodwill of companies or their managers. It should be used to highlight issues that are in the public interest.

1 McKay 2008: 1.

CHAPTER 8

CONCLUSION, SUMMARY, SAMEVATTING, BIBLIOGRAPHY

8.1 CONCLUSION

It is clear that shareholder activism is going to be a way of life in corporate South Africa and it is not going to disappear any time soon. Evidence is the United States of America and the United Kingdom, where shareholder activism started many decades ago and still persists. As it spreads across the world, South Africa cannot be spared its influence. South African shareholders must use legislation to challenge and put their proposals forward. They must also be vigorous in their approach to corporate governance.

Other South African companies are reluctant to comply with corporate governance with regard to black economic empowerment and that undermines the spirit of the country's legislation, the Codes of Good Practice and the King Codes. Shareholders must, through their investments, change the mindset and bad policies of companies. Shareholder apathy must be a thing of the past. Institutional shareholders, societies, business associations and the South African Shareholders Association must be at the forefront in fighting for shareholders rights. Shareholders must be involved in decision making, especially on issues of policy and strategy.

Shareholders should in certain instances where the profits of the company are used to pay for penalties because of price fixing and other unlawful activities, demand the resignation and prosecution of directors. Directors must be made to account for their actions. They must act in the best interests of the shareholders. Directors must manage companies and shareholders must watch them closely. Private and public funds, together with individual activists need to be supported by others in their efforts of fighting for proper corporate governance. Shareholders must continue to use media to publicly raise issues of corporate malpractice.

The most important thing for companies is to have clear policies on corporate governance. A vibrant shareholder culture will result in a vibrant corporate governance culture and a prosperous South Africa.

8.2 SUMMARY IN ENGLISH

Shareholder activism is a means by which shareholders voice their concerns or dissatisfaction in companies in which they invest. This phenomenon started centuries ago, but picked up momentum and developed in the United States of America ("USA") in the 1930's, after the fall of Wall Street in 1929. Soon thereafter, it spread to countries such as the United Kingdom and to the rest of the world.

In the USA in 1934 the government passed the Securities and Equities Act, which also contains proxy rule Rule 14A-8. This rule is used as a tool to encourage shareholders to make proposals on matters to be voted on at annual general meetings. It introduced internal corporate governance approaches such as the "negotiated agreements", the "nexus of contract" and the "one axis" approach.

In South Africa, section 185 of the Companies Act 61 of 1973 makes provision for shareholders to draw proposals to be presented at annual general meetings. Section 65 of the Companies Act 2008 will also afford shareholders to make proposals.

A company is made up of shareholders. Shareholders are people or entities that have an economic interest in a company. Examples of shareholders include private individuals, directors, employees, customers, community, government, trade partners, media, creditors *etc.* Shareholders can be classified as individuals or institutional. Institutional activists include public pension funds and private equity funds. They can be business associations, social activists and labour unions. They can have a direct or indirect beneficial interest in a company. Shareholders can also be classified as preference, controlling, majority and minority shareholders.

Companies can be incorporated as private or public. A company can be held liable for the actions of its directors. Shareholders have rights and duties in a company. These include the right to vote, monitor and elect directors *etc.* A company is juristic person with its own status. In terms of the rule in *Foss v Harbottle* a company can take legal

steps against itself and if it fails any person can take legal steps on its behalf. A person who deals with a company is protected under the *Turquand Rule*. This rule allows persons who are dealing with a company to assume that all internal company matters have been complied with and that the agent of a company is not acting *ultra vires*.

Companies are managed by directors who are appointed by shareholders. Directors should be natural persons who are not minors, or have committed serious offences or are unrehabilitated insolvents. Directors have duties such as to act *intra vires*, to exercise care, diligence and skill; to keep confidential information; to manage risks and to act as a board. Directors can be held jointly and severally for their actions. Directors can be executive, non-executive or independent non-executive directors. Directorship is terminated when a director has committed serious offences and are unrehabilitated insolvents or by agreement with a company.

Reasons for shareholder activism include corporate governance. There are different systems of corporate governance such as “insider dominated”, “outsider dominated”, “comply or else” and “comply or explain”.

Sometimes shareholder activism has an influence over the way companies are managed. Due to shareholder activism, a company can change its management style, transform and change policies.

The media, such as press, internet, radio and television play an important role in shareholder activism and therefore shareholder activists avoid the lengthy judicial process and opt for media to raise their discontent.

8.3 SAMEVATTING

Aandeelhoudersaktivisme is 'n wyse waarop aandeelhouders hul kommer of ontevredenheid rakende 'n maatskappy waarin hulle belê het, opper. Hierdie fenomeen het eeue gelede ontstaan, maar het eers momentum gekry en is verder ontwikkel in die Verenigde State van Amerika ("VSA") in die 1930's ná die ineenstorting van Wall Straat in 1929. Hierna het dit na die Verenigde Koninkryk en die res van die wêreld versprei.

Die VSA het in 1934 die "Securities and Equities Act 1934" aanvaar. Die wet maak voorsiening vir 'n volmag reël (proxy rule), die sogenaamde Reël 14A-8. Hierdie reël is gebruik as 'n meganisme om aandeelhouders aan te moedig om voorstelle te maak rakende aangeleenthede waaroor daar op algemene jaarvergaderings gestem word. Dit het interne korporatiewe beheer benaderings soos die "onderhandelde ooreenkomste", die "nexus van die kontrak" en die "een as" benadering bekendgestel.

In Suid-Afrika maak artikel 185 van die Maatskappywet 61 van 1973 voorsiening daarvoor dat aandeelhouders voorstelle mag maak wat voorgelê kan word tydens algemene jaarvergaderings. In gevolge artikel 65 van die Maatskappywet 2008 kan aandeelhouders ook voorstelle maak.

'n Maatskappy bestaan uit belanghebbende partye. Dit sluit in persone of entiteite wat 'n belang in die maatskappy het. Voorbeelde van belanghebbendes sluit in aandeelhouders, direkteure, werknemers, klante, die gemeenskap, die staat, handelsvennote, individue of instellings. Institusionele aktiviste sluit in publieke pensioenfondse en ook private "equity" fondse. Dit kan wees sakeverenigings, sosiale aktiviste en vakbonde. Hulle kan 'n direkte of indirekte voordelige belang in die maatskappy hê. Aandeelhouders kan ook geklassifiseer word as voorkeur-, beherende, meerderheids- en minderheidsaandeelhouders.

Maatskappye kan as privaat of publiek ingelyf word. 'n Maatskappy kan aanspreeklik gehou word vir die handelinge van sy direkteure. Aandeelhouders het regte en

verpligtinge in 'n maatskappy. Hierdie sluit in die reg om te stem, om direkteure te kies en te monitor, ens. 'n Maatskappy is 'n regspersoon met eie status. In gevolg van die reël in *Foss v Harbottle* kan 'n maatskappy self regstappe neem en as daar versuim is aan die kant van die maatskappy, kan enige persoon regstappe neem namens die maatskappy. 'n Persoon wat sake doen met die maatskappy word beskerm deur die *Turquand*-reël. Hierdie reël laat toe dat persone wat met die maatskappy sake doen, kan aanneem dat daar aan al die interne vereistes van die maatskappy voldoen is en dat die agent van 'n maatskappy nie *ultra vires* optree nie.

Maatskappye word bestuur deur direkteure wat aangestel word deur die aandeelhouers. Direkteure is veronderstel om natuurlike persone te wees, maar nie minderjariges nie, ook nie persone wat al ernstige misdade gepleeg het of wat ongerehabiliteerde insolvente is nie. Direkteure het pligte soos om *intra vires* op te tree, om die nodige sorg, ywer en vaardigheid uit te oefen, om vertroulike inligting vertroulik te hou, om risikobestuur toe te pas en om as 'n direksie op te tree. Direkteure kan gesamentlik en afsonderlik aanspreeklik gehou word vir hul dade. Direkteure kan uitvoerend, nie-uitvoerend of onafhanklik nie-uitvoerend wees. Direkteurskap word beeindig wanneer direkteure ernstige misdade pleeg en ongerehabiliteerde insolvente is of deur ooreenkoms met die maatskappy.

Redes vir aandeelhouersaktivisme sluit 'n gebrek aan korporatiewe beheer in. Daar is verskillende sisteme van korporatiewe beheer soos "*insider dominated*," "*outsider dominated*," "*comply or else*" en "*comply or explain*."

Soms het aandeelhouersaktivisme 'n invloed op die manier waarop maatskappye bestuur word. As gevolg van aandeelhouersaktivisme kan 'n maatskappy sy bestuursstyl verander, transformeer en beleide verander.

Die media, soos die gedrukte media, internet, radio en televisie, speel 'n belangrike rol in aandeelhouersaktivisme en vermy aandeelhoueraktiviste die lang regsproses en verkies hulle die media om hul misnoeë te opper.

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