THE RELEVANCE OF BUSINESS ETHICS IN DEFINING THE ROLE OF INTERNAL COMPANY STAKEHOLDERS

by

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In Loving Memory of

Santie Heckroodt

1931/10/15 – 2013/04/16

I carry your heart with me, I carry it in my heart.
I am never without it.

-EE Cummings

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As you climb the ladder of success, make sure you are leaning against the right building.

-H Jackson Brown Jr

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At times our own light goes out and is rekindled by a spark of another person. Each of us has cause to think with deep gratitude of those who have lighted the flame within us.

-Albert Schweitzer

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Declarations

I, Riché van Wyk, declare that the dissertation/thesis that I herewith submit for the Master's degree Mercantile Law at the University of the Free State, is my independent work and that I have not previously submitted it for a qualification at another institution of higher education.

Riché van Wyk **27 June 2014**

I, Riché van Wyk, hereby declare that I am aware that the copyright is vested in the University of the Free State.

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I, Riché van Wyk, hereby declare that I am aware that the research may only be published with the dean's approval.

Riché van Wyk **27 June 2014**

Abstract

Over the past 22 years, corporate governance internationally has revealed the following core ethical principles, namely transparency, fairness, accountability and responsibility. King lll, the latest code in South Africa, emphasises the importance of these factors and ethical leadership within a company.

The root of ethical behaviour within the company lies in the notion that the company must please society instead of just being a moneymaking machine. Companies should focus more on the triple bottom line approach, namely profit, social and environmental issues. The ethicality of behaviour lies in the balance struck by a person or an organisation between these three bottom lines. A good balance of these bottom lines will result in behaviour being deemed as ethical.

The company should draft a code of conduct to aid employees, as the internal stakeholders, in the promotion and maintenance of ethical behaviour. This code of conduct is the "ethical constitution" of a company.

Directors have the main obligation to maintain ethical behaviour. King lll refers to directors as being the "ethical leaders" of a company. They must act ethically in all their relations with stakeholders, put the company and stakeholder needs before their own and establish the company as a socially responsible corporate citizen.

Companies must comply with the notions of Corporate Social Responsibility and Corporate Social Investment in order to maintain its reputability in society. It must benefit the community as a whole and be a philanthropic being, by granting sponsorships, making donations and investing in society**.**

The importance of ethics in the business world is two-fold: firstly, it has a positive motivation to earn the respect of the society within which the company operates and, secondly, it has a negative motivation in that ethical behaviour will combat fraud and other economic crimes with which our country is associated.

It is recommended in this study that all employees should be informed of the role they play in ethics maintenance and management. It is also recommended that a separate ethics committee be established apart from the social and ethics committee to assist the company in more complex ethical issues, such as drafting codes of conduct and steering employees in the right direction.

Keywords: Corporate governance, ethics, business ethics, code of conduct, stakeholders, Corporate Social Responsibility, Corporate Social Investment, board committees.

Opsomming

Oor die afgelope 22 jaar is die volgende etiese beginsels van korporatiewe beheer internasionaal gevestig, naamlik deursigtigheid, regverdigheid, toerekeningsvatbaarheid en verantwoordelikheid. Die onlangse King lll Verslag het die belangrikheid van etiese leierskap in ‘n maatskappy onder die aandag gebring.

Die kern van etiese gedrag in ‘n maatskappy is vervat in die beginsel dat die maatskappy die gemeenskap se belange bo hul eie belange moet ag, in plaas daarvan om winsgedrewe te wees. Maatskappye moet daarop fokus om die volgende drie beginsels te verwesenlik, naamlik wins, sosiale en omgewingskwessies. Etiese gedrag lê in die balans tussen die bogenoemde beginsels – ‘n goeie balans hiervan word geag goeie etiese gedrag te wees.

Die maatskappy moet ‘n gedragskode opstel om die werknemers, as die interne belanghebbendes, te lei in die bevordering en handhawing van etiese gedrag. Hierdie gedragskode sal die “etiese grondwet” van die maatskappy wees.

Direkteure se hoofverpligting is die handhawing van etiese gedrag binne die maatskappy en om te verseker dat die maatskappy gesien word as ‘n sosiaal-verantwoordelike korporatiewe persoon. Die King lll Verslag verwys na direkteure as die “etiese leiers” van die maatskappy deurdat hulle voortdurend, in alle handelinge met belanghebbendes, eties sal optree en die belanghebbendes se belange bo hul eie sal stel.

Maatskappye moet aan die vereistes van Korporatiewe Sosiale Verantwoordelikheid en Korporatiewe Sosiale Investering voldoen om as etiese instansies beskou te word. Die maatskappy moet voordeel gee aan die gemeenskap as ‘n geheel om ‘n filantropiese entiteit te wees. Dit beteken dat maatskappye beurse en donasies moet gee en in die gemeenskap moet belê. Die gevolg hiervan is verhoogde morele waardes van die maatskappy en die gemeenskap.

Die kern van etiese gedrag is tweërlei en lê in die positiewe en negatiewe motivering daarvan: Die positiewe motivering is om die respek van die gemeenskap te verdien, en in die negatief om bedrog te voorkom.

Dit word in die studie aanbeveel dat werknemers, die interne belanghebbendes, ingelig moet word van hul rol in die etiese welstand van die maatskappy. Dit word verder aanbeveel dat ‘n etiekkomitee, afsonderlik van die sosiale en etiekkomitee, gevestig moet word om komplekser etiese kwessies aan te spreek, soos byvoorbeeld die opstel van ‘n gedragskode en om leiding aan die werknemers te gee.

Sleutelwoorde: Korporatiewe beheer, etiek, besigheidsetiek, gedragskode, belanghebbendes, Korporatiewe Sosiale Verantwoordelikheid, Korporatiewe Sosiale Investering, raadskomitees.

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Chapter One
Introduction

"Character, judgement and behaviour are connected stages in process. Character or integrity is the sum total of all our moral values and informs the behaviour of trusted adults. Good collective judgements are made when we consider not only legal rules and obligations (which should be regarded as the 'letter' of law), but also how our values (the 'spirit' of law) help us to decide fair and reasonable outcomes for all stakeholders. We must also acknowledge that this process will vary according to the situational context faced by boards. As a consequence, it is critically important not only that the behaviours of organisations are better understood, but that there are processes in place to monitor the environments in which they operate, particularly to identify those situations when rational human behaviour is most challenged."[1]

1.1 Introduction

A company cannot operate and manage its affairs on its own. It is like a "baby" that depends exclusively on the "mother". The "mother" of the company may be seen as the board of directors and its executive management. Corporate governance, a code that was recently developed and legally substantiated by the Companies Act 71 of 2008, serves as a guide to directors and management to control the company in an ethical, as well as a lawful, manner.

In the next paragraph background is provided on the development of South African company law, corporate governance and ethics.

[1] IOD 2012: 27.

1.2 Background

1.2.1 Historical background on South African company law

In 1856 the modern company form was born in the United Kingdom when investors in the United Kingdom companies gained the protection of law in the form of limited liability. Since then companies have grown to the most dominant legal form of business of all time.[2] In South Africa, the first Companies Act was promulgated in 1926, namely the Companies Act 46 of 1926. This Act was based on the English Companies Act of 1908.[3] Thereafter followed the Companies Act 61 of 1973. This, in turn, was based on the appointment of a Commission of Investigation into the Companies Act under the chairmanship of Judge J van Wyk de Vries.[4] There was a clear departure from the English company law in this Act.[5] Since then, South Africa's latest legislation, namely the Companies Act 71 of 2008, was promulgated to govern company law matters, including corporate governance.

The issuing of the Cadbury Report in the United Kingdom in 1992 generated an interest in corporate governance worldwide, and in South Africa it has come to play an important role since the issuing of the first King Report. This put corporate governance at the centre of the business world.[6] The Cadbury Report of the United Kingdom and South Africa's King I Report are the two earliest codes on corporate governance globally.

The King Committee was established by the Institute of Directors in Southern Africa (IoDSA) to draft guidelines on corporate governance in South Africa.[7] The publication of the King Report and the Code of Corporate Practices and Conduct in 1994 was a milestone in the corporate world of South Africa. King ll was issued in 2002 and various legislation and regulations were promulgated since 1994. A

[2] King Report 2009: 21.
[3] Cilliers et al 1977: 16.
[4] Cilliers et al 1977: 17.
[5] Cilliers et al 1977: 17.
[6] Marx 2008: 175.
[7] Koppeschaar et al 2012: 5.

corporate law reform programme was initiated by the South African government in 2005. The new Companies Act 71 of 2008 (Companies Act 2008) was the result of this legal reform. The King lll Report has since also been published.[8] King lll is currently the leading publication on corporate governance in South Africa.

1.2.2. Corporate governance

"Corporate governance is, in essence, a company's practical expression of ethical standards. It follows that all the typical aspects of corporate governance (such as the role and responsibilities of the board of directors, internal audit, risk management, stakeholder relations and so on) should rest on a foundation of ethical values."[9]

Sound governance is needed to contribute to a sense of fairness in the corporate sector.[10] This is so because corporate governance is aimed at fairness and transparency. Corporate governance allows for the creation of more opportunities in the business world and for making contributions to society by way of Corporate Social Responsibility and Corporate Social Investment.

Corporate governance is generally referred to as the "system by which companies are directed and controlled;[11] directors are entrusted with the management of the company on behalf of its shareholders and play a pivotal role therein".[12] Corporate governance deals with the way in which the relationships between the board of directors of an entity, its senior managers and the stakeholders of the entity should be structured and make it more likely that the senior managers and employees will manage the company in the interest of its stakeholders, and not in their own interests.[13] Stakeholders are divided into external and internal stakeholders. External stakeholders refer to stakeholders not actively involved in the business, such as

[8] Marx 2008: 175.
[9] King Report 2009: 21.
[10] Marx 2008: 176.
[11] Clarke 2010: 78. See also Cadbury Report 1992: Par 2.5.
[12] Marx 2008: 231.
[13] Kretzschmar et al 2012: 165.

creditors and the community, whereas internal stakeholders refer to stakeholders actively involved in the business, such as employees and shareholders.[14] For the purposes of this study, the focus lies on internal stakeholders, specifically the employees of the company or organisation.

The role of corporate governance is found in the need for control over the business, steering the business in the right direction, allowing for change of the business to conform with changing circumstances. There is a substantial need for corporate governance because of continuous changes in the corporate world, emerging fraud and dishonesty, and other forms of economic crime.

Companies are controlled by their boards of directors. Their duties are fully prescribed in Section 76 of the Companies Act of 2008, common law and the King Reports. The board of directors consists of the directors of the company who have all legal responsibilities and duties of the company and are obliged to perform these rights and duties ethically. This is so because a company that is run ethically holds various benefits for the company, adding to its reputation as a socially responsible corporate citizen. The board must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and account to the company and be accountable to the stakeholders of the company.[15] This is on a par with ethical behaviour, which is manifested in the consideration of others.

Corporate governance is maintained by the board of directors and by way of committees established by the board of directors, namely audit committees, remuneration committees and social and ethics committees. These committees will be represented as members on the board of directors. Members of these committees do not relieve the directors of their legal responsibilities and duties but are there to aid them in achieving efficient fulfilment of these rights and duties.[16] It should be emphasised that the members of the board of directors are the main individuals

[14] Du Plessis et al 2011: 24.
[15] Marx 2008: 322.
[16] King Report 2009: 41.

responsible for ethics management in the company.[17] This dissertation is applicable to companies and organisations that are required to have such committees.

One of the core committees that should be established in terms of Section 94 of the Companies Act 2008, is the audit committee, to be appointed by the board of directors. The audit committee assists the board of directors in meeting its oversight responsibilities of financial reporting and the external audit function.[18] It strengthens audit independence and therefore also ethical behaviour.

The remuneration committee is important because of the ethical duties resting on companies regarding salaries and bonuses of employees, maybe even the appointment of employees. The remuneration committee may be incorporated in terms of King lll for listed companies only, but it is deemed best practice for all companies to conform with this recommendation. The remuneration committee should consist of independent members to enhance fairness, one of the core principles of ethical behaviour and good corporate culture. Good corporate culture refers to the ethical environment within a business based on the seven principles discussed below.

The Companies Act of 2008, in terms of Section 72(4), makes provision for the establishment of a social and ethics committee. However, the Act does not lay down many ethical roles, duties and functions of the social and ethics committee. Regulation 43 focuses more on social than ethical functions, and therefore this dissertation will aim to establish what the ethical roles, duties and functions of the social and ethics committee are or should entail. The researcher is of the opinion that this failure to account fully for ethical duties in the mandate of the social and ethics committee is a shortcoming of the legislator that needs to be addressed. The mere inclusion of the word “including” in Regulation 43 is insufficient, and the researcher deems it best to have the mandate extended formally in legislation so that there is no confusion as to what their mandate entails. Alternatively, provision should be made for the establishment of a separate ethics committee to handle

[17] Kretzschmar et al 2012: 164.
[18] Marx 2008: 177.

ethical matters. Ethics committees should be responsible for laying down ethical behaviour in the form of a code, as referred to in the King lll Report. It seems that every company is entitled to form and draft their own ethical codes. Some guidelines need to be developed and formulated for companies to serve as benchmarks.

The question which needs to be answered is whether it is sufficient or in the best interests of the company to restrict all matters regarding ethics to the social and ethics committee. The researcher disagrees. Ethics and ethical principles are embedded in all persons, though of course it will differ from person to person, seeing that everyone's background and culture differ. Therefore core ethical principles should be laid down by which everyone should abide, notwithstanding cultural differences, in order to maintain a sound ethical environment within a company. This is possible by way of a code of conduct.

It is clear from the brief description of the various committees as set out above that all committees have some or other duty or responsibility relating to ethics. The various roles and functions of these committees will be discussed further in the Chapter Five.

1.2.3 Ethics and corporate governance

Corporate governance is very closely linked to ethical behaviour as it sets out guidelines for ethical behaviour. The importance of ethics in governance is laid down in the first chapter of King lll, headed "Ethical Leadership and Corporate Citizenship". It is stated in paragraph 12 that:[19]

> "Ethics (or integrity) is the foundation of, and reason for, corporate governance. The ethics of corporate governance requires the board to ensure that the company is run ethically."

[19] King Report 2009: 22.

The importance of ethics as a core element of corporate governance cannot be overemphasised. There is therefore a need to expand on the different views and definitions of ethics.

Various definitions of ethics have been developed by researchers. In short, ethics means to "consider not only what is good for oneself but also what is good for others".[20] Business ethics is "*applied* ethics. It is the application of our understanding of what is good and right to that assortment of institution, technologies, transactions, activities and pursuits which we call 'Business'".[21] This study will endeavour to establish the balancing act between what is good for the business and what is good for the internal and external stakeholders.

The following principles, in terms of the King lll Report, become of importance, namely:[22]

1) Discipline;
2) Transparency;
3) Independence;
4) Accountability;
5) Responsibility;
6) Fairness; and
7) Social Responsibility.

These principles overlap in a sense and need to be analysed. The principles will be discussed in Chapter Two regarding corporate governance. These principles must be taken into account when drafting a code of conduct, as they form an integral part of ethical behaviour. This study will examine various views of different authors and will define the concept of ethics and the principles relating to ethical behaviour.

In recent literature the concept of good corporate citizenship came to the fore. Good corporate citizenship is the establishment of ethical relationships between the

[20] Marx 2008: 324.
[21] Marx 2008: 324.
[22] Marx 2008: 181-184.

company and society.[23] Doing business ethically holds many advantages for a company, including the assurance of long-term survival of the company, respect of the public and content employees. Corporate collapses, business failures and fraud all have one thing in common: a lack of ethical behaviour.[24]

It is never a good idea to give one person or one body the be-all and end-all of power, it should always be delegated to other independent persons or bodies. It can be seen in the same light as the separation of powers in government and authority. Every part of a company should and must promote and maintain ethical behaviour. Ethics should also be the duty of every employee and not only of those persons involved in the management of the company. Although the employees are also stakeholders of a company, they can be seen as internal stakeholders with an ethical duty. A code of ethical conduct should be drafted and signed by all employees. This also gives them the responsibility of upholding ethical behaviour, making consequences of disregard thereof punishable.

Sison[25] emphasises the importance of the role that employees play in the corporate culture of a business, as follows:

1) Employee loyalty counts as an enormous positive externality for the company, and is a precious opportunity for the growth and virtue of an employee; and
2) Loyalty is not so much the economic result of locking in assets as a mutual ethical concern for each other's flourishing and wellbeing.

Decision-making is no longer reserved for those in positions of power; there must be a shared vision and responsive judgement of employees at all levels of the organisation.[26] This emphasises the role of the study, to determine what role employees play in ethical behaviour and ethics management.

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[23] King Report 2009: 52.
[24] Marx 2008: 323.
[25] 2008: 92.
[26] Management Extra 2009: 2.

Following the arguments and features of corporate governance and ethics stated above, the following important question arises: Could the achievement of ethical goals be maintained easier if all committees and members and employees of the company work together to achieve the ethical goals of the company?

This question remains to be answered. It is therefore clear that there might be more questions than answers in respect of ethical behaviour. It is impossible to have all the answers and therefore it is necessary to limit the scope of the study. In the next paragraph the scope of the study is discussed.

1.3 Scope of study

The focus of this dissertation is corporate governance and business ethics.

The history and philosophical nature of ethics will be discussed to gain a clear understanding of what ethics is in general before it is applied to business. The focus of the study does not lie in the philosophical background of ethics, but rather in business ethics.

It is important to note that, although this dissertation discusses the role of employees, it is not the role of employees in the employment relationship but rather their role in ethics management and the creation of an ethical corporate culture that is emphasised, and therefore labour relationships and legislation will not be discussed in detail.

The committees proposed by King are discussed as if applicable to all companies. These committees are available to assist in ethics management.

1.4 Research problem

The purpose of this dissertation is to emphasise the importance of ethics and ethical behaviour in the business world. Ethics will be discussed with relation to the rights and duties of the directors, especially their duty to be ethical at all times and in all transactions regarding the operation of the company, as well as the role that employees play in ethics management. The concept of ethics and ethical behaviour will be examined, as well as how to measure ethical behaviour: how it should be implemented, monitored, evaluated and maintained. The researcher will further examine what the role of the social and ethics committee is, especially regarding ethical duties and functions, as set out in the Companies Act 2008, which is not very specific.

The main research problem therefore is:

What is business ethics and what role do internal stakeholders, i.e. the employees of an organisation, play in the management and implementation thereof?

1.5 Secondary research questions

In order to solve the above research problem, the following secondary research questions should be answered:

1) What is corporate governance, and how has it developed internationally to ultimately become the King lll Report we apply in South Africa today? This will be answered in Chapter Two.
2) What are ethics and ethical behaviour, and how is it implemented and maintained within a workplace? This will be answered in Chapter Three.
3) What are the duties of directors in ethical management? This will be answered in Chapter Four.
4) Which mechanisms did the Companies Act of 2008 and King lll Report put in place to assist in the management of corporate governance and ethics management? This will be answered in Chapter Five.
5) What is the importance of corporate governance and the benefits associated therewith in South Africa? This will be answered in Chapter Six.
6) What is the importance of ethics and the benefits associated therewith in South Africa? This will be answered in Chapter Seven.

1.6 Rationale

This study is important since corporate governance is a fairly new concept in South Africa, and because of some ambiguity and vagueness in the Companies Act 71 of 2008, it is necessary to clarify a few uncertainties, especially regarding ethics.

Ethics is a very broad concept and many people have their own ideas of what ethical behaviour is. The researcher will aim, like the King lll Report, to lay down guidelines and principles for companies regarding ethical behaviour, the importance of a code of conduct and what the best mechanism for maintaining ethical behaviour would be.

The study will be of practical importance because it will give more clarity on what ethical “norms” could be in the corporate world by setting down “ground rules” regarding ethics, making it easier for companies to draft their code of ethics accordingly.

The concept of ethics is extremely important since companies play such an integral role in the economy and in its environment. Ethical behaviour is of the utmost importance to avoid corruption and dishonesty.

The Companies Act 2008 and King lll Report envisage that companies, through ethical behaviour, should operate optimally to benefit the economy. The aim of the study is to set guidelines on ethical behaviour to be implemented in the corporate world, as set out above, and to make a comprehensive study of what ethical behaviour is and should be.

1.7 Conceptual/theoretical framework

The theoretical basis of the study will be to harmonise the content and scope of ethics with regard to corporate governance. The aim is mainly to expand on the current view of ethics, create a new outlook, and to analyse and expand on the understanding of the concept of ethics and the viewpoints thereon.

1.8 Chapter outline

In Chapter One background is provided. The research problem and research questions are highlighted.

In Chapter Two of the study the emphasis will be placed on corporate governance developments in the United Kingdom and the United States of America and in South Africa, the history thereof, the applicability thereof as well as the importance thereof for the business to prosper as well as for the country as a whole, especially its economy.

Chapter Three is based on ethics. The researcher will focus on the concept of business ethics, its nature, role, function and importance in the corporate world. The researcher will look at why such great emphasis is placed on ethics in the business world, and the rationale behind it. The researcher will discuss the notion of ethical leadership, and sketch a picture of what and who an ethical leader is. The researcher will discuss the drafting and development of codes of conduct, their implementation and what the need for these are in managing ethics within a company through its employees, the internal stakeholders.

In Chapter Four the rights and duties of directors will be discussed, especially focusing on the role they play in ethics and ethical behaviour. The focus will be on their duties as listed in the Companies Act and their common law duties, as well as their duties in terms of King lll, and how these relate to ethics and the management thereof.

In Chapter Five the King committees, as proposed by the King lll Report, namely the board of directors, audit committees, social and ethics committees and the remuneration committees, will be discussed in detail, the role they play in effective management, the role they play in ethics as well as the interaction between the committees to ensure optimal benefit (ethical behaviour) for the company.

Chapter Six will focus on the importance of corporate governance in South Africa. Why is it necessary for such a system? What benefits does it hold for South Africa?

The chapter will focus mainly on the notion of Corporate Social Responsibility and Corporate Social Investment, developments that may have optimal benefits for the entire country and its economy if applied correctly.

Chapter Seven will focus on the importance of ethics in South Africa, looking at the benefit South African companies will receive. It is especially important in a country such as South Africa to level the playing field, to emphasise fairness and equality in the business world which is closely related to ethics. The positive and negative functions of ethics will be discussed; the negative being the prevention of fraud and the positive being the creation of positive organisational values. The researcher will also emphasise the importance of corporate sustainability for a country such as South Africa.

In Chapter Eight, the researcher will conclude the study with final remarks and recommendations for the road ahead in the corporate world.

Chapter Two
The International Development of Corporate Governance

***"Corporate governance refers to the way in which entities are directed and controlled. It is not a static form of rules but rather a set of rules involved in continuous change processes adapting to changing circumstances in which it operates. Corporate governance centres around the notion of accountability."*[27]**

2.1 Background

In paragraph 1.5 the following question was posed:

What is corporate governance, and how has it developed internationally to ultimately become the King lll Report we apply in South Africa today?

This chapter will aim to answer this question.

The development of corporate governance started in the early 1990s. Internationally, various corporate governance reports and codes have been drafted in the evolvement of this notion. In recent years voluntary codes have been employed increasingly across the globe to steer corporate governance reform.[28]

The role of corporate governance is found in the need for control over business, steering the business in the right direction, allowing to change the business to conform with changing circumstances. There is a substantial need for corporate governance because of the continuous change in the corporate world, emerging fraud and dishonesty and other related economic crime. Sound governance is needed to contribute to a sense of fairness in the corporate sector.

[27] Marx 2008: 69.
[28] Wong 2008: 3.

The focus of this chapter lies in corporate governance developments in the United Kingdom, the United States of America and South Africa, because, to a large extent, the principles of business practices and legal and regulatory environments are fairly similar, and the developments of corporate governance in South Africa, especially the King Reports, are based on the international developments in the aforementioned countries.

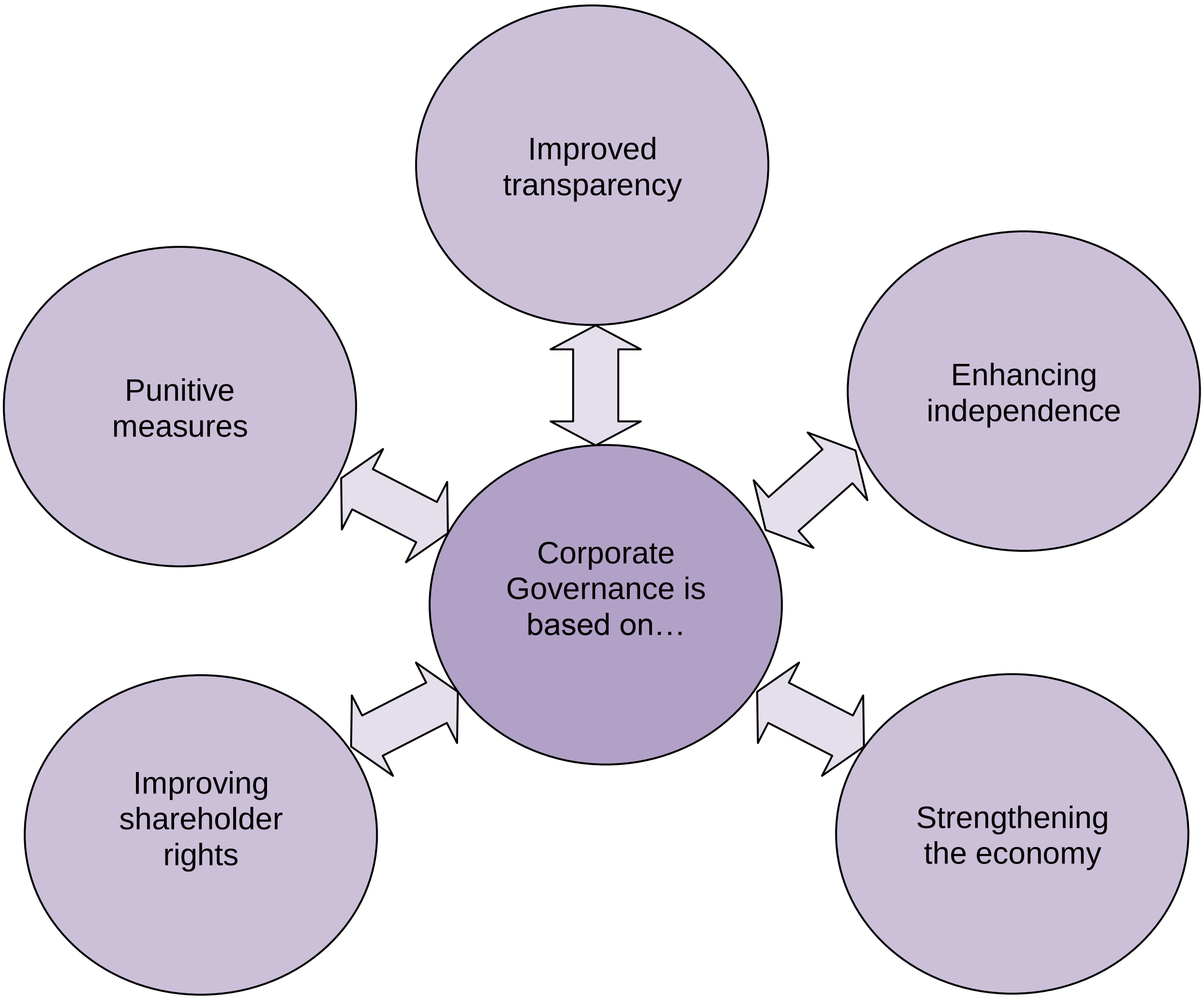
Corporate governance reforms over the past decades have generally entrenched the following principles:[29]

1) Improving transparency by way of extensive disclosure in annual accounts, executive compensation and conflicts of interest;
2) Enhancing independent monitoring of management by the board of the directors;
3) Strengthening economic alignment by methods of performance-based compensation and other financial incentives;
4) Bolstering shareholder rights by way of cumulative voting, board nomination rights and voting on executive remuneration; and
5) Imposing financial liability on corporate officers and directors, external auditors, investment bankers, and other intermediaries to ensure diligence, loyalty and honesty.

The above can be illustrated by the following example:

[29] Wong 2009: 1.

Figure 2.1: Main purpose of corporate governance



{Source: Own Figure}

2.2 The international development of the notion of corporate governance

In the following paragraphs the history and development of corporate governance in the United Kingdom and the United States of America will be discussed. The researcher will briefly refer to the most significant contributions to corporate governance of the two countries respectively.

2.2.1 Corporate governance developments in the United Kingdom

As stated in Chapter One, the issuing of the Cadbury Report (1992) launched the increased interest in corporate governance. This report contained a Code of Best Practice, designed to achieve impeccable standards of corporate behaviour.[30] It was the first formal code and created the benchmark and yardstick for many codes to follow. The Cadbury Report was followed by various other reports on corporate governance, such as The Greenbury Report (1995), the Hampel Report (1998), the Turnbull Report (1999), the Higgs Report (2003) and the Smith Report (2003).[31] The Combined Code is the best-known code, governing issues such as board composition, executive remuneration, voting disclosure and institutional shareholder responsibilities.[32]

From the above it is clear that corporate governance became a newsworthy topic in the United Kingdom since 1992. There was a need for a specialised field for the sake of corporate governance. Many authors and writers attempted to establish the so-called code of best practice to which companies should conform in compliance with corporate governance; some reports focused mainly on the role and function of audit committees whilst others focused on the role of ethics in the workplace and the importance of a code of conduct to which to conform.

These reports will be discussed briefly in the subsequent paragraphs.

2.2.1.1 The Cadbury Report and the Code of Best Practice (1992)

The Cadbury Committee was set up in May 1991 by the FRC (Financial Reporting Council), the LSE (London Stock Exchange) and the accounting profession, to address financial aspects of corporate governance.[33] This followed unexpected company failures and fraud cases in the United Kingdom, placing corporate

[30] Marx 2008: 98.
[31] Marx 2008: 98.
[32] Wong 2008: 7.
[33] Marx 2008: 98. See also Du Plessis 1994: 81.

governance in the centre of the public eye.[34] The committee defined corporate governance as the "system by which companies are directed and controlled".[35] This includes, in the more comprehensive sense, every force that bears on the decision-making of the business.[36]

The committee was concerned with the perceived low level of belief and confidence in financial reporting and the ability of auditors to provide the safeguards sought by companies.[37] The looseness of accounting standards and the absence of a clear framework of controls, and the competitive pressures between companies, were the driving forces for drafting of the Cadbury Report.[38] On the agenda were the following matters:[39]

1) The responsibilities of directors for reviewing and reporting on performance to shareholders and other parties with a financial interest;
2) The case for having company boards establish a committee of directors to deal with audit-related matters;
3) The responsibilities of auditors; and
4) Any other relevant matters. These matters included providing the company boards with agendas of matters requiring redress, organizing the structure of board committees, and the implementation of adequate internal financial controls.[40]

This committee, in their final report, recommended that listed companies comply with the disclosure of compliance and non-compliance with its codes and policies, while other entities could do so on a voluntary basis.[41] The report was very narrow and focused mainly on financial aspects, but also included a code of best practice.[42] It

[34] Marx 2008: 98.
[35] Cadbury Report 1992: Par 2.5.
[36] Jordan 2013: 3.
[37] Harvey 1995: 948. See also Du Plessis 1994: 82.
[38] Harvey 1995: 948. See also Cheffins 1997: 71.
[39] Cheffins 1997: 71.
[40] Cheffins 1997: 75.
[41] Marx 2008: 98.
[42] Marx 2008: 98.

followed the “comply or explain” approach.[43] Companies were “forced” to obey the code because any departure from the code had to be justified publicly.[44] This is a good method of attaining corporate governance since companies would not cause reputational damage to themselves and would rather obey the code than expose their own non-compliance.

The Cadbury Report confirmed the role of a code of conduct by drafting their Code of Best Practice.[45] The Code of Best Practice essentially addressed the following sections:[46]

1) The board of directors;
2) Non-executive directors;
3) Executive directors; and
4) Reporting and controls.

The Code of Best Practice was based on openness, integrity and accountability.[47] These factors will be discussed briefly in the following paragraphs.

1) Openness, in terms of the Code, refers to the basis of the confidence which needs to exist between business and all persons who have a stake in the running of the business.[48] There must be a relationship of trust. Openness promotes the efficient running of the company.
2) Integrity, according to the report, means the straightforward manner of dealing and completeness.[49] The integrity of the company relies heavily on the integrity of the persons in top management.
3) Accountability, in terms of the Code, refers to the duty placed on the board to be accountable to its stakeholders.[50]

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43 Jordan 2013: 4.
44 Wong 2008: 10.
45 Havenga 1998: 403.
46 Harvey 1995: 949.
47 Cadbury Report 1992: Par 3.2.
48 Cadbury Report 1992: Par 3.2.
49 Cadbury Report 1992: Par 3.3.
50 Cadbury Report 1992: Par 3.4.

All three the above concepts are integrated into our King Reports (discussed below).

The researcher fully agrees with the view of the writers of the report that integrity relies heavily on top management, but the researcher's argument lies in the fact that not only top management should be responsible for ethics and integrity within a company. The tone should be set from the top, yes, but should be filtrated down to the stakeholders, especially employees, so that they will also act ethically. It is not the responsibility of management alone to keep the business running, and if an employee is morally flawed, it could have detrimental effects on the business. Therefore the researcher reiterates and emphasises her standing that it is the responsibility of everyone involved in the business and not just that of management.

It is therefore clear that the report should also have focused on more than the financial aspects of the business, and should have put the obligation of corporate governance on all companies and not only large listed companies. Nevertheless, the report set a good foundation for further reports. It required a clearly accepted division of responsibilities to ensure a balance of power and authority, and a checks and balances system.[51] It set the groundwork for the separation of the roles of the chairperson and CEO in United Kingdom companies.[52] This is therefore the first step towards the strengthening of an independent board.

The report was not well received, particularly smaller companies found it burdensome to comply with.[53] It was criticised for merely being a voluntary code, and being too burdensome.[54] Although this report was criticised, it laid a very important foundation for further reports. Following the Cadbury Report, the Greenbury Report was published, and is discussed in the next paragraph.

[51] Du Plessis 1994: 83.
[52] Wong 2008: 7. See also Jordan 2013: 2.
[53] Harvey 1995: 952.
[54] Harvey 1995: 953.

2.2.1.2 The Greenbury Report (1995)

The Cadbury Report did not prescribe how directors' remuneration should be determined and approved. Consequently, the Study Group on Directors' Remuneration was set up in 1995 under the chairmanship of Sir Richard Greenbury.[55] This followed concerns about executive remuneration involving large pay increases and gains from share options in the then newly privatised utility industries, which often resulted in pay constraints for other employees, and price increases in products.[56]

The committee endeavoured to develop and identify good practices in determining directors' remuneration, and to develop an appropriate code.[57] Its final report was issued in 1995, being the prominent code on directors' remuneration and executive pay, and the role of a remuneration committee in a company.[58] The Greenbury Report contained a Code of Best Practice in addition to the report itself.[59] It required all listed companies in the United Kingdom to comply with it[60] and provided guidance and recommendations for the establishment and functioning of remuneration committees[61] as well as the disclosure of the directors' remuneration.[62] Companies had to issue annual reports on the remuneration of directors.[63] This annual report had to contain full details of each individual's remuneration package.[64]

The Greenbury Report is therefore a significant contribution to corporate governance, especially regarding directors' remuneration. Unfortunately we live in times where people in high positions misuse and abuse their positions to gain personal benefit. This report emphasises the fact that all remuneration should be disclosed. This will prevent mismanagement and unethical behaviour on the part of directors and will assist in keeping the reputation of the company in good standing.

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[55] Marx 2008: 98.
[56] Marx 2008: 98.
[57] Marx 2008: 98.
[58] Cheffins 1997: 79.
[59] Cheffins 1997: 79.
[60] Greenbury Report 1995: 12.
[61] Greenbury Report 1995: 14-16 and 21-25.
[62] Greenbury Report 1995: 26-33. See also Marx 2008: 99 and Cheffins 1997: 79.
[63] Harvey 1995: 951. See also Cheffins 1997: 79.
[64] Harvey 1995: 951. See also Cheffins 1997: 79.

The King lll Report also emphasises the importance of and need for a remuneration committee and sets out guidelines and principles for the remuneration of directors to be adhered to by the company in question. This will be discussed in Chapter Five.

Following this report, the Hampel Committee was formed, which published a combined code of the Cadbury and Greenbury Reports. This committee and its contribution towards corporate governance are discussed in the following paragraph.

2.2.1.3 The Hampel Committee (1998)

The Hampel Committee was established in November 1995, following the recommendations of the Cadbury and Greenbury Committees that they should operate as a "reviewing committee" to evaluate the previous implementation of the recommendations of other committees.[65] They described the Cadbury Report as having "struck a chord in many overseas countries; it has provided the yardstick against which standards of corporate governance in other markets are being measured".[66] The Hampel Committee was established mainly to deal with corporate governance.[67] It was tasked with promoting high standards of corporate governance in the interests of investor protection and in order to preserve and enhance the standing of companies that were listed on the London Stock Exchange (LSE).[68]

The committee's report was published in January 1998 and emphasised principles of good governance as opposed to explicit rules,[69] leaving it more to the judgement of the individual to apply the principles of ethical behaviour without placing the person within certain bounds and parameters. It reduced the regulatory burden on companies and the avoidance of following a checklist for ethical behaviour.[70] The report also set out guidelines on how to achieve the implementation of these principles of good governance.[71] This report is deemed to be one of the most

[65] Hampel Report 1998: 5. See also Marx 2008: 101.
[66] Hampel Report 1998: 7. See also Cheffins 2012: 20.
[67] Esser & Coetzee 2004: 27.
[68] Marx 2008: 101.
[69] Hampel Report 1998: 10. See also Marx 2008: 101.
[70] Marx 2008: 101 and Du Plessis et al 2011: 316.
[71] Marx 2008: 102.

balanced reports on corporate governance in the United Kingdom.[72] The committee suggested a combined code of its findings, the Cadbury and the Greenbury Reports, focusing on the following aspects: the role of directors, remuneration of directors, the role of shareholders, and accountability and audit.[73] The committee contended that the greatest concern for effective corporate governance is "the preservation and the greatest practicable enhancement over time of shareholders' investment".[74] This is in line with the notion of ethical sustainability discussed in Chapter Seven.

South Africa's King lll Report and the Hampel Committee's Report have one thing in common, the emphasis on the protection of stakeholder interests. The researcher criticises the Hampel Committee's Report for their view that ethics should be left to the judgement of an individual. Not all individuals are ethical, and to put it bluntly, even one unethical person can be the cause of the downfall of the business. Employees' conduct should be set within certain parameters with clear boundaries. A code of conduct, in the researcher's opinion, is of the utmost importance for the maintenance of ethical behaviour. Leaving persons at liberty to make their own decisions as to what is ethical or not is a dangerous situation; they should make their decisions within the guidelines and boundaries set by a code of conduct, and may only apply their own judgement to some extent. This is discussed more extensively in Chapter Three, when referring to aspirational-directional codes of conduct (paragraph 3.10.3 below).

Following the formation of the Hampel Committee, an attempt was made to develop a combined code of all the previous reports on corporate governance. In the subsequent years, this combined code was amended quite a few times until 2012. These reports, known as "The Combined Code", will be discussed in the following paragraphs. The first Combined Code will be discussed briefly in the following paragraph.

[72] Du Plessis et al 2011: 316.
[73] Hampel Report 1998: 8. See also Marx 2008: 102.
[74] Mongalo 2003: 177.

2.2.1.4 The Combined Code on Corporate Governance (1998)

The Combined Code was issued by the London Stock Exchange (LSE) in June 1998 and incorporated the recommendations of the Cadbury, Greenbury and Hampel Committees.[75] The code placed emphasis on the requirement of the company to provide the shareholders with a statement containing sufficient information to allow them to assess the extent of the company's compliance with the code.[76]

The Combined Code had 14 principles of good governance, divided into five parts, namely:[77]

1) Directors;
2) Directors' remuneration;
3) Relations with stakeholders;
4) Accountability and audit; and
5) Institutional shareholders.

This code emphasised the importance of integrated reporting within a company. It required the board to maintain a sound system of internal control to safeguard the shareholders' investment and protect the company's assets and to conduct at least an annual review on the effectiveness of internal controls and report to the shareholders thereon.[78] The review had to cover all controls, financial, operational and compliance controls as well as risk management, but the code failed to provide guidelines on what these control systems should comprise.[79]

This code further emphasised the importance of and need for integrated reporting, which is also emphasised in the King lll Report, requiring all the committees, the board, the audit committee, the social and ethics committee and the remuneration

[75] Marx 2008: 102.
[76] Marx 2008: 102.
[77] The UK Combined Code on Corporate Governance 1998 Section 1. See also Esser & Coetzee 2004: 28.
[78] The UK Combined Code on Corporate Governance 1998: Principle D2. See also Marx 2008: 103.
[79] Marx 2008: 103.

committee to file reports on the fulfilment of their duties to be included in the integrated report of the company at the end of the financial year.

This is the first step in the right direction for a fully equipped code on corporate governance and many of the aspects listed in it are included in our King Reports today.

The Combined Code therefore summarised the previous reports and promoted the inclusion of the integrated report. Following this code, the Turnbull Report was published, which is discussed in the next paragraph.

2.2.1.5 The Turnbull Report (1999)

This report was published in September 1999, setting out guidelines on maintaining a sound system of internal controls and sufficient management of risks.[80] This report strongly endorsed the idea that corporate governance is concerned with striking a balance between economic and social goals, and running the company for the benefit of all stakeholders.[81]

This report focused on the maintenance of internal control; this is also reflected in the King lll Report in the establishment of the audit committee, social and ethics committee and the remuneration committee as well as the establishment of the board of directors playing the oversight role in the maintenance of internal control.

The Higgs Report followed the Turnbull Report and will be briefly referred to in the next paragraph.

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[80] Turnbull Report 1999: 4. See also discussion in Marx 2008: 104.
[81] Mongalo 2003: 178.

2.2.1.6 The Higgs Report (2003)

The Higgs Committee was formed in 2002 and was tasked with reviewing the role and effectiveness of non-executive directors.[82] Its report was published in January 2003, containing recommendations aimed at increasing the rigour and transparency of the process of nominating and appointing directors and encouraging the spread of multi-experience in United Kingdom boardrooms.[83]

This report is of importance as it sets out guidelines for the appointment of directors in a transparent manner. It is a well-known fact that many companies these days are flawed by nepotism, and this report sets guidelines on how to avoid non-transparency in the appointment of directors.

This report was followed by the Smith Report, briefly discussed in the next paragraph.

2.2.1.7 The Smith Report (2003)

The Smith Committee was initiated by the corporate collapses in the United States of America. The aim of its report was to assist boards in making suitable arrangements for their audit committees and to assist their directors serving on audit committees to carry out their duties.[84] The report was published in 2003, setting out the essential requirements that an audit committee should meet as well as recommendations on how to achieve this.[85] This report focused on the role of the audit committees.

The researcher is of the view that this report reiterates the fact that what goes on in other countries also has an effect on the country you live in. It was an attempt to assist companies that are struggling financially to improve their future prospects by placing a focus on the role and the importance of an audit committee and the turnaround effect it can have on a company's financial position.

[82] Higgs Report 2003: 21. See also Marx 2008: 104.
[83] Higgs Report 2003: 40-41. See also Marx 2008: 104.
[84] Smith Report 2003: 4. See also Marx 2008: 105.
[85] Smith Report 2003: 4. See also Marx 2008: 105.

The Combined Codes were revised subsequent to this writing in 2003, 2006 and 2012 and are discussed in the following three paragraphs.

2.2.1.8 The Combined Code (2003)

The revised Combined Code was issued in July 2003 and superseded and replaced the Combined Code of 1998, It was derived from the review of the role and effectiveness of non-executive directors.[86] It was deemed the norm of good corporate governance practices for listed companies in the United Kingdom.[87]

From the above it can be seen that this code was the established and accepted code in the United Kingdom in the early 2000s. As with all reports on corporate governance and due to changing circumstances with which companies must conform, the code was subsequently revised in 2006 and again in 2012.

These codes will be discussed in the following two paragraphs.

2.2.1.9 The Combined Code (2006)

This Combined Code was issued in June 2006 and superseded and replaced the Combined Code of 2003[88] following the review of the previous code and the responsibilities of directors[89] and internal controls.[90]

2.2.1.10 The Combined Code (2012)

This code came into effect in October 2012 in the United Kingdom. The code, according to its foreword, is “a guide to a number of key components of effective board practice.”[91] It is based on the underlying principles of all good governance: accountability, transparency, probity and focus on sustainable success of the entity

[86] Marx 2008: 115.
[87] Marx 2008: 115.
[88] UK Combined Corporate Governance Code 2006: 1.
[89] UK Combined Corporate Governance Code 2006: 3-4.
[90] UK Combined Corporate Governance Code 2006: 14. See also Marx 2008: 118.
[91] UK Combined Corporate Governance Code (September 2012): 1.

over the longer term".[92] It emphasised the duty of the role of the board to discharge their duties in the best interests of the company.[93]

The main principles of the 2012 Code are as follows:[94]

1) Leadership;
2) Effectiveness;
3) Accountability;
4) Remuneration; and
5) Relations with shareholders.

These principles will be discussed briefly in the paragraphs that follow.

2.2.1.10.1 Leadership

Every company should be headed by an effective board being collectively responsible for the long-term goals and survival of the company.[95] The duties must be divided amongst the members of the board and no member should have unlimited power and authority.[96]

2.2.1.10.2 Effectiveness

There must be a sufficient balance of skills, experience and independence between the members of the boards to fulfil their functions in a proper manner.[97] There must be a rigorous procedure for the appointment of members and the re-election of members.[98] Members must be willing to devote substantial time to exercise their duties as members of the board.[99]

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[92] The UK Corporate Governance Code (September 2012): 1.
[93] The UK Corporate Governance Code (September 2012): 2.
[94] The UK Corporate Governance Code (September 2012): 6-7.
[95] The UK Corporate Governance Code (September 2012): 6.
[96] The UK Corporate Governance Code (September 2012): 6.
[97] The UK Corporate Governance Code (September 2012): 6.
[98] The UK Corporate Governance Code (September 2012): 6.
[99] The UK Corporate Governance Code (September 2012): 6.

2.2.1.10.3 Accountability

The board must present a fair, balanced and clear assessment of the company's current position and prospects for the future.[100] This also involves proper risk management procedures being in place at all times.[101] Emphasis is also placed on transparency within the company, especially regarding the manner of reporting.[102]

2.2.1.10.4 Remuneration

The code states that levels of remuneration must be sufficient to attract, retain and motivate directors of the quality of work to be performed and appointments to be made in order for the company to operate optimally.[103] There must be a transparent procedure for the determination of a director's salary and he may not be involved in the decision regarding his salary.[104]

2.2.1.10.5 Relations with stakeholders

There must be a mutual understanding and objectives between the directors of the company and its stakeholders.[105]

This code is a very comprehensive, all-encompassing report on corporate governance. It has broadened the principles of corporate governance extensively so as to improve the control of corporate governance, and setting out easier and clearer guidelines for companies to conform to corporate governance. The notions of leadership, effectiveness, accountability, remuneration and relations with stakeholders are all emphasised in the King lll Report. The researcher could go so far as to say that it is very likely that the King lll Report (published in 2009) may have been the foundation for the writing of this code, since it incorporated many concepts from the King lll Report.

[100] The UK Corporate Governance Code (September 2012): 6.
[101] The UK Corporate Governance Code (September 2012): 7.
[102] The UK Corporate Governance Code (September 2012): 7.
[103] The UK Corporate Governance Code (September 2012): 7.
[104] The UK Corporate Governance Code (September 2012): 7.
[105] The UK Corporate Governance Code (September 2012): 7.

2.2.1.11 Concluding remarks

Through the development of corporate governance in the United Kingdom one can clearly see how the concept has grown, especially when looking at the very first report, The Cadbury Report, and the very latest report, the Combined Code of 2012. The Cadbury Report emphasised openness, integrity and accountability as key concepts in corporate governance, whereas the Combined Code broadened the view to include leadership, effectiveness, remuneration and relations with stakeholders as key concepts. One can also see how corporate governance has evolved and become increasingly important in the past few years, given all the reports expanding the preceding reports and building thereon, reviewing the previous report to improve the new report. The success of the reports in the United Kingdom lies in:[106]

1) A tradition of self-regulation and consensus on the utility of the code;
2) Clearly defined standards;
3) The availability of information regarding corporate compliance;
4) Interested and informed shareholders and other beneficiaries; and
5) A supportive legal framework.

[106] Wong 2008: 8.

Table 2.1: Developments of corporate governance in the United Kingdom

Year	Publication	Key developments
1992	Cadbury Report	• Code of Best Practice • Audit-related matters
1995	Greenbury Report	• Code of Best Practice • Remuneration of directors
1998	Hampel Committee	• Investor protection • Combined Code of Cadbury and Greenbury Reports
1998	Combined Code	• Integrated reporting
1999	Turnbull Report	• Risk management
2002	Higgs Report	• Director nomination and appointment processes
2003	Smith Report	• Recommendations on audit committee functions
2003	Combined Code	• Role and effectiveness of non-executive directors
2006	Combined Code	• Responsibilities of directors
2012	Combined Code	• Guidelines on effective board practice

{Source: Own Table}

In the following paragraphs the development of corporate governance in the United States of America will be discussed.

2.2.2 Corporate governance developments in the United States of America

The development of corporate governance in the United States of America was initially slow. Corporate governance became a focal point after the publishing of the American Law Institute's (ALI) Report on Principles of Corporate Governance in 1994 as discussed below.

Many organisations and institutions have reported on corporate governance and many issues have since been formalized.

A brief discussion of the most significant reports and codes on corporate governance in the United States follows.

2.2.2.1 The American Law Institute (ALI) (Principles of Corporate Governance: Analysis and Recommendations, 1994)

This comprehensive project on corporate governance, that took up to 15 years to complete, was based on the duties and responsibilities of directors and officers of American companies.[107] The aim was to extract the most profound and basic principles of corporate governance, creating a form of "best practice" on corporate governance. It shaped corporate governance in the United States of America and opened the floor for many debates on the "best practice" on corporate governance.[108]

The first writing was the Tentative Draft No 1, receiving a wide range of criticism.[109] It contained regulations requiring boards to have a majority of independent directors to establish audit committees and nomination committees and to refrain from doing more on the managerial front than overseeing executives.[110] Even so, it failed to make due allowance for beneficial governance innovations already occurring voluntarily in American public companies.[111] The ALI ignored the immense pressure that market forces apply on those public companies to establish governance structures and shareholders' value.[112] The ALI, after receiving all the criticism, decided to recast their draft report and merely refer to it as recommendations. Their final work, The Guidebook, published in 1992, was modified to the point where its contents closely resembled the existing law, and was not really criticised.[113]

[107] Marx 2008: 124.
[108] Marx 2008: 124.
[109] Cheffins 2012: 7.
[110] Cheffins 2012: 8.
[111] Cheffins 2012: 8.
[112] Cheffins 2012: 8.
[113] Cheffins 2012: 10.

Part lll of this report set out recommendations regarding the composition of the board of directors, the creation, composition and functions of the audit committees as well as functions for compensation committees.[114]

The American Law Institute, when considering the ideal form of conduct, suggested that "a corporation should have as its objective the conduct of business activities with a view to enhance corporate profit and shareholder gain".[115] This is ethical behaviour in that the stakeholders are taken into account, and the directors are not merely concerned with good for themselves, but also for the company and its stakeholders.

This report was the initial yardstick for corporate governance in the United States of America and opened the floor for many opinions and debates. It was followed by many other reports, one of which is the report of the American Bar Association, discussed in the following paragraph.

2.2.2.2 American Bar Association (2001, 2002)

This Association brought out a handbook titled *The Corporate Directors Guidebook,* emphasising their immense support for sound corporate governance practices.[116] In this book they recommended that there be substantial outside director representation (independence) on boards and that executive directors should be excluded from the established audit, compensation and nominating committee boards.[117]

The principles discussed in the previous reports were codified in the Sarbanes-Oxley Act, to be discussed in the following paragraph.

2.2.2.3 Sarbanes-Oxley Act (2002)

The Sarbanes-Oxley Act was initiated after the accounting scandals involving some of the most influential and prominent companies in the United States of America,

[114] Marx 2008: 124.
[115] Esser & Du Plessis 2007: 349.
[116] Marx 2008: 133.
[117] Cheffins 2012: 5.

such as Enron, Tyco and WorldCom.[118] As a result, the Sarbanes-Oxley Act focused on imposing new rules on internal control and risk management relating to financial statements, certification of financial statements by executive directors and external auditors, the role of audit committees consisting of independent non-executives and by strict rules on auditor independence and oversight, to ensure the reliability and integrity of the financial information listed companies had to provide to the market.[119] Sarbanes-Oxley puts great emphasis on transparency and supervision of the board of directors, management and audit committees.[120]

According to Du Plessis et al,[121] the aims and objectives of the Act were as follows:

1) Restoring confidence in the accounting profession;
2) Improving the tone from the top;
3) Improving financial reporting and disclosure;
4) Improving the performance of "gatekeepers"; and
5) Enhancing enforcement tools.

Marx[122] indicates that the ultimate aim of this Act was to restore the credibility of corporate accounting and reporting.

This Act is seen as the yardstick against which corporate governance is to be measured in the United States, setting out penalties for non-compliance as well as a code of best practice to be followed.[123] This is a good approach to follow, almost similar to the "comply or explain" approach in the King II Report, in this case just "comply or pay".

Title III[124] deals with the notion of corporate responsibility. It sets out requirements for reporting by directors on the effectiveness of specified controls in the companies.[125]

[118] Marx 2008: 139.
[119] Winter 2011: 3.
[120] Ehrat 2003: 76.
[121] 2011: 305.
[122] Marx 2008: 139.
[123] Marx 2008: 139. See also Du Plessis et al 2011: 305.
[124] Sarbanes-Oxley Act of 2002.

Title VIII[126] deals with corporate and criminal accountability, a very big ethical issue in business these days because of emerging fraud worldwide. It provides for tougher criminal penalties for altering documents, obstruction of justice, defrauding of shareholders,[127] and in a sense forces directors to act in an ethical manner.

Another ethical dimension addressed in this section of the Act is that of the protection of whistle-blowers[128] who testify in legal proceedings, who regard their ethical duty towards the company and its directors and shareholders to be of the utmost importance. Whistle-blowers are members of an organisation who report misconduct regarding the law, policies and procedures within the organisation. [129]

Title XI[130] discusses corporate fraud and accountability. It provides for additional powers and authority to be bestowed upon courts and judicial officers to take more severe and wide-ranging actions, including fines and imprisonment for corporate wrongdoings such as tampering with records, impeding and obstructing of judicial proceedings, taking extraordinary or unusual payments, retaliation against and threatening of corporate whistle-blowers and any other matters relating to corporate fraud.[131]

What is interesting to note is that this is an Act and not merely a report, which carries a lot more weight than a mere report. It is a very broad source on corporate governance, mainly focusing on financial aspects but also incorporating the very important aspect of the role of whistle-blowers, a notion that has frequently come into play in recent years. It affords the whistle-blowers the protection needed to ensure that they come to the fore and report any non-compliance with corporate governance. The whistle-blowers play an important role in the maintenance of corporate governance and therefore the provisions in this Act are very important,

[125] Marx 2008: 140.
[126] Sarbanes-Oxley Act of 2002.
[127] Marx 2008: 141.
[128] Section 806 of Sarbanes-Oxley Act of 2002. See also Marx 2008: 141.
[129] Lubbe 2013: 176.
[130] Sarbanes-Oxley Act of 2002.
[131] Marx 2008: 142.

making the whistle-blowers feel at ease and free to report on unethical and unlawful matters without fear of intimidation.

The Act imposes legal responsibilities on corporate officers.[132] Corporate officers have a liability towards the company and are liable for damage caused to the company by the non-compliance with their duties. The Act is the acknowledgement of the American legislator that after the United States' corporate scandals which shocked the system, fairly unlimited self-regulation was not to be condoned any further.[133] This is in line with the Companies Act of 2008 being promulgated to codify corporate governance.

In terms of Section 406(c),[134] a code of ethics is defined as "standards (that) are reasonably necessary to promote… honest and ethical conduct".[135] It is therefore important to note that the Act also played an important role in the development of codes of ethics as integral components to the creation of an ethical corporate culture.

2.2.2.4 Concluding remarks

The United States of America is the first country to codify corporate governance in the form of legislation, giving it even more authority than reports.

The development of corporate governance in the United States of America is illustrated by Table 2.2 below.

[132] Shaner 2010: 16.
[133] Ehrat 2003: 77.
[134] Sarbanes-Oxley Act 2002.
[135] Dallas 2004: 5.

Table 2.2: Development of corporate governance in the United States of America

Year	Report	Key development
1994	ALI – Principles of corporate governance: Analysis and Recommendations	• Code of "best practice" on corporate governance • Board composition
2001, 2002	American Bar Association	• The Corporate Directors Guidebook • Board independence • Remuneration committees
2002	Sarbanes-Oxley Act	• Penalties for non-compliance • Credibility for accounting reporting • Corporate responsibility • Protection of whistle-blowers • Legal responsibilities of officials • Definition of "ethics"

{Source: Own Table}

It is needless to mention that all the developments in the United States of America and the United Kingdom have had a profound impact on the growth of corporate governance.

2.2.2.5 Conclusion of comparative study

The issuing of the Cadbury Report in the United Kingdom in 1992 initiated an interest in corporate governance worldwide, and in South Africa it has come to play a role since 1994 when the redressing of the past became of significant importance. This put corporate governance at the centre of the business world.[136] The Cadbury Report of the United Kingdom and South Africa's King I Report, discussed below, are the two earliest codes on corporate governance.

[136] Marx 2008: 175.

It is also interesting to note that corporate governance in the United States of America was codified and that in the United Kingdom it took the form of codes.

The publication of the King l Report and the Code of Corporate Practices and Conduct in 1994 was a milestone in the corporate world of South Africa. It will be discussed in the following paragraph.

2.3 The development of corporate governance in South Africa

"Good governance is a journey, and not a destination." [137]

Since the transformation of South Africa in 1994, the redressing of past issues has become of the utmost importance.[138] Change was demanded.

This needed change came with the publication of the King l Report in 1994, which will be discussed in the following paragraph.

2.3.1 The King Report on Corporate Governance and the Code of Corporate Practices and Conduct (King l, 1994)

The King Committee was formed under the auspices of the Institute of Directors in Southern Africa, with the support of the South African Chamber of Business, the South African Institute of Chartered Accountants, the Johannesburg Stock Exchange, the South African Institute of Business Ethics, and the Institute of Chartered Secretaries and Administrators in South Africa.[139]

The King l Report was the first of its kind in South Africa and was deemed to be way ahead of its time when published in 1994. It was the initiative of the Institute of

[137] Du Plessis et al 2011: 11.
[138] Marx 2008: 175.
[139] Armstrong 1995: 65.

Directors (IoDSA) and has since been accepted by many businesses and professional associations in South Africa.

This report set out a Code of Corporate Practices and Conduct which gave guidance on the following issues:[140]

1) The board of directors;
2) The chairperson of the board;
3) Non-executive directors;
4) Directors' appointments as such;
5) Directors' remuneration;
6) Board meetings;
7) Professional advice;
8) Stakeholder communications;
9) Auditing;
10) Workers' participation;
11) Affirmative action; and
12) Code of ethics.

The report was seen as a milestone for various reasons, for its code of ethics and its affirmative action plan,[141] but mainly for setting the groundwork for companies on the implementation of corporate governance actions, and for recommendation towards the legislature to enact legislation setting out guidelines for corporate governance and making non-compliance with such standards sanctionable. This recommendation was widely supported, and many corporate collapses were attributed to the inadequacy of the legislature at that stage. This inadequacy was, however, only addressed a few years later with the enactment of the Companies Act of 2008. It is astounding that it took the legislature 14 years to codify corporate governance in the form of an Act.

[140] Marx 2008: 179. See also Naidoo 2009: 32-33.
[141] Havenga 1998: 403.

Although the report was highly appraised, it was also criticised on quite a few aspects. People considered it a form of “tick box” compliance, as it was seen as a checklist rather than a way of operating or managing the company.[142] The emphasis was placed on disclosure rather than on best practice.[143] The King Report was regarded as flawed because it failed to consult widely, invite public debate and gather all possible knowledge before writing the report.[144]

The researcher would like to counter the criticism that the report is a “tick box” form of compliance. In the researcher’s opinion this is and was the necessary way of implementing ethical behaviour and corporate governance. Without guidelines or a “tick box”, how would one know whether one was complying with corporate governance? The code of best practice should not exist merely on paper; yes, but the paper should be the foundation of setting the tone. Without the paper how does one determine whether behaviour is correct or not? The researcher believes that the “tick box” approach was the correct approach at the time, setting the groundwork for ethical decision-making.

In the following paragraph the King ll report will be discussed.

2.3.2 The King ll Report on Corporate Governance and the Code of Corporate Practices and Conduct (King ll, 2002)

Developments since 1994 led to a review of the King l Report. These developments include stakeholder activism, changing legislation, globalisation and IT governance.[145]

King ll was more principle-based than disclosure-based.[146] It was premised on the philosophy that all forms of governance must reflect the society in which it operates.[147] The committee expanded the scope and extent of corporate governance

[142] Marx 2008: 180. See also Naidoo 2009: 32-33.
[143] Marx 2008: 180.
[144] Marx 2008: 181.
[145] Marx 2008: 181.
[146] Marx 2008: 181.
[147] Naidoo 2009: 33.

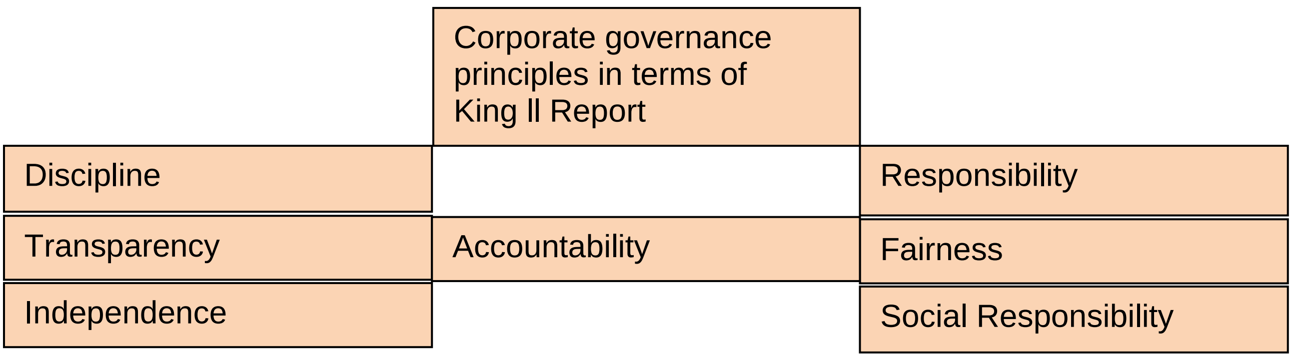
by advocating an integrated approach to satisfy the interests of stakeholders and embracing the social, environmental and economic aspects of a company's activities.[148] Corporate Social Responsibility and Corporate Social Investment took form in this report.

As is stated above, King ll was more principle-based. The main principles embedded in the report are as follows:[149]

1) Discipline;
2) Transparency;
3) Independence;
4) Accountability;
5) Responsibility;
6) Fairness; and
7) Social Responsibility.

The above can be illustrated by the following example.

Figure 2.2: Main principles of the King ll Report



{Source: Own Figure}

These principles will be discussed briefly in the paragraphs that follow.

[148] King Report 2002: 2. See also Marx 2008: 181.
[149] Marx 2008: 181.

2.3.2.1 Discipline

Corporate discipline is a commitment of a company's senior management to adhere to ethical behaviour that is universally recognised as best corporate practice.[150] It encompasses the company's awareness of and commitment to the underlying principles of good corporate governance.[151]

2.3.2.2 Transparency

Transparency refers to the ease with which an independent person might make a meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business.[152] It is an active duty of disclosure.[153]

It measures the extent to which management is making the information available that they are obliged to in a timely manner, reflecting whether investors get a true picture of the state of the company as they are entitled to.[154] It plays an integral role towards the credibility of companies.[155]

2.3.2.3 Independence

Independence refers to the extent to which mechanisms have been put in place to minimise or avoid potential conflicts of interest.[156] These mechanisms follow a wide scope, including composition of the board, appointments to committees of the board and the appointment of external parties such as auditors.[157]

All decisions and internal processes must be established in an objective, ethical manner free of undue influence.[158]

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[150] Marx 2008: 181.
[151] Marx 2008: 181.
[152] Marx 2008: 182. See also Naidoo 2009: 214.
[153] Naidoo 2009: 214.
[154] Marx 2008: 182.
[155] Naidoo 2009: 214.
[156] Marx 2008: 182.
[157] Marx 2008: 182.
[158] Marx 2008: 182.

2.3.2.4 Accountability

Accountability is an essential element of corporate governance in creating an ethical business culture.[159] All individuals charged with making decisions in a company need to be accountable for the decisions and steps they take. Mechanisms should be put in place to allow for the effectiveness of accountability.[160] Accountability should permeate all levels of the company.[161] The notion of accountability allows investors to query and assess the actions of the board and its committees.[162]

2.3.2.5 Responsibility

Responsibility pertains to behaviour that allows for corrective actions and for penalisation of mismanagement within the company.[163] Management has the responsibility, and must do whatever it takes, to keep the company on the straight and narrow.

2.3.2.6 Fairness

Systems within the company must be balanced, taking into account the interests and expectations of all persons having an interest in the company and its future.[164] The rights of various individuals and groups need to be recognised and respected.

2.3.2.7 Social Responsibility

A company must run itself and its business taking into account the community and its social impact. It must give back to the community at all times to fulfil its duties in terms of Corporate Social Responsibility. It concerns the welfare of human beings.[165]

[159] Holder 2013: 105.
[160] Marx 2008: 182.
[161] Holder 2013: 105.
[162] Marx 2008: 182. See also Naidoo 2009: 245.
[163] Marx 2008: 183.
[164] Marx 2008: 183.
[165] Naidoo 2009: 247.

The above concepts were incorporated into the King lll Report, which broadened the concepts and incorporated a large number of new principles. This report is discussed in paragraph 2.3.4. What follows in the next paragraph is a discussion of the Companies Act 71 of 2008.

2.3.3 Companies Act 71 of 2008

The Companies Act 71 of 2008 was the first attempt to codify corporate governance.

The values of corporate governance are reiterated in Section 7 of the Companies Act 2008. It is included in this study in full because of its importance to the study.

Section 7[166] sets out the purpose of the Act as follows:

(a) promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law;
(b) promote the development of the South African economy by—

> (i) encouraging entrepreneurship and enterprise efficiency;
> (ii) creating flexibility and simplicity in the formation and maintenance of companies; and
> (iii) encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation;

(c) promote innovation and investment in the South African markets;
(d) reaffirm the concept of the company as a means of achieving economic and social benefits;
(e) continue to provide for the creation and use of companies, in a manner that enhances the economic welfare of South Africa as a partner within the global economy;

[166] Companies Act 71 of 2008.

(f) promote the development of companies within all sectors of the economy, and encourage active participation in economic organisation, management and productivity;
(g) create optimum conditions for the aggregation of capital for productive purposes, and for the investment of that capital in enterprises and the spreading of economic risk;
(h) provide for the formation, operation and accountability of non-profit companies in a manner designed to promote, support and enhance the capacity of such companies to perform their functions;
(i) balance the rights and obligations of shareholders and directors within companies;
(j) encourage the efficient and responsible management of companies;
(k) provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders; and
(l) provide a predictable and effective environment for the efficient regulation of companies.

It is clear that the Act envisages that companies must be accountable to the stakeholders of the company as well as to the public, to act ethically in running the company so as to balance the rights and interests of all internal stakeholders as well as shareholders. Emphasis is also placed on a healthy economic working environment within the company. This is the main aspect where the focus of the dissertation lies. This dissertation will emphasise and discuss certain aspects of the purpose of the Act, especially subsections (a), (b), (d), (i), (j), and (l).

2.3.4 The King Report on Corporate Governance and the Code of Corporate Practices and Conduct (King lll, 2009)

The King lll Report is the most recent and most complex document on the concept of corporate governance that we have in South Africa. This report has moved to a more ethical approach of running a business. This report can be summed up by the following definition of Kretzschmar et al:[167]

[167] 2012: 164.

> *"Corporate governance is, in essence, a company's practical expression of ethical standards. It follows that all the typical aspects of corporate governance (such as the role and responsibilities of the board of directors, internal audit, risk management, stakeholder relations and so on) should rest on a foundation of ethical values."*

Corporate governance assists in levelling the playing field, especially by way of Corporate Social Responsibility and Corporate Social Investment (discussed in Chapter Six), on which a huge emphasis is placed in this report. It encourages organisations to comply with it through the "apply or explain" approach.[168] It is important to note that, unlike the King ll Report, the King lll Report is not only applicable to listed companies, but applies to all business entities.[169] This therefore means that listed companies must comply with the provisions in the King lll Report, but it is good practice for all companies to comply therewith.

The report states that good governance relies mostly on effective leadership.[170] The leadership referred to is characterised by the ethical values of:[171]

1) Responsibility;
2) Accountability;
3) Fairness; and
4) Transparency.

The above is in line with the modern concept of *ubuntu*.[172]

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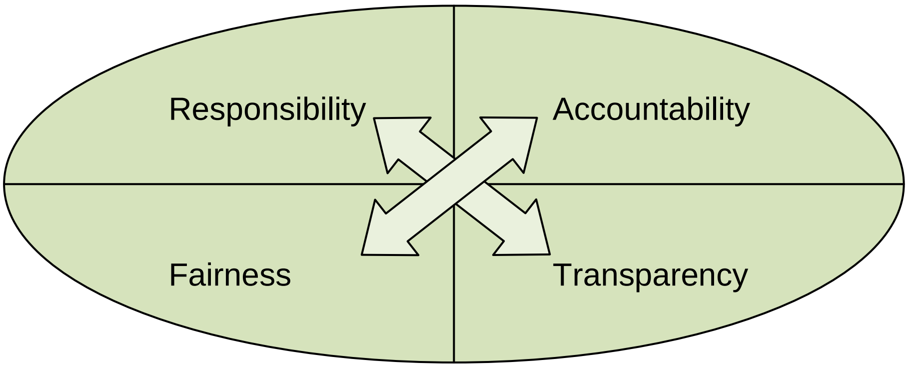
[168] Naidoo 2009: 34.
[169] Cassim et al 2012: 521.
[170] King Report 2009: 9.
[171] King Report 2009: 9. See also Wong 2008: 5.
[172] Ubuntu is roughly translated as being "human kindness".

Figure 2.3: Main leadership principles of King lll Report



{Source: Own Figure}

Responsible leaders should have one goal in mind, namely to achieve sustainable economic, social and environmental performance.[173]

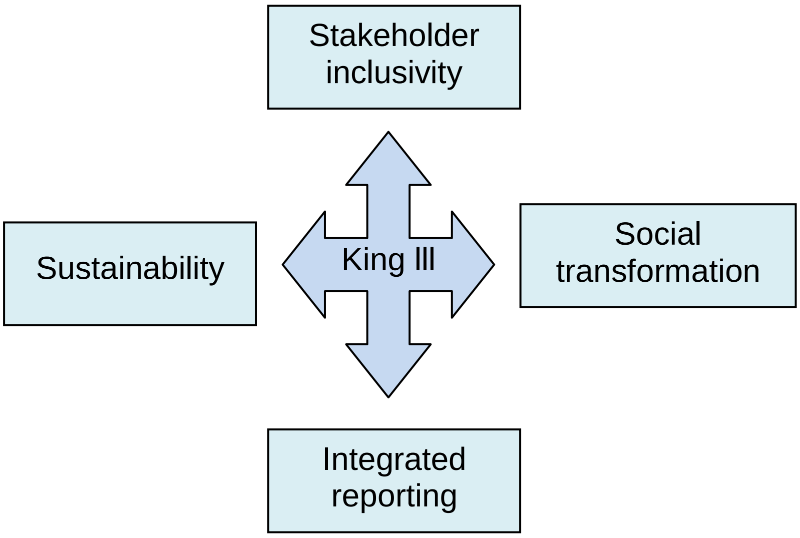
Sustainability is the primary moral and economic imperative of the 21st century,[174] and is the second pillar of the report. Nature, society and business are all interconnected and this should be well understood by the decision-makers of the company,[175] not only to decide what is in the best interests of the company but also to consider the community and the environment. Sustainability is discussed in paragraph 2.3.4.2 below and in Chapter Seven.

The main focal points of the King lll Report can be summarised as follows:

1) Inclusivity of stakeholders;
2) Sustainability;
3) Social transformation; and
4) Integrated reporting.

173 King Report 2009: 9.
174 King Report 2009: 9.
175 King Report 2009: 9.

Figure 2.4: Main principles of King lll Report



{Source: Own Figure}

What is clear from the above focal points, is that the King lll Report was influenced significantly by the reports of the United Kingdom and the United States of America, as these principles were also embedded in the their reports.

These focal points will be discussed briefly in the following paragraphs.

2.3.4.1 Inclusivity of stakeholders

The report focuses on the inclusivity of the stakeholders of the company, which is essential for achieving sustainability and the protection and promotion of the legitimate expectations of the stakeholders.[176] The term stakeholders is a broad concept and include, amongst others, the shareholders, employees, creditors, service providers and the community.[177] These stakeholders must be considered at all times. Stakeholder inclusivity is discussed in paragraph 4.4.4 below.

176 King Report 2009: 13.
177 Esser 2009: 191. See also Esser & Du Plessis 2007: 350; Davis et al 2013: 113; Botha 2009: 705 and Du Plessis et al 2011: 23.

2.3.4.2 Sustainability

Sustainability refers to something enduring and capable of longevity.[178] The concept of sustainability has been adapted to business to mean the achievement of a balanced, integrated economic, social and environmental performance.[179]

Innovation, fairness and collaboration are key aspects of sustainability.[180] Innovation allows for new approaches and expansion on current views of corporate governance and ethics; it allows for growth and new expertise.[181] Fairness is a vital and prominent foundation for corporate governance, especially since social injustice leads to unsustainability and collaboration is needed for a large-scale change.[182] These aspects will allow for the growth of the concept of corporate governance, and a new outlook as modern times lead us into unknown eras.

Sustainability (discussed in Chapter Seven) goes hand-in-hand with the triple bottom line approach (discussed in paragraph 3.8.1 below).[183]

2.3.4.3 Social transformation

Social transformation and reform and redress are of the utmost importance. Integrating sustainability and social transformation in a strategic and coherent manner will give rise to great opportunities, great efficiencies and benefits for both the company and the individual.[184]

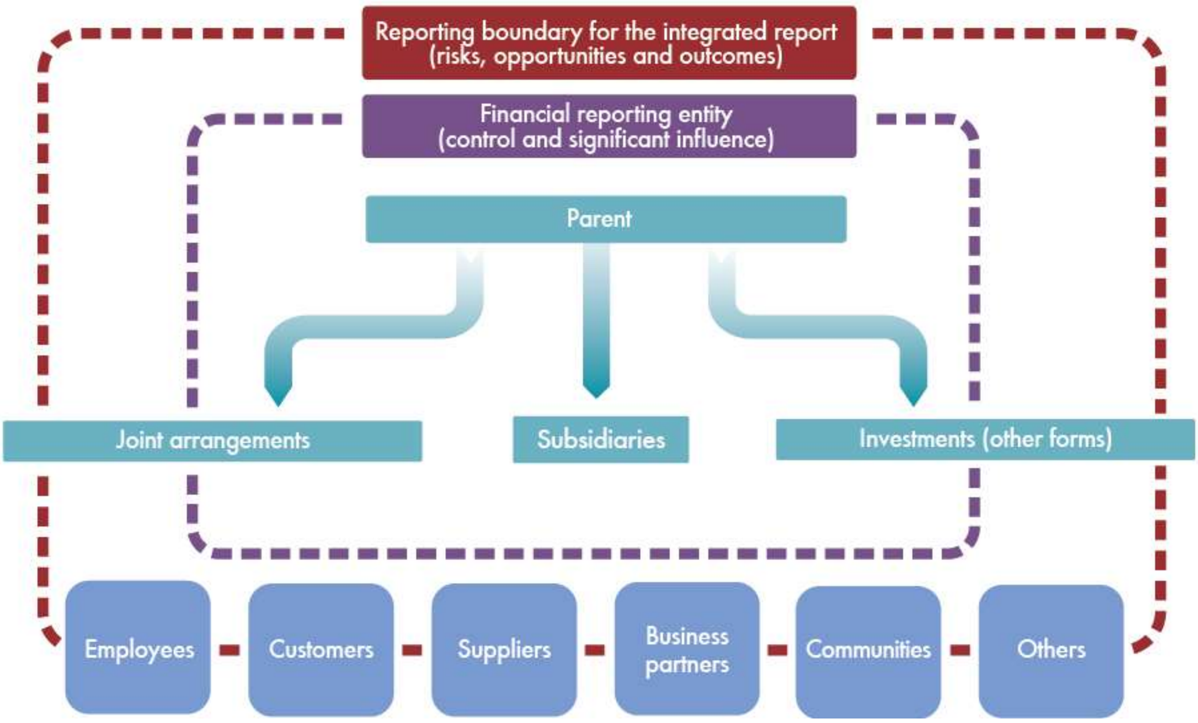
[178] Naidoo 2009: 246.
[179] Naidoo 2009: 248.
[180] King Report 2009: 13.
[181] King Report 2009: 13.
[182] King Report 2009: 13.
[183] Naidoo 2009: 249-256.
[184] King Report 2009: 13.

2.3.4.4 Integrated reporting

An integrated report is a "concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over short, medium and long term".[185]

King III has placed a focus on the necessity of integrated reporting from the company to its stakeholders at specified times and in a specified form.[186] The primary purpose of integrated reporting is to explain to the providers of financial capital, the shareholders, how the company has created value over a specified period of time.[187]

Figure 2.5: How integrated reporting should take place



{Source: 2013 IIRC Standards: 20}

Another fundamental change was King's recommendation on the establishment of certain subcommittees to assist the board in executing its functions. Corporate

185 IIRC 2013: 7.
186 King Report 2009: 13. See also IIRC 2013: 4.
187 IIRC 2013: 4.

governance is maintained through the committees established by the board of directors, namely audit committees, remuneration committees, social and ethics committees and the board of directors itself. These committees will sit as members on the board of directors. These committees do not relieve the directors of their legal responsibilities and duties but are there to aid them in achieving efficient fulfilment of these rights and duties.[188] These committees are discussed in detail in Chapter Five.

Table 2.3: Development of corporate governance in South Africa

Year	Report	Key development
1994	King I Report	• Disclosure-based. • Guidance on board of directors, chairperson of the board, non-executive directors, directors' appointment, directors' remuneration, board meetings, professional advice, stakeholder communications, auditing, workers' participation, affirmative action and codes of ethics.
2002	King II Report	• More principle-based, principles of discipline, transparency, independence, accountability, responsibility, fairness and social responsibility.
2008	Companies Act	• Codification of need for board committees.
2009	King III Report	• Based on ethical leadership characterised by responsibility, accountability, fairness and transparency. • Focal points are inclusivity of stakeholders, sustainability, social transformation and integrated reporting.

{Source: Own Table}

2.4 Concluding paragraphs

Corporate governance can be summed up as having both a positive and a negative function. The positive function is the control over the business, to ensure its

[188] King Report 2009: 41.

sustainability through changing circumstances and its good reputation as a responsible corporate citizen in the eyes of society. Its negative function is to combat and prevent fraud, dishonesty, corruption and other unfavourable circumstances in a business such as nepotism, unfair discrimination, unfair procurement practices and sexual harassment.

One can clearly see the growth of and emphasis placed on corporate governance when looking at every report, how it builds on the previous one. One started with the Cadbury Report, which mainly dealt with the financial aspects of corporate governance, laying its foundation on the following values: openness, integrity and sustainability, to the Hampel Committee which broadened the report and incorporated ethics, the remuneration of directors, the role of shareholders, accountability and audit. The Combined Code of 1998 went even further and included the notion of integrated reporting, after which the Turnbull Report was published placing an emphasis on risk management as a component of corporate governance. The Smith Report set out guidelines for audit committees, and the Combined Code of 2012 eventually set the values of corporate governance as being accountability, transparency, probity and focus, and the sustainable success of the company.

The United States of America is the only country to have codified corporate governance in the form of legislation, namely the Sarbanes-Oxley Act. This is the most important aspect of the United States' contribution. The researcher recommends that a separate Act, as in the United States, be enacted to govern specifically corporate governance in South Africa, incorporating the King lll Report, making it more authoritative than it is at this stage.

It is clear from the above discussion of the development of corporate governance that the same principles permeate every report: the principles of transparency, fairness, accountability, and responsibility as the core principles of best practice in corporate governance.

The core principles of good practice or ethical behaviour are in the structure of a business, in line with the notion of corporate governance. One can use these principles as set out above as a yardstick for measuring whether one's behaviour is in compliance or non-compliance with the code. These principles must obviously also be considered in drafting a code of ethics, which is discussed in Chapter Three.

The question regarding the international development of corporate governance in the United Kingdom and the United States of America has been answered in this chapter and we have seen how the previous developments in these two countries respectively, have influenced the writing and contents of the King lll Report.

Chapter Three
Ethics and Ethical Behaviour

"Leaders should rise to the challenge of modern governance. Such leadership is characterised by the ethical values of responsibility, accountability, fairness and transparency and based on moral duties that find expression in the modern concept of ubuntu."[189]

3.1 Background

In paragraph 1.5 the following question was asked:

What are ethics and ethical behaviour, and how is it implemented and maintained within a workplace?

The question will be answered in this chapter.

In this chapter the philosophical background of ethics will be discussed to see how ethics has evolved over the years into the ethics we know today, modern ethics. The discussion of modern views on ethics will be followed by a discussion on business ethics, after the researcher has laid a good foundation of the meaning of ethics.

The two forms of ethics will also be discussed and guidelines on drafting and the need for a code of conduct will be given.

The concept of ethics incorporates three main aspects, namely "self", "good" and "other".[190] It is the unselfish balance to be struck between what is good for oneself and what is good for others.[191] This can be illustrated by Figure 3.1 below.

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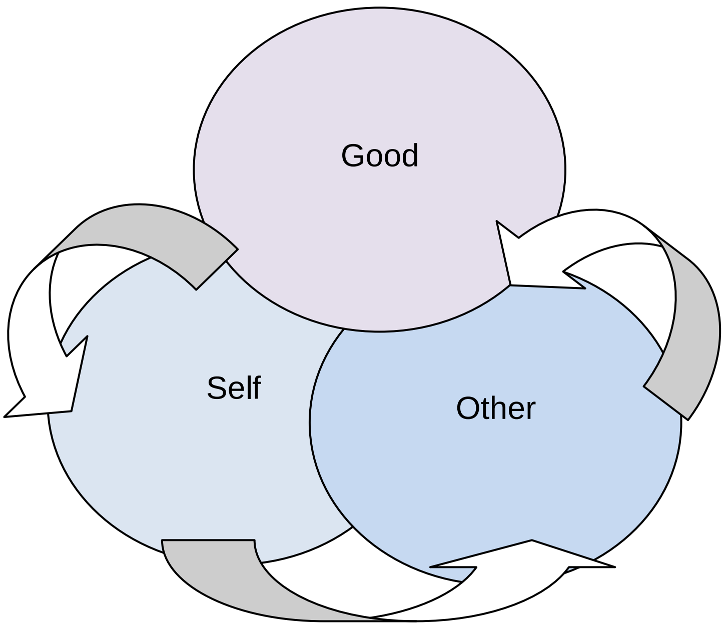
[189] King Report 2009: 9.
[190] Kretzschmar et al 2012: 16.
[191] Kretzschmar et al 2012: 16.

Figure 3.1: Overlapping concepts of ethics



{Source: Own Figure}

The term ethics refers to the character of a person and therefore incorporates the notion of what is good for “self” and what is good for “others”. Behaviour can therefore be seen as ethical if one’s actions are good for oneself and for others. The golden rule is: one must not do unto others what one does not want done to oneself.[192] This is therefore a balancing act that faces directors and managers in their decisions.

There is a relationship between ethics and values which often creates confusion. Values are a person’s convictions as to what is good and desirable.[193] People’s values differ, not everyone has the same values. Values differ as a result of a variety of factors, religion, culture, upbringing and so forth, and this is where the problem lies regarding the maintenance of ethics, as what is ethical for one is not necessarily ethical for the other. These factors of value make the enforcement and management of ethical behaviour even more complex, and difficult to attain.

[192] New King James Version 1982: Philippians 2: 3-4. See also discussion in Lubbe 2013: 150; Kretzschmar et al 2012: 18 and Pincoffs 1991: 104.
[193] Kretzschmar et al 2012: 18.

Moralism requires that organisations, particularly businesses, must be regarded as natural persons with responsibilities,[194] and this is where the concept of business ethics comes into play. Businesses must be run in an ethical, moral manner which is unselfish in the development of a virtuous organisation that is run by righteous people.[195] The notion of a corporate responsible citizen therefore takes form.

Ethical responsibility is a commitment to duty and a strong public policy emphasising external stakeholder rights.[196] This also emphasises the duty of internal stakeholders to add to and promote an ethical culture within the workplace. External stakeholders refer to stakeholders not involved in the business, such as creditors and the community, whereas internal stakeholders refer to stakeholders involved in the business, such as employees and shareholders.[197] This links with the title of the study emphasising the role that internal stakeholders play in ethical behaviour.

Corporate citizenship is known as “capitalism with a social conscience”.[198] This concept becomes prominent in the King lll Report, and is based on two main forms, namely “instrumental corporate citizenship” and “ideal corporate citizenship”.[199] The former refers to corporate social responsibility used as a mechanism and strategic resource for enhancing corporate reputation and increasing profits, while the latter reaffirms the ethical responsibility and universal human rights.[200]

Running a business ethically gives it the necessary social legitimacy for the sustained survival and support of an organisation.[201] Ethical behaviour is something that needs to be done since it is essential for a productive, fair and virtuous society (or organisation in this instance).[202] The company must deal ethically with all its stakeholders, both internal and external, and must adopt a code of ethics as a

[194] Coldwell 2010: 194.
[195] Coldwell 2010: 194.
[196] Coldwell 2010: 194.
[197] Du Plessis et al 2011: 24.
[198] Naidoo 2009: 241.
[199] Coldwell 2010: 194.
[200] Coldwell 2010: 194.
[201] Coldwell 2010: 194. See also Naidoo 2009: 244.
[202] Carrol 2009: 122.

guideline for ethical behaviour.[203] Ethics is important for various reasons, but mainly because if it is bad, bad ethics brings down people, relationships, society and, most importantly, organisations.[204] This is where the focus of the study lies, why a business needs to be run in an ethical manner. This will be discussed in Chapter Seven.

For the purposes of this chapter, an extensive background on the concept of ethics and business ethics will be discussed. In the following paragraph the philosophical background of ethics will be discussed in brief, looking at the theories of Aristotle, Kant and Mill, to gain an understanding of how ethics has evolved to how we know it today.

3.2 Philosophical background of ethics

Aristotle's virtue theory emphasises that what matters in ethical behaviour is a person's integrity, meaning one can expect ethical behaviour from a person with a well-groomed character.[205] The Deontological theory (Kant) shifts the focus from a person's character to the qualities inherent to ethical behaviour: to qualify as an ethical action it must comply with certain qualities.[206] Utilitarian ethics (Mill) focuses on the consequences of an action in order to decide its ethical worth.[207]

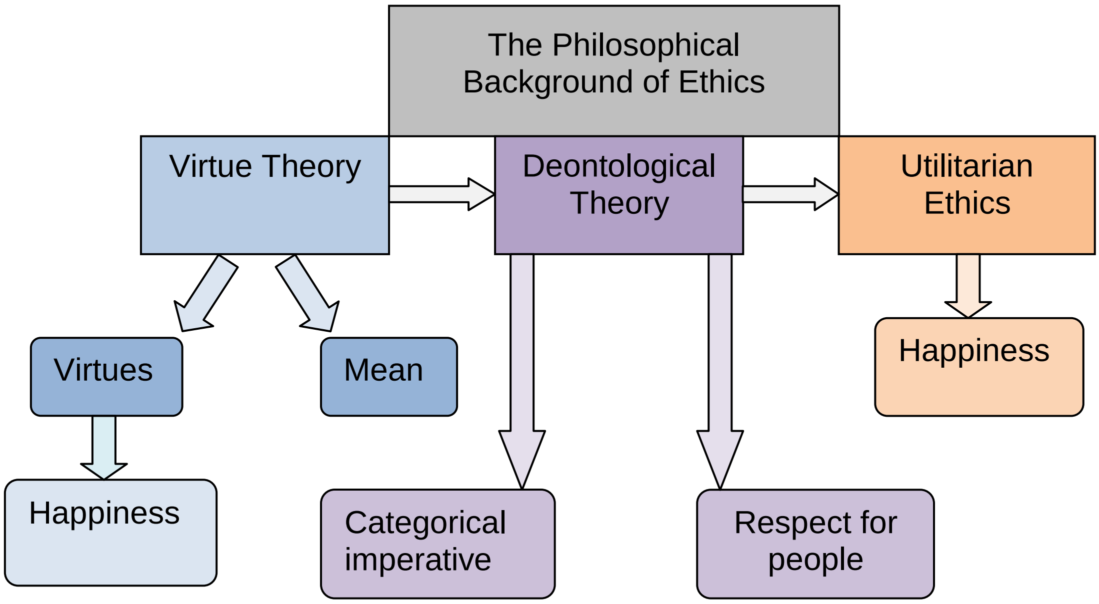
In the light of the above, it is clear that different philosophers had differing views on ethics. The researcher proposes that one follows the theory of Mill (Utilitarianism), who emphasised the role that a consequence plays in ethical decision-making, and a consequence must result in the greatest good for the greatest number, and also Kant (Deontological ethics) in that one must be comfortable with having others conform with the example set. This links with the research question of what ethical behaviour is: it is to consider not only good for yourself, but good for others. It is also in the light

[203] Naidoo 2009: 245.
[204] Carrol 2009: 123.
[205] Kretzschmar et al 2012: 71.
[206] Kretzschmar et al 2012: 71.
[207] Kretzschmar et al 2012: 71.

of this linked to the stakeholder inclusivity approach as advocated in the King III Report.

Figure 3.2 below illustrates the relationship between these three theories.

Figure 3.2: Relationship between the three ethical theories of Aristotle, Kant and Mill



{Source: Own Figure}

These theories will be discussed in more detail, starting with Aristotle's theory.

3.2.1 Virtue Theory

The Greek philosopher Aristotle is the founder of the virtue theory. The content of this theory is mainly found in his writing known as The Nimochean Ethics.[208] According to Aristotle, every person has a goal.[209] For Aristotle, happiness was the ultimate goal.[210]

[208] Kretzschmar et al 2012: 73.
[209] Van Warmelo 1973: 112.
[210] Sison 2008: 56.

His theory describes the state of a human being who has realised his own full human potential.[211] It is no easy task to reach this state of full human potential, and the key to reach this state is self-love on the human being's side; one must love oneself and must be willing to invest in one's own development to reach one's goal in life.[212]

Aristotle recognised two types of beings, those who are merely capable of contemplation and those who can really be ethically successful, the only ones who can live a good, morally or ethically excellent, and noble life.[213]

The virtue theory is therefore not in harmony with the balancing act between what is good for oneself and what is good for others, since the focus lies in the development of oneself, and will not be regarded as ethical behaviour.

The virtue theory comprises two components, namely virtue and mean. This will be discussed in the following paragraphs.

3.2.1.1 Virtues

A virtue is a trait to aid one in reaching one's goal.[214] Griseri and Seppala[215] define virtue as honesty, integrity, kindness, fairness and prudence. The way to develop a character is by the cultivation of virtues.[216] According to this theory, ethics is seen in the character of an individual.[217]

Cultivation of virtues takes place by making use of human intellect, a nature of human beings that Aristotle admired and deemed most important to live life being happy.[218] Happiness is very important to Aristotle, and he saw happiness as prosperity joined with virtue.[219]

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[211] Kretzschmar et al 2012: 73.
[212] Kretzschmar et al 2012: 73.
[213] Machan 2010: 6.
[214] Griseri & Seppala 2010: 58. See also Kretzschmar et al 2012: 73.
[215] 2010: 58.
[216] DesJardins 2006: 13. See also Kretzschmar et al 2012: 73 and Carrol & Buchholtz 2006: 220.
[217] Griseri & Seppala 2010: 56.
[218] Machan 2010: 5.
[219] Hanley 2006: 148.

How does one develop these virtues? By natural inclinations. Every person, according to Aristotle, is born with natural inclinations to know what to do in certain situations; these are our natural dispositions which should be controlled by our rational thought.[220] These dispositions become a pattern of behaviour; like second nature, these behavioural patterns being moral virtues.[221]

Aristotle created the idea of a mean to assist human beings in developing rationally controlled dispositions.[222] Humans err in one of two ways, namely:[223]

1) Humans are over-inclined to do something (excess dispositions); or
2) Humans are under-inclined to do something (deficient dispositions).

The concept of a mean is to diminish these "defective" dispositions; it is the midpoint between excessive and deficient dispositions.[224] This will be discussed in the following paragraph.

3.2.1.2 Mean

As indicated above, a mean is there to aid human beings in diminishing their defective dispositions.

There is no universal form of a mean, and it differs from person to person.[225] Aristotle emphasised that the correct attitude towards pleasure is a precondition for meeting one's personal means.[226] Humans tend to overindulge in what makes them happy, and to avoid the things that make them sad, which can lead to excess or deficient dispositions.[227] Human's natural experiences of pleasure and pain are

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220 Kretzschmar et al 2012: 74.
221 Rationally controlled dispositions that become permanent character traits (Kretzschmar et al 2012: 74).
222 Kretzschmar et al 2012: 74.
223 Kretzschmar et al 2012: 74.
224 Kretzschmar et al 2012: 74.
225 Kretzschmar et al 2012: 74.
226 Kretzschmar et al 2012: 75.
227 Kretzschmar et al 2012: 75.

therefore the main cause of our wrong dispositions.[228] One must exercise rational control over one's own feelings and will then find pleasure in doing what is right, which reinforces one's virtues.[229]

To conclude, Aristotle believed the result of always acting in accordance with virtue is a life characterised by the pleasure of knowing that one is doing good and therefore living a good life.[230] His theory is not in line with the three pillars of ethics, namely "self", "good" and "other". It focuses only on "self" and "good".

3.2.2 Deontological ethics

The focus in Deontological theory lies in the quality of one's actions.[231] The Deontological ethics is focused on duty, and not on consequence.[232] According to Allhoff and Vaidya,[233] the focus on the intention behind the action is more important than the consequences of the action to determine whether an action is good. An act of morality is dependent upon the actor's motive, and that the only good motive that is unconditionally good is doing one's duty.[234] The proponents of the Deontological approach to ethics insist that there are objective ethical standards of behaviour that everyone must respect.[235] The main philosopher of this approach is Immanuel Kant with his writings known as Fundamental Principles of the Metaphysic of Ethics.[236]

Human beings must move away from their natural inclinations and apply their minds to good, rational thinking.[237] Kant's focus, therefore, was on one's own rational thinking to determine what is right or wrong. One must be disciplined to follow these

[228] Kretzschmar et al 2012: 75.
[229] Kretzschmar et al 2012: 75.
[230] Kretzschmar et al 2012: 76.
[231] Kretzschmar et al 2012: 76.
[232] Allhoff & Vaidya 2006: 86.
[233] 2006: 85.
[234] Lopez 2010: 155 and Carrol & Buchholtz 2006: 215.
[235] Kretzschmar et al 2012: 76.
[236] Kretzschmar et al 2012: 76.
[237] Griseri & Seppala 2010: 67. See also Kretzschmar et al 2012: 76 and Allhoff & Vaidya 2006: 86.

rational decisions irrespective of the benefit, or not, from it.[238] Allhoff and Vaidya[239] state that for Kant the highest good was good will.

To act in accordance with the standard of good behaviour is "good will".[240]

As humans, we are often caught between our natural inclinations and the demands of our rational thinking. When putting natural inclinations above rational thinking one becomes corrupted and can never do what is right, or ensure consistent moral action.[241]

As discussed above, this form of ethics imposes a duty: the duty to always abide by those objective standards of ethical behaviour that one has discerned through one's own rational thinking processes.[242] For Kant, obeying objective standards of ethical behaviour from a sense of duty is the hallmark of moral behaviour.[243] According to Griseri and Seppala,[244] Kant believed that if a duty exists for one, it should exist for all. This, therefore, is the notion of universal application.

Deontological ethics consists of the following characteristics, namely the categorical imperative and respect for persons. These characteristics will be discussed in the following paragraphs.

3.2.2.1 Categorical imperative

Kant's search for an objective standard of ethical behaviour led him to the discovery of an objective moral law against which all actions could be judged, namely the "categorical imperative", to which all persons should abide.[245] The duty one has finds

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238 Kretzschmar et al 2012: 76.
239 2006: 85.
240 Kretzschmar et al 2012: 77.
241 Kretzschmar et al 2012: 77.
242 Allhoff & Vaidya 2006: 86. See also Kretzschmar et al 2012: 77.
243 Kretzschmar et al 2012: 77.
244 2010: 57.
245 Kretzschmar et al 2012: 77.

its expression in the “categorical imperatives”, which is a set of rules of behaviour derived from practical reason and tested through universal application.[246]

An action can only be considered ethical if one is willing to allow all other people to perform the same action.[247] This is therefore the principal of universal application. Moral behaviour can be defined as acting in accordance with rules that one would feel free to impose on the whole world as a valid code of conduct.[248] It would be immoral for one to disregard the principle of universability.[249] According to the Kantian theory, our fundamental ethical duty is to treat others with respect.[250]

When applying the categorical imperative, one should be guided by the principles of universability and reversibility.[251] The principle of universability demands that one should be willing to make the principle of one’s proposed action into universal law to be followed by others.[252] The principle of reversibility demands that one should be willing to live in a world where everyone else behaves in accordance with a universal law.[253]

In summary, if one is not willing to live in a world where the principle of one’s action has become a universal moral law, one’s proposed action is definitely wrong and should not be followed.

3.2.2.2 Respect for persons

The respect for persons theory is to “so act as to treat humanity, whether in your own person or in that of another, in every case as an end in itself, and never as a means only”.[254] Pincoffs[255] indicates that an individual is never to be used, not even for the

[246] Lopez 2010: 155. See also discussion in DesJardins 2006: 39 and Allhoff & Vaidya 2006: 86.
[247] Carrol et al 2006: 215. See also Kretzschmar et al 2012: 77 and Allhoff & Vaidya 2006: 87.
[248] Lopez 2010: 155.
[249] Allhoff & Vaidya 2006: 88.
[250] DesJardins 2006: 39 and Carrol & Buchholtz 2006: 215.
[251] Kretzschmar et al 2012: 78.
[252] Van Zyl & Van der Vyver 1982: 60 and Kretzschmar et al 2012: 78.
[253] Kretzschmar et al 2012: 78.
[254] Carrol & Buchholtz 2006: 215. See also Kretzschmar et al 2012: 78 and Pincoffs 1991: 105.
[255] 1991:105.

attainment of general happiness, or the avoidance of general misery. Thus, in line with this, one human being cannot use another simply for their own benefit.[256]

This view brought about another objective standard to measure the ethicality of an action or decision, namely that when it is an abuse towards other persons to meet one's own goals, the action is wrong.[257] People may not be stepping stones to meet one's own goals, but may assist in achieving one's goals, with their consent.[258]

This characteristic of the Deontological approach is in line with the three pillars of ethics being both "good" for "self" and "others" and can therefore be applied.

3.2.3 Utilitarian ethics

The focus here lies not in the quality of actions, but the outcome or consequences thereof, whether the outcome is right or wrong.[259] The forerunner of this movement is Stuart Mill with his writing Utilitarianism.[260]

Mill was convinced an action was good if it fulfilled the ultimate goal of human beings, namely happiness.[261] This is therefore in line with Aristotle's view that happiness is the ultimate goal of human beings. Mill thus believed that humans' focus as human beings only falls on how they can attain happiness. So, if a decision makes one happy, it is the right one. Actions that bring about the greatest good to the greatest number of people are good and ethical actions, while actions falling short of this ideal are unethical or wrong.[262]

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256 Allhoff & Vaidya 2006: 90.
257 Van Zyl & Van der Vyver 1982: 99. See also Kretzschmar et al 2012: 78.
258 Kretzschmar et al 2012: 78.
259 DesJardins 2006: 30. See also Kretzschmar et al 2012: 79; Lopez 2010: 154; Urmson 1953: 34 and Carrol & Buchholtz 2006: 214.
260 Kretzschmar et al 2012: 79.
261 Lopez 2010: 154. See also Kretzschmar et al 2012: 79.
262 Lopez 2010: 154; Carrol & Buchholtz 2006: 214; Sison 2008: 35; Allhoff & Vaidya 2006: 34; DesJardins 2006: 30 and Elliot 2007: 100.

Urmson[263] indicates that, according to Mill, a particular right is justified as being right if in line with a moral rule; it is wrong if it is contrary to a moral rule and that a moral rule is right if it recognises that it promotes an ultimate end. According to Elliot,[264] Mill was determined that no one must be prejudiced by another to attain happiness and was a supporter of the absolute right to freedom of expression.[265] Mill emphasised that one must also consider the effect an act will have on others before acting.[266]

The above envisages a good, sound moral life, but despite the best efforts of writers, the view of Mill has been criticised on the following grounds:[267]

1) The theory is degrading to humans;
2) Happiness cannot be the rational purpose of life;
3) Utilitarianism is unattainable;
4) Utilitarianism is self-serving; and
5) The theory is too time-consuming.

Utilitarianism is an ethical, economic and political theory that regards utility as the ultimate good and standard against which actions should be judged.[268]

In the researcher's view, the modern day approach to ethics should be the approach of Kant and Mill. We must be willing to expose our actions to society, to set an example for a better and more ethical world, and not abuse people in our endeavour to an ethical society. We must also strive to make decisions to create the greatest good for the greatest number. Our decisions must therefore be good for ourselves and others, which are the main pillars of ethical behaviour. The correct foundation is to consider whether your conduct is a good example for others to live by and whether you will be proud of the decision you have made, and whether it is good for everyone involved.

[263] 1953:35.
[264] 2007:108.
[265] Dworkin 1977: 161. See also Sison 2008: 35 and Elliot 2007: 102.
[266] DesJardins 2006: 45. See also discussion in Allhoff &Vaidya 2006: 34-46.
[267] Kretzschmar et al 2012: 80-82 and discussion in Carrol & Buchholtz 2006: 215.
[268] Sison 2008: 35.

In the paragraphs that follow, the modern approaches to ethics will be discussed.

3.3 Ethics and the law

Ethics and the law are very closely interrelated.[269] The law is a form of codified ethics.[270] The purpose of law is to create rules and regulations and to maintain order and a level playing field. The law opts to create an ethical society, but is not infallible, and does not cover all the situations where ethical questions might be raised. [271] The law cannot possibly account for every situation and every scenario that could take place in modern society.[272] Many believe that the way out of a dilemma is by concentrating on legal compliance, but for business people ethics is identified with the law.[273] Unfortunately, compliance with the law alone will not create an ethically responsible business.[274] Thus the law and ethics must be applied together within a business, and when the law fails to provide an answer, our own ethical judgement comes into play. We, therefore, when the law fails to give an answer, need to decide for ourselves, by applying ethical judgement, what is right and what is wrong.

3.4 Ethics and religion

"Let nothing be done through selfish ambition or conceit, but in lowliness of mind let each esteem others better than himself. Let each of you look out not only for his own interests, but also the interests of others."[275]

Our religion often reflects in our ethical decision-making. Religion has had an undeniable influence on ethical behaviour, since the main goal of religion is to teach what is "good".[276] The commandment of doing unto others as you would have them

[269] Van Zyl & Van der Vyver 1982: 116. See also Carrol & Buchholtz 2006: 177 and Pincoffs 1991: 91.
[270] Carrol & Buchholtz 2006: 177.
[271] Carrol & Buchholtz 2006: 177.
[272] DesJardins 2006: 11.
[273] DesJardins 2006: 10.
[274] DesJardins 2006: 10.
[275] New King James Version 1982: Philippians 2: 3-4.
[276] Lubbe 2013: 150.

do to you shows a clear influence that religion plays in ethics,[277] since this incorporates the notion of good to oneself and others. Thus, whatever we believe in, religion-wise, is the root of our inner being, the pivot around which our thinking process revolves, hence the clear relationship between the two. This is the so-called Golden Rule – doing good unto others.[278] Considering the Golden Rule is a "compass when you need direction".[279] It is therefore almost a natural inclination to consider the needs of others. The commandment to love one another[280] also sets a good tone for ethical behaviour.

3.5 Ethical leadership (King lll)

"They are people who know what they stand for. They are people of character. They set a moral compass, or a sense of ethical direction in everything they undertake."[281]

Ethical leadership is a concept that has become increasingly important due to the emphasis placed on it in Chapter 1 of King lll. Leadership is an influence process.[282] Therefore a person occupying the position of an ethical leader must have the ability and stamina to influence the behaviour of his colleagues.

Ethical leadership further requires a deliberate and steadfast commitment to be ethical as well as effective in the running of the business.[283] These leaders, in the case of a company, are the board of directors and employees in management positions.[284] Ethical leadership is, however, not merely meant for the board or management, but other employees as well.[285] This links to the researcher's view that employees have a prominent and vested role to play in ethics and ethical management within a company.

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[277] Lubbe 2013: 150. See also Kretzschmar et al 2012: 18.
[278] Carrol & Buchholtz 2006: 222.
[279] Carrol & Buchholtz 2006: 222.
[280] New King James Version 1982: Matthew 22:39.
[281] Carrol 2009: 96.
[282] Carrol 2009: 96 and Campbell & Kitson 2008: 142.
[283] Painter-Morland 2008: 182.
[284] Lubbe 2013: 166. See also discussion in Carrol 2009: 97 and Painter-Morland 2008: 188.
[285] Fraedrich et al 2011: 242.

Ethical leaders thus have the power vested in them to steer other employees in the right direction regarding ethical behaviour. They are therefore the role models in the company due to their rank and the fact that they are respected by the employees on the lower levels. Ethical leadership must flow through to the staff on lower levels looking up to management as their role models[286] in order for them to practice ethical behaviour themselves. In the light of this, what happens in management is a working example of how all employees should act for the sustainability, both financial and reputational, of a company. Management must therefore encourage employees to act in the same ethical manner as they are and to enforce ethical behaviour on employees. This is in harmony with the title of the study, which emphasises the role that internal stakeholders, namely employees, play in the implementation and management of ethics. The employees must also maintain ethical behaviour within the company, and encourage their colleagues to do the same. They must therefore also set an example for their peers.

Ethical leadership entails the following: [287]

1) Not being satisfied with mere legislative or regulatory compliance;
2) Valuing corporate and personal institutional fitness;
3) Ensuring that management actively participates in developing, implementing and achieving the correct corporate culture of ethical behaviour and sets the values to be adhered to;
4) Ensuring that integrity permeates all spheres of the company and its activities, and that the vision, mission and objectives of a company are ethically sound;
5) Aligning the board's and management's conduct with the values that drive the company and its operations; and
6) Leaders act in a consistent manner to set the best possible example for ethical behaviour.

In addition to the above, the researcher includes the following:

[286] KPMG 2012: 117.
[287] KPMG 2012: 117.

1) Teaching employees what is regarded as "ethical"; and
2) Leaders see their obligation towards ethical behaviour as the most important obligation they owe the company.

From the above, it is clear that it is vital for these "ethical leaders" that ethics must be of the utmost importance. They must be the walking-talking example of ethical behaviour.[288] They must be dedicated to running the business in an ethical manner, since the ethical "corporate culture" is mainly created by them.[289] This complies with the notion of "setting the tone from the top"; the top being management setting the example for the rest of the stakeholders.[290]

Ethical leaders must therefore:

1) Act as role models; [291]
2) Legitimise ethics discourse; [292]
3) Encourage ethical conduct and hold non-compliers accountable; [293]
4) Support the company's ethical standards by taking measures to enforce adherence to ethics policies, guidelines and procedures;[294]
5) Teach employees ethical behaviour;
6) Have the capacity to inspire others to follow their example;[295]
7) Have the capacity to motivate others to achieve the same goal;[296]
8) Create within employees the duty and opportunity to report wrongdoing; and
9) Promote on the basis of performance and ethical conduct.[297]

According to Carrol,[298] leaders have four main responsibilities, namely:

[288] Lubbe 2013: 166.
[289] Lubbe 2013: 166.
[290] Lubbe 2013: 166.
[291] KPMG 2012: 117.
[292] Carrol 2009: 97. See also KPMG 2012: 117
[293] Carrol 2009: 97. See also KPMG 2012: 117
[294] KPMG 2012: 117.
[295] Melé 2009: 203. See also discussion in Carrol 2009: 126.
[296] Melé 2009: 203. See also discussion in Carrol 2009: 126.
[297] Carrol 2009: 97.
[298] 2009: 100-101.

1) Fulfilling the mission of the company;
2) Obeying the law;
3) Being ethical; and
4) Promoting good citizenship.

Carrol[299] further suggests that one is an ethical leader in four different capacities, namely as a "private person", as an "economic agent" (representing the organisation in commerce), as a "company leader" (occupying a position of setting an example of moral and ethical behaviour) and as a "boundary spanner" (referring to ethical responsibilities beyond the organisation).

To be seen as an ethical leader, one must possess certain character traits differentiating one from others. The researcher is of the opinion that ethical leaders should have very strong ethical, virtuous and moral characteristics. According to Lubbe,[300] examples of characteristics of ethical leaders are the following:

1) They have strong personal character; they endorse robust principles that allow them to define a path and lead others through it;
2) They have a passion to do right – for their customers and employees;
3) They recognise that good ethics is good for performance and leads to a healthy bottom line;
4) They are proactive; they shape policies and do not merely follow them blindly;
5) They consider stakeholders' interests, they build a relationship of trust with the board to ensure the promotion of ethics in the business; and
6) They are positive role models in and out of the workplace; they walk the talk.

Melé[301] and Painter-Morland[302] further suggest the following essential traits of a leader:

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299 2009: 104-105.
300 2013: 167. See also in-depth discussion in Fraedrich et al 2011: 245-247.
301 2009: 204.
302 2008: 200-223.

1) Determination;
2) Integrity;
3) Intelligence (the ability to deal with a matter in the best way);
4) Self-confidence;
5) Sociability (the ability to create solid relationships with colleagues);
6) Following one's passions;
7) Having a value-driven orientation;
8) Eliciting and appreciating contention;
9) Wisdom and humility;
10) Fostering collaboration;
11) Charisma, rhetoric and motivation;
12) Redefining authenticity and diversity;
13) Fostering trust and confidence; and
14) Interdependence.

From the above it is therefore clear that various writers ascribe different traits to an ethical leader. The researcher is of the opinion that, in short, the main traits of a leader are integrity (the will to do what is right) and the ability to set an example for colleagues in doing the right thing, thus setting the tone from the top.

It is clear that if these "ethical leaders" act in an unethical manner, it is very likely to filter through to the rest of the stakeholders. It is a known fact that we live by example; if we see a bad example, we are likely to follow it blindly.

In Chapter Four the directors and their responsibilities as ethical leaders of the company will be discussed in detail.

Business and ethics go hand-in-hand. This is so because of the importance of ethics for the continuing success of a business, it is a crucial facet to be applied in the business. The intense focus on "business ethics" has therefore come to the fore in recent years. Business ethics is discussed in the following paragraph.

3.6 Business ethics

"Embedding business ethics takes more than a code of conduct. A written statement is a good start… it should be supported by ongoing action to ensure that the organisation's values are understood and implemented by every employee."[303]

The growth of business ethics is fairly recent and has been influenced by the following key factors:[304]

1) Changing management practice;
2) The need to enhance corporate reputation; and
3) A shift from shareholder to stakeholder management.

Business ethics can be defined as "the application of a moral code of conduct to the strategic and operational management of a business".[305] The importance of business ethics is that it is a set of ground rules by which the person within an organisation acts.[306] Business ethics is a basic outline of organisational and personal behaviour as required from an employee of an organisation.[307] The question is "how can a good person be good for the business?"[308]

Corporate ethical conduct is more than mere ethically motivated decisions to be philanthropic and to invest in charity.[309] Corporate ethical climate refers to the ethical meaning that employees attach to organisational policies, practices and procedures.[310] This is important since these policies, practices and procedures influence moral awareness and the criteria to be applied in ethical decision-

[303] Constabulary 1996: 164.
[304] Management Extra 2009: 2.
[305] Lubbe 2013: 139.
[306] Norman 1992: 106.
[307] Norman 1992: 106.
[308] Atkinson 2004: 951.
[309] Pritchett 1994: 994.
[310] Dallas 2004: 3.

making.[311] Corporate ethical climate rests on the perceptions of the employees to the company's values as reflected in its mission statement and code of ethics, criteria for decision-making, handling of conflicts of interest, the reward system, guidance to employees on ethical matters and the monitoring system.[312] Economic activity always has an ethical dimension, in what is good and right in economic activity.[313] It engages in a moral analysis and assessment of economic practices and activities.[314]

Du Plessis et al[315] indicate the following expectations for a business to be deemed as being run ethically:

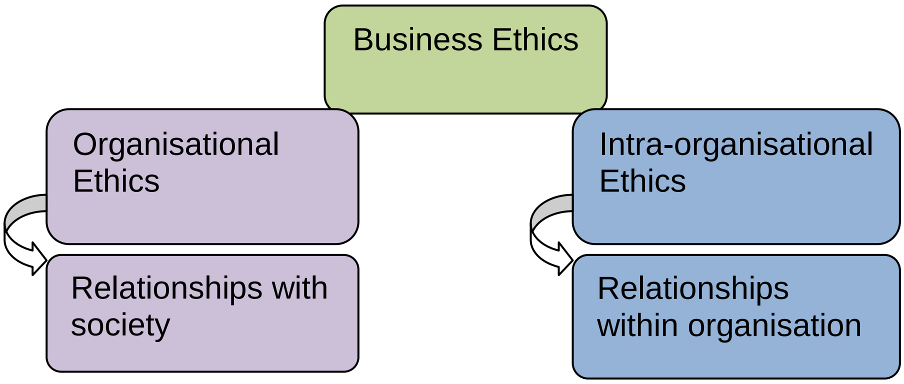
1) It must not harm its people directly;
2) It must not damage society or the environment;
3) It must not misrepresent the activities of the company; and
4) It must engage in activities that are socially desirable.

The above illustrates where the root of business ethics lies. Some even believe that when you do good to society, the business will automatically benefit in the long run.[316] A business may be said to be run for the benefit of shareholders and then its clients, with a responsibility towards its employees, and to provide overall benefit of society as a whole.[317] Further to this it is important to note that it may be argued that business must be driven by ethical norms rather than the desire to benefit the company.[318] This is an element of Corporate Social Responsibility discussed in Chapter Six.

In the business sector, what becomes of importance is organisational and intra-organisational ethics. These concepts will be illustrated in Figure 3.3 below.

311 Dallas 2004: 3.
312 Dallas 2004: 3.
313 Kretzschmar et al 2012: 20.
314 Kretzschmar et al 2012: 20.
315 2011: 433.
316 Pritchett 1994: 997.
317 Constabulary 1996: 164.
318 Pritchett 1994: 994.

Figure 3.3: Difference between organisational and intra-organisational ethics



{Source: Own Figure}

These two concepts of business ethics will be discussed in the paragraphs that follow.

3.6.1 Organisational ethics

Organisational ethics refers to businesses and organisations such as companies and their relationship with society.[319] The ethical impact of the business on society is the focus.[320] The society plays an important role in determining the ethicality of the behaviour of the company as they will constitute the dimension of being good for “others”.

Corporate Social Responsibility comes into play once again. Businesses have an impact on society, the surroundings and their clients or customers. The business has an impact on local communities, culture and the natural environment. It is imperative that the clients and customers are handled in an ethical manner, as this will add to corporate reputability of the company.

The company is therefore, once again, faced with the matter of ethics, what will be good for the company and will be good for society (“others”) at the same time. The impact of the enterprise can therefore be either good or bad to society, depending on

[319] Kretzschmar et al 2012: 21.
[320] Kretzschmar et al 2012: 22.

the ethical behaviour of the company and its approach to Corporate Social Responsibility.

3.6.2 Intra-organisational ethics

Intra-organisational ethics refers to ethics and the economic activity within the business organisation. It concentrates on the moral dimension of business practices, policies, behaviour and decisions that take place within a business.[321] It must be remembered that the people involved in the business are the most important resources of any organisation.[322] To achieve satisfactory results in the implementation of ethics, personnel departments have an integral role to play in enhancing ethical issues within the organisation.[323] This is in harmony with the main research question and title of this study, because this statement emphasises that the personnel (employees) have an integral role to play regarding ethical behaviour.

Businesses have a profound impact on the stakeholders, especially their employees. Employees may often be faced with situations in their business which may clash with their personal values and morals. Policies and cultures within a business may be such that it could also break down the trust between management and employees and also amongst employees.[324] In the researcher's opinion, problems at the workplace also often have a negative impact on a person's personal life. It is therefore important to have a well-structured ethical culture in the business for the benefit of the business as well as for the benefit of the stakeholders of the business.

Personal and organisational ethics should go hand-in-hand. Unethical behaviour in organisations is often attributed to unethical individuals. On the other hand, unethical organisations may result in the people involved with it becoming unethical. In short, people are affected by their social surroundings: ethical surroundings will result in having ethical people and vice versa. One unethical person could ruin the corporate reputation of a company. This reiterates the researcher's view that employees must

[321] Kretzschmar et al 2012: 22.
[322] Constabulary 1996: 165.
[323] Constabulary 1996: 165.
[324] Kretzschmar et al 2012: 22.

be involved with the management, maintenance, implementation and promotion of ethical behaviour, because one unethical employee could cause irreparable damage to the company's reputation of being a good corporate citizen. If all employees act in an ethical manner, the company is bound to flourish in ethical behaviour, and this will attract various opportunities and add to the ethical corporate culture of the business.

Professions also have ethical standards. For example, attorneys are subject to the ethical codes of the Law Society of South Africa and chartered accountants are subject to the ethical codes of SAICA (South African Institute of Chartered Accountants). The purpose of these ethics is to ensure that the members of the profession act in accordance with the spirit and purpose of the profession as well as to the benefit of their clients.[325] Professionals have at least three sets of ethics to which they abide, namely professional ethics, personal ethics and organisational ethics which, ideally, should coincide.[326]

3.6.3 Management's moral orientations

Managers play a pivotal role in ethics management in that they are seen as the ethical leaders of the company, and as role models for employees. It is therefore important for directors to consider the managerial candidate's ethical culture to ensure that he/she is suitable to act as an ethical role model for employees, before a person is placed in such a position.

There are three types of management ethical orientations, namely immoral management, moral management and intentional or unintentional amoral managers.[327]

Firstly, immoral management describes managers whose general behaviour, actions and decisions are contrary to ethical standards and beliefs.[328] These managers are

[325] Kretzschmar et al 2012: 24.
[326] Kretzschmar et al 2012: 24.
[327] Coldwell 2010: 195 and Carrol & Buchholtz 2006: 184.
[328] Coldwell 2010: 195 and Carrol & Buchholtz 2006: 184.

greedy and aim at self-gain to the detriment of the company, and see laws and ethical principles as a barrier preventing them from achieving what they want.[329]

These managers are completely removed from the needs and desires of others involved in a company.[330] This approach is not in line with ethical behaviour, as the needs of others are completely disregarded.

Carrol and Buchholtz[331] illustrate the following to be characteristics of an immoral manager:

1) They do wrong intentionally;
2) They are self-centred and self-absorbed;
3) They care only for their own/company interests;
4) They forthrightly oppose what is regarded as right, fair and just;
5) They show no concern for other stakeholders;
6) They are the "bad guys"; and
7) Ethics training would probably be of no benefit to them.

In the light of the above, this individual is not the ideal candidate to occupy a managerial position.

Moral managers, on the other hand, set the tone from the top by conforming to high ethical standards as well as professional standards and aim and strive to achieve fair, balanced and unselfish conduct.[332] Their motives are fair, balanced or unselfish.[333] They have respect for the law and ethical standards laid down to guide them in their ways in running the company.

Carrol and Buchholtz[334] indicate the following characteristics of a moral manager:

[329] Coldwell 2010: 195 and Carrol & Buchholtz 2006: 184.
[330] Carrol & Buchholtz 2006: 184.
[331] 2006: 185.
[332] Coldwell 2010: 195 and Carrol & Buchholtz 2006: 186.
[333] Carrol & Buchholtz 2006: 186.
[334] 2006: 187.

1) They abide by high ethical standards;
2) They abide by high personal and professional standards;
3) Ethical leadership comes naturally for them;
4) They want to excel within the bounds of ethical behaviour;
5) High integrity is portrayed in all actions;
6) They embrace the law;
7) They possess moral maturity; and
8) They are seen as the “good guys”.

In view of the above, these individuals are perfect managerial candidates.

Thirdly, one gets intentional and unintentional amoral managers.[335] Intentional amoral managers disregard ethical considerations in their decision-making process in the day-to-day running of the business, believing there is no room for ethics in the running of a business.[336]

Carrol and Buchholtz[337] describe intentionally amoral managers as possessing the following characteristics:

1) They believe ethics and business do not relate;
2) They see business and ethics as two separate worlds; and
3) They are very few.

Unintentional amoral managers are those who are carefree and unaware of ethical considerations, lacking moral sensitivity in making decisions but do not disregard the law in making decisions.[338]

Carrol and Buchholtz[339] describe these unintentional amoral managers as having the following characteristics:

[335] Carrol & Buchholtz 2006: 189.
[336] Coldwell 2010: 195 and Carrol & Buchholtz 2006: 189.
[337] 2006: 191.
[338] Coldwell 2010: 195 and Carrol & Buchholtz 2006: 189.
[339] 2006: 191.

1) They disregard the ethical dimension in decision-making;
2) They refrain from thinking ethically;
3) They lack ethical awareness;
4) They have sober intentions, but lack moral consciousness; and
5) Their ethical gears, if any, are in neutral.

In the light of the above, these candidates are not ideal for managerial positions.

It must be noted that directors should screen candidates carefully before entrusting them with managerial positions.

Ethics is a form of applying your mind. For every decision one makes in business one must ask: am I doing the right thing? In the next paragraph ethical decision-making is discussed.

3.7 Ethical decision-making

"Ethics deals with values, with good and bad, with right and wrong. We cannot avoid involvement in ethics for what we do - and what we don't do - is always a possible subject of ethics valuation. Anyone who thinks about what he or she ought to do is, consciously or unconsciously, involved in ethics."[340]

Running a business is all about making decisions. Ethics must be applied in all these decisions to ensure an outcome that is most favourable to all individuals involved, hence the concept of ethical decision-making comes to the fore, because all decisions have implications which often include ethical ones. Fault for illegal decision-making lies solely in the individual characteristics of the persons committing the violations.[341]

[340] Du Plessis et al 2011: 419.
[341] Dallas 2003: 8.

According to Dallas,[342] the following components of cognitive-effective processes form a part of ethical decision-making:

1) Moral awareness; being the awareness that an ethical issue exists or interpreting a situation as raising moral issues;
2) Moral decision-making; meaning the decision of which course of action is morally sound;
3) Moral intent; referring to the decision that moral values should take priority over non-moral values in the decision; and
4) Moral behaviours; constituting the execution and implementation of the moral decision.

Moral awareness is affected by the moral intensity of the situation at hand, and the two factors involved here are social consensus and social proximity, indicating that companiess affect the moral awareness of its employees.[343]

Companies play an important role in the degree to which employees are aware of ethics, as well as their awareness of social norms. The directors and managers of a company therefore have a positive duty to teach employees ethical behaviour, and imposing the duty on employees to uphold the ethical standards of the company.

Decision-making is no longer reserved for those in power positions; there must be a shared vision and responsive judgement of employees at all levels of the organisation.[344] With this greater empowerment of employees comes the need for guidance and support to help individuals make the right choice in difficult situations.[345] This links with the title of the study, emphasising that employees should also have a positive duty to act in an ethical manner to the benefit of the company and society, and that omitting to do so should be punishable at the discretion of the company.

[342] Dallas 2003: 10.
[343] Dallas 2003: 10.
[344] Management Extra 2009: 2.
[345] Management Extra 2009: 2.

Business practices and policies enhance employee empathy when encouraging employees to consider the consequences of their decisions on other stakeholders and assist in extensive communication between employee decision-makers and those who will bear the consequences of their decisions.[346] In the light of this, employees must be made aware of all the consequences and benefits their omission or dedication to ethical behaviour will have on the company (see discussion on awareness campaigns in paragraph 3.13.5.8 below).

Management should make decisions which avoid or restrict the negative impact on its stakeholders and society.[347] All persons having a legitimate interest's interest should be covered in the process.

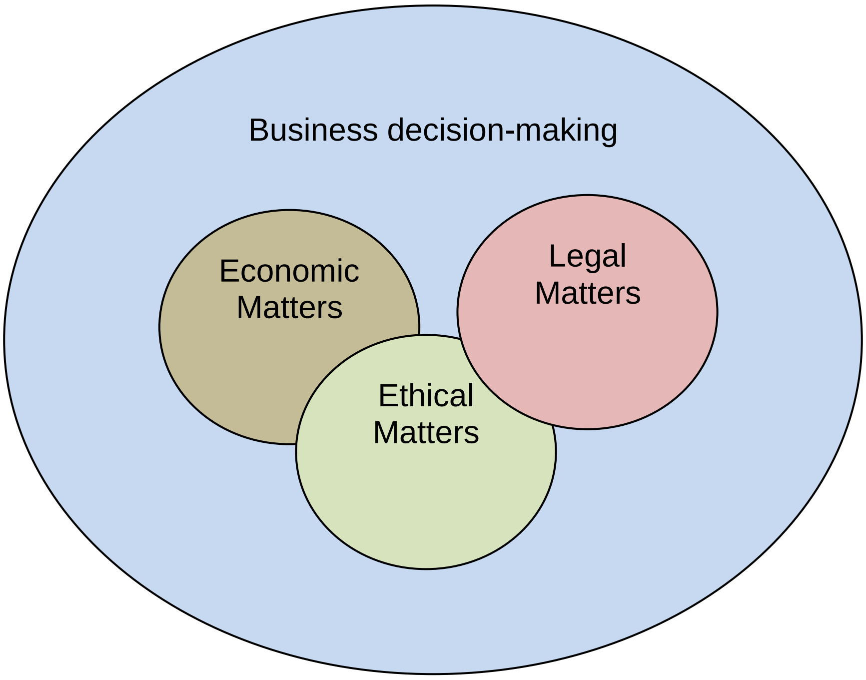
Business decisions can be divided into three categories namely: [348]

1) Decisions on economic matters;
2) Decisions on legal matters; and
3) Decisions on ethical matters.

In most cases these should harmonise or overlap with one another.[349] Figure 3.4 below represents the overlapping factors influencing business decision-making.

[346] Dallas 2003: 20.
[347] Kretzschmar et al 2012: 86.
[348] Lubbe 2013: 189.
[349] Lubbe 2013: 189.

Figure 3.4: Overlapping factors influencing business decision-making



{Source: 2013 Lubbe: 189 (adapted)}

According to Kretzschmar et al,[350] before making any decision, the decision-maker must consider the following questions:[351]

1) Is it legal?
2) Does it meet company standards?
3) Is it fair to all stakeholders?
4) Can it be disclosed?

If the answer to all the above questions is yes, one can make the decision with ease.

Figure 3.5 below illustrates the ethical decision-making process.

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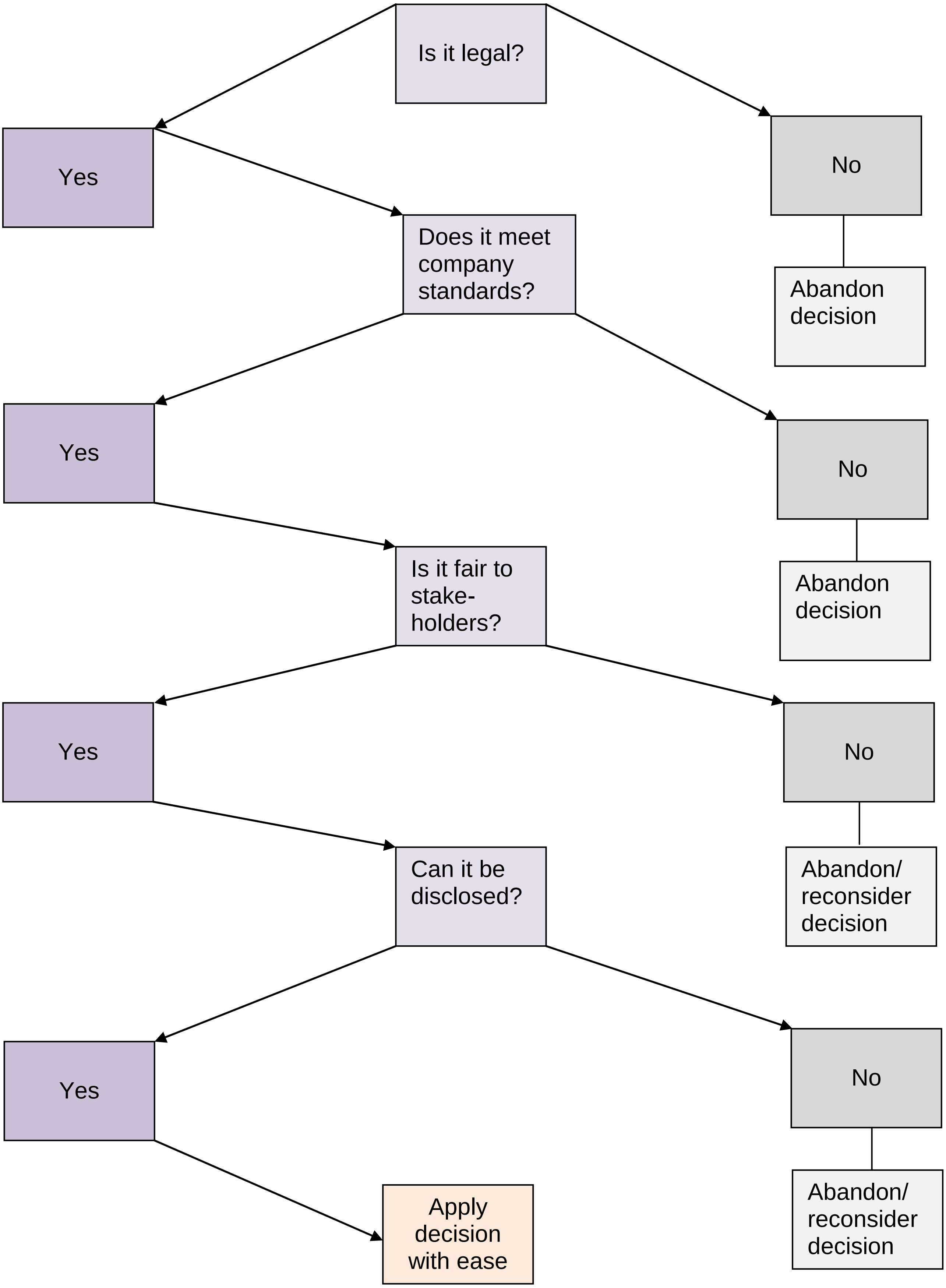
[350] Kretzschmar et al 2012 is an authoritative source on factors to consider in ethical decision-making, and will be referred to often in this section of the study.
[351] Fraedrich et al 2011: 232-241. See also a similar discussion in Campbell & Kitson 2008: 234-235 and Kretzschmar et al 2012: 86.

Figure 3.5: Ethical decision-making process



{Source: Own Figure}

These four questions will now be discussed briefly.

3.7.1 Is it legal?

For a decision to be ethically sound it must be legal. Illegality automatically renders any act or omission unethical.[352] In an ideal world we would have hard and fast rules regarding what to consider as ethical behaviour for all citizens, which include businesses as corporate citizens in society. This, however, is not the case. As discussed above, it is impossible for the law to cater for every possible situation that may confront a person.

Businesses, as corporate citizens, must also abide by laws and their fierce competition should not override their duty to act ethically.[353]

Determining whether a business decision is legal or not could become quite a daunting task, and if found to be against the law, should be abandoned immediately, unless in extreme circumstances,[354] which the decision-maker will be able to defend afterwards.

It is re-emphasised that it is of the utmost importance that not only management has knowledge of legal principles, but all employees. Employees should thus receive training on ethics and legal principles to ensure that they are equipped to make the right decision when in a problematic situation. This links with the purpose of the study reiterating the role that employees play in ethical behaviour. They must be aware of ethical codes of conduct and apply them to their day-to-day activities in the business.

Unfortunately the law is often flawed and seemingly unfair in some respects.[355] This criterion can therefore never be the only one in considering ethical decision-making.

[352] Painter-Morland & Bos 2011: 136.
[353] Kretzschmar et al 2012: 87.
[354] Kretzschmar et al 2012: 87.
[355] Kretzschmar et al 2012: 90.

3.7.2 Does it meet company standards?

Company standards are often contained and formulated in a set of company values, in a code of ethics or in policy statements dealing with specific issues, such as procurement, expense accounts or the giving and receiving of gifts, anti-bribery policies and anti-money laundering policies. These policy documents serve an important purpose within the company and are therefore central to the criteria for ethical decision-making.

Policies can be either rule-based or value-based. Rule-based policies are hard and fast rules cast in stone, black on white, which set out guidelines and principles for the members of the company and leave little to personal ethics.[356] A value-based approach involves the personal ethics of all members of a company; there are no hard and fast rules as to what is considered as ethical.[357]

The researcher is of the opinion that the rule-based approach should be followed by companies since this is the best way to ensure that everyone is aware of what the ethical standards of the company are. The researcher reiterates her support for the "tick box" method to be applied, as a way to keep ethics and ethical behaviour in check at all times. The researcher also recommends that employees complete checks and balances forms as discussed in paragraph 3.13.5.9 below.

3.7.3 Is it fair to all stakeholders?

To ensure that decisions are ethically sound, the fairness test should be applied. This means that the decision-maker must consider the impact that a decision will have on the persons who have an interest in it.[358]

One considers the impact on others by way of moral imagination and stakeholder engagement.[359] Moral imagination, in this context, means the process of interacting

[356] Kretzschmar et al 2012: 91.
[357] Kretzschmar et al 2012: 91.
[358] Kretzschmar et al 2012: 93.

with persons and parties who are likely to be affected by the decision in order to determine how they foresee that the decision will impact on them.[360] It involves putting yourself in the shoes of the person who will be affected by the decision in order to get an idea of how the person will experience it. A golden rule of ethical behaviour: you must put yourself in another's shoes, and not do unto others as you would not have done to yourself.

Stakeholder engagement refers to the process of interacting with the persons and parties who are likely to be affected by the decision in order to determine how they foresee that the decision is likely to impact on them.[361] It means the stakeholders are given the opportunity to voice their concerns and opinions before a decision that will affect them is made. The researcher also recommends in paragraph 3.13.5.10 below that employees must raise ethical concerns by means of confidential questionnaires on a monthly basis, assisting them in voicing their concerns and thus playing an integral role in ethics management. The employees are the ones on the "ground" who are aware of ethical issues, and they should feel free to report them to management in a confidential manner.

Both these methods assist one to move beyond one's own or the company's immediate self-interest and to discover how other persons and parties may be affected by such decisions.[362] If, after applying these tests, it is clear that the company will benefit at the expense of its stakeholders, the decision must be reconsidered or abandoned.[363]

It is inevitable that not all stakeholders will be content with a decision that is made, and some may not benefit while others might. Griseri and Seppala[364] suggest prioritising the various stakeholders into primary and secondary groups. Primary stakeholders would be those without whom the company would cease to exist, such as employees, shareholders and customers, whereas secondary stakeholders are

[359] Kretzschmar et al 2012: 93.
[360] Kretzschmar et al 2012: 93.
[361] Kretzschmar et al 2012: 93.
[362] Kretzschmar et al 2012: 93.
[363] Kretzschmar et al 2012: 93.
[364] 2010: 29. See also Carrol & Buchholtz 2006: 70.

those individuals not integral to the operation of the business, but still having an influence thereon, such as competition and the media.[365] In the light of this view, therefore, primary stakeholders will have preference over secondary ones.

Havenga[366] indicates that there are no substantive principles on how conflicting interests of stakeholders are to be resolved, and placing certain stakeholders in a category above others will result in unequal treatment and possibly the loss of effective control because management will be unable to manage, or will start to manage randomly. The researcher agrees with this view. A decision cannot possibly be beneficial to all, and therefore every case and circumstance will have to be decided on its own merits, with the least adverse effects.

Stakeholders are further discussed in paragraph 4.4.4 below.

If the decision seems morally sound, the decision may be implemented and the next criterion considered, namely the disclosure of the decision.[367]

3.7.4 Can it be disclosed?

This criterion assesses whether one would be comfortable in accounting publicly or privately for the decision that one has taken.[368] If you feel comfortable in explaining yourself regarding the decision reached, you can feel assured that the decision you have made is an ethical one.

This test should preferably be applied in two ways: first public and then private disclosure. Public disclosure means disclosure on television and the media and private disclosure means your own conscience and your personal or emotional involvement. It is the only criterion with a personal conscience dimension.[369] It emphasises the importance that our business decisions should be in accord not only

[365] Griseri & Seppala 2010: 29. See also Carrol & Buchholtz 2006: 70.
[366] 1997: 320.
[367] Kretzschmar et al 2012: 93.
[368] Kretzschmar et al 2012: 96.
[369] Kretzschmar et al 2012: 96.

with the law, company standards and stakeholder interests, but also with our own moral consciousness.[370]

Other ways of assisting in the process of ethical decision-making are by asking yourself the following questions:[371]

1) Recognize the event, decision or issue – do you think you are doing something wrong? Are you unsure about the ethical approach to be taken?
2) Think before you act – ask yourself, why the dilemma? Consider your various options, consult with others, think who else may be affected.
3) Decide on a course of action – determine your responsibility. Consider and consult the various policies of your institution, contemplate the best course of action by also consulting others.
4) Test your decision – apply the values of the company when making a decision, ensure you have consulted all laws, policies and other professional standards of your company, get someone else's opinion on your proposed action.
5) Proceed with confidence – communicate your decision and rationale to stakeholders, after you have ensured that you are making the right decision.

It is therefore logical to follow the above process for ethical decision-making as it will result in the best approach and protect one from liability. The process covers all legal, stakeholder and company matters, and is therefore in harmony with the ethical notion of good for oneself and for others. It is good to have ethical standards and to comply with ethical procedures, but the question arises how compliance therewith should be managed and monitored. These methods will be discussed in the paragraphs that follow.

[370] Kretzschmar et al 2012: 96.
[371] Abstract from PricewaterhouseCoopers' Code of Ethics found at www.pwc.com/ethics.

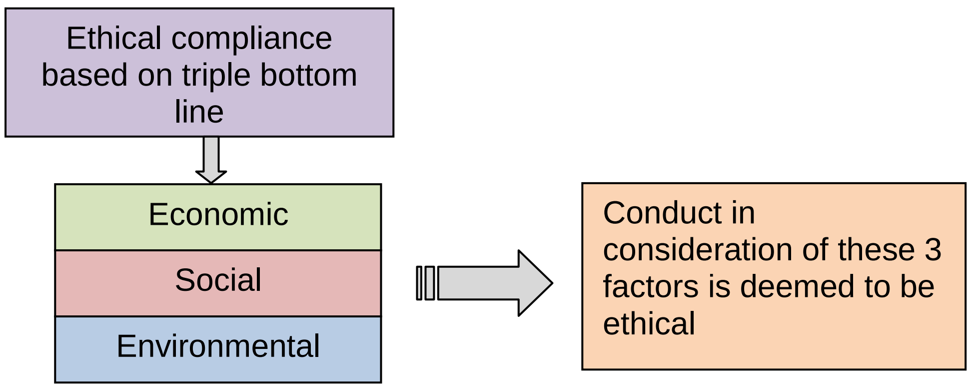
3.8. Determining ethical compliance

Ethical compliance should be monitored on a regular basis. The King III Report suggests the preparation of an integrated report as well as compliance with the triple bottom line approach,[372] discussed in the next paragraph.

3.8.1 The triple bottom line approach

King III[373] sets out the principles of good governance, and one of these is reporting on the matters within a company to all persons involved, including the stakeholders of the business. This is in harmony with the concept that ethics is good for oneself and for others. This approach considers taking into account economic/financial, social and environmental aspects as opposed to the single line approach which is merely based on profit.[374] Thus consideration of all three factors is to be manifested in the integrated report.

Figure 3.6: Triple bottom line approach



{Source: Own Figure}

This reporting, by way of an integrated report, will result in greater transparency towards stakeholders on how well management has performed its role regarding ethics management, fulfilled its Corporate Social Responsibility, and how well it has

[372] King Report 2009: 12.
[373] 2009: 12.
[374] Lubbe 2013: 158. See also Marx 2008: 336 and Painter-Morland & Bos 2011: 287.

governed the entity's operations affecting its social and environmental impact.[375] Reporting should thus sketch a holistic picture to stakeholders on how the company is being managed. This is in line with ethical behaviour, keeping stakeholders involved and up to date with the affairs of the company.

The focus has moved away from the single line approach, namely financial reporting, and companies are now also required to report on their social and environmental responsibilities.[376] Ethical compliance is therefore also measured by way of a triple bottom line approach. It considers determining the ethical risk of a company, developing a code for the ethical standards of a company, institutionalizing the ethical standards of the company and reporting thereon.[377] These factors will be discussed briefly in the paragraphs that follow.

3.8.1.1 Determining the ethical risk of the company

A company must determine its stakeholders' current perceptions on the ethical performance of the company as well as their ethical expectations.[378] In this way new ethical dangers as well as ethical opportunities can be identified more efficiently and dealt with in a proper manner.[379]

3.8.1.2 Formalizing the ethical standards of the company

All guidelines for the averment of ethical dangers and the promotion of ethical opportunities need to be formalized and recorded in a code of ethics in the company.[380]

[375] King Report 2009: 12. See also Lubbe 2013: 159.
[376] King Report 2009: 12.
[377] Kretzschmar et al 2012: 185-186.
[378] Kretzschmar et al 2012: 186.
[379] Kretzschmar et al 2012: 185.
[380] Kretzschmar et al 2012: 185.

3.8.1.3 Institutionalizing ethical standards in the company

According to Kretzschmar et al,[381] the principles contained in the code of ethics need to be institutionalized at strategic and systems levels in the company. This is discussed in paragraph 3.13 below.

3.8.1.4 Reporting on the ethical performance of the company

Companies must keep record of their ethical performance.[382] This is also a fundamental principle of the King lll Report dealing with the matter of integrated reporting. The results must be accounted, independently verified, and disclosed to all the stakeholders of the company.[383]

How to determine ethical compliance as set out in paragraph 3.8.1 above, is discussed in more detail in the following paragraph, looking at the determination of ethical risk to avert risk and to promote compliance.

3.9 Determining ethical risk

It is without a doubt the duty and responsibility of the board of directors to identify and manage risks within a company.

This is illustrated in the following examples:

1) The Turnbull Report in the UK requests directors not only to identify risks but also to identify mechanisms to manage such risks.[384]
2) The King lll Report requires directors of a company to take responsibility for risk.[385]

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381 Kretzchmar et al 2012 is an authoritative source on the institutionalizing and implementation of ethics and will be referred to often in this section of the study.
382 Kretzschmar et al 2012: 186.
383 Kretzschmar et al 2012: 186.
384 Kretzschmar et al 2012: 186.
385 King Report 2009: 76. See also Kretzschmar et al 2012: 186.

In view of the above, the responsibilities of the board relating to risk have expanded since the dawn of the triple bottom line approach. This approach entails that the board is required to report on the economic, social and environmental vision and performance of the company.[386] The researcher suggests that this specific responsibility could also coincide with that of the members of the social and ethics committee, since they are or should be charged with the duties relating to Corporate Social Responsibility. The board must convey to its stakeholders its most significant risks in these three areas, as well as the strategies in place to avert these risks.[387]

Ethical risk runs closely with social reporting, which falls under the mandate of the social and ethics committee. The researcher is of the opinion that this function can be served by both the committee and the board as a "checks and balances" approach, to ensure that effective mechanisms are in place to control ethical behaviour. Social reporting will be the reporting of matters to internal and external stakeholders and ethical reporting will be the reporting on ethical performance of the business, also known as organisational integrity.[388]

In the governance of ethics, as set out above, the first obligation of the board is to ensure that the negative and positive ethical risks of an organisation are properly handled.[389] The responsibility will often be delegated to internal audit, or human capital or the company secretariat, but why not approach the social and ethics committee to handle this function of the board? Surely it falls within the mandate of the committee and within the expertise and skills of the members of the committee.

Subsequent to the risk assessment being completed, the next step is to formalize the finding in an official code of ethics. This code should identify the standards of ethical behaviour that need to be adhered to by all in their decision-making, actions and interactions between stakeholders and the community.[390] The code is the pivot of a

[386] King Report 2009: 12. See also Kretzschmar et al 2012: 186.
[387] Kretzschmar et al 2012: 186.
[388] Kretzschmar et al 2012: 186.
[389] Kretzschmar et al 2012: 187.
[390] Kretzschmar et al 2012: 188.

company's ethics management. It provides a mirror in which one can see the reflection of what ethical behaviour is.

3.10 Codes of conduct

"If those inside the corporation are to behave ethically, they need clearly stated and communicated ethical standards that are equitable and enforced."[391]

According to Kretzschmar et al,[392] codes of conduct provide guidance to the company on ethical behaviour. Campbell and Kitson[393] state that ethical codes are "statements of the norms and beliefs of an organisation" and it reflects "the ways in which the senior people in the organisation want others to think". Havenga[394] indicates that codes of conduct express the highest standards of corporate behaviour. The researcher agrees with these views and emphasises that every company ought to have a code of conduct to guide the operations of the internal stakeholders and to ensure that they apply the acceptable ethical conduct as portrayed in the code of conduct.

The benefits of having a code of conduct can be summarised as follows:[395]

1) It helps to express and articulate values and criteria in that it sets out the values on which the organisation is built, and the values to be reflected in employee conduct *(own emphasis);*
2) It sends an ethical message to the organisation in that it sends a serious message to the organisation regarding the behaviour expected from employees *(own emphasis);*

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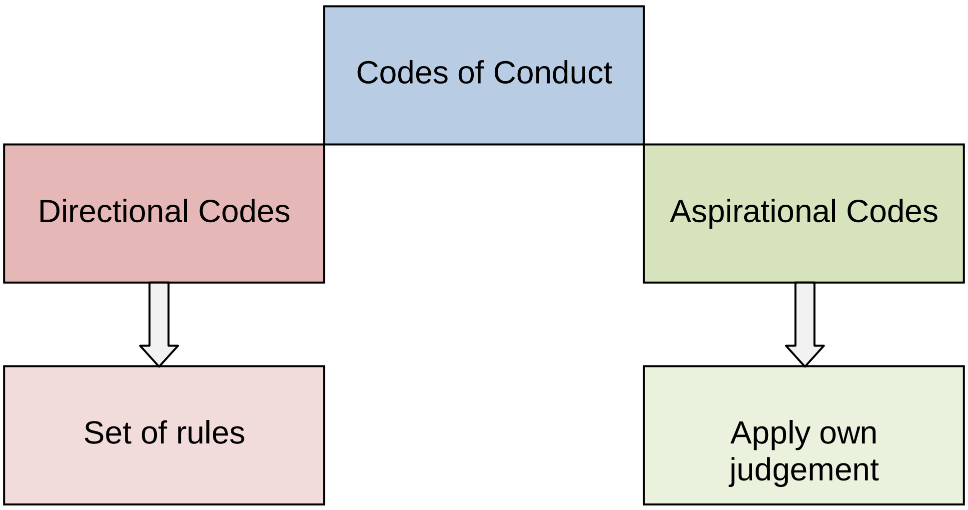
[391] Campbell & Kitson 2008: 113.
[392] Kretzschmar et al 2012 is an authoritative source on types of codes of conduct and will be referred to often in this section of the study.
[393] 2008: 112.
[394] 1998: 405.
[395] Melé 2009: 230. See also discussion in Campbell & Kitson 2008: 113-114 and Management Extra 2009: 8.

3) It provides guidelines for ethical decision-making (discussed in paragraph 3.7 above) in that it provides the guidelines to be used in ethical decision-making *(own emphasis);*
4) It aids in preventing abuses within the firm in that it provides employees with a shield against abuse from their seniors in the workplace, such as overworking for instance *(own emphasis);*
5) It fosters a corporate identity in that it assists in creating an ethical corporate culture *(own emphasis);*
6) It favours a corporate reputation in that it is a public image of the organisation's commitment to ethical behaviour *(own emphasis);* and
7) It aids in avoiding litigation against the organisation in managing employee conduct *(own emphasis).*

Codes of conduct can be either directional or aspirational, as is illustrated by Figure 3.7 below and briefly discussed in the following paragraphs.[396]

Figure 3.7: Different forms of codes of conduct



{Source: Own Figure}

[396] Kretzschmar et al 2012: 188.

3.10.1 Directional codes

As the word directional implies, this form of code directs one's actions. These codes are thus very specific as to what is ethical and unethical, what should and what should not be done. It therefore falls in line with the author's support for the "tick box" approach. It serves as a clear guidance to employees and can therefore be enforced in the organisation.[397]

The advantage of this approach is that there is a uniform set of rules to which everyone can have access; the disadvantage is probably that one may forget some of the principles.[398] The researcher suggests that employees continuously attend e-learning and training activities to keep them up to date and to ensure that they are aware of what is expected of them, and also to monitor compliance.

3.10.2 Aspirational codes

These codes are less directive as they identify ethical values, norms and principles that should guide employees in their decision-making process and actions relating to the work they do.[399] Rather than enforcing rules, they give employees a broad guideline, a discretion, when making decisions affecting the business.[400] The code is therefore not directive; it lives and grows on employees and they think about their actions before executing them. However, when one is faced with an employee who does not have the ability to distinguish between ethical and unethical behaviour, this approach may falter.

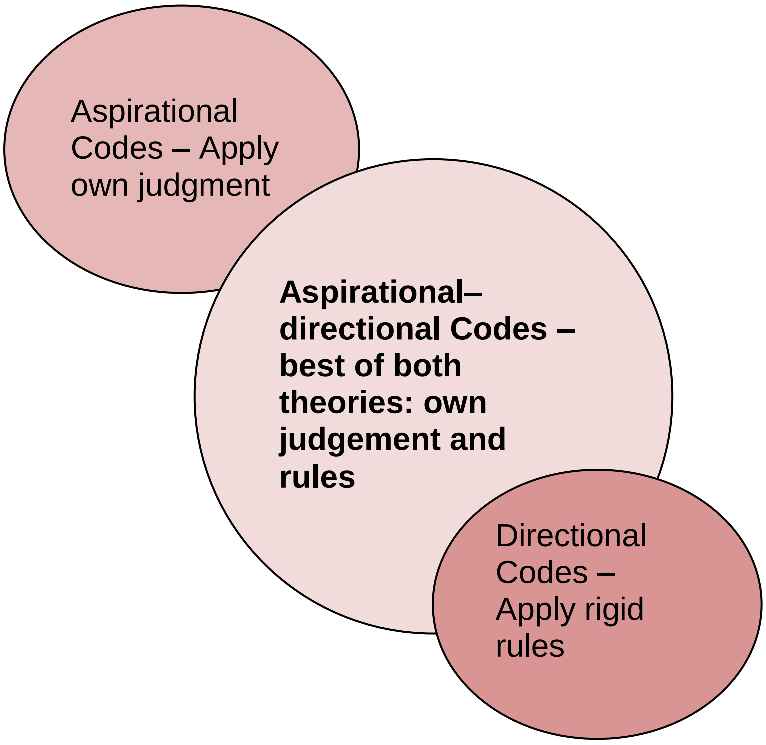
3.10.3 Aspirational-directional codes

In the researcher's opinion, a fine balance must be struck between the two forms of codes for optimal enhancement and enforcement of ethics. Ethics is an inborn characteristic that should not be forced on any person. However, due to differing

397 Kretzschmar et al 2012: 189.
398 Kretzschmar et al 2012: 189.
399 Kretzschmar et al 2012: 189.
400 Kretzschmar et al 2012: 189.

backgrounds, no two persons' ethical norms are the same. A combination form of the two codes would therefore be most efficient, giving a black-and-white set of rules as a guideline, but still allowing some discretion on the part of the employee, to determine for himself whether an action is right or wrong and thereby growing a culture that is more aware of ethics. This approach is the best approach to drafting a code of conduct. In line with the "tick box" approach advocated earlier, the employees of the organisation should still abide by hard and fast rules to determine ethical behaviour, but should be allowed to use their discretion in matters falling outside the guidelines.

Figure 3.8: Best approach to codes of conduct



{Source: Own Figure}

Now that the different forms of codes of conduct have been discussed, one must consider how one will get the message across to the members of the organisation. The development and institutionalization of ethics are discussed in the following paragraphs.

3.11 Developing a code of conduct

In this paragraph the researcher would like to highlight the effect that non-compliance with a code of conduct will have on the business. The importance of a code is discussed in paragraph 3.16 below.

It is clear that what is needed in business is to set a path that does not stray, and codes of conduct provide such a path.[401] Statements of conduct, professional standards and codes of ethics are important guidelines to the requirements of a certain vocation, sanctions for non-compliance, and the aspirations of human activity within a business.[402]

To be effective, these codes must be pragmatic; a strenuous set of standards could result in rigid, inflexible policies which in effect disallow practitioners from using their own judgement.[403]

The elements of a well-structured code are to maintain a high set of standards, to increase public confidence and to assist in decision-making within a business.[404] A code of conduct should therefore strike a balance between its three objectives to be effective. This is discussed in more detail in paragraph 3.12.

Companies are becoming more aware of the consequences of violating ethical and legal standards, and are therefore more cognizant of the code of ethics and the development thereof.[405] Such a code is a company's written undertaking[406] or "promise" that it will do business in the right way. The fact of the matter is that the mere existence of a code of conduct does not guarantee ethical behaviour, and many companies fail due to non-compliance with their codes of ethics. The

[401] Norman 1992: 97.
[402] Norman 1992: 97.
[403] Norman 1992: 100.
[404] Norman 1992: 101.
[405] Lloyd & Mey 2010: 2.
[406] See Marx 2008: 330-331: Code to be in writing and transgressions and non-compliance to be punishable.

companies lose face in society, which affects their operation and ultimately the country as a whole.

Campbell and Kitson[407] indicate that there are three elements to being successful in adopting ethics in a company, as follows:

1) The adoption of a corporate ethical code;
2) Establishing an ethics committee; and
3) Training programmes.

When drafting a code of conduct, the following elements need to be considered:[408]

1) The vision and mission of the company;
2) A set of core values;
3) Obligations towards stakeholders; and
4) Norms and rules.

The vision and mission as well as the core set of values are the aspirational aspects of the code.[409] They are the values which we aim to live by in order for us to be seen as ethical persons. It allows that the person must apply his own discretion as to what is right or wrong, as previously discussed. It is instrumental in gaining reputational capital, which refers to the reputation of the company from society's point of view.[410] It is seen as "capital" because in the long run, unethical business conduct can lead to costs for legal fees, monetary fees and sanctions.[411] On the other hand, the reputation of an ethical nature increases stakeholder goodwill and contributes to lasting mutually beneficial relationships with stakeholders such as employees and customers, suppliers, the community and shareholders.[412]

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407 2008: 113.
408 KPMG 2012: 118.
409 KPMG 2012: 119.
410 KPMG 2012: 119.
411 KPMG 2012: 119.
412 KPMG 2012: 119.

Obligations towards stakeholders, rules and norms refer to the directional aspect of the code.[413] As discussed, it gives clear and specific guidelines as to what is prohibited and what is allowed. It is a useful tool in attaining ethical conduct despite not allowing for the discretion of the employee.[414]

The above classification coincides with the researcher's view that a code must neither be aspirational nor directional, but a combination of both, the aspirational-directional code.

3.12 Critical success factors for a code

According to Armstrong,[415] an ethical code of conduct for companies must do the following:

1) Commit an organisation to the highest standards of behaviour;
2) Infuse all its stakeholders with its culture;
3) Receive total commitment from the board and CEO; and
4) Be detailed in order to be a clear guideline.

For a code to be successful, it must serve a clear purpose. The following are factors to consider in the development of a code:

1) There must be a clear purpose; management must know why they want a code and who will benefit from it;[416]
2) There must be an understanding of previous codes to ensure improvement;[417]
3) There must be a clear understanding of existing values and principles;[418]
4) The availability of local best practice examples against which behaviour can be benchmarked is important;[419]

413 KPMG 2012: 119.
414 KPMG 2012: 119.
415 1995: 69.
416 Melé 2009: 231. See also Naidoo 2009: 259-260; KPMG 2012: 119 and also Wong 2008: 9.
417 Naidoo 2009: 259-260. See also KPMG 2012: 119 and also Wong 2008: 9.
418 Wong 2008: 9. See also Naidoo 2009: 259-260 and also KPMG 2012: 119.
419 Wong 2008: 9.

5) A strong commitment from management should exist throughout the development stages of the code of conduct;[420]
6) The code must arise from a real need and strong motivation[421] (this is not something to endeavour half-heartedly);
7) The code should form part of a broader ethical outlook[422] (change will not be immediate); and
8) The code must be well written and well implemented[423] (discussed in paragraph 3.13 below).

From the above it is clear that a lot of thought and planning goes into the drafting of a code of conduct. One must consider so many factors and ensure the fairness thereof for all persons involved. In Chapter Five, the role of the social and ethics committee is discussed, and the drafting of the code falls under the ethical duties of this committee. Implementation of ethics is also a core function of the committee and management and is discussed in the following paragraph.

3.13 Institutionalizing of ethics

Employees are key to a culture of integrity.[424] This is in line with the title of the study, imposing an obligation on employees to maintain and apply ethics. By inspiring ethical leadership and pride within the organisation and by empowering employees to make a difference, ethical compliance integrates with and becomes a natural part of corporate culture.[425] This is why it is important to implement, institutionalize and make available the code of conduct to all employees.

Once a code has been drafted, it must be implemented. Implementation must be a central feature of ethical standards within the business.[426] Havenga[427] states that the

[420] Melé 2009: 232.
[421] Melé 2009: 232.
[422] Melé 2009: 232.
[423] Melé 2009: 232.
[424] Hoak 2008: 226.
[425] Hoak 2008: 226.
[426] Norman 1992: 104.
[427] 1998: 405.

effectiveness of codes of conduct depends on the mechanisms in place to enforce them. The researcher agrees with this statement and the importance of implementing codes of conduct. It is only through implementation that the codes can be enforced and applied within the business. Therefore the success of the implementation determines the success of the code.

Holder[428] differentiates between hard and soft power tools for a well-functioning ethics programme.

Soft powers include the following:[429]

1) Setting the tone from the top;
2) Training and awareness programmes;
3) Reputational due diligence on employees and vendors;
4) Effective whistle-blowing programmes; and
5) Fostering a culture of accountability.

Hard powers include:[430]

1) Audits and compliance reviews;
2) Investigations to remedy violations; and
3) Self-reporting and cooperation with authorities related to any potential violations.

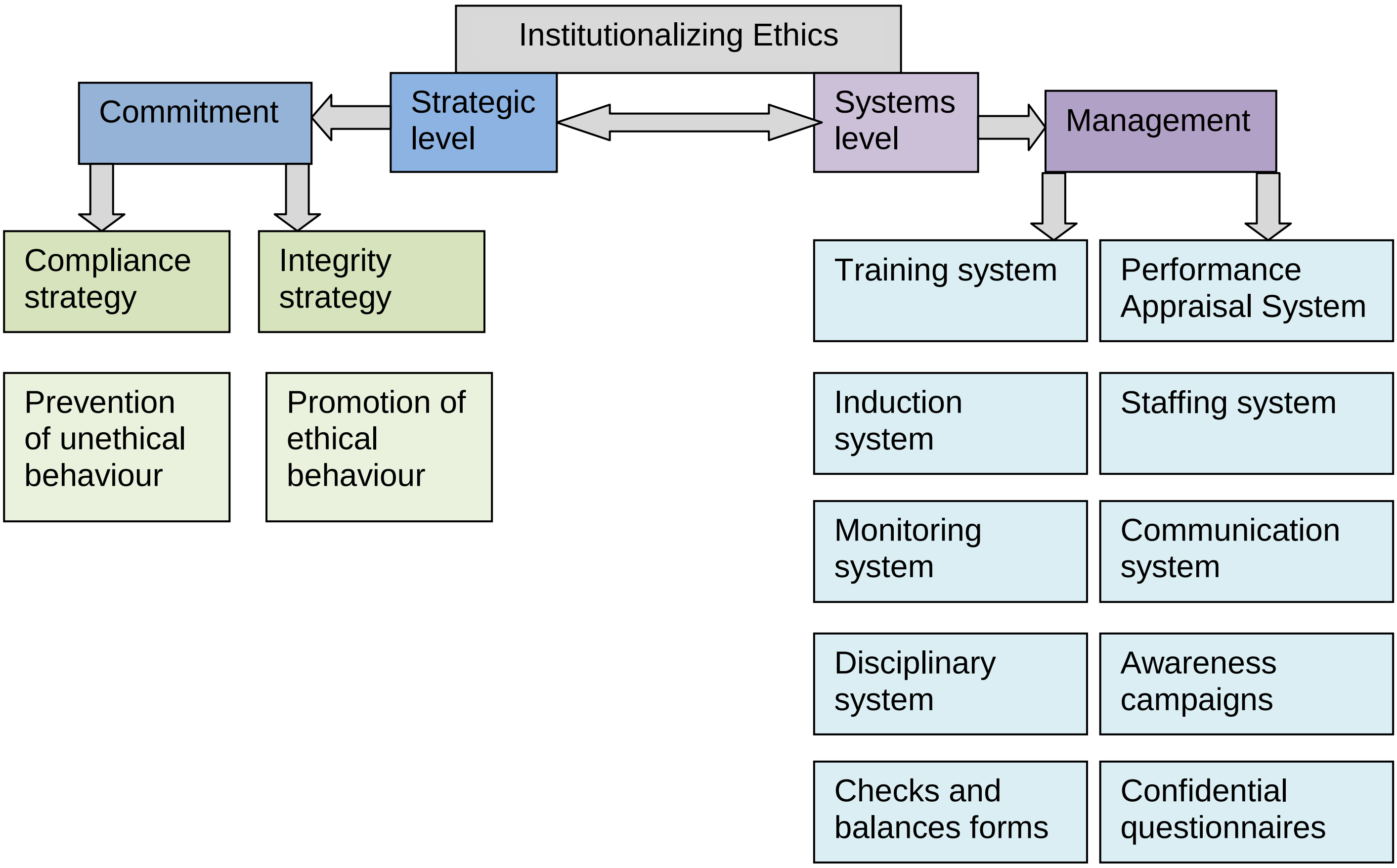
Holder[431] indicates that these tools should be combined for an effective business ethics programme.

Kretzchmar et al[432] indicate that codes of ethics have to be implemented on two levels, namely strategic and systems levels. The figure below sets out the

[428] 2013: 100.
[429] Holder 2013: 100.
[430] Holder 2013: 100.
[431] 2013: 100.
[432] 2012: 189.

differences between the two levels. These levels will be discussed in more detail in the paragraphs that follow.

Figure 3.9: Institutionalizing ethics



{Source: Own Figure}

The different levels will be discussed in the following paragraphs.

3.13.1 Strategic level

On this level the board has to take responsibility for committing the company formally to the code of ethics.[433] This commitment should be reflected in the vision, mission and identity of the organisation.[434]

[433] Kretzschmar et al 2012: 189.
[434] Kretzschmar et al 2012: 190.

The commitment should be communicated to all internal stakeholders, as well as the board's decision on how to manage ethics in the company. The outcome of the board's decision on how to manage ethics in the company will be based on two approaches, namely:[435]

1) Whether the board merely wants to protect the company from ethical failures; or
2) Whether it wishes the company to benefit actively from good ethical performance.

These two motives are contained in a compliance strategy and an integrity strategy, which are discussed below.

3.13.2 Compliance strategy

The objective of the compliance strategy is to prevent unethical behaviour in an organisation.[436] Companies following this approach commit themselves to monitoring ethics in an organisation, and they use the code as the standard against which performance is measured.[437] The intention of this approach is to ensure that employees comply with a code.[438] If the board finds non-compliance on the part of employees it will take disciplinary action, or may reward those persons who have shown the best adherence to the code (referring to the performance appraisal system discussed below).[439]

3.13.3 The integrity strategy

This approach is a value-based approach to managing ethics.[440] Ethics is seen as the driving force of a company.[441] Instead of the main focus falling on minimalizing

[435] Kretzschmar et al 2012: 190.
[436] Kretzschmar et al 2012: 190.
[437] Kretzschmar et al 2012: 190.
[438] Kretzschmar et al 2012: 190.
[439] Kretzschmar et al 2012: 190.
[440] Kretzschmar et al 2012: 191.

risk, the focus falls on the promotion of an ethical atmosphere and the promotion of the ethos of the company.[442]

3.13.4 The integrity strategy v the compliance strategy

The compliance strategy has the disadvantage of breeding the mentality that "what is not forbidden is allowed",[443] whereas the integrity theory allows individuals to apply their own minds to determine whether something is right or wrong. The compliance theory disallows the use of one's discretion, and the number of rules can overpower the individuals; they will forget the rules in any event and in effect the code will then mean nothing.[444] This is where training becomes important. The integrity strategy again gives too much freedom to the individual, which may be abused and may lead to disadvantages for the company. This theory relies on management to set the tone and example in the company. If you are stuck with incompetent management, the employees will also not know what to do, which again can result in ethical risks for the company.[445]

In the researcher's opinion, these two theories should meet in the middle. Yes, there must be hard and fast rules for specific situations, but then what happens outside such a situation? Employees should also have the opportunity and ability to assess for themselves what to do in a specific situation for which there are no guidelines; they must apply their own discretion. The researcher recommends a checks and balances form setting out the steps to ethical decision-making which employees must apply in every situation. This is discussed in paragraph 3.13.5.9 below. Employees should be encouraged to seek advice and must feel free to approach management or the board. When faced with an ethical situation and one needs to take action, some questions that may be considered are the following:[446]

[441] Carrol 2009: 99.
[442] Kretzschmar et al 2012: 191.
[443] Kretzczhmar et al 2012: 190.
[444] Kretzschmar et al 2012: 191.
[445] Kretzschmar et al 2012: 192.
[446] Abstract taken from the PricewaterhouseCoopers' Code of Ethics found at www.pwc.com/ethics.

1) Is the decision you are about to make against the standards of the company?
2) Does it feel right to make such a decision?
3) Is it legal?
4) Will it reflect negatively on the company?
5) Who else will be affected by this decision except for the company?
6) Is there an alternative option that does not pose ethical conflict?
7) How will it look in the newspapers?
8) Would you feel embarrassed if others knew about the decision you took?
9) What would a reasonable person think of the decision you are about to make?
10) Will you be able to sleep at night?

These questions must be incorporated as a guideline in the code of ethics of a company to guide employees in unknown situations. If the employee struggles with the ethical issue, he should also consult with management to guide him in the decision-making. Employees should have the ability to apply their own minds because, just as in law, there comes situations where no law exists to govern the situation and you will have to think on your feet, being armoured by the ethical values of the company as your foundation and guideline.

After the board has adopted the form of the code of ethics, it must be institutionalized. This occurs at systems level and will be discussed below.

3.13.5 Systems level

In implementing the code of ethics, the board needs to delegate authority to manage the ethical performance of a company to a specific institution in the company.[447] A specific functionary may be established, or it could be the role of existing functionaries such as the secretariat or human capital.[448] The researcher's suggestion is that the social and ethics committee should be charged with this duty; the name of the committee after all suggests that it manages ethics, and the persons

[447] Kretzschmar et al 2012: 192.
[448] Kretzschmar et al 2012: 192.

serving on this committee should have the necessary knowledge and expertise to deal with ethical matters. It is the ideal duty for this committee to fulfil.

The office to which this authority is delegated must institutionalize and manage processes and systems to ensure that ethical behaviour becomes embedded within the company.[449] The ethics management must be overseen by a higher authority.[450] In the researcher's opinion it should be overseen by the board, since ethics is the main obligation of the board. The social and ethics committee should report to the board on ethical matters on a regular basis to keep management up to date. In turn it must be communicated to stakeholders, which is in harmony with ethical behaviour.

The main objective of the institutionalizing process is to make the code of ethics more accessible to employees in order for them to apply it. This can be done through a number of systems, including:

1) Communication systems;
2) Staffing systems;
3) Induction systems;
4) Performance appraisal systems;
5) Training systems;
6) Disciplinary systems;
7) Monitoring and evaluation systems;
8) Awareness campaigns;
9) Checks and balances forms; and
10) Confidential questionnaires.

These systems will be discussed briefly in the paragraphs that follow.

[449] Kretzschmar et al 2012: 192.
[450] Kretzschmar et al 2012: 192.

3.13.5.1 Communication level

An organisation has to communicate its ethical expectations clearly to its members. The company needs to be aware of the kinds of ethical issues its members are confronted with in order to help combat the problem.[451] The company must also ensure that employees are aware of the duty to act ethically and have the ability to evaluate ethics and ethical behaviour.

Communication is therefore the pivot around which ethics management revolves daily. Employees should be motivated to convey all ethical matters to the body responsible for ethics, the social and ethics committee. Other communication methods include surveys for the employees, a help line, an open-door policy,[452] online training and hotlines, newsletters on ethics and confidential reporting standards.[453]

Employees are the most likely to discover irregularities in the business.[454] When they report such irregular conduct, they become whistle-blowers. Whistle-blowers are persons who report conduct that is contrary to the law, procedure and policies, and codes.[455] In the communication process, the drafter of the code must also ensure that the protection of whistle-blowers is clearly formulated. Whistle-blowers should know they are protected by codes, policies, the Companies Act[456] and the Protected Disclosures Act,[457] and that they should report unethical, and unlawful, conduct.

From the above it is clear that in the reporting of misconduct, whistle-blowing practices are important for good corporate governance, especially corporate leadership.[458]

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[451] Melé 2009: 232. See also discussion in Painter-Morland 2008: 283 and Kretzschmar et al 2012: 192-193.
[452] This is a policy where the employee has the freedom to consult management at any time when they feel that an ethical issue needs to be conveyed to management.
[453] Kretzschmar et al 2012: 193. See also discussion in Melé 2009: 232.
[454] Botha 2010: 574.
[455] Lubbe 2013: 176.
[456] Section 159 of Companies Act 71 of 2008.
[457] Protected Disclosures Act 26 of 2000.
[458] Botha & Van Heerden 2014: 343.

3.13.5.2 Staffing systems

These systems will ensure that persons of integrity and high ethical standards are hired by the company.[459] Ethical criteria should be embedded in the recruitment, selection and promotion policies of the company.[460] This ultimately also implies that the recruiters must have knowledge of all laws which promote ethics in the workplace, such as the Employment Equity Act, BEE Act, BBEEE Act and so forth as a toolkit to apply ethics in the recruiting process.

3.13.5.3 Induction systems

New employee induction programmes are very powerful in introducing them to the ethics policies. You make the employee aware of ethical expectations and how to use the code of ethics of the company as a guideline.[461]

3.13.5.4 Performance appraisal systems

This stems from rewarding an individual employee if he has made a difference with regard to ethics in the company.[462] Ethical behaviour should be praised, whereas unethical behaviour should be punished.[463] If his performance stands out above the rest of the employees, he should be rewarded for it and the other employees will see that it pays to act ethically in doing business. The degree to which an employee has added to the value of ethical conduct in a business must be taken into consideration when evaluating an employee.[464]

Two types of reward systems have been identified, namely outcome-based systems and behaviour-based systems. The former refers to the evaluation taking place

[459] Kretzschmar et al 2012: 192.
[460] Kretzschmar et al 2012: 192.
[461] Melé 2009: 232. See also discussion in Kretzschmar et al 2012: 193.
[462] Painter-Morland 2008: 286-288. See also Hoak 2008: 228 and discussion in Melé 2009: 238-239 and Kretzschmar et al 2012: 193.
[463] Dallas 2003: 65.
[464] Dallas 2003: 34.

based on the outcomes of an act of an employee, and the latter refers to the techniques used to come to a decision.[465]

3.13.5.5 Training system

This is a key focus area in organisational ethics.[466] It is of the utmost importance to provide training to employees to ensure they are aware of what is expected of them regarding ethics. The training must embed the culture of openness, honesty, integrity and equality, and working together as a team to create an ethical environment.[467] It also makes it easier to determine non-compliance and to take the necessary disciplinary action if someone has attended training but has not abided by the codes of ethics. Completion of training is equivalent to acknowledging that you are up to date with the contents of the code of ethics of the company.

According to Carrol,[468] ethics training has the following purposes:

1) Increasing an employee's sensitivity towards ethical problems;
2) Teaching the employees the ethical facets of decision-making; and
3) Teaching employees the code of conduct of the company.

According to Melé,[469] the training can take two forms, namely compliance-based and integrity-based. Compliance-based training places an emphasis on the law, thus preventing deviation from the code because deviation will lead to punishment, whereas the integrity-based approach refers to self-governance of a person's values within set values (discussed in detail in paragraphs 3.13.2 to 3.13.4 above).[470]

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[465] Dallas 2003: 34.
[466] Kretzschmar et al 2012: 193. See also in-depth discussion in Painter-Morland 2008: 270-280 and Carrol & Buchholtz 2006: 246-248.
[467] Constabulary 1996: 165.
[468] 2009: 185.
[469] 2009: 236.
[470] Melé 2009: 237.

Training programmes can be effective for various reasons, e.g. there is fair treatment of employees, rewards for ethical conduct and a concern of stakeholders.[471] It can also be ineffective, for instance when employees lose faith in the code, and think it only benefits or protects top management.[472] It is thus very important to get the right message across to employees to affirm their trust in the system, which will aid in the maintenance and promotion of an ethical culture in the organisation. This reaffirms the researcher's view that employees have a vital role to play in ethical management and the creation of an ethical environment by upholding the code of ethics.

3.13.5.6 Disciplinary system

Unethical and non-compliant behaviour is punishable. It is important for non-compliant individuals to be punished, so as to set an example for other non-compliant individuals that it does not pay to disobey the rules of ethical conduct. Disciplinary action may, however, only take place when it is linked to the code of ethics, i.e. made punishable thereby.[473]

3.13.5.7 Monitoring and evaluation system

Constant monitoring of ethics is vital. Ethical performance can be gauged and recorded through a variety of interventions.[474] Examples of these are to allow persons to confidentially contact management regarding an ethical issue, encouraging employees to report on fraud or corruption within a company and to allow for whistle-blowing, to name but a few.[475]

3.13.5.8 Awareness campaigns

The researcher suggests that management and ethics committees should ensure that employees are constantly aware of ethical conduct. For example, the business

[471] Melé 2009: 237.
[472] Melé 2009: 237.
[473] Kretzschmar et al 2012: 194.
[474] Painter-Morland 2008: 288-290. See also discussion in Melé 2009: 236-237 and Kretzschmar et al 2012: 193.
[475] Kretzschmar et al 2012: 193.

can publish monthly circulars to its employees and posters may be put up in the office with the details of the ethics hotline of the company, as well as the details of the ethics officers of the company.

3.13.5.9 Checks and balances forms

The researcher proposes that management and ethics committees draft pro forma forms containing the steps mentioned in paragraph 3.7 above and distribute these to employees. Employees should be informed of how to use these forms and how to apply the steps set out for ethical decision-making to every situation, before they merely make a decision. If, after applying the facts to the steps, the outcome is negative, employees should know to abandon the decision. These checks and balances forms can also be handed to management and the ethics committee to enable them to draft their report on ethical issues in the business, as discussed in paragraph 3.14 below.

3.13.5.10 Confidential questionnaires

The researcher suggests that employees complete a monthly questionnaire in which they highlight ethical issues which they have encountered. These questionnaires must be handed to management and the ethics committee to assess and plan a strategy on how to avoid or diminish the adverse effects of these ethical issues. The objectives and outcomes of these strategies must be conveyed to the employees to win the trust of employees in knowing that they are considered and that their wellbeing is important to the company.

Holder[476] sets out the benefits associated with a well-functioning business ethics programme in an organisation as follows:

1) It serves to be preventative rather than reactive; and
2) It fosters a long-term solution emphasising the culture of an organisation.

[476] 2013: 100.

In the light of this discussion, it is clear that the way in which a code of ethics is implemented is of cardinal importance to its success and the fostering of a healthy corporate climate.

3.14 Reporting and disclosing ethical performance

The King lll Report[477] places an emphasis on integrated reporting of the company to keep stakeholders informed.

The objective of reporting in the company is two-fold:[478]

1) It infuses discipline into the ethics management of a company in that it is an indication whether and to what extent a company has reached its ethical objectives; and
2) Ethics reporting satisfies stakeholders that the company actively deals with ethical risks that could have an impact on the sustainability of the company.

Ethics reporting forms part of the social reporting of a company,[479] and should therefore once again be the duty of the social and ethics committee. It is an integral part of the triple bottom line approach as set out in King lll.[480] Social and ethical reporting is a fairly new phenomenon, and much uncertainty still surrounds it at this time. However, what is undeniable is that it compels companies to report to what extent they have met specific performance standards they have set for themselves.[481] Disclosure of ethics-related conduct to society creates incentives for companies to increase their ethical standards.[482] Disclosing ethical behaviour will give the company a competitive edge, and will assist in attracting prospective employees, loyalty and retention of the existing workforce, customer loyalty and a

[477] 2009: 12.
[478] Kretzschmar et al 2012: 194.
[479] Carrol & Buchholtz 2006: 248. See also discussion in Kretzschmar et al 2012: 194 and Fraedrich et al 2011: 379.
[480] Kretzschmar et al 2012: 194.
[481] Kretzschmar et al 2012: 195.
[482] Gopalan & Hogan 2014: 47.

positive reputation.[483] These benefits are not exhaustive, and ethics reporting holds many other benefits for the company.

These reports must be done so concisely that they may carry evidentiary value.[484] Reporting must also comply with the same principles as financial reporting, i.e. relevance, reliability, clarity, comparability, timeliness and verifiability.[485]

The report must then be disclosed to the stakeholders and the board.[486] The report must be available to a wide range of diverse stakeholders.[487] This is in line with the stakeholder inclusive notion in King lll,[488] whereby the board must be accountable to stakeholders in all aspects regarding the company and its operations.

The process of social and ethical reporting is still in its gestational period, and considerable research and experimentation is expected to follow this new approach.[489]

In South Africa, ethics reporting is not well developed and is often omitted, despite the obligation in the Companies Act 71 of 2008 to file a report.[490] Fraedrich et al[491] indicate that this reporting will aid in the creation of a system of integrity. It is suggested that ethics should be reported on by the following organs, namely the ethics function, internal audit and through an internal ethics assessor.[492]

The ethics function should report on the following:[493]

1) Ethics risk identification and the assessment thereof;
2) Any development of a code, or the review or modification thereof;

[483] Gopalan & Hogan 2014: 47.
[484] Kretzschmar et al 2012: 195.
[485] Kretzschmar et al 2012: 195.
[486] Kretzschmar et al 2012: 195.
[487] Kretzschmar et al 2012: 195.
[488] Chapter 9 of King Report 2009.
[489] Fraedrich et al 2011: 379. See also Kretzschmar et al 2012: 195.
[490] Regulation 43(5)(c).
[491] 2011: 380.
[492] KPMG 2012: 121.
[493] KPMG 2012: 121.

3) Steps to prevent misconduct;
4) Report on trends regarding ethics reporting; and
5) Information regarding the enforcement of ethical standards.

Internal audit should report on the following:[494]

1) The ethical culture of a company;
2) The effectiveness of ethics strategies;
3) Risks attached to ethics strategies;
4) Adequacy and effectiveness of ethics controls; and
5) Compliance of policies and procedures relating to ethics.

The independent assessor should report on:[495]

1) Motivations to the board on the effectiveness of their policies;
2) Motivations to enhance the credibility of information provided to external and internal stakeholders; and
3) Motivations on the improvement of an organisation's ethical culture.

Ethics reports are important for various reasons, but also for depicting an accurate picture of the company's ethics management to its stakeholders. It will allow stakeholders to assess any loopholes and make suggestions on the implementation of further policies to combat these loopholes. By reporting externally, a company demonstrates its willingness to reveal vulnerability, which encourages shareholders to contribute to the cause.[496]

In the next paragraph methods will be discussed for the promotion and improvement of an ethical culture of the company.

[494] KPMG 2012: 121.
[495] KPMG 2012: 121.
[496] Fraedrich et al 2011: 381. See also KPMG 2012: 121.

3.15 Promoting and improving an organisation's ethical culture

Ethics systems require consideration of:[497]

1) Organisational values;
2) The nature of organisational decision-making;
3) The values and behaviour of the organisation's leaders;
4) The organisation's reward system;
5) Handling of conflicts of interest;
6) Availability of ethics guidance; and
7) The monitoring system of the company.

To encourage and support ethical behaviour, the organisation must value ethics and ethical behaviour highly. It can take various steps to encourage and promote an ethical culture.

Management can take various approaches and measures to improve and promote ethics in a business. There are effective and ineffective means to endeavour to promote ethics in an organisation.[498]

Effective measures include establishing a solid and specific ethical standard for the business to follow, creating a comfortable ethical environment for employees, providing training in organisational ethics for all employees and making one's ethics systems known to consumers.[499]

Ineffective means would be to create vague ethical standards that are hard to interpret, failing to familiarize employees with these standards and policies, limiting organisational training to only certain employees and assuming that employees will always apply their own ethical standards.[500]

[497] Dallas 2003: 55.
[498] Lubbe 2013: 172.
[499] Lubbe 2013: 172.
[500] Lubbe 2013: 172.

Ethics management is an extenuating task, but one may, as a guideline, adopt the following seven steps to effective ethics management:[501]

1) Assessing risks and putting in place standards and codes of ethical conduct;
2) Providing high-level managerial oversight to ensure compliance with these ethical standards (e.g. appointing an ethics officer);
3) Taking due care not to place individuals with a tendency to engage in misconduct in a position of authority where they can influence others negatively;
4) Using training programmes to communicate the agreed standards to all employees (obviously record should also be kept of their attendance);
5) Establishing systems to monitor conduct and allow employees to report abuse of the policies and standards;
6) Enforcing standards, rewards and punishments in a consistent and transparent manner within the company; and
7) Constantly reviewing the system, and taking the necessary steps to revise and improve the way the structure works.

In addition to management being able to take various routes to promote ethical awareness, one cannot disregard the roles that trade unions and workplace forums play. Workplace forums are there to promote the interests of employees in the workplace.[502] They are there to elevate worker participation.[503] They meet regularly with members (employees) and the employer to discuss issues such as disciplinary codes and procedures, rules regarding conduct not related to work performance of employees, measures to advance persons affected by unfair discrimination, matters relating to benefit schemes and matters under other laws not currently in existence.[504] In view of this, they can play an important role in ethics promotion and assist in fostering a corporate culture. Trade unions represent members in the event

[501] Lubbe 2013: 173.
[502] Grogan 2010: 76. See also Havenga 1997: 322.
[503] Havenga 1997: 322.
[504] Grogan 2010: 82.

of grievances and disciplinary matters; they aim to protect members' rights and to improve them.[505]

Now that one has a clear understanding of ethics and the management thereof, one can look at the important roles codes of conduct play in the business.

3.16 Codes of conduct as a way of maintaining and promoting an ethical culture

One of the effective means, as mentioned above, is establishing solid and specific ethical standards for a business, and its people, to follow. A good way to do this is to develop a code of conduct.

Aspects that may be addressed in a code of conduct are as follows:[506]

1) Conflicts of interest;
2) Receiving of gifts, gratuities and entertainment;
3) Giving of gifts, gratuities and entertainment;
4) Protecting company proprietary information;
5) Discrimination;
6) Sexual harassment;
7) Kickbacks;
8) General daily conduct;
9) Employee theft; and
10) Proper use of company assets.

The above list is definitely not exhaustive. Many other aspects may be covered by the code, in fact, the more aspects that are covered, the better.

[505] Grogan 2010: 35.
[506] Lubbe 2013: 184 and Carrol & Buchholtz 2006: 243.

Although the above matters may also be included in a disciplinary code, it is important to distinguish between disciplinary codes and codes of ethics. A disciplinary code regulates disciplinary matters, and sets out offences for misconduct as well as dismissal procedures.[507] This differs from a code of ethics, which aims at regulating the behaviour of employees, focusing on the values to be portrayed by employees to promote ethical behaviour and a healthy corporate culture in the company without setting out disciplinary and other related procedures.

The code of conduct of a business is one of the main tools for ethics management and enforcement within a business. Lubbe[508] sets out the following purposes as examples:

1) As a rule book, a code acts to clarify what behaviour is acceptable and vice versa;
2) As a signpost, a code can lead employees to consult other individuals or corporate policies to determine ethical behaviour;
3) As a mirror, a code gives a reflection of what ethical behaviour should be and whether one is conforming with the rule or not;
4) As a magnifying glass, the code suggests a note of caution to be more careful and to give greater reflection before acting;
5) As a shield, the code averts unethical behaviour;
6) As a smoke detector, the code leads employees to contact the appropriate authority and to report violations; and
7) As a club, the potential enforcement of the code causes employees to comply with the code's provisions.

3.17 Increase in ethical awareness

In the past few years there has been a gradual increase in ethical awareness, especially after the King reports on corporate governance.

507 Grogan 2010: 131.
508 2013: 186 and Carrol & Buchholtz 2006: 243.

Matters which could have led to the increase in ethical awareness include:[509]

1) The possible positive impact that good governance reports has had on the public's expectations of ethical conduct in business;
2) The guard dog role that the media fulfils with regard to unethical conduct; and
3) The public in a third-world country such as South Africa who experiences the impact of unethical conduct has taken a stand against it, and has requested more ethical behaviour from certain functionaries in the country.

3.18 Concluding remarks

In this chapter the origin and development of ethics were discussed. The important point to remember is the three main components of ethics: good, self and other. We have learnt from the origin of ethics that it rests mainly on morals and virtues, and what you see as being right or wrong. The researcher has illustrated that the tone must be set from the top (management), but also that it is the responsibility of all employees to promote ethics. It was illustrated that just because one occupies a management position, it does not mean that one is ethical or moral, hence the need for a code of conduct to guide the behaviour of the members of the company.

The researcher emphasised the importance of business ethics as well as the importance of ethical leadership. The researcher has emphasised the role and characteristics of an ethical leader in a company.

The researcher illustrated the different types of codes, namely directional and aspirational. Directional codes are strict guidelines to direct actions, whereas aspirational codes allow the use of one's own judgement. The researcher suggested a combination of the two forms of codes, giving the employees some sort of freedom when it comes to ethics but still giving them a boundary not to be crossed.

Certain questions to be considered in ethical decision-making were also discussed, but this list is not exhaustive. It must be understood, to sum up, that when you are uncomfortable in making any decision, you are probably making the wrong one.

[509] Lubbe 2013: 192.

Guidelines were also given on how to determine an ethical risk, which is of the utmost importance in corporate governance.

It was also emphasised that the interests of stakeholders are paramount; they must always be handled in a fair, transparent manner. We must put ourselves in the other's shoes, respect the rights of a person and not do anything detrimental to that person.

The root of ethical behaviour lies in the notion that the company must please society instead of just being a moneymaking machine. One must look past profit only, and focus on the triple bottom line approach, namely profit, social and environmental issues. The ethicality of behaviour lies in the balance struck by a person or organisation between these three factors for consideration. A good balance of these factors will result in behaviour being deemed as being ethical. The board is also required to report on how it has managed these considerations to the stakeholders.

The nature of codes of conduct and the importance thereof was also discussed. This code will be the "ethical constitution" of the business. It is the pivot around which ethical behaviour revolves within an organisation. The researcher distinguished between the two types of codes, namely aspirational and directional codes, and emphasised her support for an aspirational-directional code, encompassing rigid rules but also allowing for the application of one's mind and the use of one's independent judgement when faced with an ethical situation.

The researcher discussed the factors which need to be accounted for when drafting a code of conduct, namely the vision and mission of the company, the set of core values underlying the company, obligations towards stakeholders and the norms and rules to be applied and adhered to. The code must set a clear purpose. This will ultimately lead to an improvement in stakeholder goodwill, and thus to higher productivity and will be of benefit to the company. It definitely pays to do business in an ethical manner!

The implementation and institutionalization of ethics was discussed at the various levels, namely the strategic and systems levels. The strategic level refers to the commitment of a company to its code and the prevention of non-compliance with the code. The systems level focuses on making the code well-known and accessible and available to the employees of the organisation. The researcher suggested ways to ensure that employees are aware of what is expected of them regarding their conduct on a day-to-day basis in the working environment, e.g. awareness campaigns, checks and balances forms and confidential questionnaires. These recommendations are not exhaustive at all. The manner of awareness will differ from organisation to organisation, depending on the circumstances.

Companies are also “forced” to act in an ethical manner since they are required to report on it annually. The objective of the report is two-fold: it infuses discipline into the ethics management of a company and keeps the stakeholders up to date and satisfied that their interests are being protected.

In the last paragraph we see how the focus in recent years has moved to and stayed on the concept of ethics. It is therefore an indicator that there will be even more focus on the promotion and maintenance of ethics in the future.

The research question has been answered as follows:

1) The question of what ethics is has been answered, in that it is the balancing act of what is good for oneself, and what is good for another.
2) The question as to whose responsibility ethical behaviour is, was also answered in that, although directors and managers play the dominant role in management thereof, the whole company, all internal stakeholders, must be involved in the maintenance of ethical behaviour within the company.

To conclude, one can thus define business ethics as striking a balance between good for the company and good for society, taking into account the triple bottom line approach and the interests of all stakeholders.

In the next chapter the duties of directors will be discussed, especially the role that they play in ethics management.

Chapter Four

Duties of Directors in Ethics Management

"When exercising their duties, directors should also take note of the ethics of governance in terms of which the board's decisions and actions are underpinned by the following four basic values of good corporate governance, namely: responsibility, accountability, fairness, and transparency. The ethics of governance requires that a director of a company should be faithful to the ethical values of corporate governance."[510]

4.1 Background

In paragraph 1.5 above the following question is posed:

What are the duties of directors in ethical management?

This question will be answered in this chapter.

Section 1 of the Companies Act[511] defines a company as a "juristic person".

Companies are managed by the board of directors. Universally, two forms of boards exist, the one-tier board and the two-tier board.

According to the one-tier approach, followed in the United Kingdom, there is only one single board of directors that is responsible for all functions within a company.[512] The one-tier board manages both decision management and decision control.[513] South Africa follows the one-tier board system. In terms of this one-tier or unitary approach, ownership and control is clearly separated.[514] The board is appointed by the

[510] Botha 2009: 712.
[511] Companies Act 71 of 2008.
[512] Jungmann 2006: 435.
[513] Bezemer et al 2014: 17.
[514] Esser 2014: 40.

shareholders, leading to the separation of management by two distinct organs, the shareholders and the directors.[515]

According to the two-tier model followed in Germany, the board consists of two boards, namely a management and a supervisory board.[516] The supervisory board appoints and dismisses members of the management board, and monitors them, and they in turn manage the affairs of the company and set its goals and guidelines.[517] It has been debated whether South Africa should rather follow the European board structure, the two-tier structure, but it has become evident that the one-tier approach is more favourable.[518]

The duties of directors have long been under the scrutiny of the public, and the concepts of fiduciary duty and care and diligence as the norm for directors' conduct under common law have been expanded vastly to add more to the to-do list of directors. The concepts "fiduciary duty" and "degree of skill, care and diligence" have been considered to be too vague as a guideline for directors' conduct. Ultimately, directors must act in an honest manner and in the best interest of the company.[519]

Directors are now specifically charged with a wider duty of care and skill, incorporating the implementation of human rights protection and promotion in the business.[520] The observance of human rights is not a voluntary matter but a legal obligation imposed by Section 8 of the Constitution of South Africa. Companies, specifically their directors, must consider the following: the potential impact of the company and its own capabilities which are central to the nature of corporate responsibility towards a particular (human) right.[521]

A company must have the objective of conducting business with the view of enhancing economic success, taking into account the legitimate interest of its

[515] Esser 2014: 40.
[516] Jungmann 2006: 432.
[517] Jungmann 2006: 432.
[518] Havenga 2005: 617.
[519] Esser 2011: 321.
[520] Bilchitz 2008: 783.
[521] Bilchitz 2008: 789.

stakeholders.[522] Companies are further required to consider the interest of the public.[523] Directors must be aware of the protection afforded to stakeholders in terms of other legislation, such as labour law, not only in terms of the Companies Act. King III,[524] in terms of Principle 2.3, emphasises the duty of directors to run the business on an ethical foundation.

The United States of America's courts applied the concept of the "business judgement rule", whereby the courts agreed that they should not interfere in the decisions made by directors when using their "business judgement". The courts felt that they had no authority to intervene in matters of which they had no knowledge. This has filtered into South African law, and has even been legislated in terms of Section 76(4)(a),[525] the courts holding that they will not second-guess a decision made by a director within the scope of the articles of association, made with due care and skill and in a bona fide[526] and honest manner.[527]

There is immense pressure on directors to be accountable for all decisions made, and therefore their ethical duty is emphasised. They must therefore be willing to defend their decisions in public. This can only be done if the director is confident that his decision was an ethical one (see ethical decision-making in Chapter Three). The question therefore lies in whether the director carried out his or her function in a proper or permissible manner and in good faith, linking this duty of care to that of ethical decision-making.

Directors should have certain qualities to enable them to perform their duties in an ethical manner and to give them the judgement to make ethical decisions. In the following paragraphs the qualities of directors will be examined as well as their duties under common law and the Companies Act 71 of 2008.

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[522] Esser 2011: 323.
[523] Havenga 1998: 333.
[524] 2009: 55.
[525] Companies Act 71 of 2008.
[526] Du Plessis 2004: 315 – Bona fide implies in terms of the purpose for which the power was conferred.
[527] Du Plessis 2004: 315.

4.2 Qualities of a director

"Leadership is a potent combination of strategy and character. But if you must be without one, be without strategy."

-General Norman Schwarzkopf

4.2.1 Definitions of directors

An executive director is "an individual involved in the day-to-day management and/or in the fulltime salaried employment of the company and/or its subsidiaries."[528]

A non-executive director can be defined as "independent of management".[529] King II defines it as "an individual not involved in the day-to-day management and not a fulltime salaried employee of the company or its subsidiaries. An individual in fulltime employment of the holding company or its subsidiaries, other than the company concerned, would also be considered to be a non-executive director unless such individual by his/her conduct or executive authority could be construed to be directing the day-to-day management of the company and its subsidiaries".[530]

4.2.2 Qualities of a director

King III[531] indicates a director must be an individual of integrity and courage.

King III[532] states that "in the capacity of a steward, a director must act with responsibility, accountability, fairness and transparency". According to these ethical foundations, directors have the following moral duties to fulfil in the business:[533]

[528] Marx 2008: 42. See also Naidoo 2009: 114.
[529] Marx 2008: 43. See also Naidoo 2009: 114-115.
[530] Marx 2008: 43. See also Naidoo 2009: 114-115.
[531] 2009: 39.
[532] 2009: 20. See also Botha 2009: 712.
[533] King Report 2009: 21-22. See also Botha 2009: 712.

1) Conscience;
2) Care;
3) Competence;
4) Commitment; and
5) Courage.

A director of a company is at the top of the management hierarchy, and plays a central role in the operations of the organisation,[534] therefore must have the inherent qualities of a leader. (Refer to Chapter Three for an in-depth discussion of ethical leadership.)

The effective application of directorial behaviour requires that participants in directorial behaviour should possess certain qualities.[535] Firstly, there must be the ability to use relevant information as well as factual knowledge concerning the matter at hand; secondly, there must be an understanding of how the company is controlled; thirdly, there must be a form of commitment to the activities undertaken, a willingness to act in a determined way; and fourthly, there must be the ability to deliver when it is necessary to deliver.[536]

According to Naidoo,[537] a director must have:

1) Strategic focus;
2) Financial knowledge;
3) Effective communication skills;
4) Judgement and leadership ability;
5) General management experience;
6) Knowledge of the company and the industry; and
7) Broad understanding of macro-economic, legal and regulatory environment and team orientation.

[534] Shaner 2010: 41.
[535] Finch 1992: 179.
[536] Finch 1992: 180.
[537] 2009: 127.

According to Naidoo,[538] qualities of non-executive directors include:

1) Adequate time to devote to the company;
2) High ethical standing;
3) Successful track record in the field;
4) Superior intellectual capacity; and
5) A sense of commitment.

When looking at the above one can therefore define the traits of a director as follows: a person who can apply his mind to the facts before him in any matter involving the company, a person who is wholly committed to the company and is determined to deliver the best possible service he can to the members of the company as well as the public, in an ethical manner.

The main traits of a director therefore include loyalty, good faith and an avoidance of conflict of interest.[539]

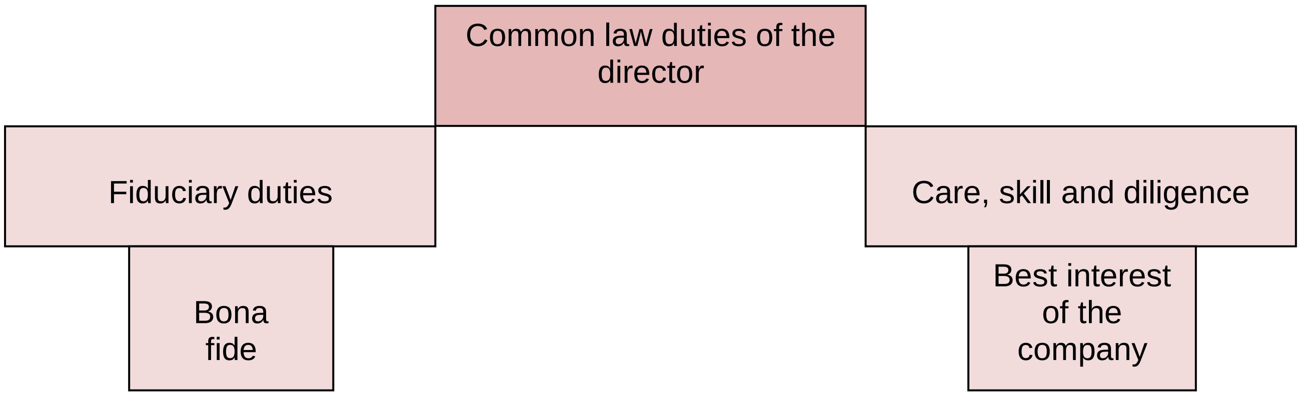
Now that the traits of the individual as a company director have been established, the common law duties of the director are discussed in the next paragraph.

4.3 Common law duties of a director

The common law duties of a director are the duty to act with the necessary skill and expertise and the fiduciary duty towards the company which he directs.

[538] 2009: 127.
[539] Cassim 2008: 731.

Figure 4.1: Common law duties of the director



{Source: Own Figure}

These duties will be discussed in the following two paragraphs.

4.3.1 The common law concept of fiduciary duty

The notion of fiduciary relationships originated from the English rules of equity.[540] Roughly translated, equity is fairness. Equity could be likened to the concept of ethics. All ethical decisions must be made to be fair to all parties involved, and this is the tremendous task that directors are required to perform.

Directors stand individually in a fiduciary relationship to their company.[541] A fiduciary is a person who occupies a special position of trust.[542] A director is seen as a trustee, being authorised to act on the company's behalf and being entrusted to protect the company's assets.[543] Cassim et al[544] illustrate that a fiduciary relationship is a relationship of trust and confidence.

[540] Havenga 1996: 366. See also Havenga 1998: 7 and *Bellairs v Hodnett* 1978 (1) SA 1109 (A).
[541] Blackman et al 2002: 8-29. See also Cilliers et al 2000: 139 and Cassim et al 2012: 509.
[542] Sher 2005: 129. See also discussion by Blackman et al 2002: 8-30.
[543] Naidoo 2009: 159; Esser & Du Plessis 2007: 348; Havenga 1998: 11-13; *French Hairdressing Saloons Ltd v National Employers Mutual General Insurance Association Ltd* 1931 AD 60.
[544] 2012: 512.

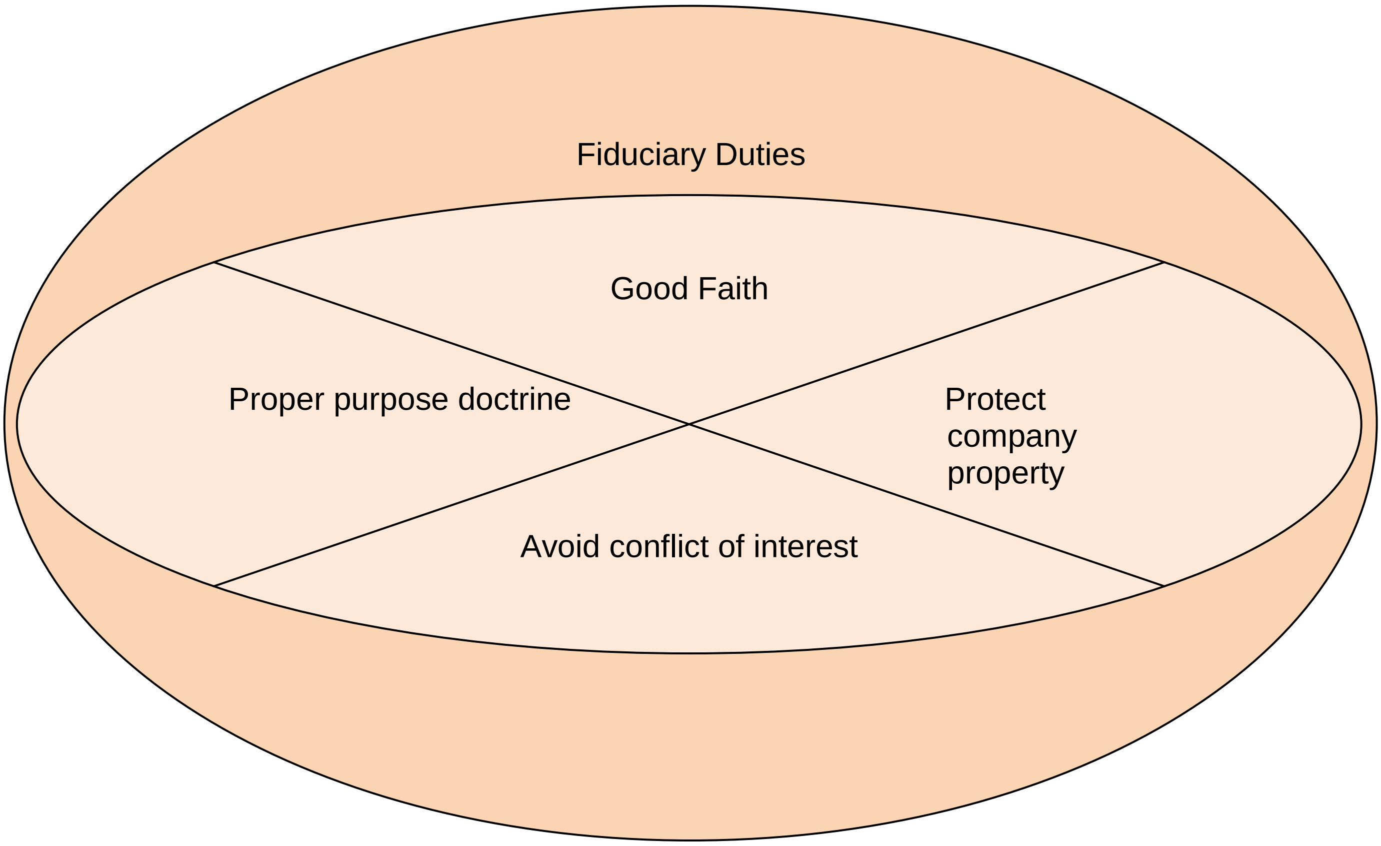
The main responsibility of directors is to act in a bona fide manner and in the best interests of the company.[545] This means that the kernel of the matter may be whether one party has relinquished his own self-interest and agreed thereto to act solely on behalf of another party.[546]

The fiduciary duty, as explained above, involves four main aspects, namely:[547]

1) To act in good faith;[548]
2) To exercise his powers for a proper purpose;
3) To avoid a conflict of interest; and
4) Not to misuse company property.

[545] Delport & Vorster 2011: 292-296. See also McLennan 1996: 94 and Davis et al 2013: 114 and the discussion by Benade et al 2009: 130.
[546] Blackman et al 2002: 8-30. See also *Volvo (Southern Africa) (Pty) Ltd v Yssel* 2009 (6) SA 351 (SCA).
[547] Sher 2005: 130. See also Havenga 1996: 41 and Du Plessis et al 2011: 240.
[548] See discussion by Havenga 1998: 332-334. See also *Atlas Organic Fertilizers Pty Ltd v Pikkewyn Ghwano Pty Ltd & Others* 1981 (2) SA 173 (T); *SA Fabrics Ltd v Millman* 1972 (4) SA 592 (A); *Novick & Another v Camour Holdings Ltd & Others* 1979 (2) SA 116 (W); *Levin v Felt ant Tweeds Ltd* 1951 (2) SA 401 (A) and *R v Herholdt & Others* 1957 (3) SA 236 (A).

Figure 4.2: Fiduciary duties of a director



{Source: Own Figure}

A director, as a fiduciary, must act in good faith in all dealings, as well as in an honest manner.[549] The common law fiduciary duty can be summarised as the duty of the director to exercise his powers bona fide and for the benefit of the company.[550] Cassim et al[551] indicate that fiduciary duties are based on loyalty, good faith and the avoidance of conflict of interest. In *Fisheries Development Corporation SA Ltd v Jorgenson,*[552] the court found that a director is bound to serve the best interests of the company in the execution of his duties to the exclusion of any other party.

A fiduciary relationship must exist between the company, its stakeholders and the directors. A director stands in a fiduciary relationship to his company, meaning that

[549] Sher 2005: 129. See also Havenga 1998: 8, where the duty to act in the interests of another is emphasised.
[550] Delport & Vorster 2011: 292-296. See also McLennan 1996: 94 and Davis et al 2013: 114 and the discussion by Benade et al 2009: 130.
[551] 2012: 509.
[552] 1980 (4) SA 156 (W).

he must act in good faith towards the company, must exercise his powers as director for the benefit of the company and must avoid a conflict of his own interests with that of the business.[553] Daily, with the emerging business, it becomes more urgent to define what good faith is. Directors, because of the fiduciary position they occupy, are obliged to act with the utmost fidelity towards their beneficiary, and stemming from this we also see the duty of loyalty and care that the directors must adhere to.[554]

The following common law duties are of importance, namely:[555]

1) The duty to act only under available powers;
2) The duty to exercise powers for the purpose for which they were conferred;
3) The duty to act in the best interests of the company;
4) The duty to exercise unfettered discretion; and
5) The duty to avoid conflicts of interest.

These duties will be discussed briefly below.

4.3.1.1 Duty to act only under available powers

At common law, directors are under a distinct duty not to exceed their powers or their limits of authority.[556] A director has a fiduciary duty to take cognizance of and recognise limitations on their powers as well as their authority to act on behalf of the company.[557] Cassim et al[558] indicate that this is an essential facet of the fiduciary duty of directors to act in good faith and in the best interests of the company, although not distinctly referred to in the Companies Act 71 of 2008.

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553 Benade et al 2009: 130 and Cilliers et al 2000: 139. See also Havenga 1998: 366; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *R v Herholdt & Others* 1957 (3) SA 236 (A) and *S v de Jager & Another* 1965 (2) SA 616 (A).
554 Nowicki 2008: 466. See also Havenga 1998: 13.
555 Naidoo 2009: 162. See also Cilliers et al 2000: 141 and KPMG 2012: 185.
556 Cassim et al 2012: 532.
557 Delport & Vorster 2011: 298. See also Cilliers et al 2000: 144.
558 2012: 533.

Directors must act within the scope of the powers conferred on them, failing which their acts will be *ultra vires*.[559] The director has a duty not to act *ultra vires*, failing which he will be in breach of this duty.[560]

The director will be in breach of his fiduciary duty if he acts:[561]

1) Beyond the corporate capacity of the company; and
2) Beyond the powers conferred on him in terms of the Memorandum of Incorporation (MOI).

4.3.1.2 Duty to exercise powers for the purpose for which they were conferred

Powers may only be used for their legitimate purpose, namely an authorised business purpose.[562] Cassim et al[563] define "proper purpose" as that directors must exercise their powers for the objective purpose for which the powers were given, and not for an ulterior purpose. Powers should be exercised only for the benefit of the company and not the director himself.[564] This duty is strictly interpreted and may lead to liability of the director if it is breached.[565]

4.3.1.3 Duty to act bona fide and in the interests of the company

According to Blackman et al,[566] a director must act "bona fide in the interests of the company as a whole". According to Cassim et al,[567] this includes the collateral body of shareholders, including future shareholders; the term company refers to the shareholders. As indicated above, in the *Fisheries Development Corporation v Jorgenson*[568] case, the court found that a director is bound to serve the best interests of the company in the execution of his duties to the exclusion of any other party. This

559 Cassim et al 2012: 165.
560 Blackman et al 2002: 8-56.
561 KPMG 2012: 185.
562 KPMG 2012: 185.
563 2012: 525.
564 See discussion in *Fisheries Development Corporation SA Ltd v Jorgenson* 1980 (4) SA 156 (W).
565 Cassim et al 2012: 525. See also Blackman et al 2002: 8-58 and Naidoo 2009: 163.
566 2002: 8-61.
567 2012: 515.
568 1980 (4) SA 156 (W).

duty requires the honest exercise of all powers and judgement used in the exercise of these powers.[569] The directors must also act fairly in their decision-making.[570]

Every director is bound to the company by a fiduciary duty, regardless of his capacity on the board.[571]

4.3.1.4 Duty to exercise unfettered discretion

Cassim et al[572] indicate that this duty is an essential aspect of the duty to act in good faith. A company is entitled to the independent and unbiased judgement of every director involved in the company.[573] Directors must exercise independent judgement and discretion and act in an objective, transparent manner, acting positively to protect the interests of the company.[574] In the light of this, a director must consider the affairs of a company in an objective manner,[575] and cannot merely act as a dummy or a puppet and blindly follow the recommendations of others.[576]

4.3.1.5 Duty to avoid a conflict of interest

A director, as a fiduciary, has the duty to avoid a conflict of interest. This is one of the most important duties of directors.[577] It implies that a director may obtain no other benefit from the company than the remuneration to which he is entitled.[578] In the light of this, a director must never permit a conflict between his duties and personal interests and must disclose all such conflicts to the board.[579]

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[569] KPMG 2012: 185. See also Havenga 1998: 331.
[570] Cassim et al 2012: 516.
[571] Naidoo 2009: 163.
[572] 2012: 532.
[573] Blackman et al 2002: 8-106 and Cassim et al 2012: 528.
[574] Delport & Vorster 2011: 298. See also KPMG 2012: 185.
[575] Cilliers et al 2000: 145.
[576] Delport & Vorster 2011: 298. See also the discussion in *Fisheries Development Corporation of SA Ltd v Jorgenson* 1980 (4) SA 156 (W) and also *S v Shaban* 1965 (4) SA 646 (W).
[577] Cassim et al 2012: 534.
[578] Cilliers et al 2000: 141.
[579] Naidoo 2009: 164. See also Havenga 1998: 331 and Blackman et al 2002: 8-111.

According to Cassim et al,[580] there are two rules regarding conflicts of interest, namely the "no conflict rule" and the "no profit rule". The "no profit rule" means that directors are not entitled to benefit from any profit made by them in their capacity as directors whilst performing the duties of directors.[581] The "no conflict rule" means that a director occupying a fiduciary position may not put himself in a position of a conflict of interest.[582] In terms of Section 76(2)(a)(i) and (ii),[583] a director may not use his position as director to gain an advantage for himself or for a person other than the company itself or the wholly owned subsidiary of the company, nor may a director in his capacity as director knowingly cause harm to the company or a subsidiary of the company.

Withholding certain information is a breach of the duty to disclose as well as a breach of the duty to act in a bona fide manner and in the best interests of the company.[584] In terms of Section 76(2)(b),[585] a director must disclose all information that becomes known to him that is material to the company, not generally available to the public, not already known to directors and not information that is protected from disclosure by legal or ethical duty. This duty imposes a further duty on directors to act ethically.[586] This is so because they are not permitted to withhold any information from the board that may be to their own benefit. The duty to disclose is discussed in paragraph 4.4.2.2. below.

4.3.2 The common law concept of the duty to act with care and skill

"In the exercise of his powers and the discharge of his duties, a director shall at all times exercise that degree of care, skill and diligence that a reasonable man who had such training and experience as the director has would exercise as a director of the company, provided that the degree of care, skill and

[580] 2012: 536.
[581] Cassim et al 2012: 536.
[582] Cassim et al 2012: 536.
[583] Companies Act 71 of 2008.
[584] Havenga 1995: 439.
[585] Companies Act 71 of 2008.
[586] Cassim et al 2012: 554.

diligence that the director is required to exercise shall not be less than which would be exercised by a person of reasonable competence and experience.'"[587]

The directors have the responsibility, just like a mother does, to nurture, care and protect its "baby". This is where the duty of care, skill and diligence comes in. The director must care for the company, nurturing it, promoting its best interests and protecting it from any harm.

A director must exercise his powers and carry out his duties in a bona fide manner and for the benefit of the company, and in doing this he must exercise the required degree of care and skill.[588] This means "to use that amount of care which ordinarily careful and prudent men would use in similar circumstances".[589]

According to *Fisheries Development Corporation SA Ltd v Jorgenson,*[590] the duty of care and skill depends to a considerable degree on the nature of the company's business and the duties assigned to the director, and a director is not required to have any special acumen and need only act reasonably in the same manner that a director in his position would act.

Finch[591] states that a director should exhibit the skill and care reasonably expected of a person who has undertaken his role in his specific industry and type of company. She suggests an objective test as the yardstick to measure directors' behaviour. According to her, directors should be judged on the functions they undertake and their qualifications to act as directors should not be prejudicial to them.[592] The researcher respectfully disagrees with Finch's view that the qualifications of a director are less important than the degree of skill that he uses. Obviously one needs some sort of qualification in order to have the background knowledge to know whether one is acting with due skill and care in a matter.

[587] Du Plessis 2010: 268.
[588] Benade et al 2009: 135.
[589] Nowicki 2008: 467.
[590] 1980 (4) SA 156 (W).
[591] 1992: 203.
[592] Finch 1992: 203.

Cassidy[593] indicates that there is no reason why directors need not meet the standards expected from other professionals. There is no reason why directors need not meet the objective standard of reasonableness.[594] The director is required to equip himself with sufficient knowledge of the business's affairs.[595]

According to the case of *Fisheries Development Corporation SA Ltd v Jorgenson,*[596] the following principles exist regarding the duty of care, skill and diligence:

1) The extent of the director's duty depends to a considerable degree on the nature of the company's business and the specific duties and obligations conferred on a specific director;[597] responsibilities of executive and non-executive directors vary immensely. The executive director who is involved with the day-to-day running of the business, will obviously have to exercise a higher degree of care and skill than the director not involved in the day-to-day management of the business;
2) A director is not required to have special business skills, but is required to act with the necessary skill and care of a reasonable person with his level of knowledge;[598] and
3) If a specific task is assigned to an official, the director is entitled to rely on the good judgement of such an official in the performance of the assignment, but must still apply his own mind and discretion to the decision made by such an official.[599]

In the past, the courts have adopted a lenient approach to the duty of care, skill and diligence.[600] Currently, with the legislation of directors' duties, in this case specifically

593 2009: 384.
594 Cassidy 2009: 384.
595 Naidoo 2009: 165.
596 1980 (4) SA 156 (W).
597 Du Plessis 2010: 264. See also Bekink 2008: 100; Havenga 1998: 321; *Wolpert v Uitzigt Properties (Pty) Ltd & Others* 1961 (2) SA 257 (W).
598 Du Plessis 2010: 265. See also Bekink 2008: 100.
599 Du Plessis 2010: 265. See also Bekink 2008: 100.
600 Cassim et al 2012: 554.

Section 76(3)(c),[601] the legislature imposes a higher standard for directors' conduct of care, skill and diligence.[602]

A significant innovation of the Companies Act[603] is that, for the first time in South Africa's corporate law regime, the fiduciary duties of directors and the duty of care and skill have been partially codified or set out in statute.[604] The common law outlook on directors' duties have been formalized in terms in Section 76 of the Companies Act 71 of 2008, and further expanded by the King lll Report. The inclusion of these duties in legislation does not abolish common law provisions, and it could be said that Section 76 is only a partial legislation of directors' duties.[605] This legislation was to make the law on directors' duties clearer and more accessible.[606] According to Esser and Delport,[607] the Companies Act 2008 has made provision for an objective and a subjective test to be applied, as opposed to the acceptance of the lesser of the two as applied in common law. In view of this, a higher expectation of directors' duties may exist.[608] The researcher is of the opinion that this is a valuable contribution to the understanding and evaluation of the duties of directors.

The provisions of Section 76 are discussed below.

4.4 The codification of the rights and duties of directors

Section 76 of the Companies Act 71 of 2008 has partially codified.[609] the common law duties of fiduciary duty and the duty to act with skill and care into a section in the legislation. This will be discussed in the next paragraphs.

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601 Companies Act 71 of 2008.
602 Cassim et al 2012: 558.
603 Companies Act 71 of 2008.
604 Cassim et al 2012: 507.
605 Esser & Delport 2011: 453 and Havenga 2013: 263.
606 Cassim et al 2012: 508.
607 2011: 453.
608 Esser & Delport 2011: 453.
609 Cassim et al 2012: 507.

4.4.1 The standards of directors conduct (Section 76)

Section 76 of the Companies Act 2008 has codified the duties of the directors. Section 76[610] expects the following from the director of a company:

1) Not to misuse his position as director to gain a personal advantage and harm the company; and
2) Notify the company of any matter that comes to his attention that he is bound to disclose.

The Companies Act[611] therefore prescribes that the directors should act in an ethical manner. The Act prescribes that directors should look after the interests of the company instead of their own interest (Section 75), acting ethically in considering the interests of others and by being open and transparent when reporting or engaging with the board (Section 76). A director must therefore perform his functions in a certain prescribed manner.

A director must perform his powers and functions in terms of Section 76(3):[612]

1) In good faith;
2) In the best interests of the company; and (the researcher suggests the inclusion of other stakeholders in line with the stakeholder inclusive approach advocated in King lll)
3) With a degree of skill and care as is expected from a person in his position, and must have the general knowledge and experience of a director.

In summary of the above, the duties of directors may therefore be divided into positive and negative duties. Positive duties include the application of the business judgement rule and the duty to disclose matters to the board. The negative duties include all actions not to be taken by a director in the running of his office. These

[610] Companies Act 71 of 2008.
[611] Companies Act 71 of 2008.
[612] Sections 76(3)(a)-(c) in Companies Act 71 of 2008. See also discussion in KPMG 2012: 187.

duties will now be discussed in more detail, firstly the positive duties and thereafter the negative duties.

4.4.2 Positive duties

Directors are required to act in the best interests of the company and in good faith at all times. In line with common law, the most prevalent positive duties, encompassing all duties, lie in the obligation of the director to act in good faith and with the necessary skill, care and diligence as would be expected from a reasonable person taking on the same function and office and having the general knowledge and skills of the particular director.[613]

4.4.2.1 The business judgement rule

The business judgement rule is legislated in Section 76(4)(a) of the Companies Act.[614]

Directors are charged with making various decisions on a day-to-day basis. A possibility exists that a decision taken can have an adverse effect, or that the director made an honest mistake.[615] According to Cassim et al,[616] the business judgement rule "is a rule of restraint that prevents the court from interfering, with the benefit of hindsight, in honest and reasonable business decisions of the directors of a company".

The business judgement rule aims to protect a director from liability for such decisions, if not made in a reckless manner, by way of a test. According to Kennedy-Good and Coetzee,[617] application of this rule has two effects, namely:

[613] Benade et al 2009: 59.
[614] Companies Act 71 of 2008.
[615] Kennedy-Good & Coetzee 2006: 278.
[616] 2012: 563.
[617] 2006: 278.

1) It precludes the courts from examining the merits of a decision made by a director if it is established that the decision was made in good faith; and
2) It creates a presumption in favour of a director of due care and good faith.

The test applied provides that if a director has taken all reasonable steps to be informed, has no material financial interest and has believed on a rational basis that his decision was in the best interest of the company, such director is not in breach of his duties.[618] Section 76(4)(a)[619] only protects informed and reasonable business decisions.[620]

There is thus an overlap between the business judgement rule and the duty of care and skill.[621] With reference to the business judgement rule, it refers specifically to the decision-making aspect of care and skill.[622] A director will be considered to have exercised his duties with proper skill and care if:[623]

1) He/she has taken reasonably diligent steps to become informed of a specific matter under the board's attention;
2) He/she had no material personal financial interest in the subject matter of a decision, had no knowledge of a related person having an interest and he/she complied with the requirements of Section 75 in respect of any interest as set out in (1); and
3) He/she made a decision, or acted in support of a decision of a committee of the board, having a rational basis for believing and did believe that the decision was in the best interests of the company, and is entitled to rely on the performance of other persons referred to in Section 76(5) or who have been delegated certain powers by the board as well as any information, recommendations and opinions of these persons.

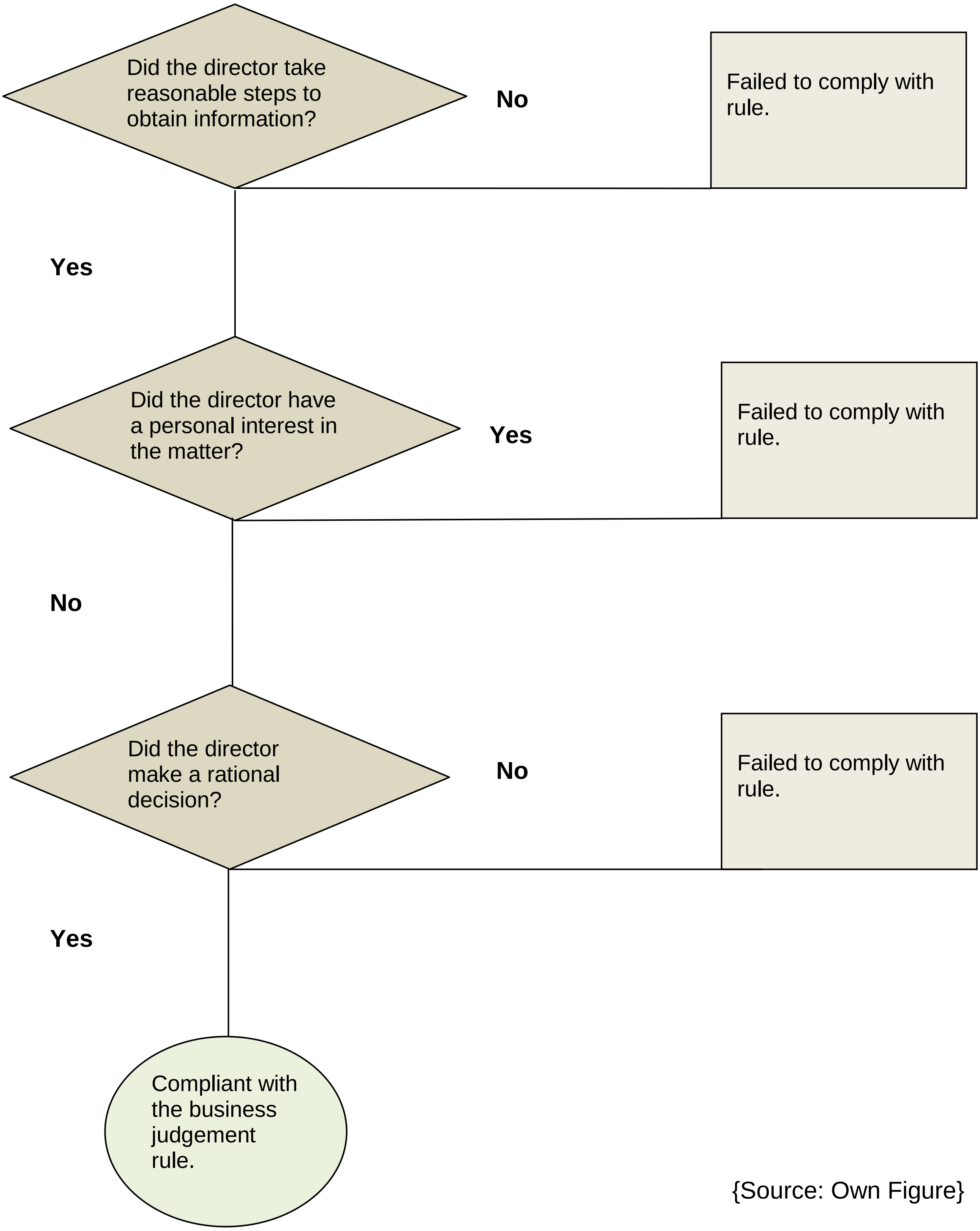
618 KPMG 2008: 187. See also Kennedy-Good & Coetzee 2006: 64.
619 Companies Act 71 of 2008.
620 Cassim et al 2012: 565.
621 Kennedy-Good & Coetzee 2006: 63.
622 Kennedy-Good & Coetzee 2006: 64 and Havenga 2000: 27.
623 Davis et al 2013: 124. See also the test set out in Hippert 1997: 18; Naidoo 2009: 171; Havenga 2000: 27 and Benade et al 2009: 59-60.

The business judgement rule test induces directors to take well-informed, calculated business risks and not having to worry about incurring legal liability.[624] It allows directors a structure for taking calculated business risks; the calculation between reward and potential risk.[625] From the above it is also clear that directors cannot be held liable for mere errors in judgement, but are liable if an act was reckless.[626]

These considerations will be explained in Figure 4.3 below.

[624] Hippert 1997: 20.
[625] Lee 2005: 53.
[626] Botha 2009: 711.

Figure 4.3: Application of business judgement rule



{Source: Own Figure}

4.4.2.2 The duty to disclose

In terms of Section 76,[627] a director must disclose and communicate to the board as soon as possible any information that comes to his or her attention unless he or she is of the opinion that the information is immaterial to the company, generally available to the public, known to the other directors or he or she is not bound to disclose the information on a legal or ethical basis.[628] A director must disclose to the company a business opportunity that comes his way if it will interest the company.[629] This must be done in a formal manner by serving a written notice on the board setting out the nature and extent of the interest.[630] After making such disclosure, the director is required to recuse himself from the meeting immediately and may not be involved in the matter any further.[631]

Section 75[632] discusses the director's duty to disclose his personal financial interest to the board members. The director has the following duties regarding disclosures:

1) He must avoid a conflict of interest;[633]
2) He must disclose any interest in a future contract; and
3) He must disclose all interest he has in an existing contract.

These duties will be briefly discussed below.

4.4.2.2.1 Conflict of personal financial interest

A director in a fiduciary position may not put himself in a situation where his personal financial interests are in conflict with the interests of the company.[634] A director is bound to disclose all interests that he may have in a matter, flowing from the general

[627] Companies Act 71 of 2008.
[628] Section 76(2)(b) of Companies Act 71 of 2008. See also Delport & Vorster 2011: 280 and discussion by Benade et al 2009: 60.
[629] Pretorius 2004: 70.
[630] Section 75(4) of Companies Act 71 of 2008.
[631] Section 75(5)(d) of Companies Act 71 of 2008.
[632] Companies Act 71 of 2008.
[633] See Havenga 1998: 343-345 for a discussion on the avoidance of a conflict of interest.
[634] Havenga 2013: 257.

principle that a director is not entitled to "secret profit" and that his contract will be voidable at the instance of the board.[635] What is meant by "secret profit" is any profit made by a director not specified in the company's constitutive documents or in a separate agreement with the company.[636] The main consideration is whether a profit was made in the occupation of office.[637]

4.4.2.2.2 Interest in future contracts

If a director of a company has a personal financial interest in respect of a matter before the board, or is aware that a related person has an interest in the matter, he or she must disclose this interest to the board in its general nature and must supply all material information relating to the matter at the board meeting, must recuse himself or herself from the meeting after making the disclosure and must not take part in any way in the consideration of the matter.[638]

4.4.2.2.3 Interest in existing contracts

If a director acquires a personal financial interest in an agreement or other matter in which a company has a material interest, or is aware of a related person having an interest after a matter has been approved by the board, the director must promptly disclose the nature and extent of that interest, as well as material circumstances relating to the interest held by the director or his related person.[639] A personal financial interest is a material financial interest.[640]

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[635] Benade et al 2009: 60. See Havenga 1998: 345-350 for a discussion on secret profits.
[636] Havenga 2013: 258.
[637] Havenga 2013: 258.
[638] Benade et al 2009: 61.
[639] Cassim et al 2012: 571. See also discussion by Delport & Vorster 2011: 282 and Benade et al 2009: 61.
[640] Cassim et al 2012: 571.

4.4.3 Negative duties

A director must not use his or her position as director, or any information obtained during his or her office as director, to gain advantage for himself or any person other than the company itself and must refrain from causing any harm to the company.[641] Directors should not misuse or abuse the powers entrusted to them and may not use these powers in an improper or impermissible way.[642]

The functions and responsibilities of corporate directors arise by virtue of the nature of the company.[643] Company management is only as effective as those behind management, meaning that control over management is vital in many aspects.

A director must not appropriate for himself a business opportunity[644] that was meant for the improvement of the company. If this does occur, the company may claim the benefit back from the director.[645]

4.4.4 The duty to protect stakeholder interests

South African law needs to consider the unique South African context, including the best interests of the country as a whole, its citizens, the recent political developments and our unique socio-economic situation as mandated in our Constitution.[646] The stakeholder theory rejects the perception that the company's sole criterion in management decisions should be its fiduciary duties towards shareholders, but emphasises that the legitimate expectations of other stakeholders be considered.[647] This means the company must consider the community within which it operates, its customers, employees, suppliers and the environment.[648]

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641 Benade et al 2009: 62.
642 Du Plessis 2004: 310.
643 Havenga 1996: 40.
644 See discussion in Havenga 2013: 257-261.
645 Cassim 2008: 734.
646 Havenga 2005: 618.
647 Sison 2008: 75.
648 Havenga 2005: 618.

Although the board is accountable to the company, it should take account of the legitimate expectations of all company stakeholders,[649] and not only those of the shareholders. Consideration of the interests of stakeholders is not merely good business practice, but also politically expedient and morally and ethically sound.[650]

“Shareholder” interests traditionally served the highest interest and protection from the company. The function of directors was mainly to create profit for the shareholders.[651]

However, the view of the public has changed and the scope has widened to include various other stakeholders to be afforded protection.[652] These stakeholders include investors, employees, consumers, the general public and the environment.[653] Labour law also compels consideration of these interests of other stakeholders, especially employees. Protection of stakeholder interests is also emphasised in various parts of the King lll Report on good governance. Stakeholders are mainly dealt with in Chapters 1, 2 and 8 of the report.

The main responsibility of the company is to add value, thereby protecting its reputation, and should follow a stakeholder inclusive approach.[654] The stakeholder inclusive approach recognises that companies have many stakeholders having a significant effect on the long-term growth of the company.[655] A very important and precise balance must be struck between the various interests of the stakeholders and advancing the interests of the company.[656] The interests of a shareholder or a stakeholder may even take precedence based on a belief of what serves the company’s interests best.[657]

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[649] Esser 2009: 197. See also Blackman et al 2002: 8-16-1 and Carrol 2009: 198-199.
[650] Esser & Du Plessis 2007: 350.
[651] Esser 2009: 191.
[652] DesJardins 2006: 67.
[653] Esser 2009: 191. See also Esser & Du Plessis 2007: 350; Davis et al 2013: 113; Botha 2009: 705 and Du Plessis et al 2011: 23.
[654] Esser 2009: 197.
[655] Esser 2009: 197.
[656] King Report 2009: 12; Esser 2009: 197. See also discussion in DesJardins 2006: 66 and Sison 2008: 76.
[657] Blackman et al 2002: 8-16-1.

This stakeholder inclusive approach will be the decisive factor in determining corporate viability and the prosperity of the business.[658] This is so mainly because this will earn the respect of the company's stakeholders and ultimately the community as a whole. When employees feel respected, they will most probably excel in their duties knowing that they are recognised as integral role players in the company. Investors may even invest further in a company known for its integrity and honest dealings with its role players.

Cassim et al[659] indicate that the pluralist approach will be for a company that is socially responsible and will consider the impact of its activities on stakeholders. This approach emphasises that non-shareholders, i.e. stakeholders, are important facets of the company, whereas the shareholder is merely one facet of many others.[660] According to this approach, the interests of the shareholders should come second to the interests of stakeholders where it would be in the best interests of the company.[661]

The enlightened shareholder approach requires of directors to maximise the profits for the benefit of the shareholders, allowing for the consideration of stakeholder interests only if it is subordinate to profit maximisation and the interests of the shareholders.[662] According to King lll,[663] the legitimate interests and expectations of stakeholders are merely instrumental. The aim is to balance the interests between all stakeholders to the benefit of the shareholders.[664]

It is clear that the duties prescribed by the Companies Act 71 of 2008 enforce ethical behaviour. This is seen in the fact that directors should rather consider what is good for the company, its shareholders and stakeholders, instead of their own interests. King lll, in Chapter 1, has elaborated on the duties of directors in the notion of ethical leadership and all the principles that it lays down for directors to comply with in order

[658] Esser & Du Plessis 2007: 350; Botha 2009: 705 and Du Plessis et al 2011: 7.
[659] 2012: 517.
[660] Cassim et al 2012: 518.
[661] Cassim et al 2012: 518.
[662] Cassim et al 2012: 519.
[663] 2009: 12.
[664] Cassim et al 2012: 519. See also Gopalan & Hogan 2014: 14.

for their behaviour to be seen as ethical. This is so because, as the "captain of the ship (the company)", they must steer the company and its members in the right direction, setting the tone from the top and moulding the members into ethical beings in the workplace.

In the next paragraph the emphasis on the duty of directors to act in an ethical manner, as portrayed in the King lll Report, will be discussed.

4.5 King lll on the duties of directors

As highlighted earlier, King lll aims to create ethical leadership. All leaders, namely management and directors, must have an ethical foundation. The focus on ethics is not necessarily contained in the Companies Act 2008, but is emphasised in the King lll Report. It reiterates the common law duties of fulfilling a fiduciary duty and exercising due care and diligence, but broadens their duties by emphasising the ethical nature of their duties because of the nature of directors setting the tone from the top.

Principle 2.14[665] states the following:

> "directors of companies are appointed in terms of the constitution of the company and in terms of the Act. Each director of a company has:
>
> > 'A duty to exercise the degree of care, skill and diligence that would be by a reasonably diligent individual who has the general knowledge, skill and experience that may reasonably be expected of an individual carrying out the same functions as are carried out by a director in relation to the company and the general knowledge, skill and experience of the director as well as a fiduciary duty to act in good faith and in a manner that the director reasonably believes to be in the best interests of the company.'"

[665] King Report 2009: 32.

This is in line with the standards of directors' conduct as set out in Section 76 of the Companies Act 2008 discussed above.

The report also imposes the duty on the director to apply his mind, using objective judgement in decision-making.[666] This in turn means that the director should have adequate access to all resources to enable him to make a decision. In order to fulfil their duties properly, directors must have unrestricted access to the company's information.[667] Directors are obliged to be independent at all times, and to act in the best interest of the company is of paramount importance. Personal interests of the director should never take precedence over the interests of the company.[668] This is also in line with Section 76[669] relating to the standards of director conduct, especially the duty of disclosure by the director.

Therefore the notion that ethical behaviour is to consider what is good for others, to be applied by the company in its daily undertakings, is confirmed by King lll. King lll regards integrity and courage as integral traits of a director of the company.[670] This again emphasises the focus on ethical leadership that the King lll Report envisages. It sets out the following criteria to be considered before the appointment of directors:[671]

1) The knowledge and experience required to fill the gap on the board;
2) The apparent integrity of the individual; and
3) The skills and capacity of the individual to discharge his duties on the board.

The board of directors is discussed in detail in the next chapter, where the ethical duties of directors are discussed.

[666] King Report 2009: 32.
[667] King Report 2009: 32.
[668] King Report 2009: 32.
[669] Companies Act 71 of 2008.
[670] King Report 2009: 39. See also Davis et al 2013: 114.
[671] King Report 2009: 41.

4.6 The directors' and the company's duty to promote human rights

There is a need for binding human rights standards which will force the companies to accept certain standards as the lowest common denominator.[672] This means that there is a certain standard to be adhered to in protecting and promoting the human rights of individuals within the organisation.

The reason for the focus on the importance of human rights in business mainly results from apartheid. For some, apartheid represented an opportunity to make profits by the oppression of black South Africans.[673] Bilchitz[674] indicates that the emergence and implementation of ethical principles was a good way to reverse the effects of the apartheid way of doing business. King lll[675] states that the protection of human rights will free people from unfair discrimination in the workplace and will encourage self-development.

The King ll Report indicated the importance of human rights in companies and was flawed in many aspects, one of which is that it set out no remedy for the violation of human rights or environmental infringements.[676]

Directors are now specifically charged with a wider fiduciary duty incorporating the implementation of human rights protection and promotion in the business.[677] The observance of human rights is not a voluntary matter, but a legal obligation imposed by Section 8 of the Constitution of South Africa. Companies, specifically its directors, must consider the following: the potential impact of the company and its own capabilities, which are central to the nature of corporate responsibility towards a particular right.[678]

[672] Bilchitz 2008: 771.
[673] Bilchitz 2008: 771.
[674] 2008: 772.
[675] 2009: 22.
[676] Bilchitz 2008: 773.
[677] Bilchitz 2008: 783.
[678] Bilchitz 2008: 789.

4.7 Miscellaneous duties of directors

A director should bear in mind certain factors or criteria to create optimum value for shareholders. Factors to be considered are:[679]

1) The company's business;
2) The company's product lines;
3) Risk assessment processes;
4) Delegation of board authority to management;
5) Acquisitions, mergers and takeovers;
6) Economic and business issues, both local and global, facing the company;
7) Committee and board evaluations;
8) Internal and external audit functions;
9) Human resource practices;
10) IT dependency and requirements;
11) Internal controls (including financial controls);
12) Long-term scenario and strategy;
13) Specific problems affecting the business at a specific point in time;
14) Environmental and stakeholder issues (sustainability issues);
15) The values, ethics and culture of the company; and
16) Short-term and long-term finance arrangements.

The above list of duties includes many duties that are of an ethical nature, namely the duty to handle sustainability issues, observing the values, ethics and culture of the company and the practice of human resource management, risk assessments and running the company as a business.

4.8 Appointment of directors

In order to promote the effectiveness of the board, one must ensure that such person who is appointed will act in the best interests of the company first before satisfying

[679] KPMG 2012: 86.

his own interest. The appointment of directors is of the utmost importance because one must ensure that one appoints a person with the same spirit and purport that the company envisages in its vision and mission. There are various factors to consider before an appointment to such a position of trust is made. One must make sure one selects the appropriate candidate. The appointment of directors, and considerations to be made, will be discussed in the following paragraphs.

Directors of a company are appointed in terms of the constitution of the Company and in terms of the Companies Act 2008. In terms of Section 66(1),[680] a business and its affairs must be managed under the direction of the directors, as a board, who have the authority to exercise all of the powers and functions of the board unless the Memorandum of Incorporation provides otherwise. The directors of the company are elected by the holders of shares entitled to vote.[681] Section 66(4)(b)[682] indicates that in a private company, 50% of directors must be elected, others can be appointed in a different manner. King lll sets out the following criteria to be considered before the appointment of directors:[683]

1) The knowledge and experience required to fill the gap on the board;
2) The apparent integrity of the individual; and
3) The skills and capacity of the individual to discharge his duties on the board.

Over and above these requirements in terms of King lll, the board should also consider certain disqualifications to act as director as prescribed by the Companies Act 71 of 2008 and the company's Memorandum of Incorporation (MOI). Certain factors start to play a role in the appointment of directors, and will be discussed below.

[680] Companies Act 71 of 2008.
[681] Benade et al 2009: 50.
[682] Companies Act 71 of 2008.
[683] King Report 2009: 41.

4.9 Disqualification to act as a director

A juristic person, unemancipated minor, or a person under similar legal disability or a person who does not meet the qualifications as set out in the MOI, is ineligible to act as a director.[684]

A person is automatically disqualified from acting as a director in the following circumstances set out in Section 69(8)(b) of the Companies Act 2008:[685]

a) A court has declared a person to be delinquent or unfit or has prohibited a person to act as a director of a company;
b) The person is an unrehabilitated insolvent, has been removed from an office of trust on the grounds of misconduct involving dishonesty, has been prohibited in terms of public regulation to be a director, and
c) Has been convicted of an offence and imprisoned without option of a fine, or fined above the prescribed amount for offences of theft, fraud or perjury.

Apart from being disqualified from being a director, one can also be declared delinquent, which affects the capacity to act. Factors leading to delinquency will be discussed in the following paragraph.

4.10 Delinquency

A person may be declared delinquent on the following grounds:[686]

a) If a person acted as director well knowing to be disqualified to act as such;
b) Whilst being under an order of probation acted as director contrary to that order;
c) Whilst grossly abusing the position of trust as a director;

[684] Section 69(7) of Companies Act 71 of 2008. See also discussion in Delport & Vorster 2011: 262-263 and Benade et al 2009: 51.
[685] Davis et al 2013: 130-132. See also Benade et al 2009: 52.
[686] Section 162(5) of Companies Act 71 of 2008. See also discussion in Delport & Vorster 2011: 263-264 and Benade et al 2009: 53.

d) Took personal advantage of information or an opportunity for the company or its subsidiary contrary to Section 76(2)(a);
e) Intentionally or by gross negligence lead to harm for the company or its subsidiaries contrary to Section 76(2)(a);
f) Acted in a manner that amounted to gross negligence, wilful misconduct and breach of trust;
g) Has been repeatedly personally subject to a compliance notice for non-compliance with certain provisions of the Act;
h) Has been convicted personally at least twice for an offence under any legislation, or be subject to an administrative fine; and
i) Within a period of 5 years was a director of one or more companies and was subject to an administrative fine or convicted of an offence.

Although one considers many factors when appointing directors, these individuals are often not what they may seem, and may commit a breach of duty for which they may be held liable. These liabilities are described in the following paragraph.

4.11 Liability of directors

Directors will be liable for damages to the company in the event of a breach of a fiduciary duty, breaches as set out in Section 77(3) of the Companies Act 2008[687] and as a consequence of the director acting in any of the following ways:

1) Acting without the necessary authority;[688]
2) Acquiescing to the company carrying on business recklessly;[689]
3) Being present or involved in a decision to vote against certain decisions contravening the Companies Act;[690]
4) Being part of an action or omission aimed to defraud;[691] and
5) Signing or authorising publication of misleading financial statements.[692]

[687] See also discussion in Delport & Vorster 2011: 301-305.
[688] Naidoo 2009: 177 and Davis et al 2013: 125-127.
[689] Naidoo 2009: 177 and Davis et al 2013: 125-127.
[690] Naidoo 2009: 177 and Davis et al 2013: 125-127.
[691] Naidoo 2009: 177 and Davis et al 2013: 125-127.

4.12 Concluding remarks

The purpose of this chapter was to answer the research question of what the ethical duties of directors are.

In this chapter the role and functions of directors were discussed. The necessary qualities that a director should possess were referred to, and it cannot be overemphasised that the most important characteristic is good faith. Good faith implies that the director should at all times put the needs of the company first, over and above his own, and must preserve and nurture the company's assets. The notion of ethical behaviour is again honoured in that directors should consider what is good for others.

The duties of a director are firstly to act in good faith and, secondly, to act with the necessary skill, diligence and care. The duty of good faith coincides with the fact that the director has a position of trust or fiduciary duty towards the company, and must act with the utmost fidelity towards the company. In furtherance to the all-encompassing fiduciary duty, the duty to act only under available powers and for proper and legitimate purpose, the duty to act in the interests of the company and the duty to avoid a conflict of interest, are further duties with which a director must comply. All these duties have one thing in common: ethical behaviour. All duties of directors have an ethical element, which is why a clear understanding of the duties of directors is so pivotal to the study of ethics.

The duty to act with due care and skill requires a director to apply his mind. The standard of the conduct, as required by Section 76 of the Companies Act, can be measured by the reasonable man test; what a reasonable person would do in the same situation and with the same circumstances and qualifications. It was emphasised that a director need not possess special business skills, with which the researcher disagreed. One cannot afford to have a layman in the top management of a company.

[692] Davis et al 2013: 125-127.

The researcher emphasised the role of the business judgement rule in affording protection to directors when making decisions affecting the company, to prevent liability on their part. The director must ensure that he had not received any personal benefit from a decision made in order to be protected. This conforms with the notion of ethics in considering what is good for others, and not what is good for oneself.

A director must also act ethically in that he may not abuse his position of trust towards the company and its stakeholders. This will cause irreparable damage to the ethical culture of the workplace, and would cause employees to no longer consider the importance of ethics within the workplace. Ethics is also seen in the notion of the stakeholder inclusive approach as set out in King lll. The director is forced to consider not merely what is good for the company, but also its stakeholders. The director puts himself at the bottom of the chain. King lll also emphasises the duty of directors to be ethical leaders, placing an immense duty on directors to act within a certain scope of conduct deemed ethical.

The directors also have a duty to reverse the negative effects of the old South Africa by promoting human rights within the organisation, also an ethical duty.

The research question as to what the ethical duties of directors are, has been answered in the following way:

1) Directors have a duty to look out for what is good for others by avoiding a conflict of interest, and disclosing their personal financial interests to the board;
2) They need to act in good faith, for proper purpose and in the best interests of the company; and
3) They need to act reasonably and diligently at all times.

In the following chapter the ethical duties of board committees will be discussed.

Chapter Five
The Ethical Duties of Board Committees

"The board should delegate certain functions to well-structured committees but without abdicating its own responsibilities."[693]

5.1 Background

The purpose of this chapter is to answer the research question in paragraph 1.5, which reads as follows:

Which mechanisms did the Companies Act of 2008 and King lll Report put in place to assist in the management of corporate governance and ethics management?

This question will be addressed in this chapter.

Principle 2.23 of King lll states that the board should delegate certain functions to well-structured committees but without abdicating its own responsibilities.[694] Section 72(3)[695] clearly states that the board will remain responsible, despite having delegated its powers to its subcommittees.[696] It envisages the establishment of various committees in the fulfilment of corporate governance, namely the board of directors, audit committees, social and ethics committees and the remuneration committees (in terms of King lll). These are sometimes referred to as the board committees of a company.

The role of board committees is described as follows: it is an aid to assist the board and its directors in discharging their duties and responsibilities.[697] Board committees

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[693] Section 72(3) of Companies Act 71 of 2008 and King Report 2009: 28. See also Davis et al 2013: 142 on the distinction between delegation and abdication of duties.
[694] King Report 2009: 28. See also discussion in Delport & Vorster 2011: 275.
[695] Companies Act 71 of 2008.
[696] See also discussion in Delport & Vorster 2011: 275.
[697] Coetzee 2008: 20.

have the full authority to execute the functions conferred upon them.[698] However, directors cannot use this as a shield and still play the oversight role. They must be aware of the activities of these committees at all times.[699] It is in turn also the committee's duty to keep the board informed of its activities.[700] There is therefore a reciprocal responsibility for the maintenance of ethics, and day-to-day management of the business.

Board committees allow a smaller group to deal with certain issues. It acts as a "filter" in discussing and summarising complex issues, and may provide an independent form of checks and balances in areas where some board members may be faced with an ethical difficulty, such as a conflict of interest.[701]

Board committees add to the value of corporate governance in that they reinforce the role played by non-executive directors and in the monitoring of company activities. and allow for the growth and development of non-executive directors within the business.[702]

In order for the board committees to function optimally, all members should be briefed properly on what is expected of them when acting on the committee, as well as the aims and goals of the committees, and of course they must have some skill, knowledge and expertise to perform the mandate of the committee.

The Companies Act 2008 in Section 72 makes provision that a company may incorporate board committees. Certain committees are required in terms of the Companies Act 71 of 2008, and in the discussion below the exclusions and inclusions of companies required to have committees are discussed. This dissertation is aimed at companies who are required to have these board committees.

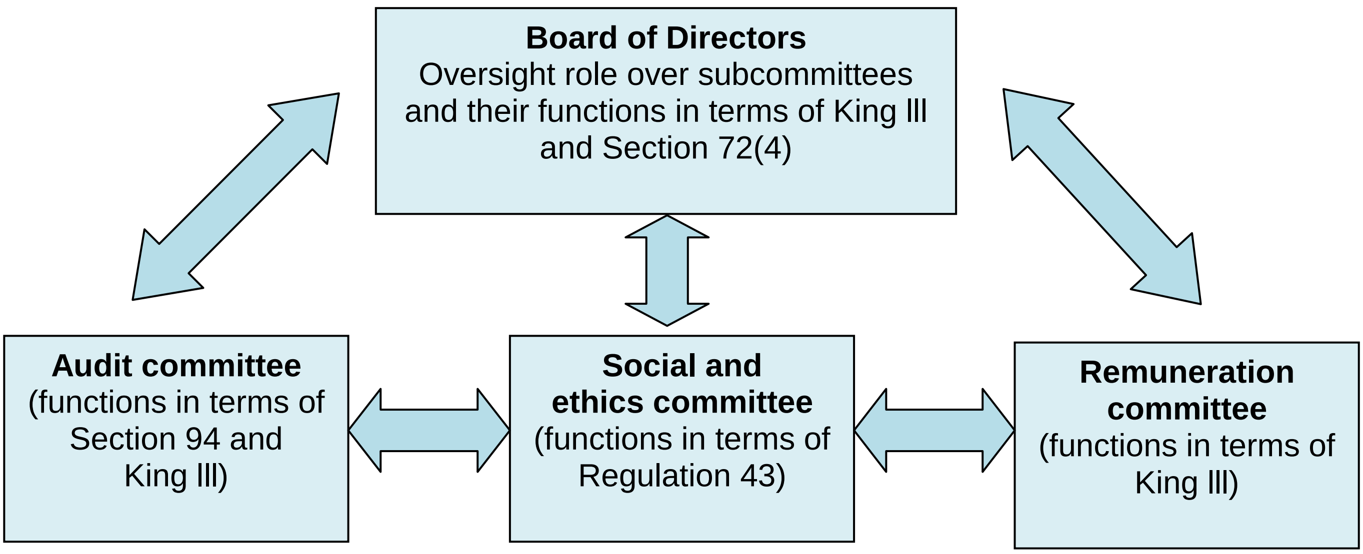
698 Coetzee 2008: 20.
699 KPMG 2012: 88.
700 KPMG 2012: 88.
701 KPMG 2012: 88.
702 KPMG 2012: 88.

In view of the above, certain companies may have board committees in terms of Section 72,[703] being the following:

1) The board of directors (in terms of Section 72 of Act 71 of 2008);
2) Audit committee (in terms of Section 94 of Act 71 of 2008);
3) Social and ethics committee (in terms of Regulation 43 of Act 71 of 2008); and the
4) Remuneration committee (in terms of King lll).

The relationship between the committees is explained in Figure 5.1 below.

Figure 5.1: Relationship between the board committees, indicating the oversight role of the board



{Source: Own Figure}

The following table sets out a summary of the composition of the committees.[704]

[703] Companies Act 71 of 2008.
[704] KPMG 2012: 89.

Table 5.1: Composition of the various committees

	Audit Committee	**Remuneration Committee**	**Social and Ethics Committee**
Composition of committee	Minimum three independent non-executive directors	Majority of independent, non-executive directors	At least three directors/prescribed officers of which one must be non-executive

{Source: 2012 KPMG: 89 (adapted)}

First to be discussed is the "mother" of all the committees and is charged with the oversight role of all matters within the company, namely the board of directors. Thereafter the researcher will discuss the audit committee, the social and ethics committee and the remuneration committee.

5.2 Board of directors

The board may delegate certain functions, but the ultimate responsibility and accountability for management in the business and its affairs lies with the board of directors.[705] It is a primary tenet of corporate governance that directors should manage the affairs of the company with the help of certain subcommittees to assist them in fulfilling their duties.[706]

Companies should be headed by a board that should direct, govern and be in effective control of the company.[707] The primary duty of the board is to create value, trust and confidence within the company and its stakeholders.[708]

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[705] Section 66 of Companies Act 71 of 2008. See also Shaner 2010: 15.
[706] Section 72(1) of Companies Act 71 of 2008. See also Shaner 2010: 15.
[707] King Report 2009: 21.
[708] King Report 2009: 21.

The board should ensure that all deliberations and decisions or actions should be based on the four ethical values underpinning good governance and ensure that each director should adhere to his or her duties as a director.[709] These values are:[710]

1) Responsibility;
2) Accountability;
3) Fairness; and
4) Transparency.

5.2.1 Functions of the board

The board is the head of the company responsible for steering it in the right direction. It has the responsibility of directing the company in the drafting of policies, strategies and standards.[711] It controls the company by laying down a code of ethics, overseeing communications and disclosures, reporting on and monitoring risks.[712] It is also accountable to shareholders for creating, protecting and enhancing wealth and the resources of the company, reporting to the stakeholders on a regular basis, and ensuring that the company is seen as a responsible corporate citizen.[713]

The above illustrates the duty of the board to run the company in an ethical manner, ensuring that all stakeholders are adequately protected and involved in the processes.

5.2.2 Oversight of the responsibilities of the board

The board of directors has the main responsibilities within the company, and obviously the responsibilities are vast and complex. What follows in the next paragraphs is a brief outline of the responsibilities of the board.

[709] King Report 2009: 20.
[710] King Report 2009: 9.
[711] Naidoo 2009: 129.
[712] Naidoo 2009: 129.
[713] King Report 2009: 54-55. See also Naidoo 2009: 130.

The board has the responsibility for the strategic direction of the company and for the control of the company; set the values to which the company will adhere to as formulated in its code of conduct; ensure that its conduct and that of its management aligns to the values and is adhered to in all aspects of business and the promotion of the stakeholder inclusive approach to governance.[714] Therefore the values that should be adhered to for ethical behaviour are also enforced and structured by way of a charter. The board must have a charter setting out its responsibilities.[715]

The board should collectively manage the relationships within the company as well as the enforcement and compliance with corporate governance.[716] The board should act as the focal point and custodian of corporate governance.[717]

It must monitor the relationship between management and the stakeholders of the company (it is the link between management and the stakeholders) and ensure that the company survives and thrives.[718]

The King lll Report requires a director of a company to take responsibility for risk.[719] The Turnbull Report in the United Kingdom requests directors not only to identify risks, but in addition to identify mechanisms to manage such risks.[720]

The board plays a very important role when it comes to Corporate Social Responsibility, in that it is charged with the task of ensuring that the company is seen as a responsible corporate citizen that does not undermine the sustainability of its social and natural environments, but rather protects and enhances them.[721] This task is to ensure the fulfilment of the core notion of ethics to consider not only what is good for oneself, but also what is good for others. The board must not only consider the financial performance of a company but also its impact on the natural surroundings and society, it must protect, enhance and invest in the wellbeing of the

[714] King Report 2009: 20.
[715] King Report 2009: 21.
[716] King Report 2009: 21.
[717] King Report 2009: 21.
[718] King Report 2009: 22.
[719] King Report 2009: 73. See also Kretzschmar et al 2012: 186.
[720] Kretzschmar et al 2012: 186.
[721] King Report 2009: 21.

economy, society and the environment; and ensure that the company's performance and interaction with its stakeholders is guided by the Constitution and its Bill of Rights.[722]

The board has the main responsibility for maintaining ethics because it sets the "tone from the top". This was discussed in both Chapters Three and Four. It has a responsibility to ensure the building and sustainability of an ethical corporate culture in the company; determining the ethical standards which should be articulated clearly and ensuring that the company takes measures to achieve adherence to these standards in all aspects of the business; that adherence is measured; internal and external ethics performance is aligned around the same ethical standards; ethical risks and opportunities are incorporated in the risk management process; a code of conduct and ethics-related policies are implemented; compliance with the code of conduct is integrated in the operations of the company; and the company's ethics performance should be assessed, monitored, reported and disclosed.[723] They must ensure that integrity permeates all aspects of the company,[724] filtering through to even the lowest level of employees.

The board should also be responsible for information technology governance, the assurance that the company complies with the applicable, and considers adherence to, non-binding rules, codes and standards; the assurance of an effective risk-based internal audit; the assurance of the knowledge of the stakeholders' perceptions of the reputation of the company; the assurance of the integrity of the company's integrated report; and the reporting of the effectiveness of internal control systems of the company.[725]

The board of directors can be likened to a mother looking after a baby; it must constantly act in the best interest of the company and the society as a whole, being part of the notion of ethics and ethical behaviour.

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[722] King Report 2009: 20.
[723] Regulation 43(5)(c) of Companies Act 71 of 2008. See also King Report 2009: 21.
[724] King Report 2009: 22.
[725] King Report 2009: 23.

The board should at all times act in the best interests of the company in that directors must adhere to legal standards of conduct, the directors should take independent advice in connection with their duties, real and perceived conflicts must be disclosed to the board at meetings and it must be managed effectively.[726]

The board has a duty to consider the implementation of business rescue proceedings, when deemed necessary.[727]

The board has the following responsibilities:[728]

1) It must be entrepreneurial, steer the business in the right direction and drive it forward, whilst keeping a vigilant eye over the activities and controlling them;
2) Members must have sufficient knowledge of the operations of the business, and always remain independent; and
3) Members must remain focused on the growth of the business whilst considering their responsibility towards their employees, business partners and society.

The above responsibilities are in harmony with ethical behaviour in that the other stakeholders, namely the employees, business partners and society, are involved in the decision-making of the board. The board then considers not only what is good for the company but also “others” involved in the company.

5.2.3 Composition of the board

The board must comprise a balance of power, with the majority of non-executive directors who are independent.[729] Persons appointed to the board must have the necessary knowledge, skills and resources for conducting the business.[730]

[726] Section 76(2)(b) of Companies Act 71 of 2008. See also King Report 2009: 23.
[727] Section 129(1) of Companies Act 71 of 2008. See also King Report 2009: 24.
[728] Naidoo 2009: 107.
[729] King Report 2009: 25.
[730] King Report 2009: 25.

Every board should have a minimum of two executive directors, one to be the CEO to have the portfolio of finance.[731]

The composition of the board must allow for different talents and expertise amongst its members to ensure that, as a team, it will have sufficient knowledge and expertise to apply in the running of its business. It is suggested that board members should have the following talents:[732]

1) Innovation: at least one member must have the talent of being innovative;
2) Analysis: at least one member must have an analytical mind;
3) Organisation: at least one member must be organized to ensure long-term success;
4) Execution: at least one member must have the talent of running and managing a business in meeting objectives and forcing performance; and
5) Human relations: At least one member must have background knowledge on human relations, a very important subject.

With the right members on the board, the company will prosper and be competitive.

5.2.4 Characteristics of a well-functioning board of directors

In order to have a competitive and knowledgeable board, it must have certain characteristics. These characteristics include:[733]

1) Non-executive directors as members of the board to ensure independent views and independence in general;
2) Evaluation of the skills and knowledge of members must be renewed on a regular basis to ensure that the board can handle any situation facing it;
3) Independent directors must chair and control meetings;

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[731] King Report 2009: 26.
[732] Naidoo 2009: 125.
[733] Naidoo 2009: 125.

4) The separation of the role of the chairperson and CEO is of integral importance;
5) Stakeholders must have open communication to the board;
6) The CEO must meet its performance targets to maintain a competitive edge;
7) Succession planning must be in place and formalized at all levels of management; and
8) The independence of directors must be assessed on a regular basis.

If the above characteristics are present, the board should be able to handle every situation facing it, and be able to manage and control the business effectively for the benefit of itself, its stakeholders and the community. This is ethical behaviour.

5.3 The audit committee

The board of directors has the responsibility to ensure that a company has an effective and independent functioning audit committee.[734] Section 94 of the Companies Act 71 of 2008 provides for the establishment of the audit committee and sets out the role and function of the committee.

The incidence of business collapses and fraud worldwide has resulted in a renewed emphasis on the audit committees, especially the transparency factor,[735] being part of the notion of corporate governance. Audit committees will reach their goal only if they function properly and the role of the committees is respected, understood and observed by all parties involved. It is a subcommittee of the board of directors consisting of a majority of independent non-executive directors tasked with an oversight role to assist directors in meeting their financial reporting, risk management and control and audit-related responsibilities.[736] It fosters an ethical culture in doing business by ensuring financial integrity.[737]

[734] King Report 2009: 22.
[735] Assadourian 2006: 590.
[736] Marx 2008: 1. See also Naidoo 2009: 143.
[737] Marx 2008: 2.

5.3.1 Definition and descriptions of the audit committee

The audit committee could be described as "a committee of directors of a corporation whose specific responsibility is to review the annual financial statements before submission to the board of directors. The committee generally acts as liaison between the auditor and the board of directors and its activities may include the review of nomination of the auditors, overall scope of the audit, results of the audit, internal financial controls and financial information for publication."[738] Alternatively, an effective audit committee is defined as "qualified members with authority and resources to protect stakeholder interests by ensuring reliable financial reporting, internal controls and risk management through its diligent oversight efforts".[739]

The audit committee, as seen from the above definition, plays an integral role in the management of the company, especially its oversight role in ensuring reliable financial reporting and the protection of stakeholder interests and combatting of fraud.[740]

What does this have to do with good for others? The audit committee ensures good communication of financial information to others, considering the needs of the stakeholders and what information will be relevant to them. They also ensure the integrity and transparency of financial records and statements presented to the board, preventing any misrepresentation or unethical acts that may occur.

5.3.2 Composition of the committee

The composition of the committee is contained in Section 94(4) of the Companies Act 2008, stating that a member must be a director of the company who satisfies any applicable requirements in subsection (5)[741] and not be involved in the day-to-day management of the company, must not be a prescribed officer or full-time employee

[738] Marx 2008: 40.
[739] Marx 2008: 41.
[740] Blackman et al 2011: 8-16-7.
[741] Section 94(4)(a).

of the company and must not be a material supplier or customer of the company.[742] The member should not be related to any person in subsections (a) and (b).[743]

Section 94(5)[744] states that the Minister may prescribe minimum qualification requirements for members of an audit committee as necessary to ensure that the committee comprises members with the necessary skills and expertise, knowledge and experience to ensure an effectively functioning committee.

In summary, the members should be independent, non-executive directors with the necessary knowledge and expertise.

5.3.3 Entities required to have an audit committee

Section 94 of the Companies Act 2008 determines that the following entities are obliged to have an established and functioning audit committee:[745]

1) Public companies;
2) State-owned companies, unless they are granted exemption by the Minister; and
3) Any company who voluntarily decides to have an audit committee in terms of its Memorandum of Incorporation.

5.3.4 Skills and knowledge required of members of the audit committee

Regulation 42 of the Companies Act 71 of 2008 requires members of the committee to have knowledge and experience of: [746]

[742] Section 94(4)(b)
[743] Section 94(4)(c).
[744] Companies Act 71 of 2008.
[745] KPMG 2012: 90.
[746] See also discussion in KPMG 2012: 91.

1) Economics;
2) Law;
3) Corporate governance;
4) Finance;
5) Accounting;
6) Commerce;
7) Industry;
8) Public affairs; and
9) Human resource management.

The members of the audit committee must therefore be skilled and have extensive knowledge of the above fields to be able to fulfil their duties effectively. The researcher suggests that they must also be persons of strong ethical character and integrity to ensure the truthfulness and ethicality of their duties.

5.3.5 Role and function of the audit committee

One of the main reasons for the formation of audit committees is to delegate authorities away from the board of directors.

Section 94(7) of the Companies Act 2008 sets out the following functions of the audit committee:[747]

1) Nomination and appointment of an auditor;[748]
2) Determining the fees paid to the auditor;[749]
3) Ensuring the appointment of an auditor complies with the provisions of the Act and other legislation relating to the appointment of auditors;[750]
4) Determining the nature and extent of non-audit services to be provided to the company or related company;[751]

[747] See also discussion of Section 94(7) in Delport & Vorster 2011: 359-360.
[748] Section 94(7(a).
[749] Section 94(7)(b).
[750] Section 94(7)(c).
[751] Section 94(7)(d).

5) Pre-approving any proposed agreement with the auditor for the provision of non-audit services to the company;[752]
6) Preparing a report to be included in the report at the end of the financial year, setting out how the committee has performed its functions, stating that the auditor was independent at all times of rendering the services and commenting in an appropriate manner on the financial documents of a company;[753]
7) Receiving and dealing with complaints and concerns relating to accounting practices, internal audit of the company, the content of financial statements, internal financial controls within the company or any other related matter;[754]
8) Making submissions to the board on any matter concerning the company's accounting policies, financial control, records and reporting;[755] and
9) Performing any other oversight functions as determined by the board.[756]

Certain duties are also delegated to the committee by the board of directors, in terms of Section 94(7),[757] namely:[758]

1) Financial statements;
2) Integrated reporting;
3) Combined assurance;
4) Risk oversight;
5) Internal audit;
6) Compliance with laws and regulations;
7) Finance functions;
8) Interactions with external auditors;
9) Independence;
10) Miscellaneous duties; and
11) Reporting.

[752] Section 94(7)(e).
[753] Section 94(7)(f).
[754] Section 94(7)(g).
[755] Section 94(7)(h).
[756] Section 94(7)(i).
[757] Companies Act 71 of 2008.
[758] Blackman et al 2011: 8-16-18. See also discussion of audit committee duties by Davis et al: 285-286 and. KPMG 2012: 92-94.

These delegated duties will be discussed very briefly in the following paragraphs.

1) Financial statements

The committee will be responsible for reviewing all financial statements and reports prior to the approval of the board.[759]

2) Integrated reporting

The committee shall oversee all forms of integrated reporting, be it financial information, sustainability, interim results or summarised information.[760]

3) Combined assurance

The committee must ensure that the combined assurance received by the company is sufficient for the specific company and it must monitor the relationship between the external assurance providers of the company.[761]

4) Risk oversight

The committee shall oversee:[762]

a) Financial reporting risks;
b) Internal financial controls;
c) Fraud risks related to financial reporting; and
d) The risks related to financial reporting.

[759] KPMG 2012: 92.
[760] KPMG 2012: 93.
[761] KPMG 2012: 93.
[762] KPMG 2012: 93.

5) Internal audit

The committee shall:[763]

a) Ensure the independence of internal audit, and that it has the necessary resources, budget, standing and authority to discharge its functions;
b) Be responsible for the appointment, performance and assessment of the chief audit executive;
c) Approve the internal audit plan, and oversee staffing and objectives;
d) Encourage cooperation between internal and external audit;
e) Ensure the function is subjected to an independent quality review; and
f) Ensure compliance with laws and regulations.

6) Compliance with laws and regulations

Legal and regulatory requirements must be considered by the committee in so far as they may have an impact on the financial statements.[764]

7) Finance functions

The committee must review the expertise, resources, and experience of the company's finance function and disclose the results in the integrated report.[765]

8) Interaction with external auditors

The audit committee plays a key role in overseeing the external audit function; as such this interaction is critical.[766]

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763 KPMG 2012: 93.
764 KPMG 2012: 93.
765 KPMG 2012: 93.
766 KPMG 2012: 93.

9) Independence

The committee must assess the independence of the external auditor and should determine whether the auditor received any direct or indirect remuneration from the company except in its capacity as auditor and for the rendering of professional services.[767] It must consider whether the auditor's independence may have been compromised and consider any further matters relating to the IRBA (Independent Regulatory Board for Auditors).[768]

10) Miscellaneous duties

The committee should also:[769]

a) Ensure that the audit engagement partner is rotated every five years;
b) Ensure that it is aware of reportable regularities; and
c) Review the quality and effectiveness of the external audit process, and evaluate the performance of the auditor.

11) Reporting

The committee must, in terms of Section 61(8)(a)(iii),[770] report on all significant matters arising from its meetings, and attend the annual general meeting to answer questions.

Marx[771] is of the view that it adds to the effectiveness of corporate governance by reinforcing the role played by non-executive directors and also monitoring company activities. It plays an important role to ensure the interests of stakeholders are properly protected with regard to financial reporting and internal control of the business.[772] It assists the board in discharging its fiduciary duties.[773] These roles are

[767] KPMG 2012: 94.
[768] KPMG 2012: 94.
[769] KPMG 2012: 94.
[770] Companies Act 71 of 2008.
[771] 2008: 50.
[772] Marx 2008: 51.

very closely linked to the features of ethical behaviour as they are focused on protecting the interests of the stakeholders and reinforcing the fiduciary duties of the board.

The audit committee is tasked with the review of internal control structures including financial control, accounting systems and reporting, review of a company's internal audit functions, liaison with appointed external auditors, monitoring the compliance of the company with legal requirements and obligations imposed on the company by law and monitoring the compliance with the entity's code of conduct.[774] It is increasingly charged with the responsibility of monitoring ethics compliance and whistle-blowing.[775]

It must be emphasised that the appointment of the committee does not in any way relieve the board of directors from any duty it has also falling within the ambit of the duties of the committee.[776] It is not a shield or cover for directors when abdicating their own duties.

5.3.6 Characteristics of a well-functioning audit committee

Firstly, it is important to note that the value of the audit committee is directly related to the calibre of its members, its status in the eyes of the board and senior management and its charter.[777]

Characteristics include, but are not limited to, the following:[778]

1) Independence;
2) Being accountable to the board;
3) Having the appropriate and necessary qualities and skills;

[773] Marx 2008: 52.
[774] Marx 2008: 55.
[775] Marx 2008: 57.
[776] Section 94(7)(10) of the Companies Act 71 of 2008.
[777] Marx 2008: 53.
[778] Marx 2008: 54.

4) Being of sufficient size, having appropriate terms of office;
5) Having an effective charter/mandate;
6) Having a resourceful and competent chairperson;
7) Being properly resourced;
8) Being fully informed;
9) Working effectively with internal audit;
10) Monitoring risk management;
11) Actively engaging in monitoring and evaluating the audit process;
12) Having access to appropriate legal resources;
13) Ensuring full participation of all parties;
14) Working to a properly structured agenda;
15) Keeping proper minutes of all its meetings; and
16) Ensuring proper disclosure in the annual report.

In the following paragraph the benefits of a well-functioning committee will be discussed.

5.3.7 Benefits associated with a well-functioning audit committee

An audit committee which functions optimally brings about numerous benefits and advantages to everyone involved in the sphere of the company. Some of these benefits include:[779]

1) Improving communication between the board of directors, auditors and management;
2) Improving the quality of accounting and internal control functions, helping directors to fulfil their legal responsibilities;
3) Strengthening the objectivity and credibility of financial reporting;
4) Strengthening the independence of the external audit function;
5) Strengthening the independence of the internal audit function;

[779] Marx 2008: 51.

6) Creating a climate of discipline and control which will reduce the opportunity for fraud; and
7) Creating the forum where a director and the external and internal auditor can raise matters of concern and have them debated.

The well-functioning audit committee will reinforce stakeholders' belief in the integrity of the company, which will ultimately lead to increased productivity. Employees will trust and have respect for management again. This will also lead to the respect of the community if the company continues to prosper and does things the right way. Respect from the community is also gained by a well-functioning social and ethics committee, discussed in the following paragraphs.

5.4 The social and ethics committee

In terms of Section 72(4) of the Companies Act 71 of 2008 it is now a legal requirement for certain companies to have a social and ethics committee. Many companies do not comply with this requirement. Regulation 43[780] was promulgated to give an exposition of the duties and functions of the committee. These duties, however, lean more towards the social functions than the ethical functions, therefore the need to establish which ethical duties should be assigned to this committee, or whether an independent ethics committee should be established separate from the social and ethics committee.

The dawn of democracy in South Africa was accompanied by a growing awareness of corporate social and ethics responsibility, commonly known as Corporate Social Responsibility.[781] A company should be seen as a responsible corporate citizen. Paragraph 1.2 of the King lll report states the following: "The board should ensure that the company is and is seen to be a responsible corporate citizen".[782] This is where the essence of the social and ethics committee lies. King lll advances the view

[780] Companies Act 71 of 2008.
[781] Rossouw 2012: 3.
[782] King Report 2009: 20.

that a company must be a responsible member of the society in which it operates.[783] It goes further to say “as a responsible corporate citizen the company should protect, enhance and invest in the wellbeing of the economy, society and natural environment. Responsible corporate citizenship implies an ethical relationship of responsibility between the company and the society in which it operates.”[784]

Corporate Social Responsibility essentially has four elements to be considered, namely:[785]

1) The company must consider and be accountable for its impact on the marketplace in which it operates;
2) It must consider its social impact on the workplace;
3) It must consider the impact on the communities in which it operates; and
4) It must consider how its activities have an impact on the natural environment.

The committee helps to embed and integrate Corporate Social Responsibility into the company’s business ethos and practices.[786]

The King lll Report indicates a few practical implications while it delivers practical guidance for sustainability of social ethical behaviour. They are the following:[787]

1) The company should consider its impact on society and the environment;
2) The company should protect, enhance and invest in the wellbeing of the economy, society and the environment;
3) The company should be guided by the South African Constitution and the Bill of Rights;
4) The company should collaborate with internal stakeholders to promote ethics and corporate citizenship; and

783 Rossouw 2012: 4.
784 King Report 2009: 22.
785 Rossouw 2012: 4.
786 Kloppers 2013: 170.
787 Rossouw 2012: 5.

5) The company should develop measurable corporate citizenship policies and implement them.

Notwithstanding the responsibility of a company to act in a corporate responsible way, Principle 1.3[788] of the King lll Report also emphasises the duty of the committee to ensure that a company trades in an ethical manner. Ethics management involves the process of assessing ethics risks and opportunities, developing or revising the codes of ethics and policies of a company, integration of ethics standards and reporting and disclosure of maintenance of ethics in the workplace.[789] This process has been fully discussed in Chapter Three and need not be repeated here.

5.4.1 Entities required to have a social and ethics committee

The factors to be considered as material for determining the company's impact on society are the company's annual turnover, the size of its workforce and the nature and extent of its operating activities.[790]

The Companies Act 71 of 2008 specifically sets out which companies need to comply with the requirement of having a social and ethics committee in Regulation 43(1), which states that all state-owned companies and public listed companies as well as companies with a public interest score[791] above 500 points are required and obliged to have a fully functioning social and ethics committee.

Certain companies are also exempt from having a social and ethics committee. The instances are where other legislation prescribes the same type of committee as the social and ethics committee in terms of the Companies Act 2008 and if the nature of

[788] King Report 2009: 22.
[789] Rossouw 2012: 5.
[790] Regulation 43 of Act 71 of 2008. See also discussion in Rossouw 2012: 8 and Davis et al 2013: 143.
[791] Rossouw 2012: 9: Factors to consider when calculating the public intersect score include the number of employees in the company, the amount of debt at the close of the financial year and annual turnover of the company and the number of shareholders of the company at the close of its financial year.

the company's activities are such that it does not have a significant impact on public interest.[792]

It is therefore clear that the Companies Act 2008 looks after the interest of the stakeholders, by ensuring that certain companies have this committee to address their needs.

5.4.2 Composition of the committee

Regulation 43(4) of the Companies Act 2008 prescribes the membership or composition of the committee. The committee must consist of at least three board members.[793] At least one of these directors should not be involved in the day-to-day management of the company, and should not have been involved in the management of the company in the preceding three financial years.

The regulation only refers to these three members but leaves scope for the board to appoint any further members as it deems necessary to meet the objectives of the committee.[794]

5.4.3 The role and function of the social and ethics committee

The mandate of the committee, in terms of Regulation 43(5)(a),[795] are:

1) To monitor the company's activities with regard to the following five areas of Corporate Social Responsibility:
    a) Social and economic development;
    b) Good corporate citizenship;
    c) The environment, health and public safety;
    d) Consumer relationships;

[792] Rossouw 2012: 9.
[793] Including either directors or prescribed officers.
[794] Rossouw 2012: 9.
[795] Companies Act 71 of 2008.

e) Labour and employment;

2) To draw matters within its mandate to the attention of the board as it is required to do; and
3) To report to the shareholders at the company's annual general on the matters within its mandate.

The above duties are not exhaustive and merely focus on social aspects of the committee, except for the role of good corporate citizenship which includes the promotion of equality, prevention of unfair discrimination and the reduction of corruption, contributing to the development of the communities in which its activities are predominantly conducted or services marketed, and keeping record of sponsorships, donations and charitable giving.[796]

Despite the committee having been named the social and ethics committee, it seems that the legislature has placed the main emphasis on the social aspects of the business in only highlighting good corporate citizenship as an ethical duty of the committee; however, allowing for the expansion of the mandate by using the word "including". This means the committee will have a discretion as to what its mandate should consist of. The researcher emphasises that the ethical duties mandate of the committee should rather be expanded in the Regulations itself instead of leaving it up to the committee to decide which ethical matters it will work with.

In the researcher's view the committee should also be charged with assisting the board in drafting the code of conduct of the company, assisting the board in the maintenance and implementation of such a code of conduct, handling grievances from the employees on ethical conduct, giving advice to employees and management on how to deal with an ethical dilemma. The mandate can definitely be expanded to include more ethical duties when one looks at Chapter Three, and all the different stages in the implementation of ethics. The committee is charged with the reporting function, so it should definitely be charged with all other duties regarding ethics before it can actively and effectively report on the ethical behaviour in the company.

[796] Regulation 43(5)(a)(ii).

Kloppers[797] suggests that the committee must establish policies and standards based on nationally and internationally recognised documents addressing Corporate Social Responsibility, reviewing Corporate Social Responsibility issues which will have an impact on the company, monitoring and reporting to the full range of stakeholders on the compliance or non-compliance with the established standards, policies, rules and regulations and overseeing the company's Corporate Social Responsibility initiatives.

5.4.5 Reporting responsibilities of the social and ethics committee

There has been a significant increase in the level of corporate responsibility reporting in most countries in the recent years.[798] In short, the committee has monitoring and reporting responsibilities in terms of the regulations of the Companies Act 71 of 2008.[799] The monitoring responsibilities include:[800]

1) Its duty to monitor the company's activities;
2) Keeping in mind the social impact associated therewith in six areas; namely:
    a) Social and economic development;
    b) Good corporate citizenship;
    c) The environment;
    d) Health and safety;
    e) Consumer relationships; as well as
    f) Labour and employment.

It goes without saying that the members should have adequate knowledge and skills of relevant legislation and policies to fulfil their duties properly.

The committee's reporting responsibility is two-fold. Firstly, Regulation 43(5)(b)[801] imposes a duty on the committee to draw matters within its mandate to the attention

[797] 2013: 188.
[798] Nehme & Wee 2008: 157.
[799] Regulation 43(5)(b) &(c)
[800] Rossouw 2012: 10.
[801] Companies Act 71 of 2008.

of the company's board as and when the committee deems necessary for the board to consider such matters and give feedback to the committee on how to handle such matters.[802] The Act does gives a guideline on what matters should be reported on[803] as contained in the mandate above. The committee must report on all social and ethical matters that pose a material risk to the company, this is why the functions of this committee must be expanded in the Act itself to include more ethical duties since it is the one who must report on it. Recommendations on the expansion of these functions will be made in Chapter Eight.

The second reporting responsibility is to report on the matters within its mandate to shareholders at the company's annual general meeting.[804] The committee can hardly report on ethical matters if it does not have a profound, pivotal role in the implementation and monitoring of ethics, which currently lies with the board of directors. The need for the extension of the mandate of the committee is therefore a pressing matter.

When monitoring and reporting on social matters within its mandate, the regulations of the Act expressly require the committee to report and make reference to the Broad Based Economic Empowerment Act and the Employment Equity Act, two pieces of legislation aimed at redressing the inequalities of the past, especially regarding black South Africans.[805] The committee must establish guidelines and aims to be met, and if such aims are not met it should be reported on thoroughly and made available to the stakeholders of the company.[806] The Act is not clear on whether or not the social and ethics committee will in future assume responsibility for employment equity matters.[807] If it does, these will probably include matters preventing unfair discrimination and the assistance in affirmative action matters as contained in Chapters 2 (prohibition on unfair discrimination) and 3 (affirmative action).[808]

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[802] Rossouw 2012: 11.
[803] Regulation 43(5)(a).
[804] Regulation 43(5)(c).
[805] Kloppers 2013: 173.
[806] Kloppers 2013: 174.
[807] Kloppers 2013: 175.
[808] Employment Equity Act 55 of 1998.

The researcher's recommendation is that since the role of the committee includes ethics, the committee should definitely assume some responsibility for equity matters. It is in any event the link for employment and ethical grievances to the directors of the company. The committee already has the oversight function to report on ethical matters, so why not actually be involved in the employment equity of a workplace?

The committee is required to monitor good corporate citizenship of a company and report thereon.[809] A socially responsible business will be seen as a good corporate citizen, refraining from unfairly discriminating against employees. A good corporate citizen contributes towards the development of societies in which the business operates.[810]

The committee must keep thorough record of the business's sponsorships, donations and charitable giving which are manifestations of a socially responsible citizen, in line with the duty of Corporate Social Responsibility, and the notion of ethics and ethical behaviour in that they give to others, considering the needs of others instead of their own. Corporate Social Investments, whereby businesses invest in the development of the community, also fall under the notion of Corporate Social Responsibility and should be reported on by the committee.[811]

5.4.6 Skills and knowledge of members of the social and ethics committee

From the following discussion it is clear that the members of the social and ethics committee are required to have certain skills and knowledge, including knowledge of the environment, health and safety, consumer relationships and labour and employment issues. In this paragraph the researcher will briefly discuss the required skills and knowledge of the committee members in the performance of their designated functions.

[809] Kloppers 2013: 176.
[810] Kloppers 2013: 176.
[811] Kloppers 2013: 177.

5.4.6.1 The environment, health and public safety

The committee must monitor the company's activities having regard to relevant legislation, other legal requirements or prevailing codes of best practice with matters regarding the environment, health and public safety.[812] Members are therefore required to have a working knowledge of legislation relating to the environment, health and public safety.

5.4.6.2 Knowledge about consumer relationships

The members must have a sound knowledge of the company's advertising, public relations and compliance with consumer protection laws.[813] This again implies a sound knowledge of the laws on consumer protection. When reporting on any aspect within its mandate, the committee must refer to relevant legislation, code of best practice and other legal requirements as implied by Regulation 43(5)(a).[814] The committee therefore plays a prominent role in maintaining transparent and ethical relationships with all key stakeholders.[815] The committee must promote, develop and ensure fair labour practices, providing consumers and clients with protection against unethical conduct.[816]

5.4.6.3 Sound knowledge of labour and employment issues

The committee is required to report on labour practices within an organisation in terms of the International Labour Organization Protocol on decent work and working conditions, employment relationships and the company's contribution to the educational development of its employees.[817] Sound knowledge is required, as stated above, of all the labour legislation in order to report optimally on the compliance or non-compliance of the company. The committee must promote skills

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[812] Regulation 43(5)(a)(iii).
[813] Kloppers 2013: 180.
[814] Companies Act 71 of 2008.
[815] Kloppers 2013: 180.
[816] Kloppers 2013: 181.
[817] Kloppers 2013: 183.

development and ensure an environment where all will have the opportunity to develop and learn to enhance their employment prospects.[818]

The members must have the above skills and knowledge to enable them to conform with the notion of ethics and ethical behaviour, for example, they must know about health and safety to be able to assist others in need. They must have knowledge of consumer relationships to add value to other persons involved in the business. They must have a sound knowledge of labour issues to protect the stakeholders' interests at all times, and handle employment-related matters with integrity.

5.4.7 The powers and benefits of a social and ethics committee

The committee is empowered with many rights and duties to fulfil. It has various powers. These powers enable committees to perform their monitoring and reporting functions.[819] Powers entrusted to the social and ethics committee include:[820]

1) The power to require from any director, or prescribed officer or employee of the company, any information or explanation that is needed for the committee to fulfil its mandate;
2) The right to attend any general meeting of the shareholders of a company;
3) The right to receive all communications and notices related to any general meeting of the shareholders; and
4) The right to address any general meeting of the company's shareholders on any part of the business of such a meeting that is related to the mandate of the committee.

Section 72(10) of the Companies Act 71 of 2008 envisages that a company must pay all the reasonable expenses incurred by the committee if the costs or expenses are for any fees of a consultant or specialist engaged by the social and ethics committee in the performance of its functions. In the researcher's view the company will also

[818] Kloppers 2013: 183.
[819] Rossouw 2012: 24.
[820] Section 72(8) & (9) of the Companies Act 71 of 2008. See also Rossouw 2012: 24.

save money if it has a well-functioning social and ethics committee with sufficient expertise, experience, knowledge and skill to handle all dilemmas it could face. It should be unnecessary to appoint an outsider for assistance.

The members must at all times exercise due care and diligence in the performance of their functions.[821] They must act with the same degree of care that a director does, and the same criteria for the evaluation of their conduct will be used as for the directors of the company. Members in breach of this duty will be liable for any loss caused by their actions.[822]

In the light of the above, the members of the social and ethics committee must at all times exercise their duties with such care and skill in order to protect and promote the interests of the stakeholders, thereby acting in an ethical manner. The researcher is of the opinion that, in line with the stakeholder inclusive approach, stakeholders must be considered at all times in all duties performed by the social and ethics committee.

The remuneration committee is also required to perform its functions in an ethical manner to gain the trust of the members of the organisation. It needs to apply its knowledge and skills to promote fairness and equality regarding remuneration matters. Ethicality is therefore of the utmost importance. The remuneration committee is discussed in the next paragraph.

5.5 The remuneration committee

Directors' remuneration is one of the most critical aspects of ethics and corporate governance. Although not specifically required in terms of the Companies Act 71 of 2008, it is entrenched in the King lll Report, albeit only being applicable to listed companies. It is best practice for all companies to invest in the establishment of a remuneration committee, since King lll does apply to all entities in any event.[823] The

[821] Kloppers 2013: 185.
[822] Kloppers 2013: 186.
[823] Cassim et al 2012: 521.

committee plays an integral role in the reporting standards regarding directors' remuneration and remuneration of key management personnel.[824] It should assist the board in setting and administering remuneration policies.[825] It must also disclose all remuneration policies in the integrated report of the company.[826]

King lll states that companies should remunerate directors and executives fairly and responsibly.[827] Companies should adopt remuneration policies aligned with the strategy of the company and linked to individual performance.[828] These policies should address base pay and bonuses, employee contracts, severance and retirement benefits and share-based and other long-term incentive schemes.[829] Despite the committee having to justify its remuneration policies as being fair, the remuneration policies must also be enticing in order to attract directors to run for office and to promote the quality of the board.[830] There is therefore a fine balance to be maintained by the committee.

The remuneration committee is charged with the writing of a remuneration report in terms of Principle 2.26 of the King lll Report.[831]

This report, as part of the integrated report, must set out the following:[832]

1) All benefits paid to directors;
2) The salaries of the three most highly-paid employees who are not directors;
3) The policy on base pay;
4) Participation in the share incentive schemes;
5) The use of benchmarks;
6) Incentive schemes to encourage retention;
7) Justification of salaries above the median;

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[824] King Report 2009: 49.
[825] King Report 2009: 30. See also Naidoo 2009: 147.
[826] KPMG 2012: 96.
[827] King Report 2009: 30.
[828] King Report 2009: 30.
[829] King Report 2009: 30.
[830] KPMG 2012: 96.
[831] King Report 2009: 30.
[832] King Report 2009: 30.

8) Material payments that are ex gratia in nature;
9) Policies regarding executive employment; and
10) The maximum expected potential dilution as a result of incentive awards.

5.5.1 Composition of the remuneration committee

The chairperson of the committee as well as the majority of its members must be independent non-executive directors.[833] Remuneration decisions should preferably be made by those persons who will not benefit from them.[834]

5.5.2 Skills and knowledge of the members of the remuneration committee

The committee members must have experience in negotiating extremely complex reward packages, which should not be excessive and must be appealing to shareholders.[835] Members must be mindful of the fact that remuneration is a reward for enterprise, they should be rewarded for excellent work and be punished for failure in the performance of their duties.[836] Members must be able to motivate their decisions fully.[837] It is therefore recommended that the members have sound legal and accounting backgrounds. The researcher is of the opinion that the members should also have knowledge of labour legislation to determine the ceiling amounts for salaries. This will improve the integrity and ethicality of all policies and procedures, plans and documents drafted by the remuneration committee.

5.5.3 Functions of the remuneration committee

Functions generally include the following:[838]

[833] KPMG 2012: 97.
[834] KPMG 2012: 97.
[835] KPMG 2012: 97.
[836] KPMG 2012: 97.
[837] KPMG 2012: 97.
[838] Davis et al 2013: 144. See also KPMG 2012: 99.

1) Annual review of remuneration policies for senior executives and directors;
2) Annual review of the basis of the calculation of remuneration of senior executive and directors to ensure that it is reasonable;
3) Review of current industry practice and professional recruitment organisations' publications;
4) Review of different methods of remunerating senior executives and directors;
5) Review of existing or proposed share option schemes;
6) Review of retirement and termination payments;
7) Review of fringe benefits; and
8) Review of related party transaction disclosure, if applicable, in the financial statements.

These functions will keep the policies and procedures updated. It is, however, required of the members to stay informed of changing legislation at all times to ensure that their policies remain in good order.

If these functions are performed effectively, it holds many benefits for the company, including the respect from its employees, and also attracting future employees of a high standard to the company.

5.6 Concluding remarks

Section 72 of the Companies Act 2008 requires certain companies to have an audit committee, a social and ethics committee, and a board of directors. King lll recommends the incorporation of a remuneration committee. These committees have full authority to act on behalf of the board of directors, but are not a shield for gross negligence on a director's part. The directors must always be aware of the activities of the subcommittees, and vice versa. The committees must report on the performance of its duties.

The company is headed by the board of directors, which plays the most integral role in the management of the company as well as the enforcement of an ethical culture within a company. Its primary duty is to create value; value for the business, by setting the tone from the top, balanced with value for society by respecting, protecting and promoting the environment. It must oversee that the vision and mission and values of the company are upheld at all times, ultimately ensuring that the company survives and thrives. It must establish the company as a socially responsible corporate citizen.

The audit committee, established in terms of Section 72 read with Section 94 of the Companies Act 2008 setting out the functions of the committee, is mainly tasked with financial reporting, risk management and control and audit-related responsibilities and fosters an ethical culture in doing business. It reviews the integrity of financial statements before tabling it before the board, thereby promoting an ethical culture within the business, and also in the fact that this will combat fraud and protect stakeholder interests.

In order to optimally fulfil their duties, qualifications, knowledge and skills of members were briefly discussed. The most pertinent of these is the knowledge of ethical behaviour.

The audit committee has various functions, which were discussed in this chapter. The most important function that it performs is the duty to ensure transparency and correctness of financial records. It focuses mainly on audit and financial-related matters and bringing irregularities to the attention of the board. It was emphasised that a well-functioning committee holds many advantages for a company, but mostly it plays a role in the integrity of financial reporting.

Regulation 43 of the Companies Act 2008 sets out the functions of a social and ethics committee. However, it focuses mainly on social functions rather than on ethical functions. This committee was presumably formed to assist the board in attaining the desired ethical culture and being established as a responsible corporate citizen. The duty of Corporate Social Responsibility (discussed in the following chapter) falls within the scope of the duties of this committee. Ethics management should also fall within the ambit of the duties of this committee, to assist the board in its oversight function. Regulation 43(5) emphasises that the committee must monitor matters relating to Corporate Social Responsibility, and report thereon to the board.

The researcher has emphasised that the need for the expansion of the mandate of this committee is a pressing matter to encompass more ethics-related duties; alternatively a separate committee should be established. Persons on this committee should, in the researcher’s opinion, have sound legal knowledge.

The remuneration committee plays an integral role in reporting on directors’ remuneration, which is always a matter for debate. It sets up remuneration policies to be disclosed in the annual integrated report of the company. It plays an important role in the prosperity of the company by keeping remuneration packages appealing to attract suitable individuals, thereby adding value to the business. It is recommended that the members should have a legal and accounting background to assist them in the performance of their duties. The committee must review all remuneration policies and any other matters relating to a form of remuneration on an annual basis.

The above is a brief summary of what was discussed in this chapter. To summarize, it must be stated that running a business as a corporate citizen requires the teamwork of all the committees established within the company, each adding value to the system in its own way.

The research question on the ethical duties of the committees can be answered by the following table:

Table 5.2: Most pertinent ethical duties of the board committees

Board Committee	Key Ethical Purpose
Board of directors	• Sets the tone from the top regarding ethical behaviour • Acts in the best interests of the company • Puts the company's interests above the members' personal interests • Acts in a bona fide manner • Acts in a position of trust • Oversight responsibility for monitoring ethical behaviour • In terms of King lll the board of directors is the ethical leader • Creating a healthy ethical corporate culture
Audit committee	• Ensuring transparent procedures in financial reporting • Adding to the integrity of financial reporting • Ensuring independence with regard to financial reporting
Social and ethics committee	• Promotion and developments of codes of conduct • Promotion of charitable giving in the form of Corporate Social Investment and Corporate Social Responsibility • Adding value to the workplace and the community • Promoting a healthy and safe working environment • Respect, and be a channel for members of the organisation to lay grievances
Remuneration committee	• Integrity of remuneration policies and salaries

{Source: Own Table}

In the following chapter the importance and benefits of corporate governance in a country such as South Africa will be discussed.

Chapter Six

Importance of Corporate Governance in South Africa

"The success of companies in the 21st century is bound up with three independent sub-systems – the natural environment, the social and political system and the global economy. Global companies play an important role in all three and they need all three to flourish."[839]

6.1 Background on Corporate Social Responsibility

In paragraph 1.5 above the following question is posed:

What is the importance of corporate governance and the benefits associated therewith in South Africa?

The above question will be addressed in this chapter.

One of the main aspects of corporate governance is the notion of Corporate Social Responsibility. Some descriptions of Corporate Social Responsibility centre around the corporate compliance of the business with the spirit as well as the letter of the law, whilst other descriptions refer to this notion as a business approach by which an organisation takes into account the manner in which its activities may impact the various stakeholders involved.[840] Wolpert[841] suggests that there are two requirements aimed at organisations, namely that the ultimate goal of an organisation is to serve the interests of society as a whole, and that it must contribute to societal good by creating financial prosperity. Corbett[842] indicates the goal of Corporate Social Responsibility as "to develop particular decision-making capacities within organisations that will allow the company to take those (stakeholder) interests into account in a rational and legitimate way". In view of this,

[839] King Report 2009: 11.
[840] Nehme & Wee 2008: 131.
[841] 2008: 760.
[842] 2008: 414.

Corporate Social Responsibility is a very important evolvement in South African law and holds many benefits for the country. Corporate Social Responsibility will be discussed in the following paragraphs.

Kloppers[843] defines the Corporate Social Responsibility movement as follows: "a bundle of trends comprising regulatory frameworks aimed at improving corporate practices and leading to changes in these practices, the mobilisation of corporate role players to support the development of states, and a management trend that enhances the legitimacy of a business". Nehme and Wee[844] define Corporate Social Responsibility as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". There is, however, no consensus on the actual definition of Corporate Social Responsibility.[845]

In the modern age, the company is not merely concerned with its own personal gain, but also its contribution to the economy and the social wellbeing of the country. These contributions to society refer to making donations to charities, being eco-friendly and so forth to create a better society for all. Such contributions can add to the long-term viability of a company, even if immediate profit is not generated.[846]

Corporate Social Responsibility also plays an important role in the triple bottom line approach, as was discussed in Chapter Three. It relates to the conduct of directors of a company in a voluntary manner or by way of direct or indirect legislation, taking into consideration social, economic and environmental issues in decision-making.[847] A business's operations depend considerably on the natural and social environments within it operates.[848]

[843] 2013: 122.
[844] 2008: 131.
[845] Nehme & Wee 2008: 132. See also Assadourian 2006: 572.
[846] Gopalan & Hogan 2014: 13.
[847] Esser 2011: 321.
[848] Lubbe 2013: 155

As indicated in King lll,[849] a business's Corporate Social Responsibility extends to economic, social and environmental spheres, (the triple bottom line approach discussed above),[850] also known as the three "p"s. The three "p"s refer to profit, people and planet, respectively. It is an "art to balance these three aspects for the following reasons: operating a business is not economically viable without profit, but profit should not be sought after at all costs and at the expense of the wellbeing of the society and the natural environment within which the business functions".[851] The triple bottom line approach also emphasises the notion of ethics as it considers what is good for others, namely the community.

A company is a "pathological institution, a dangerous professor of the great power it wields over people and societies".[852] According to this view, companies can be either good or evil, moral or immoral and responsible or irresponsible. Thus, ethics and Corporate Social Responsibility play an integral role in the foundation of the company, in its roots, to prevent the falter of the businesses as well as for the protection of our community and economy. The foundation on which the company operates must be one of ethical values, to strive towards meeting the requirements of Corporate Social Responsibility.

King lll requires of companies to be good corporate citizens, to give back to society and not merely to take from it. The notion of Corporate Social Responsibility has been developed as a way to establish good corporate citizenship,[853] in order to combat the notion of unethical and irresponsible running of businesses.

According to Vlok and Kloppers,[854] Corporate Social Responsibility is a continuing commitment by a business to behave ethically, to contribute to economic development whilst improving the quality of life of the workforce and their families, as well as the local community and society as a whole.

[849] King Report 2009: 30, 118.
[850] See Naidoo 2009: 243.
[851] Lubbe 2013: 155
[852] Esser 2011: 317.
[853] Corporate citizenship refers to "business taking greater account of its social, environmental and financial footprints". Esser 2011: 319.
[854] 2009: 299.

Corporate Social Responsibility is the "behaviour by businesses over and above legal requirements, voluntarily adopted because it is deemed to be in the long term interests of the company. It is linked to the concept of sustainable development (meeting the needs of the present without compromising the ability of future generations to meet their own needs) and relates to the way in which a company is managed."[855] It is the "commitment of business to contributing to sustainable economic development, working with employees, their families and local communities, the fundamental idea being that companies have an obligation to work towards meeting the needs of a wider array of stakeholders".[856] The notion to have an obligation to satisfy the notion of what is good for others is the cornerstone of Corporate Social Responsibility.

Vlok and Kloppers[857] indicate the main objectives of Corporate Social Responsibility as follows:

1) It improves the quality of life of a company's workforce, their families, local communities and society as a whole;
2) It contributes to development; and
3) It must be extraneous to regular business activities.

Corporate Social Responsibility, according to Diale,[858] is an all-inclusive umbrella form of a term incorporating all the following aspects:

1) That a company has a responsibility for its impact on society and the natural environment even beyond legal guidelines;
2) That a company has a responsibility for the behaviour of others with whom they do business and interact; and
3) That business needs to manage its relationship with wider society, whether for corporate viability or for the good of society.

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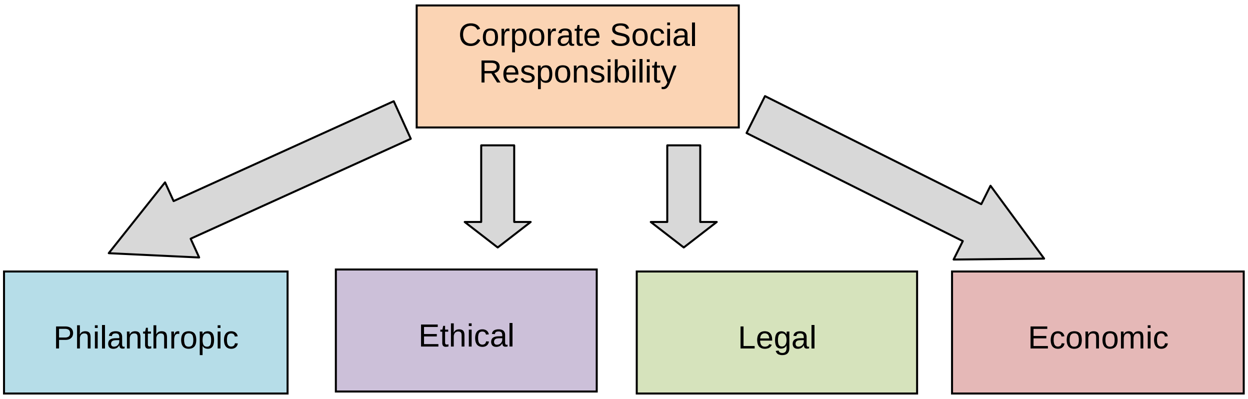
855 Esser 2011: 320.
856 Diale 2012: 689.
857 2009: 304.
858 2012: 689.

Taking the above into consideration, and according to Lubbe,[859] Sison[860]and Nehme and Wee,[861] Corporate Social Responsibility can be expressed as four main responsibilities:

1) Philanthropic responsibility, giving back to communities and society and improving the quality of life;
2) Ethical responsibility, doing what is right for yourself and others and avoiding harm;
3) Legal responsibility, abiding by the law as a codification of what is right or wrong; and
4) Economic responsibility, as the foundation of all these aspects, focusing on maintaining the organisation and taking care of financial commitments and the stakeholders of the company.

Figure 6.1: Four responsibilities of Corporate Social Responsibility



{Source: Own Figure}

Corporate Social Responsibility can be seen as "the efforts corporations make above and beyond regulation (the legal level) to balance the needs of stakeholders (charitable and ethical levels) with the need to make a profit (economic level)".[862]

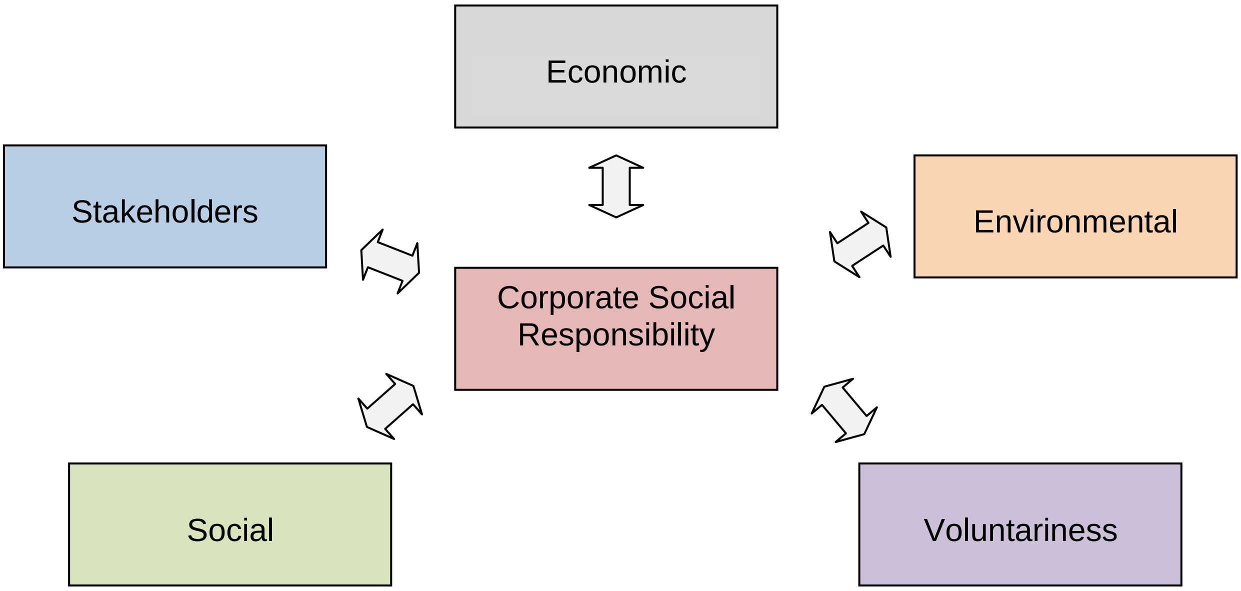
[859] 2013: 156.
[860] 2008: 72.
[861] 2008: 135.
[862] Nehme & Wee 2008: 141.

Having discussed the four main responsibilities of Corporate Social Responsibility, one can look into the different dimensions to gain a better understanding of what they entail and what is expected of a company as a good corporate citizen. There are five main dimensions to Corporate Social Responsibility, namely:[863]

1) Stakeholder;
2) Social;
3) Economic;
4) Voluntariness; and
5) Environmental.

The above five dimensions will be discussed briefly below.

Figure 6.2: Five dimensions of Corporate Social Responsibility



{Source: Own Figure}

6.1.1 Environmental dimension

The environmental dimension refers to the natural environment. It is the commitment to creating a cleaner environment, taking into consideration environmental impacts

[863] Coldwell 2010: 192.

the business effects, and thinking of a way to combat these negative impacts.[864] For example, a business may use less paper to protect the trees.

6.1.2 Social dimension

The social dimension refers to the relationship the business has with the society within which it conducts its business. This refers to making contributions to a better society, consideration of the effects of business on the community, going hand-in-hand with the environmental dimension.[865] Companies are not required to be charitable, or good corporate citizens, but it is desirable that they act as such regardless in order to have a positive impact on society.[866] Examples of the social dimension are making donations to society and giving sponsorships to sports organisations that benefit the community as a whole. This goes hand-in-hand with Corporate Social Investment discussed below.

6.1.3 Economic dimension

The economic dimension refers to the company's socio-economic or financial aspects. This incorporates defining Corporate Social Responsibility in terms of business operations, contributing to economic development and also the preservation of organisational profitability.[867] Becoming a socially responsible company does not necessarily entail financial sacrifices and quite often improves financial performance.[868] Companies need to buy new material and contract suppliers and thereby enhance the economic environment.

[864] Coldwell 2010: 192.
[865] Coldwell 2010: 192.
[866] Nehme & Wee 2008: 140.
[867] Coldwell 2010: 192.
[868] Assadourian 2006: 572.

6.1.4 Stakeholder dimension

The stakeholder dimension refers to stakeholders and stakeholder groups. It focuses on the way in which organisations interact with employees, suppliers, customers, shareholders and the communities.[869] When a company conducts itself in a socially responsible manner, it sends positive signals to various stakeholders.[870] Companies need to assist employees to improve their future, for example by giving study bursaries.

6.1.5 Voluntariness dimension

The voluntariness dimension refers to ethical actions not prescribed or addressed by existing law, which include actions based on ethical policies, standards and principles as the foundation of the business.[871] Companies should voluntarily make donations, be philanthropic in nature.

Taking the above into account, one must not forget the responsibility of the board of the company, ultimately the company, to protect and promote human rights within the organisation and society, as discussed in Chapter Four.[872]

Having a full comprehension of what Corporate Social Responsibility entails, one can now delve deeper into the roots of the concept and what its purposes and benefits are for society.

In summary to the above, the Corporate Social Responsibility ideal for a company, while producing society's desired goods and services, is to generate a profit, obey the law, live up to ethical expectations and contribute to philanthropic activities.[873] It therefore definitely pays to be "green" and to act in a socially responsible manner.[874]

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[869] Coldwell 2010: 192.
[870] Nehme & Wee 2008: 138.
[871] Coldwell 2010: 192.
[872] Bilchitz 2008: 754.
[873] Sison 2008: 73.
[874] Cornelius & Kogut 2003: 50.

6.2 Provisions of the Companies Act 2008

Section 7(d)[875] confirms that one of the purposes of the Companies Act 71 of 2008 is to reaffirm the concept of the company as a means of achieving economic and social benefit.[876]

It is clear from the above that not only King lll requires companies to be socially responsible, but that the Companies Act 2008 imposes the duty on a company in terms of Section 7(d). Corporate Social Responsibility should therefore not be seen as a “should have”, but as a “must have”. This means that companies should feel obliged to conform with the notion of Corporate Social Responsibility, and understand its essence and the benefits that go with it, be committed to enforcing it, instead of having it merely as a gimmick to attract business.

In the next paragraph, Corporate Social Responsibility will be discussed in relation to sustainability issues.

6.3 Environment and sustainability issues

During the last few decades, public discussions on conservation and sustainable development increased in relation to the seriousness of problems such as global warming.[877] The fear of the possibility of ruining the planet has in a way forced people to give back to Mother Earth, in some way what has been taken from it, or to prevent further loss, therefore the need for Corporate Social Responsibility.

One of the three main elements on which a company must report, in terms of the triple bottom line approach, is the environmental aspect, and therefore the integrated report of a company should include a sustainable development report.[878] This report should state the following:[879]

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[875] Companies Act 71 of 2008.
[876] Esser 2011: 321.
[877] Lubbe 2013: 179.
[878] Lubbe 2013: 179.
[879] Lubbe 2013: 179.

1) How well management has performed its role as stewards of the earth's natural resources;
2) How well management has governed the entity's operations regarding its environmental impact; and
3) How well management has fulfilled its Corporate Social Responsibility.

The fact that companies need to report on Corporate Social Responsibility and their contribution to the environment plays an important role in the implementation of Corporate Social Responsibility, as it compels companies to do something by forcing them to report thereon. They must act positively in order to prepare a meaningful report.

Companies are by nature competitive, and having the support of the society, they will gain from their actions to benefit the environment. Companies would not want to be seen as "the bad guys" who are ruining the environment one day at a time. The report is therefore of the utmost importance for companies to monitor their own compliance with Corporate Social Responsibility strategies. It is a yardstick against which to measure their actions, and they will know when to do more and where to help the community.

In the following paragraph, the implementation of Corporate Social Responsibility within a company will be discussed.

6.4 Implementation of Corporate Social Responsibility

Corporate Social Responsibility strategies mean nothing merely on paper; they should be practised. A discussion on the implementation of the strategies as well as who will be responsible for such implementation follows below.

6.4.1 Who should be in charge of implementation?

The right employees should be in charge of the implementation of Corporate Social Responsibility; the implementation thereof will probably lie with management. Skills, expertise and knowledge are vital for the success of Corporate Social Responsibility management.[880] Management as well as employees must understand the value of the implementation of Corporate Social Responsibility initiatives.[881]

6.4.2 Implementation strategies

Firstly, Corporate Social Responsibility issues should be identified, and thereafter be remedied by way of procedures to be developed by the skilled persons responsible for the implementation of Corporate Social Responsibility.[882] This implies developing a feedback and detailed Corporate Social Responsibility strategy to ensure continuous improvement.[883] Record must be kept of all Corporate Social Responsibility-related activities and non-compliance therewith must be handled in a disciplinary manner.[884]

In the following figure the implementation procedures are illustrated.

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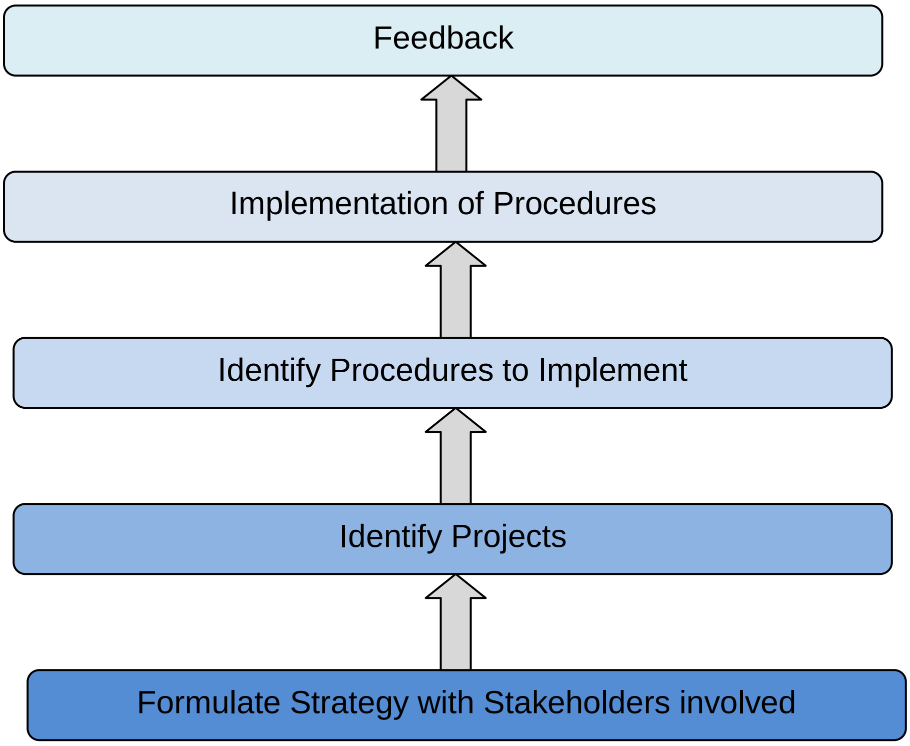
[880] Esser 2011: 332.
[881] Esser 2011: 332.
[882] Esser 2011: 332.
[883] Esser 2011: 332.
[884] Esser 2011: 332.

Figure 6.3: Implementation of Corporate Social Responsibility



{Source: Own Figure}

The role of the stakeholders in the improvement and development of Corporate Social Responsibility cannot be overemphasised. They need to participate actively and be involved in all stages of the process to develop, implement and improve Corporate Social Responsibility programmes in a company, and stakeholders should also be involved in the decision-making.[885] The inputs of the entire business are necessary to develop a strategy; this will also ensure that everyone is aware of their duties and the duties of the company in terms of Corporate Social Responsibility.

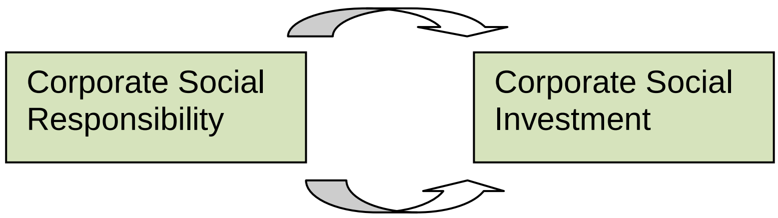
After all problem areas have been identified, and strategies developed to combat these problems, it is time to become engaged in making the strategies on paper a reality. Ultimately, all Corporate Social Responsibility notions must be in line with the company's business model.[886] Since all stakeholders are also involved in the implementation and development of Corporate Social Responsibility strategies,

[885] Esser 2011: 333.
[886] Esser 2011: 333.

training is recommended to ensure that everyone is up to date and informed about what Corporate Social Responsibility entails to aid them in their decision-making. Employees must be encouraged to participate. One can even reward an employee for making a significant contribution to the company's goal and to the society. Regular projects can be organized to encourage all employees to give back to society.

Apart from the notion of Corporate Social Responsibility, the notion of Corporate Social Investment emerges, but the concepts overlap and are interrelated. Corporate Social Investment is an investment made in society to better the environment and the lives of persons in the community. Corporate Social Investment will be discussed in the next paragraphs. What follows is a diagram depicting the relationship between Corporate Social Responsibility and Corporate Social Investment.

Figure 6.4: Hand-in-hand relationship between Corporate Social Responsibility and Corporate Social Investment



{Source: Own Figure}

6.5 Corporate Social Investment

Corporate Social Investment refers to the company utilising its own resources to benefit the community, to make an investment in the community.[887] It is also commonly referred to as ethical investments.[888] It is an operation that is entirely external to company management. The core of this notion lies in the fact that investments that are deemed harmful and unethical to society should be eliminated

[887] www.csisolutions.co.za.
[888] Nehme & Wee 2008: 158.

from investment portfolios, regardless of how profitable they can be; the focus lies mainly on sustainability.[889]

Investments in the community are made in a variety of ways, and investments are made in various fields, including arts and culture, sports, agriculture, orphans and vulnerable children, job creation, skills development and so on.

6.5.1 Benefits of Corporate Social Investment for the company

Companies are often faced with ethical dilemmas, one of them being why they should give their money, their profit, to society, instead of keeping it for the growth of the business. The fact is that Corporate Social Investment is not only for the benefit of society, but also holds benefits for the company. Incorporating Corporate Social Investment into the business holds the following advantages for the business:[890]

1) It will give the company a competitive edge;
2) It will show the heart of the company and therefore improve its credibility;
3) It will improve the living conditions of employees and their families;
4) It creates brand awareness;
5) It conforms with industry charters;
6) It stabilises the social and economic environment;
7) It gives rise to new business ideas;
8) It allows the society to enquire about the business; and
9) It enhances the corporate image and returns on the investment.

Corporate Social Investment is an ethical action in that it considers the good of others by making a contribution to the development or growth of an individual or a community, and not expecting any return thereon, but yet receiving a return thereon, which is the good for oneself. This then illustrates the perfect relation between what is good for oneself and what is good for others.

[889] Nehme & Wee 2008: 158.
[890] www.csisolutions.co.za.

6.6 Concluding remarks

A range of significant socio-economic challenges still exists, regardless of the incorporation of Corporate Social Responsibility. Matters such as HIV and Aids, education, job creation, service delivery and skills development come to mind.[891] It goes to show that an even larger emphasis should be placed on Corporate Social Responsibility and the benefits it will have for society, and that businesses must be encouraged to participate in Corporate Social Responsibility initiatives.

We live in a country with tremendous sustainability issues. We are often confronted with news that soon we will have no water, and no food nor electricity. This is worrisome. Corporate Social Responsibility is there to help. As discussed, it can help by addressing one of its four responsibilities, or maybe attending to all of them, namely its philanthropic responsibility, its ethical responsibility, its legal responsibility or its economic responsibility imposed on companies. Its aim is to set an example for society to protect and maintain our natural resources. If companies have no respect for the environment, society will lose its respect for the company. It will lose its corporate reputation. Companies can make investments in the future of the country by giving the poverty-stricken communities and individuals opportunities for further study. It is therefore of the utmost importance that Corporate Social Responsibility notions must be implemented properly by persons who are skilled for the task of implementation. The success of Corporate Social Responsibility lies in the success of the implementation thereof. Corporate Social Responsibility issues must firstly be identified, after which procedures must be put in place to address these issues. These procedures must be drafted by persons with the necessary knowledge of Corporate Social Responsibility, and employees must be made aware that non-compliance with Corporate Social Responsibility procedures is punishable. The strategies on paper must be implemented in practice in such a way that they become reality and make a real difference in society, otherwise the efforts will be fruitless.

Companies will also gain societal respect by making contributions to society in the form of Corporate Social Investment, whereby the company will invest in the growth

[891] Popp 2012: 182.

and prosperity of the community. The benefits of Corporate Social Investment were discussed in this chapter and it is clear that it is to the benefit of both the company and society to comply with Corporate Social Responsibility and Corporate Social Investment procedures.

It was emphasised further that Corporate Social Responsibility must be applied by all persons within a company, failing which it could hold disastrous consequences for the company.

In view of the detrimental effects non-compliance with Corporate Social Responsibility can have on a company, these effects must be avoided at all costs by making sure that Corporate Social Responsibility is implemented thoroughly in a business by a person who is skilled to do so, and must be practised by all stakeholders involved in the company.

A company can make a significant impact on society; the question is, will it be good or will it be bad?

The research question posed in paragraph 1.5 can then be answered as follows:

Corporate governance allows for Corporate Social Responsibility, which has also lead to the development of Corporate Social Investment. Both these notions, if applied correctly by a company, hold many benefits, such as growing the client base and satisfied employees, competitiveness and the respect of the community, which in turn has a huge benefit for the growth of our economy.

In Chapter Seven the importance and benefits of ethics in South Africa will be discussed.

Chapter Seven
The Importance of Ethics in the Corporate World of South Africa

"So what might ethical responsibility within the business world have to do with poverty, unemployment, wage gaps, crime, family breakdown, HIV-Aids, globalisation, social capital, skills development, gangsterism, substance abuse, war and conflict or peace and so on? Maybe nothing, maybe everything."[892]

7.1 Background

In paragraph 1.5 above the following research question is posed:

What is the importance of ethics and the benefits associated therewith in South Africa?

This question will be answered in the following paragraphs.

Since the 1990s there have been increasing numbers of reports on mismanagement of companies, and ethical behaviour of employees has been scrutinized and researched intensively. It is a well-known fact that South Africa has lost significant amounts of money as a result of white-collar crime.

Any reflection on ethical leadership should honour the concepts of ethics and morals. The importance of ethical leadership cannot be overemphasised, and it must also be emphasised that leaders should lead by example, so as to teach the younger generation ethical values.

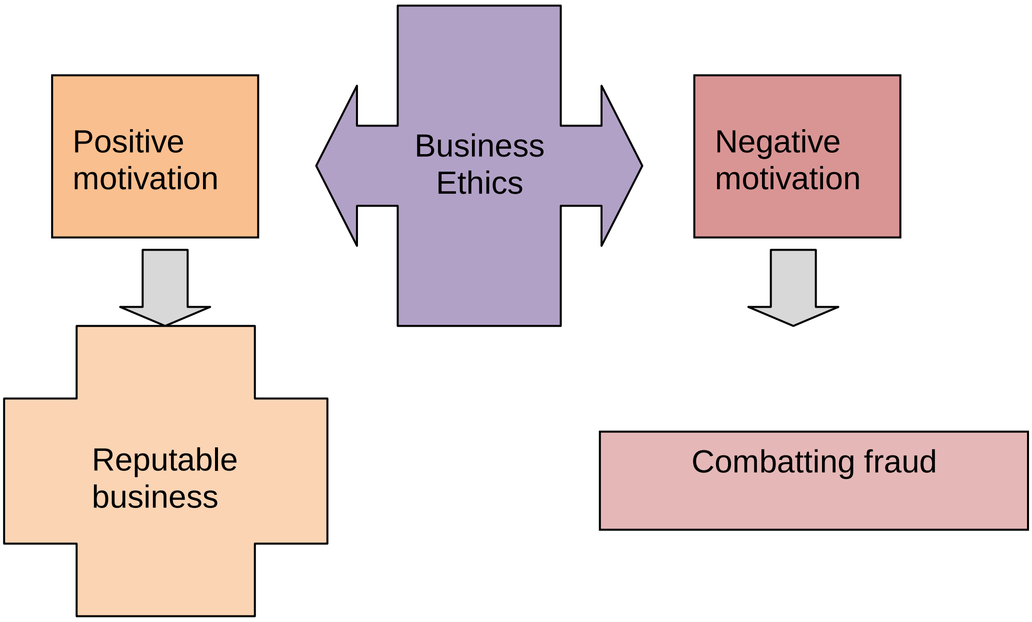
Business is not mainly viewed as a right given to us in free democratic societies, but as an opportunity allowed by society as long as companies remain good corporate

[892] Dames 2008: 105.

citizens, earning the respect of the community.[893] By running a business ethically, one acquires the right (or licence) to operate.[894]

The importance of business ethics is two-fold. Firstly, it has a negative motivation and, secondly, a positive motivation. The negative motivation is the need to combat fraud, and the positive motivation is the realisation of a successful and reputable business.[895]

Figure 7.1: Positive and negative motivations of ethical behaviour



{Source: Own Figure}

The quest for ethical leadership and growing moral challenges in South Africa in civil society, the working world, business and politics is dominating the public domain.[896] The notion of an ethical society in a third-world country such as South Africa seems almost unachievable taking into account all the issues in our country. Immoral acts are the thorn in the flesh of our country, affecting many aspects and spheres of our country; for example, the immoral ways of the police in using their authority and trust

[893] KPMG 2012: 116.
[894] KPMG 2012: 116.
[895] KPMG 2012: 116.
[896] Dames 2008: 100.

position in society for immoral acts such as raping a citizen are one of the biggest threats to the ideal of a safe and secure society.

Society needs active and constructive engagement of ethical leadership in every level of society and in businesses; the leaders must act on immoral practices in order to change these into good ethical practices.[897]

In this chapter, the ethical problems facing society will be discussed as well as suggestions to combat these problems. The importance of ethical behaviour cannot be overemphasised. The following paragraphs will depict the benefits of ethical behaviour.

7.2 Constitution of South Africa

The Constitution of South Africa is the highest law of the country and applies to everybody, including juristic persons such as companies. The importance of ethical behaviour is also prominent in Section 195,[898] thereby enforcing the importance thereof for the growth of a healthy society.

Section 195 of the Constitution indicates that public administration must be governed by democratic values and principles such as the promotion of high standards of professional ethics, promotion of efficient, economic and effective use of resources, transparency must be provided for by supplying the public with timely services, accurate information and being accountable.[899]

Emerging democracy should achieve the ideal society by planning the future whilst taking cognizance of the past, striking a balance between the fears of those who have and the needs of those who have little or nothing, and learning to live in a

[897] Dames 2008: 104.
[898] Constitution of South Africa.
[899] Naidoo 2012: 663.

democracy and unlearning life in an oppressive state.[900] The state must, when applying ethics, envisage the future and also realise it for the people.[901]

The promotion of ethical leadership will promote good governance and prevent corruption, ideally leading to a better country for us all.

The combatting of fraud by way of ethical behaviour is discussed in the following paragraph.

7.3 Ethics as a mechanism to combat fraud (negative motivation)

Weak accountability and evasive societal ethics make corruption in lower levels of government almost pervasive.[902]

Ethical leadership, as set out in the King lll Report, holds many advantages for an organisation and for the country as a whole. One of these is the combatting of corruption and fraud in terms of the notions of accountability, transparency, responsibility, etc.

The challenges of historical business practices since apartheid are part of the ethical questions which face many businesses and individuals in the modern South Africa.[903] South Africa has a reputation for doing business undercover.[904] Business holds the key to transform society into a moral one.[905]

As previously discussed, ethical leadership is of the utmost importance. This term is embedded in all the instruments of corporate governance and is expressly referred to in the three King Reports.

[900] Dames 2008: 107.
[901] Dames 2008: 107.
[902] Popp 2012: 183.
[903] Dames 2008: 104.
[904] Dames 2008: 104.
[905] Dames 2008: 104.

Naidoo[906] illustrates that leadership rests on three pillars, namely:

1) The moral character of the individual concerned;
2) The ethical foundation of the concerned person's vision and outlook on the business world; and finally
3) The morality of the choices and actions made or performed by the individual.

A lack of the qualities mentioned above will undoubtedly lead to unethical leadership instead of ethical leadership. Unethical leadership, especially in the public sector, will mean corruption, a lack of responsiveness to the needs of clients, a lack of discharge of duties and mainly just functioning ineffectively.[907] This will undoubtedly have disastrous consequences for the economy.

As discussed earlier in this work, ethical behaviour and good governance are closely interlinked. There is also a link between good governance and corruption.[908] This is so because corruption violates all the principles that good governance stands for, mainly accountability, openness, transparency and ethical leadership.[909] Corruption is a challenge to good governance mainly due to unethical leadership having disastrous effects on the country, especially the public sector.[910]

Without ethical leadership, accountability and transparency are absent, which makes it easy for corruption to take place.[911] This leads to further problems such as ineffective, unfair procurement policies and nepotism in the workplace, inadequate financial controls and the abuse of government assets in the public sector.[912]

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[906] 2012: 660.
[907] Naidoo 2012: 661.
[908] Naidoo 2012: 662.
[909] Naidoo 2012: 662.
[910] Naidoo 2012: 662.
[911] Naidoo 2012: 662.
[912] Naidoo 2012: 662.

The solution to ethical problems lies in the establishment of moral and competent leadership[913] of the individuals in top management as well as the rest of the stakeholders of the company.

Unfortunately ethical leadership in the business world is not a given.[914] It is a goal for the common good, and is not a matter of individual reflection.

Ethical labour practices can contribute towards moral leadership nationally, continentally and globally to tackle corrupt practices.[915]

7.4. Ethics and organisational success (positive motivation)

A key objective of a business is obviously to stay in business for a long time. The business should not only be socially responsible and practise good corporate citizenship, but must also have the goal of profitability, which would enable them to make social investments in the community. Some will argue that, without the notion of sustainable development, neither business nor societies will benefit. Others argue that this will become a megatrend that will ignite competition, which in turn will benefit the economy if businesses are more profitable.[916] Be that as it may, ethics and sustainability play an integral role in the long-term success of any company.

Sadly, all this is just a painting of what business should be like, and many businesses hide behind the screen of being seen as ethical when in fact they are not.[917] Ethics is seen as a mechanism to earn more money, and not as an end in itself, which means that behaviour cannot be seen as being ethical.[918] Unethical employees will be the pitfall of the business.[919] Ethical organisational environments are described as being the behaviour, norms, rules and values that are inherently

913 Naidoo 2012: 662.
914 Dames 2008: 105.
915 Dames 2008: 102.
916 Bosman & Buys 2010: 10.
917 Bosman & Buys 2010: 10.
918 Bosman & Buys 2010: 10.
919 Lloyd & Mey 2010: 1.

honest and shared with all the employees so as to improve performance within the company and to achieve good relations with all stakeholders.[920]

It is time that businesses realise that sustainable development is part of ethical behaviour, and that they should integrate sustainable development concepts into strategic initiatives.[921]

7.5 Ethical leadership as a *sine qua non* for curbing corruption and promoting good governance

Ethical leadership should be participatory, transparent, responsive, efficient, equitable and must obviously abide by the rule of law.[922] Applying these qualities can ensure good governance, a reduction in corrupt activities, thereby reinforcing the trust and respect of the community for an organisation.[923]

Ethical leaders must set the tone from the top and set an example for other stakeholders, increasing awareness of what is right, good and important,[924] inspiring stakeholders to abide by the same principles and acting for the good of society and not only as profit-hungry organisations.

Ethical leadership will bring about various improvements and reinforce trust in the organisation. It will lead to job satisfaction of employees and increase their dedication and productivity within the workplace, once again improving our country.[925]

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[920] Lloyd & Mey 2010: 2.
[921] Bosman & Buys 2010: 10.
[922] Naidoo 2012: 678.
[923] Naidoo 2012: 678.
[924] Naidoo 2012: 678.
[925] Naidoo 2012: 679.

Good governance and Corporate Social Responsibility must envision good business practices based on integrity to accommodate the needs of poverty-stricken communities.[926]

Sustainable development in South Africa is also largely dependent on ethical behaviour.[927] The ethical issue in sustainable development is the basic struggle of life and death; if business does not begin to practise sustainable development, life as we know it will soon become extinct.[928] This is discussed in paragraph 7.7 below.

7.6 Ethics and corporate and social capital

Companies may not be demonstrating adequate "commitment to invest in people" and opportunities to previously disadvantaged businesses.[929]

Transparency and collective responsibility in business conduct and practices are required for sustainability.[930] Corporate Social Responsibility and business hold the key to heal and bring peace within society.[931] It may be the agent to foster stability and contribute to peace through commerce by restoring the social fabric of society.[932]

The transformation of the socio-economic conditions of poor communities is of the utmost importance for the creation and upholding of an equitable and morally sound society.[933]

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926 Dames 2008: 105.
927 Bosman & Buys 2010: 9.
928 Bosman & Buys 2010: 9.
929 Dames 2008: 106.
930 Dames 2008: 106.
931 Dames 2008: 106.
932 Dames 2008: 106.
933 Dames 2008: 110.

7.7 Ethics and corporate sustainability

The foundation of sustainability is ethical behaviour.[934] The issue is so important that it can be compared to a situation of life versus death, in that if businesses do not begin to practise the tenets of sustainable development, life as we know it may very well become extinct.[935]

It is important for businesses to realise they have an important role to play in the sustainability of our country. According to Painter-Morland and Bos,[936] there are various benefits for a business investing in sustainability, as follows:

1) Sustainability is a prudent, long-term strategy, it is to the benefit of the long-term survival of the company;
2) There is a huge unmet market potential among the world's developing economies that can only be met by sustainable ways; the business will obtain more business opportunities;
3) Costs can be minimised significantly through sustainable practices, the business will save money and become more eco-efficient, taking into account the environment;
4) Competitive advantages exist for sustainable business; the business will attract environmentally conscious customers, thereby becoming more prosperous and gaining a competitive advantage; and
5) Sustainability is a good risk management strategy; an example of this is avoiding litigation by not selling unsustainable products.

In view of the above, it can only be beneficial for businesses to do business in a more sustainable manner, thereby setting an example for the rest of South Africa for a better tomorrow.

[934] Painter- Morland & Bos 2011: 286. See also Bosman & Buys 2010: 9.
[935] Bosman & Buys 2010: 9.
[936] 2011:29.

In a world and a country stricken by poverty, sustainability becomes of even more importance, and it is not just one person's responsibility, but a responsibility imposed on the entire nation, to work together for a better country, based on morally sound values and caring for others in the community, such as with the notion of Corporate Social Responsibility.

7.8 Concluding remarks

The importance of ethics is two-fold; it has a negative and positive motivation. The negative motivation refers to the prevention of unethical conduct whereas the positive motivation will be to earn the respect of the society within which the company operates. Ethics then has a negative and positive connotation, both preventative and promotional.

Ethics is also embedded as a value in the Constitution, in terms of Section 195, where it is indicated that public administration must be governed by democratic values such as the promotion of a high standard of ethics. Ethics therefore underlies all business, and is important to the business. All businesses must strive to meet the standards as set out in Section 195 for an open and transparent manner of doing business.

Ethics plays a very important role in combatting corruption in South Africa. If individuals were trained to be ethical, corruption would be less prominent. Business ethics holds the key to transforming society into a moral one.

Ethics plays a pivotal role in the success of a company because ethical companies will draw the best human resources to the company and will give the company its social legitimacy to run the business, thereby increasing its profits, allowing it to further contribute to society and so it goes on.

It pays to run your business in an ethical manner.

The question that was posed can be answered as follows:

1) Ethical behaviour will combat fraud; and
2) South Africa will earn the respect of the world again after being branded as a corrupt country.

In the following chapter, the study will be summarised and final recommendations made.

Chapter Eight
Conclusions and Recommendations

8.1 Summary of conclusions

It is clear from this study that in the development of corporate governance, the same principles percolate through every report: the principles of transparency, fairness, accountability, and responsibility as the core principles of best practice in corporate governance. These principles must also be considered in drafting a code of ethics. One can use these principles as set out above as a yardstick or benchmark to measure whether one's behaviour is in compliance or non-compliance with the code of ethics.

The nature of codes of ethics and the importance thereof were also discussed. The code is the "ethical constitution" of the business. It is the pivot around which ethical behaviour revolves within an organisation. The researcher distinguished between the two types of codes, aspirational and directional codes, and emphasised support for an aspirational-directional code, a combination of the above codes, encompassing rigid rules but also allowing for the application of one's mind and the use of one's independent judgement when faced with an ethical situation.

The root of ethical behaviour lies in the notion that the company must please society and the employees (internal stakeholders) instead of being only a moneymaking machine. One must look past profit, and focus more on the triple bottom line approach, namely profit, social and environmental issues. The ethicality of behaviour lies in the balance struck by a person or organisation between these three factors. A good balance of these factors will result in behaviour being deemed as ethical. The board is also required to report on how it has managed these considerations to the stakeholders.

The implementation and institutionalization of ethics was discussed on the various levels, namely the strategic and systems levels. The strategic level refers to the commitment of a company to its code and the prevention of non-compliance with the code. The systems level focuses on making the code well known, accessible and available to the employees of the organisation. The researcher emphasised the pivotal role employees play in ethical behaviour and management and further suggested ways to ensure that employees are aware of what is expected of them regarding their conduct on a day-to-day basis in the working environment, e.g. confidential questionnaires, awareness campaigns and checks and balances forms. This complies with the purpose of the study, namely that business ethics is an obligation not only of directors and managers, but also employees, the internal stakeholders, within a company. It is management's duty to ensure that employees are aware of what is expected of them, and how they should manage and apply ethics. It then becomes the duty of the employee to apply the codes of conduct in his/her decision-making and everyday activities.

A director must act ethically in that he may not abuse his position of trust towards the company and its stakeholders. This will cause irreparable damage to the ethical culture of the workplace, and would cause employees to no longer consider the importance of ethics within the workplace. Ethics is also seen in the notion of the stakeholder inclusive approach as set out in King lll. The director is forced to consider not merely what is good for the company, but also its stakeholders. This again reinforces the purpose of the study, emphasising the obligation of directors. King lll also emphasises the duty of directors to be ethical leaders, placing an immense duty on directors to act within a certain scope of conduct deemed ethical.

The company is headed by the board of directors which plays the integral role in the management of the company as well as the enforcement of an ethical culture within a company. Its primary duty is to create value, value for the business, by setting the tone from the top, balanced with value for society by respecting, protecting and promoting the environment. It must oversee that the vision, mission and values of the company are upheld at all times, ultimately ensuring that the company survives and thrives. The board must establish the company as a socially responsible corporate citizen. In the light of this, the company should also serve all its stakeholders and not only be profit-orientated.

The ethical duties of board committees can be summarised as follows:

1) The board of directors must set the tone from the top regarding ethical behaviour, act in the best interests of the company, put the company's interests above its personal interests, act in a bona fide manner, act in a position of trust, oversee and monitor ethical behaviour, act as ethical leaders and create a healthy ethical corporate culture.
2) The audit committee must ensure transparent procedures in financial reporting, add to the integrity of financial reporting and ensure independence with regard to financial reporting.
3) The social and ethics committee must promote and develop codes of conduct, promote charitable giving in the form of Corporate Social Investment and Corporate Social Responsibility, add value to the workplace and the community, promote a healthy and safe working environment and gain respect, and be a channel for members of the organisation to lay grievances.
4) The remuneration committee must see to the integrity of remuneration policies and salaries.

Companies will also earn societal respect by making contributions to society in the form of Corporate Social Investment, whereby the company will invest in the growth and prosperity of the community. It is to the benefit of both the company and society to comply with the notion of Corporate Social Responsibility and Corporate Social Investment procedures.

The researcher further emphasised that Corporate Social Responsibility must be applied by all persons within a company, failing which it could hold disastrous consequences for the company. This links to the main purpose of the study by enforcing the obligation of employees to add to business ethics and the ethical culture of the company.

In view of the detrimental effects non-compliance with Corporate Social Responsibility can have on a company, these effects must be avoided at all costs by making sure that Corporate Social Responsibility is implemented thoroughly in a business by a person who is skilled to do so, and must be practised by all employees involved in the company. This emphasises the purpose of the study that even employees within the organisation must be committed to Corporate Social Responsibility, and other ethical procedures.

We live in a country with huge sustainability issues. We are often confronted with news that soon we will have no water, and no food nor electricity. This is worrisome. Corporate Social Responsibility is there to help. It can help by making use of one of its four responsibilities, or maybe the use of all of them, namely its philanthropic responsibility, its ethical responsibility, its legal responsibility or its economic responsibility imposed on companies. Its aim is to set an example for society to protect and maintain our natural resources. If companies have no respect for the environment, society will lose its respect for the company. It will lose its corporate reputation. Companies can make investments in the future of the country by giving the poverty-stricken communities and individuals opportunities for further study. It is therefore of the utmost importance that Corporate Social Responsibility notions must be properly implemented by persons who are skilled to execute the task of implementation. The success of Corporate Social Responsibility lies in the success of the implementation thereof. Corporate Social Responsibility issues must firstly be identified, after which procedures must be put in place to address these issues.

Corporate Social Responsibility is in harmony with the notion of ethics in that it considers what is good for others.

The importance of ethics is two-fold: it has a negative and positive motivation, The negative motivation refers to the prevention of unethical conduct whereas the positive motivation will be to earn the respect of the society within which the company operates.

Ethics plays a very important role in combatting corruption in South Africa. If individuals were trained to make ethical decisions, corruption would be less prominent. Business ethics holds the key to transforming society into a moral one.

Ethics plays a pivotal role in the success of a company because ethical companies will attract business and will give the company its social legitimacy, thereby increasing its profits, allowing it to further contribute to society.

The importance of ethics and the role it plays in corporate sustainability and the benefits it holds for companies were discussed, and it became evident that it is in the best interests of the company and South Africa as a whole to do business in an ethical manner.

8.2 Recommendations

1) The researcher suggests that employees constantly undertake e-learning and training activities to keep them up to date and to ensure that they are aware of what is expected of them regarding ethical behaviour. This supports the main purpose of the study that employees (internal stakeholders) involved in the business should be committed to business ethics.
2) It is recommended that codes of ethics be drafted in an aspirational-directional manner by giving rigid guidelines but yet allowing for independent judgement of the individual.
3) It is recommended that Section 76 of the Companies Act 2008 should be amended to include the duty to act in the best interests of the company *and* its stakeholders, as a duty of directors, or a similar protection of stakeholder interests. (This is in line with the stakeholder inclusive approach in King lll, but will carry more weight if legislated in the Companies Act.)
4) The mandate of the social and ethics committee should be expanded formally (in terms of Regulations) so as to allow for the inclusion of more ethical functions to assist the board in fulfilling its ethical duties.
5) In furtherance to the above, it may be recommended that the social and ethics committee should be split into two separate committees with different designations, focus and functions.
6) It is recommended that the social and ethics committee be charged with drafting a code of conduct to be reviewed by the board, and implemented by all employees, i.e. internal stakeholders.
7) The organisation must implement policies integrating ethics into the organisation's values and mission via codes, ethics training, an ethics hotline and committees.

8) The researcher recommends that ethics should be rooted in all aspects of business.
9) It is recommended that ethics should form part of all school and university syllabi as a compulsory subject to mould the society into ethical beings.
10) It is recommended that future research be done on the following:
    a) Future research could be done on the implementation and enforcement of ethical behaviour in the three spheres of government, namely local, provincial and national spheres of government.
    b) A critical analysis of all disastrous economic crimes and how it can be attributed to unethical behaviour, can be studied.
    c) Research the viability of including the subject of ethics and ethical behaviour in school syllabi and the curricula of academic programmes at universities and technikons (universities of technology).
    d) Research can be done on how ethical behaviour can enhance law enforcement in our country.

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