

Unitary Board or Two-tiered Board for the New South Africa ?

Michael Spisto*

In South Africa, there is no doubt that the duties of company directors and managers are issues, which are attracting much attention at present. With rapidly developing and changing labour legislation in South Africa, it is essential to consider the extent to which South Africa should reassess its traditional principles of company law and corporate governance policies in order that it may take into account the participatory roles of employees in the workplace. It is considered that employee participation in decision-making in the corporation improves productivity standards and product quality. It has been shown in some countries, such as in the United Kingdom, that where workplace-based institutions for worker representation did not supplement adversarial labour relations, labour and management relations were exceedingly poor. This ultimately affected the efficiency and performance of the enterprise system as a whole. South Africa's company law is largely based upon the unitary board structure created in England. The main purpose of this paper is to propose a new corporate governance model for South Africa, which would be advantageous to all of its corporate stakeholders. The current unitary board structure operating in South Africa is unacceptable, as it does not provide employees with rights enabling them to engage in the decision-making processes of the corporation with their employers at an adequate level. If South Africa hopes to successfully improve corporate productivity levels with its re-entry into international markets, it is proposed that a new two-tier German-based system of corporate governance be adopted, which would assist in improving management and labour relations and ultimately the productivity of the corporation.

1. Introduction

Corporations are the most common business structure in the Western world and have been so ever since the nineteenth century. This is mainly because corporate structure has given businesses independence from their investors and limited their liability. Corporations are thus able to acquire funds from a large number of investors. Consequently, a number of large companies have come into existence.[1] Some Chinese intellectuals were of the opinion that corporations greatly contributed to the prosperity of countries and, in so doing, improved the well being of society. [2]

Furthermore, the cornerstone of company procedure is based upon a provision found in the articles of almost all companies, which states that the *directors* should manage the business of the company. Thus, the standard operating procedures at present can be described as pyramidal in form. [3] At the base are the shareholders whose vote is required to elect the board of directors and to decide upon their major corporate actions. The directors, who constitute the policy-making body of the company and who select its officers, represent the next level. At the top of the pyramid are the officers who have some discretion but, in general, must execute

* Lecturer in Law ,Centre For International Corporate Governance Research (CICGR) and School Of Law, Victoria University, Melbourne, Australia
Email: Michael.spisto@vu.edu.au

the policies formulated by the board. This “pyramidal” form of a company reflecting the distribution of powers has currently been criticised throughout the world, including various bodies within countries such as South Africa. This arises because the “pyramidal” form *omits* to include the participation on the board or at management level of any other group or body, other than the directors themselves, the shareholders or the officers. In other words, in terms of this “pyramidal” type of model, amongst other bodies, the employees, the customers of the business, the suppliers and the creditors are expressly *excluded* from such participation.

Hence, the very *exclusion* of the other bodies or stakeholders from partaking in or being invested with the various powers of the company by virtue of this “pyramidal” form brings the principles of corporate governance to the fore. Thus, the roles and duties of company directors and managers is an issue, which is currently attracting much attention internationally and in South Africa, not only from the public sector and media, but also from the law reformers and politicians. Traditionally, company law assumes that the directors’ role is to run their company for the benefit of its shareholders *alone* and to maximise profits for them. However, this view is too narrow and outdated. That is, directors should, especially in the larger type of corporations, have regard to a wider range of interests and should also consider the rights of the other corporate stakeholders. More specifically, directors should have concerns not only for its shareholders, but also for its employees, customers, suppliers and creditors. This idea, by extending its application, would also refer to and include the environment and community at large. Hence, the question of whether we should change our perception of the corporation from one being run by its directors dedicated exclusively to its shareholders to that of a corporation whose main purpose would rather be for the creation of wealth, not only for its owners and creditors, but also for its employees and the community and the environment is a question, which is, at present in South Africa, very significant.

Various recommendations on directors’ duties in light of the above, have found their way into legislation across the globe. Therefore, the issue to be considered is how and to what extent legal rules and policies should develop in South Africa, which place directors under a *positive duty* to take account of the interests of bodies other than the shareholders of the corporation. Evidence exists, which supports the fact that where some employees participate in the decision-making processes of the company, other employees in that company generally perform better. This, in turn, directly impacts upon and improves the economic productivity levels of the corporation. These results then provide a win-win situation for all. To best accomplish this, it is proposed that South Africa needs to replace its existing unitary board structure with the two-tiered board structure, which is currently adopted in Germany.

2. What is corporate governance ?

The term ‘corporate governance’ has recently become a very widely used term in modern corporate practice. Although, it has been the focus of attention in developed countries since the 1980s [4], the meaning is not clear. The popular use of the term, however, is to refer to the functions of directors and managers in especially larger corporations, including the structure of management. Therefore, what directors do to carry out their fiduciary duties, and what the law prescribes they *ought* to do, are issues affecting all of us in our daily lives. Ultimately, we have a struggle between two basic principles, which form the pillars of authority in our society - corporate activity and freedom of enterprise on the one hand, and legal procedure and accountability on the other. Jacoby writes that in the last decade, corporate governance has become a controversial issue because the rules for governing public corporations are being challenged by many critics, ranging from investors to social activists. Consequently, some critics hope to give greater power in corporate decision-making to shareholders, whilst others hope to provide this to other stakeholders, such as employees and customers. However, Jacoby emphasises an important point, which is that no two countries deal with corporate governance issues in precisely the same way. [5]

Furthermore, it is important to remember that the main task of corporate governance in any modern company is to reduce its costs so that it may *increase* productivity and managerial efficiency. Consequently, corporations should divide and balance corporate powers amongst the shareholders' meetings, the board of directors and the managers. Thus, corporate governance must address the balancing of powers and interests amongst the corporate stakeholders. [6] In effect, the main objective of corporate governance is to improve corporate efficiency. Thus, questions regarding the nature of the corporation, the reasons for incorporation, for whose benefits the corporation is governed and how the corporation should be governed should be addressed. These answers would provide the direction and basis for judging corporate efficiency. [7] Hocking wrote a political biography on Lionel Murphy, whose professional life in Australia covered many fields, from labour lawyer to Senator to Attorney General to High Court judge. Murphy died in 1986. Regarding the question of company law, she notes that Murphy pointed out that under Australian company law, management owed no duty at all to employees. English judges continued to rule that company law provided no authority with which to support the contention that company directors had any obligation or duty to their employees, Murphy noted that whilst,

“such is not the law in Australia either ... the question may fairly be asked, I think, whether it should be. Was it possible ... to take the law in the direction ... to introduce ‘a new concept of social responsibility’ into the law?” [8]

Many countries around the world have recently taken into account and have adopted procedures and rules, internally and through the enforcement of legislation, which provide *non-shareholder interests* with mechanisms for improved participation in corporate governance practices. It is along these lines together with domestic pressures from within that have compelled South Africa to re-evaluate its position with regard to its corporate governance practices. Hence, the real issue to be considered is how and to what extent legal rules should develop, which place directors under a positive duty to take account of the interests of bodies other than shareholders in the corporation. A model of corporate governance for South Africa, based on the German two-tiered board structure, is proposed, which takes into account the extent to which other non-shareholder interests and rights, especially those of the employees, should be considered. Therefore, the nature of the employees' rights to participate in the decision-making processes of the corporation, alongside the directors and shareholders, is highlighted in the discussions in this paper.

3. Board Structures

An important question to be considered is the extent to which employee participation in the decision-making processes in the enterprise would *actually* improve productivity standards and product quality.

In this regard, Jacoby notes,

“(i) n theory, giving employees a voice in governance – either at the workplace or corporate levels – should enhance their willingness to invest in firm-specific skills and to share productivity-enhancing ideas with the employer. ...Voice should also reduce...turnover-related costs.” [9]

Consequently, it can be argued that if South Africa has any hope of successfully improving its productivity levels to a significant degree with its re-entry into international markets, then management and labour *must* establish improved corporate governance systems to address stakeholder concerns and in interacting with one other.

Furthermore, it is significant to note that

“(s)ome corporate systems have cultivated some of the strongest economies in human history, yet it is hard to say which country’s corporate governance system is best.” [10]

However, one of the most influential corporate governance systems in the world has emanated from Germany. This system has

“...either created powerful corporate economies in the world enormously, or carried out drastic corporate reforms and brought new insights to corporate development. ... (T)he German...model operate(s) in the strongest corporate economies in the world. ... (E)conomies, political preferences and cultural and legal traditions are important conditions that shape a country’s corporate system. ... (Therefore) the development of a corporate system in a specific country should be studied in the country’s own historical context. ...” [11]

In developing a new corporate governance model for South Africa, the corporate governance models of Britain and America with unitary board structures and of Germany with a two-tier board structure have been considered.

3.a Britain

The British system of corporate governance would not take the present system of corporate governance in South Africa much further than it is at the moment. This is because the UK system adopts a one-tier board structure. Furthermore, it has always been held that in this type of board structure the interests of employees and the interests of shareholders conflict. [12] A single-tiered board structure for South Africa is not recommended. The problem with one-tier board systems is that they are required to fulfill two incompatible corporate functions. That is, it is both the supreme executive body and the supervisory organ. This raises the possibility of abuse of executive power by management and doubts about the accountability of directors are high. Originally, these problems were foreseen and a disclosure system was introduced to improve the lack of accountability caused by one-tier boards with two functions. [13] Therefore, a model of corporate governance should be designed for South Africa, which is based upon the two-tiered board structure model. Moreover, one-tier board systems emphasise the role of non-executive directors on the basis that the non-executive directors’ independent judgment and monitoring of corporate governance strategies can raise the standards of good corporate governance. [14] The two-tier board system constantly attempts to enhance the independence and strength of the supervisory board. Independent auditors are introduced into many jurisdictions and, therefore, major creditors, financial institutions and related companies can effectively influence the board. Recently, proposals that interested groups should have representatives on the board have increased. [15] .Furthermore, Dore notes,

“...what seems to me the obvious “social justice” case for subordinate-employee power...is most obvious here in Britain where, last year, executive compensation (not including stock options) rose by 15% while average salaries rose by 5%.” [16]

Hence, Jacoby identifies two distinctive governance systems in industrial countries. There is the “shareholder” or Anglo-American system, also referred to as the “market-outsider system” or “stock-market capitalism” model. There is also the “stakeholder” system, which is also referred to as the “relational-insider” system, the “dedicated-capital” system or “welfare capitalism” model. This model is used in Germany. Thus, the

shareholder model is an “exit” model, in terms of which shareholders sell their shares to express dissatisfaction with management. The stakeholder model is a “voice” model, in terms of which the other

stakeholders within the corporation, including the employees and shareholders, express concerns by *communicating directly with management*. These systems provide employees with very different roles in corporate governance. *Employees have little or no influence on corporate matters under the shareholder system. Under the stakeholder model, employees have a moderate role, through custom, in Japan, and an important role, through statute, in Germany.* In Germany, this occurs through a legal system of work councils and co-determination. In Japan, most large companies have unions and joint committees with access to senior management. Thus, employees are important stakeholders and management mediates between the shareholders, employees and other stakeholders. [17]

Moreover, the British have recently accepted the fact that their hesitation to take a significant step forward to reform their existing corporate system has made the UK corporate system and company law outdated. Since the mid-nineteenth century, the development of UK company law has been a process of constant addition of new rules to the existing legal framework. Thus, although the law became voluminous and complex, no attempts were made to reassess its traditional principles and policies. [18] The British have not been willing to accept the two-tier board system of corporate governance. They believe that such a board structure would facilitate a worker participation system. This would contradict traditional mainstream corporate theory, which is that corporations should be run only for the interests of shareholders. Consequently, the interests of employees and shareholders remain in conflict. It will, however, be interesting to see, with the development of corporate laws within the European Union, whether the UK's corporate governance system will move towards a two-tier board system, which would incorporate employee participation. [19] In modern times, the British view of corporate governance, which is reflective of a unitary board structure, cannot be taken seriously. All stakeholders need to play some role in the governance of the corporation. It simply can no longer be run only for the benefit of the shareholders.

3.b The United States of America

The model of corporate governance used in the USA is also composed of a unitary board structure. The shareholders are the owners of the corporation. In America, it is believed that shareholders alone should direct management decision-making. This can be achieved either through proxies, through the fiduciary duties of managers and corporate boards, or through legal and economic means, which align management decisions with shareholder interests. In other countries, however, there is a greater willingness through the law and through the managers and shareholders to allow employees to participate in corporate governance. [20]

Jacoby quotes an American union official, who said,

“it is amazing to me that in Europe...the corporations feel that they have [an ethical] obligation to their employees. ...Th [is] comes naturally from the European culture.” [21]

O'Connor also suggests that the American system of corporate disclosure does not provide sufficient information about their employees. He believes that employees show up as payroll expenses rather than being considered as a potential source of value to the corporation. [22] The important point is that in order for corporate law to be able to protect employees while holding directors accountable, it must recognise that directors have enforceable fiduciary duties towards its employees. [23] Moreover, Gulati emphasises the fact that all corporations involve and affect many other groups *other* than the shareholders themselves and the members of the upper management team. These other stakeholders are the employees, the lower and middle management teams, the creditors, the suppliers, the customers and even the government and local communities. All of these groups play important parts in the decision-making processes of the corporation.

“The puzzle, therefore, is why U.S. corporate law ignores them. ...The thrust of O’Connor’s article is the argument that labor has an important part to play in the governance of corporations and that this role needs to be recognized within corporate law.” [24]

Another interesting point is that the Anglo-American share of the world’s outward foreign investment pie has fallen from 66% in 1980 to about 50% in 1997. In contrast, German investment rose sharply during this period. [25] So, the US style of corporate governance, which adopts the “shareholder” system, has waned considerably in popularity. Thus, the economic case for the superiority of Anglo-American governance and of the Anglo-American version of “free markets” is weak. [26].Furthermore, Jacoby believes that the question of costs and benefits will force American workers into the position of being amongst the least influential group of employees in the advanced industrial world. Thus,

“...not a few journalists and even some respected academics are asserting that U.S.-style corporate governance promotes “rent extraction” – greed, in plain English – and is not, as was alleged back in the 1990s, a system of “optimal contracting.” [27]

In fact, O’Connor states that

“(historically), unions in the United States did not support reform proposals for German-style codetermination because labor was reluctant to challenge the “system” that established managers as “thinkers” and workers as “doers”.” [28]

Thus, employees in the US have been restricted to workplace discussions concerning wages and working conditions. This allowed managers the opportunity to maintain control over strategic decisions. Thus, when the German economy began to perform better than that of the US, corporate law scholars reexamined the employees’ role in the German system of codetermination. Davies also believes that commentators and institutions in the 1980s began to take an interest in both the German and Japanese systems of corporate governance especially when the economies of these countries “out-performed” that of the U.S. economy. [29] .Sullivan also notes that in the 1980s and 1990s, there was a great deal of interest in the German and Japanese “insider systems of corporate governance”, as compared with the American shareholder model of corporate governance. This was due to the fact that the German and Japanese systems produced excellent returns economically and was hugely successful in achieving “social cohesion.” [30] Sullivan believes that each country is different and, therefore, no one system of corporate governance can be applicable to all. Therefore, Sullivan correctly submits that there is inadequate attention to the question of what it is that makes each country different from another. [31] .In describing the US model of corporate governance, the US unitary board structure is composed of different committees, which can include an auditor, an executive, a compensation or a nomination committee. Most companies have the first three types of committees attached to their unitary board structure. Thus, although executive and auditor committees are composed of internal appointments and are involved in the daily management and financial control operations of the corporation, compensation and nomination committees, which are composed of outside directors, supervise the executive directors and managers. This step towards a two-tiered structure has improved the effectiveness and accountability of the US one-tier board. [32]

However, the American system of corporate governance does not encourage or direct the directors towards an adequate consideration of the other stakeholders in the corporation other than the shareholders. The system is very outdated and does not conform to modern global trends on corporate governance that take into account the rights and interests of all the corporate stakeholders.

O’ Connor submits correctly that

“(i) n the end, we must engage in an honest discussion of the political issues involved – issues that do not lend themselves to precise mathematical testing. These political issues involve questions such

as, “what kind of society do we want to live in?” In defining a “socially optimal” corporate governance system, we should talk about the quality of life, rather than just about gross national product and shareholder value.” [33]

3c. Germany

Germany evolved a system of corporate governance, which was quite different from the UK through its radical reforms. It has a corporate governance system in place, which is very different from the Anglo-American model. Germany has one of the *most successful* corporate economies in the world. Therefore, many countries could derive significant insights and advantages from the institutional structures of this type of governance system. Hence, the Germans operate an institutionalised stakeholder model. [34] The German style is designed to be advantageous to *all* stakeholders in the corporation, not just the shareholders and the directors. German attitudes attach much significance to the concept of “co-operation” rather than that of “confrontation”. Germans have an overwhelming sense of commitment to the community and seem to think in the long term and not to expect too much too soon. The German educational system also works closely with industry. [35] In this way, Germans have great respect for and pride in their industry. German companies place their employees and customers *before* the shareholders. [36] Hence, the shareholders are but only one group of stakeholders and that, although important, making a profit is *not* the only thing that counts. Furthermore, board remuneration is not as important to Germans as it is in other countries, such as the US or UK. Germans see profit as being important, but not the only aspect to consider when making decisions. Thus, there are virtually no stock options for tax reasons and pay is not tied to profits. Directors would receive about 65 percent of their income as a basic salary. The balance would be comprised of annual bonuses and other company benefits. [37]

According to German law, a mandatory two-tiered board structure must be established in corporations, which consists of a supervisory board and a management board. However, stock companies founded after 10 August 1994, which employ fewer than 500 people, are exempt from the co-determination system. This does not apply to stock companies founded before this date (other than family businesses) where one-third of the seats on the supervisory board must consist of the employee representatives. [38] The supervisory board is selected by and composed of shareholders and employees. The supervisory board supervises the management of the corporation, whilst the management board manages the company. German legislation strictly separates the functions of the two boards to allow the creation of optimum effectiveness. In this way, the supervisory board closely scrutinizes the performance of the management board. Thus, the interests of the employees will not be neglected. Hence, a system was developed of placing matters of supervision into the hands of shareholder committees. Therefore, this type of system identified the need for *supervision* and placed this function into the hands of a group of people. It also identified the need for *direction and management* and placed this function into the hands of another group of people. In this way, large German companies today have a supervisory board, termed the “Aufsichtsrat”, and a management board, termed the “Vorstand.” [39] Thus, whilst the “Vorstand” proposes, the “Aufsichtsrat” disposes. [40] Consequently, the main function of the supervisory board is to ensure that the management board acts competently through a framework of consensus. [41] The question of employee representation on the supervisory board is highly significant. Although their power is somewhat limited by the casting vote of the chairman and the general meeting of shareholders, employee members can use their position to bargain. In this way, employees may threaten not to vote for a particular member to be elected onto the management board (which usually spells out an end to that management nomination). [42] The “Vorstand” is accountable to the “Aufsichtsrat” legally. [43] By having employee representatives and bankers on the supervisory boards improves the effectiveness of the system as a whole. Supervisory boards have the power to appoint or dismiss. Generally, if the “Vorstand” is not performing well, the “Aufsichtsrat” may give them another opportunity to improve. The “Aufsichtsrat” will generally only intervene if the management board is slow in acting in remedying its poor performance levels. [44]. Over the years, supervisory boards have shifted towards the ideology that they should be advising and counselling the management boards rather than confronting them.

[45] In this monitoring manner, the focus is on mistakes being prevented rather than being detected. Thus, in Germany, co-operation rather than confrontation, is significant. This is demonstrated in the relationships between sections of the German economy, including proprietors, management, employees, the financial sector, government and academia.

Furthermore, the Germans believe that companies have a human and personal component to it and will “produce a general benefit for the community as a whole.” [46]

“The underlying ideology is that worker participation in the decision-making will promote trust, co-operation and harmony.”[47]

Thus, the German two-tiered board system encourages employees to participate in the decision-making process. This system promotes trust, co-operation and harmony and therefore improves the relationships between the employer and employee. Thus, the right to be consulted ensures that informal discussions occur. Employers believe that informed and trusted employees are more loyal and would have a greater understanding of the problems of the company. Thus, Germany’s two-tier board system therefore appears to be a more efficient system than the one-tier board system. [48]. Furthermore, the German government has played an important part in shaping German corporate patterns. Consequently, industrialisation in Germany has been a more organised process as compared to that of the UK. Banks also play a very influential role. Banks in Germany are commonly represented on supervisory boards. In this way, companies acquire access to information, which they ordinarily may not have. In some cases, the banker may even become the chairman of the supervisory board. [49]. German legislation can be described as having a “broad social and economic” base. [50] Thus, the system of corporate governance in Germany is characterised by two main features – its *two-tiered board structure and its system of co-determination*. The Co-determination Act of May 1976 provides for the *proportions of employee and shareholder representatives on the supervisory board*. [51] The members of the executive board manage the company and the supervisory board members control and monitor the management board. The supervisory board may *inter alia* appoint and dismiss members of the executive board and examine annual financial statements.

Most German industries are carried out by one of two types of incorporated companies, which are those companies with limited liability (*GmbH or Gesellschaft mit beschränkte Haftung*) and the share companies (*AG or Aktiengesellschaft*). The remaining companies, which do not fall into either of these two categories, are hybrids and families usually control them. [52]. All AG’s must have a management board. Additionally, all AG’s must have a supervisory board whatever their size, but co-determination is not mandatory if the company has fewer than fifty employees. However, in smaller GmbH companies (with less than 500 employees) a managing director (*Geschäftsführer*) is appointed, who may, regardless of the contractual rights therein, be dismissed at any time. Therefore, these companies are not required to have supervisory boards. In larger GmbH companies, the principle of co-determination applies and a supervisory tier must be established. This is so even in the case where there is only one shareholder. In this way, the number of employees would determine whether a supervisory board has to be formed or not. Shareholders would hold two-thirds of the available seats on the supervisory board, whilst the employees or unions would hold one-third of the seats. This would also apply to AG companies that have less than 2000 employees. In the case where an AG company has more than 2000 employees, half of the available seats would be held by employees/unions.

The chairman of the supervisory committee is always a representative shareholder (except in the coal, iron and steel industries where the chairman is neutral) who has the right of two votes, which he or she cannot delegate, in the event of a deadlock. Both employees and the unions usually choose representative employees. One employee representative must be selected in each case from the salaried staff and from the executive staff. [53] Thus,

“supervisory independence is ensured by the explicit provisions of law stating that the two boards have absolutely separate functions and that the supervisory board cannot take over any managerial duties. The law requires that each public company (AG) and each limited liability company (GmbH) with more than 500 employees must have a supervisory board.” [54]

The system of co-determination operates through the structure and mechanisms of the supervisory board. In this way, a certain proportion of supervisory board members must be employees. These employee representatives ensure that employees’ interests are not neglected. It is thought that, through co-determination, *participation of the employees* in decision-making will promote sound working relationships. [55]

4. A new model of corporate governance : The case of South Africa

“While Anglo-American systems are moving to adopt a wider conception of stakeholder interests,” [56] a new corporate governance model for South Africa is ultimately proposed, which is the central aim of this paper. In this model a structure will be created, which will bring the employee into the decision-making processes of the corporation at board level.

“ Corporate development has come to the stage where human capital or employees play an important role in creating and increasing corporate value. Employees physically own companies, the outcome of corporate performance directly concerns their interests.” [57]

In this way, South Africa should have a corporate system in place in terms of which employees consciously play a dynamic role in corporate governance. Jacoby endorses these sentiments. He notes,

“...many types of employee voice are associated with better firm performance, which is hardly surprising given that employees possess inside information about inefficient processes and ineffectual managers, and are at least as motivated as shareholders to see that the firm is run effectively. ...Voice and civic values are associated with equity in the distribution of economic rewards and equity, in turn, is associated with higher long-term growth rates. ...” [58]

It should be stated,

“ (e) ven after a sound model is adopted work is still needed, because there are always gaps between theories and practice. These gaps have to be filled by informal rules and norms shaped by tradition, culture and customs. In fact, peoples’ social relationships and behaviour are more greatly influenced by such informal rules and norms. Any law cannot completely reflect reality, cannot predict all foreseeable events and cannot extinguish language obscurity. Moreover, a law usually lags behind social development.” [59]

The traditional shareholder primacy model, which firmly entrenches the principle of maximizing shareholder profits, should be rejected and abandoned. Corporate law in business today must take into account the rights of all of the stakeholders in the corporation. Society and business require greater recognition of the rights of non-shareholders.

Thus, a provision should be inserted into the South African Companies Act 61 of 1973 that reads,

“the directors of a company must recognise and pay sufficient regard to the rights of all of the stakeholders of the corporation, which include, but are not limited to, the employees, the shareholders, the suppliers, the creditors, the community and the environment.”

Both company and labour law are inextricably dependent upon one another. It makes good sense for each branch of law, through its respective legislation, to recognise the rights of all stakeholders in the corporation. In this way, the rights of employees in the decision-making processes of the corporation at all levels would be widely recognised. Company law should therefore formulate a multi-fiduciary model, which would *oblige* the directors to become fiduciaries for all of the stakeholders.

A simple and clear provision should be inserted into the Companies Act 61 of 1973 that reads,

“the directors act as the fiduciaries for all of the stakeholders in the corporation.”

Thus, a unitary board system, in any form, is *not* the preferred option. A two-tiered board system, based upon co-determination, is recommended on grounds both of *principle and of pragmatism*. In principle, it provides a clear division of function. Pragmatically, the principle of co-determination would not work well in a unitary board system. In this way, a two-tiered board structure would consist of a supervisory board and a management board. The supervisory board would consist of shareholder and employee representatives. Since South Africa has not yet endorsed the two-tiered board structure, a choice between this model and the unitary board structure might be created. Thus, in the *transition phase*, until the two-tiered board structure is widely accepted and legally adopted, corporations could be given the option of choosing between the unitary board and the two-tiered corporate governance models. It is also proposed that a corporation might, at any time, change from the unitary board structure to the dual board structure and *visa versa*, provided that it calls an extraordinary general meeting and, at such meeting, acquires a two-thirds majority of votes in favour of the change called for.

THE DEPARTMENT OF TRADE AND INDUSTRY (THE DTI) SOUTH AFRICA

The DTI issued a policy document for public comment in May 2004. [60]

According to the South African Minister of Trade and Industry, the main purpose of this policy paper is to establish the approach that government intends taking to review company law in South Africa.

The report also establishes a

“...framework for detailed technical consultation to ensure that we have company law, which is up-to-date, competitive and designed for a modern corporation that is not only a domestic institution operating in a new environment but also an international competitor.” [61]

This will involve a review of the current Companies Act, 1973, the Close Corporations Act, 1984 and the common law. [62] The Minister also acknowledges the fact that since the introduction of the 1926 Companies Act there has only been one significant review of South African company law and that occurred through the introduction of the 1973 Companies Act.

Although the 1973 Act was a major review of South African company law, it left the traditional framework and principles of English law firmly *entrenched* in South African company law. [63] This policy document will be used as the foundation to draft a new Companies Act to be considered by cabinet for publication in September 2005. It will then be published for public comment during the period September to December 2005. The State President will proclaim the Bill in June 2006. [64] The broad areas of review will focus upon issues of company formation, finance, corporate governance, mergers and takeovers, liquidation and corporate rescues and non-profit corporate entities. The DTI policy document has recommended certain changes in the areas of company formation and corporate governance, which are relevant to the discussions and arguments in this paper.

Major Reform Proposals Of The Department Of Trade And Industry

The proposals set out in the DTI public discussion document have highlighted key principles. The following major proposals and concerns of the DTI are sound:

(1) Any regulatory policy must recognise the unique South African context and therefore promote equity in such a manner, which is consistent with the South African Constitution. [65]

(2) Company law should encourage principles of transparency and high standards of corporate governance and therefore recognise the broader social functions of corporations. [66]

(3) The review will also consider the relationship between company law and any other rules, which protect the interests of shareholders, employees, the State, the environment, consumers and suppliers. [67]

(4) From an international perspective, company law review is a continuous process, which ensures that the laws are reflective of market practices and societal needs. Because we now live in a world of greater globalisation, increased electronic communication and greater sensitivity to social and ethical concerns, South Africa must review its legislative policies or be left behind. There is a growing recognition by companies and governments that higher standards of corporate governance are required. There is a need for further interdependence between corporations and communities. Corporate failures in South Africa have revealed serious defects in the current standard of corporate governance, which have resulted in extensive losses to investors. [68]

(5) Current company law does not contain clear rules regarding corporate governance issues and the duties and liabilities of directors. These matters have been left to the common law and Codes of Corporate Practice. Thus, there is no extensive statutory scheme, which covers the duties, obligations and accountability of directors. Thus, directors and senior management of large companies are generally “immune from legal control”, except in more serious criminal cases. Another significant weakness is the “absence of a public institution” charged with the powers to “enforce the rights of shareholders and other stakeholders.” [69]

(6) In South Africa, company law must consider the rights and interests of the other corporate stakeholders such as the community, customers, employees, suppliers and the environment. Thus, consideration must be given to both the economic factors and also to the social and environmental factors. In this regard, a review of company law in South Africa would follow world trends and also consider the country’s unique social and legislative environment. Hence,

“a company should have as its objective the conduct of business activities with a view to enhancing the economic success of the corporation, taking into account, as appropriate, the legitimate interests of other stakeholder constituencies.” [70]

Consequently, directors should consider the policies and principles, which are reflected in the Constitution and other legislation for the benefit of other stakeholders.

Based upon the arguments in the paper, the following proposal of the DTI is arguably incorrect and unconvincing:

“There has been a question in South Africa for some time whether we should follow the example of continental Europe in establishing a two-tier board or whether a unitary board structure should be required. While a two-tiered board provides for the opportunity for stakeholder representation, the European experience has shown that this type of Board structure is often inefficient, may deter

investment and is not necessarily desirable for stakeholders. Furthermore, South Africa has largely adopted a unitary board structure to date and imposing a legal requirement for a two-tier structure may be costly. For this reason, the position of this policy document is that a unitary board structure be retained, but that stakeholder representation on that board should be optional.” [71]

This DTI proposal and the bases underpinning it are arguably incorrect. Essentially, in addressing the criticisms of the DTI, the advantages of a two-tiered board structure of corporate governance are noted as follows:

(1) Regarding the issue of *efficiency*, which was raised by the DTI, the two-tiered board structure identifies the need for supervision and places this function into the hands of a group of people. It also identifies the need for direction and management and places this function into the hands of another group of people. In this way, large German companies today have a supervisory board and a management board. Shareholder and employee representatives on the supervisory board proceed with management by co-operation rather than by confrontation. [72] Based upon these features, the two-tiered board structure is certainly a far more efficient system of corporate governance than the unitary board system.

(2) Regarding the question of the *desirability* of the two-tiered board structure for stakeholders, which was raised by the DTI, shareholders would hold two-thirds of the available seats on the supervisory board, whilst the employees or unions would hold one-third of the seats. This would apply to AG companies that have less than 2000 employees. In the case where an AG company has more than 2000 employees, half of the available seats would be held by employees/unions. Both employees and the unions usually choose representative employees. One employee representative must be selected in each case from the salaried staff and from the executive staff. Based upon these features, the two-tiered structure would certainly be one, which would allow a greater amount of stakeholder representations in having created its supervisory boards. Furthermore, banks in Germany also commonly sit on supervisory boards. In this way, companies may have access to information, which they ordinarily may not have. [73] This would be a more desirable system for corporate stakeholders.

(3) Regarding the question of attracting *investment*, which was raised by the DTI, the two-tiered board structure, through the German legislation, enshrines the principle of “commercial prudence” in accounting procedures, rather than the principle of having to show a “true and fair view”, which is found in other accounting systems. Thus, in this way, accounting reserves for risks are made. Consequently, profits are reduced, but reserves are maintained in case the company experiences financial difficulties at some stage. This has an overall positive effect on all of the stakeholders, which German corporations value highly. Therefore, although the profits are reduced, “commercial prudence” ensures that the business survives. This principle is more important to German companies than any of the reasons, which attempt to maximise shareholder wealth and company profits. Thus, in this way, the stock market is far less at the centre of the stage. This system has given rise to the success of German industry over the last forty years. In particular, the German industry has prospered due to the creation of a well-motivated and trained workforce, a relatively stable macro-economic climate and an effective two-tiered board governance system. In this way, Germany has consistently had a rising currency. This success may be due to the fact that there is a genuine belief that co-determination is socially desirable and economically beneficial. [74] Therefore, on the whole, the two-tiered board system in Germany has not deterred, but very much *enhanced*, German investment.

(4) It is not clear what the DTI intends to say when it submits that “a two-tier structure may be costly.” Although it may be *costly* (from a monetary point of view) for South Africa to convert from a unitary to a two-tiered board structure of corporate governance, the advantages of having a two-tiered board system in place would easily outweigh the financial costs, which may be involved. In any event, it would appear (from the wording “(f) or this reason”) as if the DTI has placed primary emphasis on the question of costs. The DTI ought not to rely on the questions of costs as its prime reason to reject the two-tiered board system. If

the DTI is referring to costs of a non-pecuniary nature, it needs to spell out exactly what it intends in its proposals in this regard.

5. Conclusion

Based upon the aforementioned discussion, the proposed change of a corporate governance model from a unitary to a two-tiered board structure will offer an improved system of corporate governance to corporations in South Africa. This is particularly relevant in so far as the participation of the employees in the decision-making processes of the corporation at board level is concerned. South Africa has thus far been reluctant to recommend a change from its traditional unitary board structure to the two-tiered board structure. However, the two-tiered board structure is the preferred option as it furthers the interests and the rights of employees in the decision-making processes of the corporation. These systems could be introduced into the unitary board structure whilst the development of the dual board structure is underway. Ultimately, however, if South Africa is firmly intent on turning its economy into one that is stronger and better, corporations will have to introduce the two-tiered board model of corporate governance into their business practices.

Through co-determination, participation of the employees in decision-making will promote sound working relationships, happier employees, loyal customers and improved corporate productivity. The DTI policy report has made some sound proposals on the questions of corporate law reformation. Many of the sentiments, which have been expressed in this paper regarding stakeholder interests in corporate governance, have been recommended as a way forward for South African corporate governance. Unfortunately, the DTI is arguably incorrect in its recommendation to retain the unitary board system of corporate governance in South Africa. Hopefully, in the future, the DTI might place a greater value on the effects and advantages of the two-tiered board structure of corporate governance for South Africa. Any new changes are always viewed with great skepticism, but changes are vital to progress. It is recommended that a change in corporate governance from a unitary to a two-tiered board system be seriously considered. This change is an economic necessity and a moral imperative and will contribute to a wealthier and happier South Africa.

Endnotes

- [1] Y Wei (2003), *Comparative Corporate Governance A Chinese Perspective*, Global Trade and Finance Series, Vol. 3, Kluwer Law International, 2.
- [2] *Ibid* 8.
- [3] RI Tricker (1984) *Corporate Governance: Practices, procedures and powers in British companies and their boards of directors*, The Corporate Policy Group, Oxford, 236.
- [4] Wei, above n 1, 3.
- [5] SM Jacoby (2000) "Corporate Governance in Comparative Perspective: Prospects for Convergence", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 5.
- [6] Wei, above n 1, 2.
- [7] *Ibid* 37.
- [8] J Hocking (2000) *Lionel Murphy A Political Biography*, Cambridge University Press, 220.
- [9] Jacoby, above n 5, 24.
- [10] DC North (1990) *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, New York, 37-69, quoted in Wei, above n 1 at 12.
- [11] *Ibid* 12-14.
- [12] Wei, above n 1, 15.
- [13] Wei, above n 1, 126.
- [14] Committee on Financial Aspects of Corporate Governance (1992) *Report of the Committee on the Financial Aspects of Corporate Governance*, para.4.6, quoted in Wei, above n 1 at 47.
- [15] *Ibid* 47.
- [16] R Dore (2000) "Comment: Papers on Employees and Corporate Governance", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance* Vol. 22, No. 1, 159.
- [17] Jacoby, above n 5, 6-7.
- [18] Wei, above n 1, 15.
- [19] Wei, above n 1, 130-133.
- [20] MW Finkin and SM Jacoby (2000) "Introduction", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 1-2.
- [21] *Ibid* 13.
- [22] M O'Connor (2000) "Labor's Role in American Corporate Governance Structure", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 127.
- [23] *Ibid* 103-104.
- [24] M Gulati (2000) "Incorporating Labor", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No 1, 171.
- [25] Jacoby, above n 5, 29.
- [26] *Ibid* 30.
- [27] *Ibid* 31-32.
- [28] O'Connor, above n 22, 102.

[29] P Davies (2000) "Employee Representation and Corporate Law Reform: a Comment from the United Kingdom", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance* Vol. 22, No. 1, 136.

[30] M O'Sullivan (2000) "Variety and Change in the Role of Employees in Corporate Governance", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance* Vol. 22, No. 1, 180.

[31] *Ibid* 182.

[32] Wei, above n 1, 137-138. See also Charkham (1995) *Keeping Good Company, A Study of Corporate Governance in Five Countries*, Oxford University Press, New York, 191.

[33] *Ibid* 133.

[34] T Araki (2000) "A comparative analysis: corporate governance and labor and employment relations", *Comparative Labour Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 89.

[35] Charkham above n 32, 9.

[36] *Ibid* 10.

[37] *Ibid* 21.

[38] D Sadowski, J Junkes and S Lindenthal (2000) "The German Model of Corporate and Labor Governance", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, Vol. 22, No. 1, 34.

[39] Charkham above n 32, 14.

[40] *Ibid* 22.

[41] *Ibid*.

[42] *Ibid* 23.

[43] *Ibid* 44.

[44] *Ibid* 47.

[45] *Ibid* 50.

[46] Wei, above n 1, 143.

[47] M Lutter (1982) "The German System of Worker Participation in Practice" *Journal of Business Law*, 154-155, quoted in Wei, above n 1 at 145.

[48] *Ibid* 144.

[49] Charkham above n 32, 41.

[50] Wei, above n 1, 15.

[51] Charkham above n 32, 14.

[52] *Ibid* 15.

[53] *Ibid* 18.

[54] KJ Hopt (1997) "The German Two-tier board (Aufsichtsrat), A German View on Corporate Governance", in KJ Hopt & E Wymeersch (eds), *Comparative Corporate Governance, Essays and Materials*, 6, quoted in Wei, above n 1 at 17.

[55] Charkham, above n 32, 13.

[56] Wei, above n 1, 19.

[57] *Ibid* 25.

[58] Jacoby, above n 5, 30-32.

[59] Wei, above n 1, 4.

[60] "South African Company Law for the 21st Century Guidelines for Corporate Law Reform: Guidelines for Corporate Law Reform".

[61] *Ibid* 5.

[62] *Ibid* 10.

[63] *Ibid* 4.

[64] *Ibid* 53.

[65] *Ibid* 9.

[66] *Ibid* 10.

- [67] Ibid 11.
 [68] Ibid 14.
 [69] Ibid 18.
 [70] Ibid.
 [71] Ibid 39.
 [72] Charkham above n 32, 14-56.
 [73] Ibid.
 [74] Ibid.

Reference

- Charkham, J.1995. *Keeping Good Company: A Study of Corporate Governance in Five Countries*, Oxford University Press.
- Davies, P.,2000. "Employee Representation and Corporate Law Reform: A Comment From the United Kingdom", *Comparative Labor Law & Policy Journal: Employees And Corporate Governance*, 22(1): 135-147.
- Dore, R. 2000. "Comment: Papers on Employees and Corporate Governance", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, 22(1): 159-178.
- Department of Trade and Industry, 2004. *South African Company Law For The 21st Century: Guidelines For Corporate Law Reform*, available: <http://www.dyi.gov.za> (accessed 11 August 2004).
- Finkin, MW & Jacoby, SM. 2000. "Introduction", *Comparative Labor Law & Policy Journal: Employees And Corporate Governance*, Fall, 22(1): 1-3.
- Gulati, M .2000. "Incorporating Labor", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, 22(1): 171.
- Hocking, J.2000. *Lionel Murphy: A Political Biography*, Cambridge University Press, Australia.
- Hopt, KJ.1997. "The German Two-Tier Board (Aufsichtsrat), A German View on Corporate Governance", In K.J. Hopt & E. Wymeersch (eds), *Comparative Corporate Governance, Essays And Materials*: 6.
- Jacoby, SM. 2000. "Corporate Governance in Comparative Perspective: Prospects for Convergence", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, 22(1): 5-32.
- Lutter, M. 1982. "The German System of Worker Participation in Practice", *Journal Of Business Law*, 154-155.
- North, DC. 1990. *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, New York, 37-69.
- O'Connor, M. 2000. "Labor's Role in American Corporate Governance Structure", *Comparative Labor Law & Policy Journal: Employees And Corporate Governance*, 22(1): 97-133.
- O'Sullivan, M.2000. "Variety and Change in the Role of Employees in Corporate Governance", *Comparative Labor Law & Policy Journal: Employees And Corporate Governance*, 22(1): 179-194.
- Sadowski, D, Junkes, J and Lindenthal, S.2000. "The German Model of Corporate and Labor Governance", *Comparative Labor Law & Policy Journal: Employees and Corporate Governance*, 22(1): 33-66.
- Tricker, RI.1984. *Corporate Governance: Practices, Procedures and Powers in British Companies and Their Boards of Directors*, The Corporate Policy Group, Oxford.
- Wei, Y.2003. *Comparative Corporate Governance: A Chinese Perspective*, *Global Trade And Finance Series*, Vol. 3, Kluwer Law International, Australia.