

# Corporate Governance: South Africa vs. The United States

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## Introduction

Executive compensation will be analyzed by reviewing the recent historical trends of CEO pay in South Africa and the United States. CEO pay structures in each country will also be discussed along with regulations on executive compensation in each country.

Board structure will be the focus of the next section of our paper. The major factors that influence board structure will be discussed along with a review of board committees, purpose, and composition.

An overview of sustainability will be provided by highlighting key legislation, principles, and requirements that impact sustainability within the country. We will then begin discussion on profit sustainability by analyzing economic figures and current research on South Africa's economic outlook. People sustainability will be assessed by reviewing provisions in the Companies Act, and South Africa's plan to reduce their effect on climate change will be emphasized when discussing planet sustainability.

## Executive Compensation

Since the mid 1990's, CEO pay in both the US and South Africa has steadily increased (Brenner & Schwalbach). The remuneration data provided by Towers and Perrin that was analyzed by Brenner and Schwalbach showed that both the median growth of total pay for US CEO's of 0.09 annual change and a 0.11 annual change in the pay for executives in South Africa from 1995 to 2005. Brenner and Schwalbach also observed that the CEO compensation was more strongly linked to performance pay in both the US and South Africa, as both countries follow English common law.

In a recent article that appeared in Bloomberg, The CEO pay and benefits of the top 250 CEO's in the US were compared to that of the average worker. The pay ratio of the top 5 CEO's pay and benefits in the US to the average worker's pay and benefits ranges from 1795 to 1135 (Kunze, Whiteaker, & Smith). This is not shocking that the CEO's of companies like JC Penny, Abercrombie & Fitch, and Starbucks Corp. make so much more than the average employee. Similarly in South Africa the CEO's of the mining industry have been exposed for the economic inequalities between their compensation and that of the workers (McKay). Executives of these

large mining firms have taken large pay cuts, as much as \$500,000 less per year, as unions of miners and laborers have received an 8% pay increase to move the average pay to 3 to 4 times the minimum wage in South Africa. McKay goes on to quote Stewart Bailey, a spokesman for AngloGold Ashanti, A South African mining company, "No direct comment on remuneration, save for the fact that our excom is 25% smaller now than it was this time last year, and overall executive pay for the group is roughly 40% less than a year ago. We're cutting more than 40% our corporate and management roles and taking our overhead down by more than half in 2014".

Since there is no hiding the fact that the CEO's in both the US and South Africa make much more than the average employee in that same company, the next comparison we will draw is between total compensation of CEO's in South Africa to that of US CEO's. Fernandez et al. analyzed CEO pay and reported that even though US CEO's are paid more than their foreign counterparts, it was on average only 26% more. When comparing the pay of CEO's in the US to those in South Africa, the US CEO's have much higher average and median total pay. It is also important to note that the breakdown the CEO's total pay differs between the US and South Africa.

In South Africa, the mean total pay of the CEO was 1.7 million in 2006. Forty-three percent of this compensation came in salary, 7% in other pay, 36% in bonuses, and only 14% in stock and options. For comparison the US CEO's received a total mean salary pay of 5.5 million in 2006. It is also important to note that the total pay of the CEO's in South Africa was much lower than that of even the non-US average of 2.8 million. South Africa also was one of the countries compared that had some of the lowest percentage of total pay in the form of stock options at 14% of total pay. When looking at the data from Towers Perrin's 2005/2006 Worldwide Total Remuneration report, the breakdown of variable pay for South African CEO's was based more heavily on variable bonuses that were short term performance related measures opposed to long term incentives (Geiler & Renneboog).

For US mean total salary of US CEO's 5.5 million, the breakdown of their compensation was drastically different than their South Africa counterparts, as only 28% of this pay came from base salary, 6% from other pay, 27% in bonuses, and 39% in stock and options (Fernandez). It is clear that US CEO's are forced take more of their compensation in the form of stock and options in order to mitigate the potential for agency problems as this is designed to align the interest of the CEO with that of the stockholders. This is supported by the analysis of the Towers Perrin's 2005/2006 Worldwide Total Remuneration report done by Geiler and Renneboog, as they show that CEO variable pay for US CEO's was more heavily received in the way of long term incentives and much less in short term performance related measures.

## **Executive Compensation Regulations in the United States**

Executive compensation regulations have existed in the United States since the Great Depression, due to the Securities Act of 1933 and the Securities and Exchange Commission (SEC) Act of 1934. This act required mandatory disclosure of executive compensation for public companies. It was made possible through the Senate Banking and Currency Committee hearings, better known as the Pecora hearings. This act was brought forth by the request of policy makers and shareholders. Investors also thought about when considering this act because the information was deemed material to the operation of the corporation. However, upon the implementation of the act, it served more to embarrass executives and led them to limit their compensation rather than empower shareholders. As evidenced by the 1934 act, this would be the bill that created the Securities and Exchange Commission (SEC). The SEC serves to regulate and enforce laws in the securities industry (Saurez, 2012).

Since the 1930's, the SEC has expanded compensation disclosures. Firms must now disclose all forms of compensation in table form in order to allow for easy comparison between companies (Saurez, 2012).

In 1992, the SEC announced it would no longer allow the "ordinary business" exception to hinder shareholder executive compensation proposals during shareholders' meetings. Also during that year, the SEC announced it would require companies to include information in their compensation committee report showing the company's performance versus a comparable benchmark company. The reasoning behind this implementation was to show investors the relationship between pay and performance. A performance graph would now be included showing a historical comparison of the company's stock performance against both a comparable firm and a leading index. Additionally, the SEC mandated the compensation committee to report on both the goals of the executive compensation packages and the relationship between performance and pay (Saurez, 2012).

In 2002, Sarbanes Oxley Act made it illegal for companies to give loans for personal reasons to directors and executives (Schneider, 2011).

In 2010, the Dodd-Frank Financial Services Reform and Consumer Protection Act was passed. This bill required companies to give shareholders a "say on pay," which gives shareholders the ability to vote on executive compensation a minimum of once every three years. This act applies to almost every company, with very limited exceptions (Saurez, 2012). The Dodd-Frank Act focuses on the following things: regulating the national economy and furthering international coordination, creating a financial stability oversight committee to reduce gaps in current regulations, and protecting consumers by increasing current financial service regulations. The act also specifically deals with corporate governance and executive compensation by addressing the following issues recovery of invalidly given compensation, executive pay disclosures and internal pay equity, disclosures regarding executive and director hedging, voting by brokers, disclosures about duality and an explanation if it exists, reports of incentive compensation payable by designated financial institutions along with the risk of the relationships, and independence of members on the compensation committee (Schneider, 2011).

Below, is a summary of the US regulations on compensation (Saurez, 2012).

	US Laws
Regulatory Control of Pay Levels	No
Disclosure Requirements	Statutory (Act of 1933 and 1934)
Requirements Apply To...	CEO and Four Highest-Paid Executives
Performance Graph	Mandated
Individual Disclosures	Mandated
Remuneration Report	Mandated
Say on Pay	Permitted
Specified Format	Mandated in the form of a Summary Table

### **Executive Compensation Regulations in South Africa**

In 2008, the Companies Act established disclosure and approval requirements concerning executive pay (“Remuneration”, 2013). These requirements have since been revamped by the King III report. Additionally, the JSE Stock Exchange also had minimum requirements, which have since been increased by the King II report (Scholtz, 2012).

There have been three King Reports on corporate governance in South Africa. The first two in 1994 and 2002 focused on good corporate governance. The 2009 King Report, King Report III, focused more heavily on executive compensation and executive compensation regulations. King Report II bestowed upon shareholders a greater voice in the pay practices and policies of a company. In order to implement this, the report suggested a non-binding vote on shareholder pay. This vote would give companies feedback on policies related to pay, not necessarily pay levels (“Remuneration”, 2013). Additionally, it will increase the accountability of executives to the shareholders. King Report III goes a step further and recommends remuneration committees composed of non-executive directors in order to monitor and determine executive compensation. King Report III also required disclosure between salary and performance. In addition, management must provide the rationale behind the basis on which an executive’s salary is measured. This requirement leads towards a more performance-based compensation (Scholtz, 2012).

King Report III deals with the following four particular areas: performance-related remuneration, remuneration policies, annual bonuses, and share-based payments. Concerning performance-related remuneration, both short-term and long-term performance-related awards must be unbiased and practical. The remuneration policies create value for a company throughout the implementation of the remuneration policy. Each company should have a remuneration committee helping the board setting and overseeing remuneration policies. Shareholders should vote with a non-binding advisory vote on the policy implemented by the remuneration committee at the annual meeting. Annual bonuses must be regularly reviewed in order to confirm the bonuses are unbiased. The annual bonuses must relate to the company’s performance based upon their objectives. These objectives set by the company must be consistent with long-term shareholder value. Lastly, both employees and executives are not allowed to participate in stock

options. Additionally, the chairman of the board is not allowed to receive stock options or similar incentive awards directed towards share price and/or corporate performance. The vesting of rights is based on performance conditions measured on a time span applicable to the particular company and industry the individual is working in. However, this time span cannot be less than three years (Scholtz, 2012).

### **Comparison of Executive Compensation Regulations: United States v. South Africa**

- Disclosure Requirements on Aspects of Remuneration
  - Specific Options Granted
    - South Africa (Best Practice/Recommendation)
    - United States (Comply or Explain)
  - Minimum Vesting Requirement
    - South Africa (Best Practice/Recommendation)
    - United States (Comply or Explain)
  - Perquisites
    - South Africa (Best Practice/Recommendation)
    - United States (Comply or Explain)
  - Termination Principle
    - South Africa (Best Practice/Recommendation)
    - United States (Comply or Explain)
  - SERP (Supplemental Executive Retirement Plan)
    - South Africa (Best Practice/Recommendation)
    - United States (Comply or Explain)
  - Pay Components
    - South Africa (Best Practice/Recommendation)
    - United States (Comply or Explain)
  - Individual Pay
    - South Africa (Not Applicable)
    - United States (Comply or Explain)
  - Performance Link
    - South Africa (Not Applicable)
    - United States (Comply or Explain)

- Compensation Committee
  - Compensation Committee
    - South Africa (Best Practice/Recommendation)
    - United States (Comply or Explain)
  - Member Minimum
    - South Africa (Three People)
    - United States (Not Applicable)
  - Chair
    - South Africa (Independent, Non-Executive)
    - United States (Not Applicable)
  - Composition
    - South Africa (Majority Non-Executive)
    - United States (Exclusively Independent)

(Geiler, 2011)

### **South Africa Board Structure**

Board of directors' play an integral part within the corporate governance structure both in the United States and South Africa. In this section, we will be discussing some of the key legislations both in United States and South Africa and their implications in the corporate world primarily focusing on directorial positions. Furthermore, we will be discussing board diversity, roles and responsibility of the board in the US and South Africa.

### **Legislation:**

The enactment of Sarbanes-Oxley Act of 2002 in the United States and the adoption of the King I, II and III report in South Africa resulted in significant transformation of the board structure in the US and South Africa respectively. The goals of these documents or codes were to enforce the agency theory as well as to discourage a director from pursuing a course of action that would benefit others or himself/herself at the expense of the corporation (Buccino & Shannon, 2003).

The Sarbanes-Oxley Act of 2002 was primarily enacted as a result of disappointing corporate scandals from companies such as Enron, Arthur Andersen, WorldCom, and Adelphia Communications. Prior to 2002, only two members of the board were required to be independent. The Act required publicly traded US companies to now have majority of their board of directors be fully independent. Independent directors aren't expected to have any material relationship with the company either directly or indirectly. These directors must not be employed as an executive officer in the past three years, should not earn direct compensation in excess of \$120,000 during the last three years, can't be employed as internal or external auditor in the last three years, and also should not serve on multiple boards "if those commitments create scheduling conflicts that do not permit them to serve responsibly" (Buccino & Shannon, 2003).

The Act clearly stated that these independent directors must not be on the company's payroll, can't have any business relationship with the company and must not have any potential future relationship with the company. Furthermore, the Act required publicly traded companies to have their audit committee be composed of board members with at least one member being financial expert. The audit committee has complete authority over the auditors and the auditors can only report to the audit committee. Under the 2002 Act, employees can provide anonymous and confidential complaints regarding auditing matters to the audit committee.

In 1994, the first King report was published by the King Committee to promote the highest standards of corporate governance in South Africa. In 2002, South Africa published King II report thus moving away from the idea of the single bottom line or the shareholder view toward a triple bottom line or the stakeholder view. It encouraged companies to be a responsible corporate citizen. King III published in early 2009 enforced the various propositions proposed in the second King report under "comply and explain". For example, King III demanded the appointment of senior independent directors where there is an executive chairman, emphasized on detailed disclosure over executive remuneration, and further clarified the role of the non-executive director (Board Governance In South Africa, 2009).

In 2008, South African government passed the Companies Act "the Act". In 2011, following the Act, South Africa passed subsequent legislations; The Companies Amendment Act of 2011 and the Companies Regulation of 2011. These Acts together with the King report defined directorship and further outlined directors' roles and responsibility. Three different types of directors exist in South Africa: executive directors, non-executive and alternate directors. All carry equal responsibility to ensure that the company complies with the current law and is properly governed (Director's Guide 2011). Executive directors are salaried and involved in the daily running of the company. Alternate directors are responsible in filling the vacated positions whenever a director is not able to fulfill his or her duties. Boards of directors are not personally liable for any potential debts of the company. At least 50% of the directors and 50% of any alternate directors of a profit company are required to be elected by the shareholders. The amendment act stated that any particular director can be appointed to more than one committee; however he or she will only be counted once when calculating the minimum number of directors required for the company (Director's Guide 2011). Key rights and powers of directors according to the above legislations are listed as follows.

## Rights

Discharge their duties without interference from co-directors

claim reimbursement for company related expenses incurred

Inspect the company's accounting records, assisted by an accountant

Take independent professional advice at the expense of the company

Participate in the strategic management of the company and attend and vote at board meetings

## Powers

Directors have power to issue shares

The Board has the authority to resolve that the company voluntarily begin business rescue proceedings and place the company under supervision

To ratify Pre-Incorporation contracts

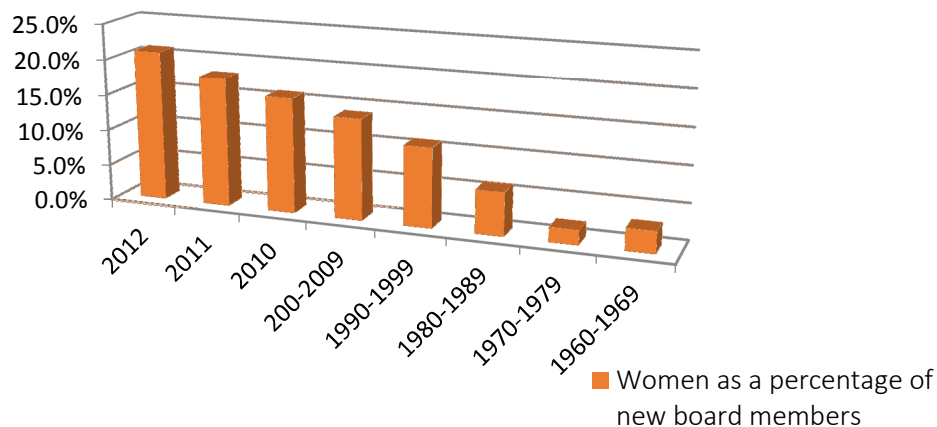
Board may make, amend or repeal any necessary or incidental rules relating to the governance of the company in respect of matters not addressed in the ACT

(Director's Guide 2011)

## Diversity: United States

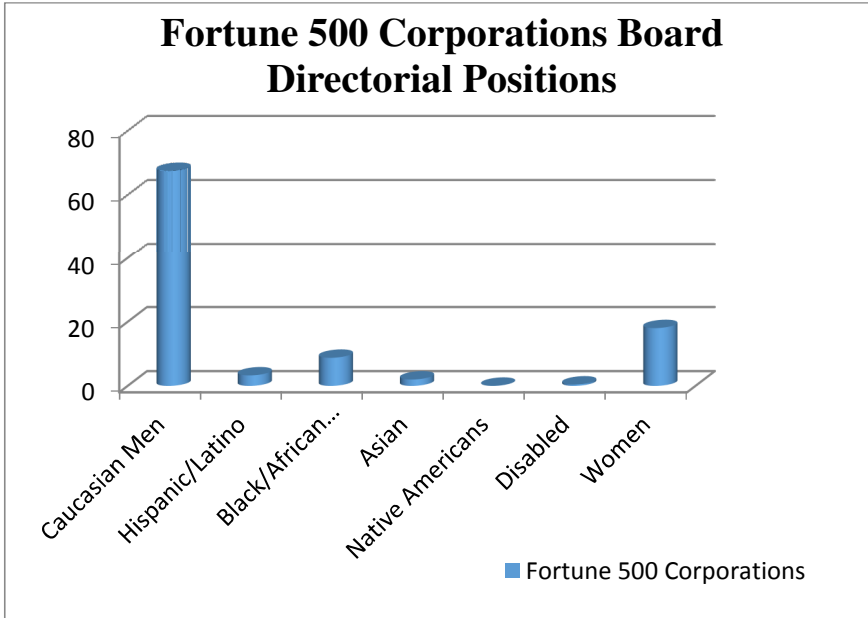
Board Diversity in the United States continues to be a major obstacle. According to Ernst & Young corporate governance database, only 14% of the more than 5000 corporate board seats for S&P 500 companies were occupied by women in 2006. Six years later in 2012, the figure increased only to 17%. 10% of companies listed in the S&P 500 still don't have women directors and 28% just have one. 26% and 36% of S&P 1500 have either no women directors or only one woman directors respectively (Twaronite, 2013). As we can see from the above table, the rate of new members of female directors in the US is gradually increasing. However, directorial positions still lack gender diversity compared to other developed nations. It is possible that the lack of progress may impact US competitiveness since studies indicates that companies with more women on their board outperform companies with fewer or no women directors (Twaronite, 2013).

**Women as percentage of new board members in the US**



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Caucasian men comprise 67.51% of Directors and overall, women fare better than minorities when it came to representations on these boards. 3.28 % of Hispanics/Latinos, 8.77% of Black/African American, 1.99% Asian, 0.04% Native Americans and 0.44% disabled members hold directorial positions in a fortune 500 company. Companies specializing in food products/services tend to have the highest representation of both minorities and women on average. Furthermore, companies focusing on

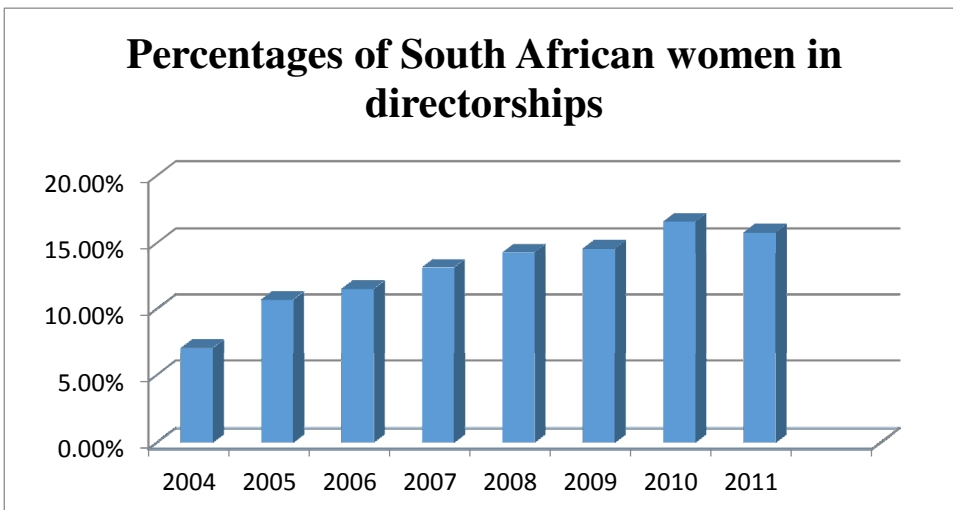
aero/defense/transportations represent higher demographics of Hispanics compared to other industry (Menendez, 2010). The report presented by Senator Robert Menendez in 2010 suggested that corporations with the highest diversity at the top were those that invest significant time and capital into this effort. These companies often tend to invest in minority communities because they believe that by engaging the growing sectors (minority) of the population will directly correlate with diversity at the top level.

**Diversity South Africa**

A South African census relying on data gathered from 2010-2011, revealed that 15.8% of all South African directorships in listed public companies were held by women (du Plessis, Saenger, & Foster, 2012). When comparing the result with other developed nations such as Australia, Canada, China, United Kingdom..., South African companies are taking the lead in percentage of female board positions and female executive manager positions. The following table is taken from a study in 2011 done by Business Unity South Africa (BUSA) that compared diversity structure among 269 companies listed on the Johannesburg Stock Exchange.

	<b>Women</b>	<b>Black</b>
Directors	14%	25.3%
Executive Directors	7.4%	9.5%
Non-Executive Directors	12.9%	27.6%
Independent Non-Executive Directors	21.2%	38.1%

The Businesswomen’s Association of South Africa (BWASA) is the largest and most prominent association of business and professional women in the country. According to a leadership



census conducted by BWASA from 2004-2011, we are seeing a gradual increase in the participation of women in the leadership positions (du Plessis, Saenger, & Foster, 2012).

The Institute of Directors in Southern Africa, as defined on its

company’s website, is a non-profit company representing directors, professionals, and business leaders. It promotes good corporate governance by promoting those who are charged with governance duties “to effectively and legally discharge those duties” (The IoDSA's Objectives, 2014). The figure on the left side indicates the increasing membership rate in IoDSA among blacks and female (Integrated Report 2012, 2012).

Membership	2012	2011	2010	2009	2008
Female members	1 601	1 363	1 077	910	755
% Female members of total membership	27%	26%	24%	23%	21%
Black members	2 770	2 350	1 909	1 620	1 291
% Black members of total membership	47%	45%	42%	40%	36%

Black economic empowerment, following apartheid, has played a significant role in pressuring businesses to introduce sufficient diversity onto their boards. The importance of board diversity is highly emphasized in King III report. In 2010, The King committee issued a Practice Note on Broad-Based Black Economic Empowerment (B-BBEE). In the Note, the committee stated that the involvement of the less fortunate or people with disabilities should be based on the “premise of equal partnership in the corporate sphere, with their contribution being equally valuable” (du Plessis, Saenger, & Foster, 2012). Business in South Africa acknowledges that the implementation of B-BBEE in the post-apartheid era is not only ethically right, but also an imperative measure in the socio-economic uplifting of black people.

### Structure

Board structure in South Africa has been influenced heavily by the King documents. With each successive entry, three of them in total, fundamental changes have been made that shape how companies are governed in South Africa today. The country has made significant efforts to

modernize board structure and governance policies to fit the new ideas of the twenty first century and the corporate social aspects needed in a country with significant past racial divides. Spencer Stuart reports that board structure is influenced by five major factors: Corporate social investment, diversity and development of human capital, Black Economic Empowerment (BEE), environmental impact and finally health and safety. All of these ideas and regulations combine to make South Africa one of the world's leaders in progressive board governance, beating the United States in most major diversity categories.

Overall, boards in South Africa are taking a more professional and proactive approach to governance, especially in larger and more influential companies. This aggressive approach is not entirely voluntary though; the country is well-known for high standards of board regulation. South African boards are required to balance many standards from entities besides the government. Shareholders, the media, unions and public watchdog groups play a significant role and have an effect on decisions such as board diversity, elections and overall make-up, more so than in the United States. The government has several acts and amendments that dictate legally how boards are structured. The Corporate Laws Amendment Act, recently passed in 2008, sets regulations on South African based companies that are "widely-held." This means that much of their business is done outside SA borders. These companies, for instance must permit sale of shares to the public and report in accordance to international financial reporting standards. Regulations such as these are seen throughout the corporate model and are one example of why SA has tried so hard to integrate and include their citizens regardless of race in the entire business structure. The Public Finance Management Act passed into law in 1999 sets out to create financial standards that benefit citizens by overcoming the country's financial governance issues. The King reports have had the largest impact on overall board structure in SA, outlining board responsibilities and placing accountability for the company in the board's hands. King II separates the roles and responsibilities of the chairperson and CEO, strongly suggesting that the two positions not be held by the same person. King III introduced the "Senior Independent Director" who serves on boards with an executive chairman (duality) who focuses on transparency and disclosure of executive actions. This position is very similar to lead directors in the United States. Lead directors are often hired by companies to run many board functions if the CEO is also the chairman of the board. This is done to ideally prevent many of the inherent conflicts of interest that occur with duality.

Corporate Social Responsibility has become a major factor in board make-up since the publication of King II in 2003. Boards are strongly recommended to have blacks comprise 40-50% of their executives within the company. Firms are also strongly recommended to have 25% of their shares held by blacks. While the government has stopped short of requiring many of these guidelines, many companies have complied with or worked towards the standards set into place, resulting in a much better social environment in the country; however, most of the black population is still impoverished and the criticisms of BEE and the actions thus far is that it only helps blacks who were already well-off.

Committees are a large focus of boards in South Africa. All boards in South Africa are recommended to have an audit committee, remuneration committee and a risk management committee. King II set these recommendations in motion, especially for the risk management committee when it stated that the boards are responsible for identifying the risk involved in the company's business actions.

According to Spencer Stuart, the average board size in South Africa is 12 members; however, recent trends suggest that this number is increasing steadily due to many new regulations. Larger companies are inherently under more scrutiny and thus often have more board members

to lead the large number of required committees and meet the diversity standards. Audit committees have to consist of solely independent and non-executive directors, which is a reason many companies need to have more board members just to meet these requirements. The bank industry, with all of its regulations, commonly has boards in excess of 20 directors. This can lead to management problems when trying to balance the ideas and opinions of more directors. When new members are needed or existing ones leave, the succession plan for members of the board falls under the responsibility of the remuneration committee, unless a nominations committee exists. Terms can last up to 3 years in some cases.

South Africa has defined that the role of the board is to “probe the CEO” and reach a full understanding of the reasons for his or her decisions. The South African Economic Development Department (EDD) was formed in 2009 and is responsible for coordinating the development of the country’s new growth plan and oversees key state entities that work with economic development.

## **Sustainability**

Sustainability in South Africa has been influenced heavily by its constitution. The constitution of South Africa was passed in 1996. The passage of the constitution was seen a new beginning for South Africa, and an opportunity to move beyond the racial discrimination, oppression, and violence that inflamed the country for decades. This sentiment is reflected in the constitution by placing emphasis on the South African core values of human dignity, equality, advancement of human rights, non-racialism, and non-sexism. The constitution also contains a provision devoted strictly to the environment. The environmental provisions state “everyone has the right to an environment that is not harmful to their health or well-being, and to have the environment protected, for the benefit of present and future generations (SA Constitution).” The constitutional tenants of equality, human rights, and the environment are unmistakable in the corporate governance codes of South Africa. This denotes the significance that the ideals in the constitution have had on shaping the country’s approach toward profit, people, and planet sustainability.

The role of the corporation in South Africa forever changed with the introduction of the King Reports on Corporate Governance. The King Reports were prepared by the King Committee, and were developed under the leadership of King Committee Chairman, professor Mervyn King. To date, there have been three King Reports. “The purpose of the King Reports was, and remains, to promote the highest standards of corporate governance in South Africa (King 6).”

The first King Report, known as King I, was issued in 1994. King I held many similarities to the UK’s Cadbury Report of 1992. The Cadbury Report and King I both emphasized the importance of corporate governance by providing guidelines focusing on corporate board and financial governance. King I deviated from the Cadbury Report in that it included recommendations for sustainability reporting in the areas of the environment, health and safety, and affirmative action (Ntim et al. 87). “The King Report of 1994 went beyond the financial and regulatory aspects of corporate governance in advocating an integrated approach to good governance in the interests of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice. In adopting a participative corporate governance system of enterprise with integrity, the King Committee in 1994 successfully formalized the need for companies to recognize that they no longer act independently from the societies and the environment in which they operate (King 6).” The inclusion of the environment and social responsibility as components of corporate governance was not something that was widely

practiced at the time that King I was released, and positioned South Africa at the forefront of corporate governance practices around the world.

The second King Report, known as King II, was issued in 2002 and introduced the concept of integrated sustainability reporting to South Africa. According to King II, “every company should report at least annually on the nature and extent of its social, transformation, ethical, safety, health, and environmental management policies and practices (“King”).” King II also added sustainability reporting requirements in the areas of black empowerment and HIV treatment and prevention (Ntim et al. 87). King II made such an impression on the South African business community that portions of the report were later adopted by the Johannesburg Stock Exchange (JSE) as requirements for listing companies (“King”). This action provided additional credibility to King II, and helped push sustainability reporting in South Africa forward.

The third King Report, known as King III, was issued in 2009, and in typical King fashion, once again bolstered the requirements for sustainable reporting. The integrated reporting feature in King III was designed to be more forward looking and include actionable goals. More specifically, King III stated that “the integrated report should have sufficient information to record how the company has both positively and negatively impacted on the economic life of the community in which it operated during the year under review. Further, it should report how the board believes that in the coming year it can improve the positive aspects and eradicate or ameliorate the negative aspects, in the coming year (King 12).” The linkage of sustainability issues with results and actions was a change from King II, and revealed the committee’s desire to create more equity between financial and sustainability reporting.

King III also featured a new governance compliance method. The King I and II reports utilized the compliance method of comply or explain. This meant that when a listed company did not abide by a principle of the code, it was required to explain why in its annual report. In a situation where a company fails to comply with a specific principle, the apply or explain method allows a company to explain why, or explain how it applied a different principle and still achieved the overall sustainability goal contained in the report (King 7). This provides more flexibility to companies and places more significance on the end result of sustainable goals rather than the means used to achieve them. The King Committee felt that the apply or explain method more closely aligned with the ideals of South African corporate governance, and as a result, apply or explain was adopted.

The Companies Act of 2008 provided a critical addition to South Africa’s corporate governance structure by adding binding, legal requirements to the non-binding recommendations of the King Reports. The goal of the act “was to ensure that the regulatory framework for enterprises of all types and sizes promoted growth, employment, innovation, stability, good governance, confidence and international competitiveness (Companies 6).” The act designates director responsibilities and director expectations for behavior; requires the appointment of a company secretary, who is responsible for advising the board on matters of compliance; contains specific provisions regulating financial statements and audit requirements; requires the formation of an audit committee and defines their responsibilities; delineates rules on the rotation of auditors; prescribes stakeholder rights to initiate a business rescue plan; and describes shareholder options for legal action.

The Johannesburg Stock Exchange (JSE) is currently ranked the 19th largest stock exchange in the world by market capitalization and the largest exchange in the African continent (Johannesburg Stock Exchange). At the end of August 2013, the JSE had a market capitalization of \$887 billion (Hanna). With about 400 companies across the exchange’s Main

Board and AltX (a board for promising small to medium-sized companies), the JSE is well-known for its world-class regulation (Hanna). In 2011, it won the GTI's award for best stock exchange regulator in the world (Homes).

The JSE launched a Socially Responsible Investment (SRI) Index in 2004 to encourage businesses to pursue more robust transparency and sustainability initiatives. The Index philosophy is founded on the principles of the three pillars of the triple bottom line, namely environmental, social and economic sustainability, with good corporate governance underpinning each (Johannesburg Stock Exchange). These principles provide the foundation for the SRI indicators, which include the categories of the environment, society, governance and related sustainability concerns (ESG), and response to climate change. For each of these four categories, companies are measured on their ability to develop and implement responsible policy and strategy, the effectiveness of their management and performance, and the quality of their reporting. In 2010, the JSE became the first exchange in the world to require listed companies to move towards integrated reporting (Johannesburg Stock Exchange).

## **Profit Sustainability**

The Companies Act of 2008, the King Reports on Corporate Governance, and the sustainability initiatives taken by the Johannesburg Stock Exchange have provided South Africa's business organizations with a solid framework for economic sustainability. This was reinforced in 2009 when South Africa ranked 6th in the GovernanceMetrics International (GMI) corporate governance rankings, which placed them highest in the emerging markets group (GovernanceMetrics International). According to GMI President and CEO Howard Sherman, "many of the country rankings come as no surprise, as our research and ratings place a great deal of emphasis on transparency and accountability. As emerging markets in particular compete for global capital and develop a cross-border shareholder base, it seems inevitable they will face pressure to become more transparent and less insular. South Africa serves as good example here. Its average rating of 6.49 was the highest among all of the emerging markets we cover and higher than many developed markets. We think that translates into a competitive advantage for the South African economy (GovernanceMetrics International)." The GMI ratings and comments from their CEO suggest that South Africa's governance measures have strengthened their economic reputation abroad. This could lead to increased investor confidence and more capital inflows for the country.

A recent study in the *Corporate Governance: An International Review Journal*, speaks to the financial benefit a company can achieve through strong governance disclosures. In the study, the authors hypothesized that there was a positive association between high levels of information and transparency in the form of increased disclosure of shareholder and stakeholder corporate governance practices and firm value (Ntim et al.). The authors sample included 169 companies listed on the Johannesburg Stock Exchange. Corporate governance variables were obtained from the disclosures made in the selected companies' annual reports, and the market valuation method that was used was Tobin's Q. The companies were evaluated over a five year period. The research found a positive association between high levels of information and transparency in the form of increased disclosure of both shareholder and stakeholder corporate governance practices and firm value. This bodes well for South Africa's profit sustainability as companies following the disclosure principles in the King Reports may experience a boost in firm value due to their transparency.

When viewing economic factors not exclusively related to corporate governance, South Africa displays promise for economic sustainability. To begin, South Africa is the largest economy in

Africa with a GDP around \$400 billion, and owns some of the richest mineral reserves in the world with an estimated value of \$2.5 trillion (“South”). Additionally, in 2013, Ernst and Young designated South Africa as the most attractive investment destination in Africa, and the World Bank ranked South Africa 39th in their “Doing Business Index (“South”).” South Africa is also a member of the BRICS partnership, which includes the countries of Brazil, Russia, India, and China. The BRICS was formed to promote cooperation between member countries on economic, political, and cultural issues. The BRICS nations are considered to be some of the most powerful emerging markets in the world so South Africa’s inclusion in this group, should bolster their economic prospects.

Unfortunately for South Africa, not all of the economic indicators are positive. In a 2014 article from the Journal of Educational and Social Research, a study was conducted that compared South Africa to fellow BRICS members Brazil, China, India, and Russia in terms of attracting Foreign Direct Investment. Foreign Direct Investment occurs when an investment is made by a company or entity in one country, into a company or entity based in another country. Using World Bank figures from 2010, the article reported that China recorded the largest amount of FDI inflows with \$185.8 billion inflows, followed by Brazil with \$48.5 billion, Russia with \$43.3 billion, India with \$24.2 billion, and South Africa with \$1.2 billion. According to the study South Africa was last in net inflows as percentage of GDP, last in GDP growth rate, and second to last in trade openness. Combine this with a 2013 unemployment near 25% (Vollgraff & Mbatha), and approximately 45% of the population living in moderate to extreme poverty (“Poverty”), the economic sustainability of South Africa appears to face some real challenges.

In an article published in the Journal of Corporate Law Studies in 2010, an argument is posited that South Africa’s corporate governance system may not be stringent enough to achieve their desired goals for sustainability. The article states that more regulation is needed for three primary reasons. The first is to provide stronger incentives for companies to achieve compliance (Croucher and Miles). The article argues that relying on codes of governance principles, like the King Reports, is ineffective because no real penalty exists for those that do not comply. Alternatively, with a statutory based corporate governance system, governments can punish violators through fines, imprisonment, or license suspension. Consequences such as these are more likely to elicit obedient behavior from companies than the relatively benign enforcement mechanism of explaining yourself publicly. Secondly, the article indicates that more regulation would provide clearer standards that would make monitoring corruption and unethical behavior much simpler (Croucher and Miles). The lack of specificity in codes of principles allow companies a lot of discretion in terms of what actions they will take and how their actions will be measured. This makes it challenging to draw meaningful profit sustainability comparisons across companies, and provides an environment where dishonest activity is more difficult to detect. Finally, the article suggests that increased corporate governance regulation would bring more legitimacy to South Africa (Croucher and Miles). The author explains essentially that nations that can adeptly execute and enforce their governance policies gain esteem around the world, while those that cannot, lose it. The author implies that South Africa’s current framework puts the country at risk to be discredited on the world stage, which would deter investment and make profit sustainability much more difficult to achieve.

## **People Sustainability**

In this section we will discuss some of the ‘people’ aspect of corporate sustainability. The Companies Act and Companies Regulations seemed to be the most prevalent. It was also noted in one of the articles that both the Kings Report and the Companies Regulations mirror each other in many ways, though those ways are not commented on specifically.

The Companies Act became effective on May 1st 2011 and changed the landscape of corporate law in South Africa. While it does not specifically refer to Corporate Social Responsibility (CSR) the act makes an attempt to ensure that CSR becomes infused and embedded in a company's governance structures. From a CSR perspective the Act's contribution is found in Section 72, which authorizes the Minister of Trade and Industry to prescribe through the use of regulations that a company or category of companies described in terms of their annual turnover, the size of the workforce and the nature and extent of their activities must have social and ethics committees. The Minister has acted on this mandate and on April 26, 2011 the Companies Regulations, 2011 were released, which among other things introduced the new requirement that companies falling within a certain category must establish a social and ethics committee. These actions could be regarded as an attempt by Government from an external position to put pressure on the private sector to operate in a socially responsible fashion, thereby enhancing its social legitimacy. The Companies Regulations, 2011 says that companies that are state-owned, listed public companies, or companies that have in any two of the previous five years scored above 500 points in terms of regulation must appoint a social and ethics committee consisting of not less than three directors prescribed officers of the company. At least one of these directors or prescribed officers must be a director not involved in the day to day management of the company and who has not been so involved in the preceding three financial years. The requirements include that at least one of the members of the committee should be a non-executive director represents an attempt by the legislature to enhance transparency in the functioning of the committee and to act as a counterbalance to corporate greenwash (HJ Kloppers, 2013).

The Companies Regulations, 2011 has five defined areas: social and economic development, good corporate citizenship, the environment, health, and public safety, consumer relationships, and labor and employment. We will discuss four of the five in this section (HJ Kloppers, 2013).

The social and economic development, including the company's standing in terms of goals and purposes of the following four items (HJ Kloppers, 2013):

1. The 10 principals set out in the United Nations Global Compact Principals.
2. The OECD recommendations regarding corruption.
3. The Employment Equity Act.
4. The Broad-Based Black Economic Empowerment Act.

Good corporate citizenship, including the companies (HJ Kloppers, 2013):

1. Promotion of equality, prevention of unfair discrimination, and reduction of corruption.
2. Contribution to the development of communities in which its activities are predominately conducted or within which its products or services are predominately marketed.
3. Record of sponsorship, donations, and charitable giving.

Consumer relationships, including the company's advertising, public relations and compliance with consumer protection laws (HJ Kloppers, 2013).



Labor and employment including (HJ Kloppers, 2013):

1. The company's standing in terms of the International Labor Organization Protocol on decent work and working conditions.
2. The company's employment relationships and its contribution toward the educational development of its employees.

As you can see the Companies Act and the Companies Regulations both help the 'people' aspect of corporate sustainability by promoting equality, educational development, development of the surrounding communities, and other items as well.

## **Planet Sustainability**

In this section we will discuss the 'planet' aspect of corporate sustainability. We will focus mainly on the 'White Paper' and discuss some aspects of the Companies Regulations.

The South African government's response to the universal crisis of global warming has resulted in the creation of the National Climate Change Response White Paper, a proposed country-wide course of action that would aid in the stabilization of greenhouse gas emissions and intervene in current harmful environmental practices. The role of communication and the media is crucial to the success of any policy implementation as well as of the establishment of an action inspired mind-set amongst citizens that will bolster lifestyle change to support the cause. The White Paper defines climate change as "the trend of changes in the earth's general weather conditions as a result of an average rise in the temperature of the earth's surface often referred to as global warming". The purpose of the National Climate Change Response White Paper is to outline the country's vision of effective climate change response short-term, medium-term, and long-term, and of the transition into a lower-carbon economy and society. The White Paper also states that South Africa needs to develop and implement education training and public awareness programs on climate change and its effects to promote and facilitate scientific, technical, and managerial skills. It also shall provide public access to information, public awareness of, and participation in addressing climate change. The White Paper even gets into some 'dangerous territory' by proclaiming that "government departments will start communicating with citizens about climate change to inform them and educate them and to influence their behavioral choices" (Shelly Smith, 2013).

Under the Companies Regulations, 2011 in South Africa there are five defined areas. One of those is the environment, health, and public safety. This includes the impact of the company's activities and of its products and services. The company's committee should monitor the company's activities having regard to any relevant legislation, other legal requirements, or prevailing codes of best practice with regard to matters concerning the environment, health and public safety, including the impact of the company's activities and of its products or services. In effect this regulation requires the members of the committee to have a working knowledge of legislation relating to the environment, health, and public safety. The King Report on Corporate Governance for South Africa 2002 also addresses these issues and requires companies to report on an annual basis on the nature and extent of their policies and practices regarding health and safety and environmental management (HJ Kloppers, 2013). As you can see both the 'White Paper' and Companies Regulations contribute to the 'planet' aspect of corporate sustainability.

## Conclusion

Altogether, many policies in South Africa are being newly implemented but the ideas behind these initiatives are often very forward-thinking and difficult to enforce all at once. SA's history of racial tensions has led to the government strongly pushing integration on all levels of business and government. While there is still much to accomplish, steps are being taken in the right direction; however, the numerous regulations that have been implemented in a short period of time have led to lack of understanding, enforcement and implementation. Time will tell how well board governance can be handled with such a large amount of changes and regulations occurring all at once. Everything from executive compensation to sustainability and board structure has changed significantly in the past ten to fifteen years and is likely to continue to improve as these laws begin to take a stronger hold. It is South Africa's goal to set an example for the rest of the world in many of the aspects we have discussed and they are well on their way to attaining this goal.

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