CHAPTER 9

CORPORATE SOCIAL RESPONSIBILITY

ABRIDGED CONTENTS

A Introduction

The inability of governments worldwide to protect individuals from economic insecurity has led to a renewed interest and public expectation that corporations have public responsibilities in furthering the interests of the public or the public good. Crowther explains: "…it might be argued that the focus of war has shifted from imperialistic or ideological reasons to economic reasons – at least as far as governments and countries are concerned. But governments, as the epitome of the nation state, are becoming less important because what are becoming more important than governments and nation states are the multinational companies operating in a global environment. Some of these multinationals are very large indeed – larger than many nation states and a good deal more powerful. Arguably it is here that the economic war for the global village is taking place."[1] There exists no consensus as to what the 'interests of the public' or the 'public good' entail. In this chapter these terms will refer to benefits that may be made available to certain sections of the community including employees, customers, suppliers, even the community as a whole as a result of corporations' philanthropic acts.

Other factors contributing to this renewed interest in corporate social responsibility have been an increased awareness of impending ecological crises as well as changes in the structure of the economy. The political climate in the 1980's and 1990's has led to a move towards ideological preference for private sector solutions to socio-economic ills. Conservative and social democratic governments in Europe and Australasia have generated a non-interventionist trend and a move to privatisation.[2]

This renewed interest has re-opened the debate as to whether decision-making in companies or corporations should be guided purely by considerations of profit or

1 *International Dimensions of Corporate Social Responsibility* (2005) v-vi.

2 Deery and Mitchell "The Emergence of Individualisation and Union Exclusion as an Employment Relations Strategy" *Employment Relations* (1999) 3; Parkinson Corporate *Power and Responsibility* (1996) xiii; Harrington "Public Sector on the Wane" 1992 *Business and Society Review* 1992 28.

whether companies should also consider the interests of third parties including the community at large. This question is enveloped in controversy.[3] There is also uncertainty and controversy as to the following:

(i) What exactly does corporate social responsibility entail?

(ii) What motivates companies to spend money for the benefit of others?

(iii) On what basis, if at all, do companies owe this responsibility?

(iv) Does the law allow for such philanthropic acts by companies, and if so, to what extent?

(v) To whom and to what extent are there responsibilities owed?

(vi) Is corporate social responsibility good for business?[4]

It is the purpose of this chapter to address some of these questions from differing viewpoints. Since employees are amongst the recipients of the benefits of corporate social responsibility it can be used as a means to address employee needs where other means such as legislation or collective bargaining[5] have proved insufficient. Specific benefits derived by employees as a result of corporate social responsibility include the following:[6]

(i) ethical and honest conduct with respect to employees;

(ii) proper flow of information between employees and their superiors;

(iii) a say in the creation of social politics within the company;

(iv) careful consideration of employee complaints and proposals by the company;

(v) company facilitation of the formation of trade unions or other employee representative bodies and participation in their activities;

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3 Crowther and Jatana *Representations of Social Responsibility* (2005) 2 state: "…over the last decade the question of the relationship between organisations and society has been subject to much debate, often of a critical nature. The decade has witnessed protests concerning the actions of organisations, exposures of corporate exploitation and unfolding of accounting scandals."

4 Carter "The Limit of Corporate Social Responsibility" 1982 *Merc Law Review* 519; Butler and McChesney "Why They Give at the Office – Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation" 2001 *Cornell Law Review* 1195.

5 See ch 5 subsections B and C *infra* where the decline of trade unions and consequent decentralisation of collective bargaining is discussed.

6 Crowther and Jatana *op cit* 28.

(vi) the provision of safe working conditions;
(vii) in case of redundancies the company takes care of ex-employees;
(viii) the possibility of equal development for employees;
(ix) salaries that are adjusted in such a way by the company that they at least fulfil basic needs of employees.

It will be demonstrated that not only is corporate social responsibility legally possible, but it is also good for business. Furthermore the benefits both to employees as well as employers of the implementation of good governance systems will be discussed.

B The Concept "Corporate Social Responsibility"

Socially responsible behaviour has been described as "action that goes beyond the legal or regulatory minimum standard with the end of some perceived social good rather than the maximisation of profits".[7] The recipients of this socially responsible behaviour can be categorised into the following groups:
(i) The community within which the company operates;
(ii) suppliers of the company;
(iii) employees of the company;
(iv) consumers of the company's goods or services;
(v) society generally;
(vi) the environment.

Parkinson distinguishes between relational responsibility and social activism.[8] Relational responsibility refers to assistance to groups such as employees, suppliers, consumers or the community who are affected by the company's business activities. Social activism on the other hand, benefits groups who fall outside the scope of the company's business activities. Parkinson explains it

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7 Slaughter "Corporate Social Responsibility: A New Perspective." 1997 *The Company Lawyer* 321.
8 Parkinson *Corporate Power and Responsibility* (1996) ch 9.

thus: "Social activism, in contrast constitutes an effort by companies to address social issues that arise independently of the way the company conducts its business and thus represents an extension of corporate activity into essentially non-commercial spheres".[9] Although, as Parkinson admits, these concepts can sometimes overlap in practice, the distinction is useful since relational responsibility will usually coincide with company objectives to make profits, or at least have a neutral effect on profits, whereas social activism can result in profit sacrifice and consequently a shift in the corporate goal of profit maximization. Purely charitable donations that are not related to the company's business are difficult to reconcile with the goal of profit maximization. The constraints imposed by the law on such philanthropic acts are discussed hereunder.

It has been demonstrated by some writers on this topic,[10] including Parkinson, that usually there is no real conflict between profit maximization and socially responsible behaviour on the part of companies. This being so, from whatever viewpoint one departs, such philanthropic behaviour causes no controversy. Problems arise however, as will be demonstrated hereunder, when the conduct clashes with a profit maximization motive. This will be the case where the philanthropic behaviour is not a response to exterior or interior forces in the interests of profit maximization of the company, but rather it is conduct for the sake of the interests themselves. In short, the interest of outsiders, not those of the company are preferred. Therefore Parkinson makes a further distinction: Responsibility that requires a change in company objectives as opposed to responsibility that only constrains the pursuit of existing company objectives to maximise profits.[11] These constraints might be legally imposed such as minimum wage laws or legislation that protects the environment, or they can be self-imposed in the sense that they constitute an economically rational response to market pressure in the form of public opinion generally, or the opinion of the parties with whom the company has dealings. These self-imposed constraints usually reduce

9 *Ibid* 269.
10 See Carter "The Limit of Corporate Social Responsibility" 1982 *Merc Law Review* 1982 519; Slaughter *op cit 323*; Crowther and Jatana *op cit* 9.
11 Parkinson *op cit* 268 – 271.

profits in the short term in the interests of bigger long-term company profits. They are therefore not inconsistent with the goal of profit maximization.

Parkinson concludes that the content of company codes, the attitude of managers and directors and the way companies spend their money indicate that there has been no shift away from the profit goal in the corporate world.[12] The same conclusion is reached by Slaughter when she states: "Much of the debate about social responsibility can be disposed of by the simple observation that what is considered to be socially responsible behaviour is often also good for business or at least a sensible course of public relations which will improve the company's image and contribute to profitability in the long run."[13] After having done a thorough survey of US cases Carter concludes[14]: "Corporate managements rightly believe that it is their responsibility to obtain corporate benefit from every dollar spent and courts have almost uniformly insisted on it" and "the author has searched the literature and his memory without success for a purely altruistic corporation act. Those which have come to his attention could be or usually were justified on the basis that they satisfied public expectations and therefore were of value to the corporation or were otherwise of direct benefit to the corporation. Furthermore, in more than 25 years of attending meetings of a board, which was known to be quite public-spirited, the author does not recall ever having heard the term public interest or a synonym uttered. It is his distinct impression that with respect to all decisions the members of the board believed they were acting in the corporate interest".

He also refers to a study undertaken by the Conference Board, an independent, non profit business research organization, to determine the motivation for corporate giving, as well as a study undertaken by the Foundation of the South Western Graduate School of Banking of Corporate Ethical Policy Statements and concludes: "In summary it appears corporate altruism under the present system of corporate governance and under the law today, not only is not practiced, it is not

[12] Parkinson *op cit* ch 9.
[13] Slaughter *op cit* 321.
[14] *Ibid 534*.

permissible. Corporations make contributions and other expenditures for social benefit only when, in the business judgment of management it is in the corporate self-interest".[15]On the other hand, the view that companies are not always motivated by self interest and that companies can and do act altruistically for no other reason than charity has also been put forward.[16]

Although it is rarely possible to predict or accurately calculate in real money terms exactly what the long term benefit to the company of socially responsible acts will be, it is clear that the bulk of such corporate conduct can easily be classified or interpreted to be of benefit to the company in the long run.[17]In terms of Slaughter's definition of social responsibility quoted above[18], therefore, most of the so-called socially responsible conduct which companies indulge in would not be classified as socially responsible behaviour since its end is the maximization of profits as opposed to some perceived social good.

C Motivation of Companies to Spend Money for the Benefit of Third Parties and the Community at Large

1 Introduction

Motivation for these seemingly philanthropic acts is many and varied. Furthermore, it is impossible to establish with certainty what the motivation of a company is. It is usually based on a combination of factors. As shown hereunder benefits a company can possibly derive from such actions are largely dependent on whom the beneficiaries of such conduct are.

15 *Op cit* 537-539.

16 See Mangrum: "In Search of a Paradigm of Corporate Social Responsibility" 1983 *Creighton Law Review* 21.

17 For discussion on how socially responsible behaviour towards the community, customers and consumers, employees and various charities are of benefit to companies see Slaughter op *cit 322* - 324 and Parkinson *op cit* 281-303.

18 *Op* cit 321.

2 *Benefits to the Company*

Although moral responsibility might be a motivating factor for company expenditure on for example the control of pollution, or community projects, or the provision of safe and pleasant working conditions, or ensuring products and services are of an acceptable quality, or the sponsorship of art or education, and so on, it is apparent that such expenditure can also provide benefits to the company.[19] These include:

(i) an enhanced public image;

(ii) tax rebates, for example where a company contributes to social welfare, education or the arts;

(iii) the ability to attract and retain a productive, loyal and competent workforce (usually by sponsoring education, paying competitive wages and providing superior working conditions);

(iv) companies can commercially apply the results of research they have sponsored;

(v) involvement in community projects such as job creation schemes can improve morale amongst employees and the community at large. This in turn will stimulate the local economy on which the company relies for survival. A social environment, which is healthy, is essential for the conduct of successful business enterprises;

(vi) opportunities for business contacts, staff perks, and an advertising medium for high profile groups as well as tax incentives can all flow from company sponsorship of the arts;

(vii) the prevention of further government intervention. Where companies address social and environmental problems it will not be necessary for government to find their own solutions such as increased taxes, prohibitive legislation, compulsory regulations and intervention. In this way, voluntarily assumed constraints for the prevention of for example environmental damage reduces the need for government intervention.[20]

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19 Parkinson *op cit* 290-301.

20 *Idem* 299.

Most authors [21] including Parkinson[22] and Slaughter[23] would agree that socially responsible behaviour is usually also good for business and will contribute to the profitability of the company in the long run. It is often not possible to predict or gage exactly how much money particular socially responsible conduct will generate especially where the pay-off comes in the form of an enhanced public image or the conduct serves as a form of advertising. Nevertheless it seems to be generally accepted that companies will act in the public interest so long as it is also in the company's interest. Self-interest and not altruism therefore seems to be a major motivating factor for corporate social responsibility.[24]

3 Abuse by directors

Since spending on charity is often up to the discretion of directors, the abuse by directors of company money in the pursuit of self-interest is commonplace. Donations to an art gallery or a favourite charity might benefit no one besides the director in that s/he will receive preferential treatment amongst those of high social profiles. Clearly such donations are inconsistent with the goal of profit maximization.

D The Law and Corporate Social Responsibility

1 Introduction

Company law plays an important role in how well the economy works. How well the economy works, in turn, is crucial to the economic and social well being of a country's citizens.[25] Re-election of governments operating in democratic systems is largely dependent on the overall performance of the economy, which is in turn largely determined by business. It follows therefore, that it is essential for any capitalist democratic state to retain the confidence and hence the co-operation of

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21 See Carter *op cit* 538-539.
22 Parkinson *op cit* chapter 9.
23 Slaughter op *cit* 321.
24 See Carter *op cit* where the author's thesis is that the limit of corporate social responsibility in USA is long-term self-interest.
25 Saxena *Taxman's Politics, Ethics and Social Responsibility of Business* (2004) 17.

the business sector.[26] Such confidence can only be achieved where a country's laws not only permit but also encourage profitability. In an increasingly globalised world economy, governments must be sensitive to the possibility of reduced investor confidence (both local and international), resulting in not only massive capital outflows, but also a failure to attract foreign investment. The *King Commission* Report [27](hereinafter "King Report II') is fully aware of these facts and states as follows: "However, it must constantly be borne in mind that entrepreneurship and enterprise are still among the important factors that drive business: Emerging economies have been driven by entrepreneurs, who take business risks and initiatives. With successful companies, come successful economies. Without satisfactory levels of profitability in a company, not only will investors who cannot earn an acceptable return on their investment look to alternative opportunities, but it is unlikely that the other stakeholders will have an enduring interest in the company." [28]:

Government policies and legislation that are insensitive to business confidence will clearly have disastrous effects on employment and economic growth and stability. The King Report II continues:[29] "The Company remains a key component of modern society. In fact, in many respects companies have become a more immediate presence to many citizens and modern democracies than either governments or other organs of civil society. As a direct consequence, companies remain the legitimate and necessary focal point for profit making activities in market economies. They are also increasingly a target for those discontented with business liberalisation and globalisation, an agenda that companies are perceived as driving. In the global economy are many jurisdictions to which a company can run to avoid regulation and taxes or to reduce labour costs …"

26 *Idem.*
27 *King Commission Report II* 2002 (hereinafter King Report II).
28 *Ibid* par 7.
29 *Ibid* par 14.

Any suggestions therefore that companies should be forced by law to be more socially responsible and to allocate funds to the public good at the expense of profitability should be considered carefully in the light of the above.

2 The Neo-American model

The company laws of South Africa, England and the United States of America (hereinafter USA) will be compared hereunder. All three of these countries embody what has been referred to as the neo-American model of capitalism as compared with the Rhine model found operating in parts of Western Europe and Japan.[30]

In terms of the neo-American model the starting point is that since companies are essentially the property of shareholders, shareholders have the right to insist that the company be run for their benefit.

The separation of ownership and control (i.e. shareholders own the shares of a company whereas directors control the administration and general running of the company), has led to the need for company law in these systems to intervene to protect the interests of shareholders. As such, company law places some constraints on management behaviour thus curtailing the ability of management to use company funds for philanthropic ends. These constraints come in the form of the common law *ultra vires* doctrine, the common law duty of directors to act in good faith in the best interests of the company, and the duty of directors to exercise diligence, care and skill. These will be discussed in turn hereunder.

3 Constraints on Managerial Conduct

3.1 The Ultra Vires Doctrine.

The objects clause in a company's memorandum of association sets out the activities for which the company has been formed. These activities, however, may be altered by special resolution in terms of both South African and English company law. In terms of the *ultra vires* doctrine a transaction beyond the scope of

30 For a detailed description of these models, see Parkinson *Corporate Power and Responsibility* (1996) ix-x.

the objects clause is *ultra vires* and void. The justification for this doctrine, which could easily result in hardship to innocent third parties contracting with the company, was that it protected both shareholders and creditors of the company from abuse of power by directors. The English Companies Act has been amended so that the objects clause no longer limits the company's capacity in that the validity of such act or contract may no longer be questioned on the grounds of lack of capacity.[31] The company is bound by the transaction. Nevertheless, directors who enter into contracts beyond the capacity of the company in terms of its objects clause remain liable to the company for any loss that may result from entering into such *ultra vires* transaction. Where such transactions are beneficial to the company they can be ratified.[32]

Section 36 of the South African Companies Act states: "No Act of a company shall be void by reason only of the fact that the company was without capacity or power so to act or because the directors had no authority to perform that act on behalf of the company by reason only of the said fact and except as between the company and its directors neither the company nor any other person may in any legal proceedings assert or rely upon any such lack of capacity or power or authority." [33]

As is the case with English law, despite the validity of the *ultra vires* transaction the directors in South African law are still liable to the company. Prior to the conclusion of the *ultra vires* act, a court on application of a member/shareholder can grant an interdict preventing such action. If the act has already been concluded the director(s) responsible can be held liable for breach of their fiduciary duty.[34]

31 Companies Act 1989 s108 inserting ss 35-35B into the Companies Act of 1985.
32 S 35(3) of the English Companies Act of l989 specifically provides for this.
33 Companies Act 61 of 1973.
34 Cilliers *et al Entrepreneurial Law (*2000) 150.

The modern trend however has been to have very broadly drafted objects clauses so that most activities will probably not be *ultra vires.*[35] In so far as philanthropic acts that fall outside the objects clause are concerned, the law will in order to protect the interests of the company and indirectly the interests of the shareholders, hold directors responsible for such acts liable for any loss.

3.2 Duty to Act in Good Faith and in the Interests of the Company[36]

An action, which is within the power or capacity of the company, may still constitute a breach or fiduciary duty on the part of directors. This duty to act *bona fides* is in technical terms owed to the company as a separate legal entity in terms of both English and South African law. However, usually in promoting the success of the business, the best interests of the shareholders are also served. The fact that directors owe a fiduciary duty to the company, as a separate legal entity is not incompatible with the notion that directors owe such a duty to shareholders. Despite the fact that the standard formulation of the duty of directors in running the business is expressed in terms of benefiting the company, Parkinson[37] argues that this does not mean that the directors must literally direct their efforts at benefiting a legal entity. This he concludes would be futile since an artificial entity is not incapable of expressing well-being nor is it capable of having interests. Therefore he concludes[38] that "the duty of management can accordingly be stated as a duty to promote the success of the business venture in order to benefit the members".

The law in the USA differs from South African and English law in that in many states the legislation specifically states that fiduciary duties are owed to the shareholders.[39] In USA shareholders can specifically define duties of directors for

35 Slaughter "Corporate Social Responsibility: A New Perspective" 1997. *The Company Lawyer* 326.

36 Directors' fiduciary duties towards employees will be discussed hereunder in sub-section F.

37 Parkinson *op cit* 76.

38 *Ibid* 77.

39 Slaughter *op cit* 320.

which they will be held liable for breaching and which breaches could bear the sanction of loss of office.[40]

The King Report II, when delineating the role of directors, re-iterates this common law duty of directors by stating that directors must always: “exercise the utmost good faith, honesty and integrity in all their dealings with or on behalf of the company”[41] and “act in the best interests of the company and never for any sectoral interest.”[42]

It appears however, that in the view of the King Report II this duty can coexist and is quite compatible with a duty to take other stakeholders’ interests into account. The report states further that directors “must act with enterprise for and on behalf of the company and always strive to increase shareowner’s value, while having regard for the interests of all stakeholders relevant to the company”.[43]

This statement is reminiscent of English company law. Legislation provides that: “The matters to which the directors of the company are to have regard in the performance of their functions include the interest of the company’s employees in general as well as the interests of its members”.[44] The Act then goes on to provide that this duty is owed “to the company and is enforceable in the same way as any other fiduciary duty owed to the company by its directors”.[45] In other words it would be incumbent upon the directors themselves to enforce such duty and the employees would not be able to bring an action to prevent a breach of such duty. It seems unlikely however that the directors would bring an action against themselves!

40 Butler and McChesney “Why They Give at the Office – Shareholder Welfare and Corporate Philanthropy in Contractual Theory of the Corporation” 2001 *Cornell Law Review* 1201.

41 *Ibid* par 2.2.

42 *Ibid* par 2.4.

43 *Ibid* par 2.13.

44 S 309(1) of English Companies Act of 1985.

45 S 309(2) of English Companies Act of 1985.

In summary therefore, despite the mandatory language used in both the English law and the King Report II, such obligations are practically unenforceable, and merely provide directors with the discretion to have 'due regard' to the other stakeholders.

The King Report II does not spell out who all the stakeholders relevant to the company are. However stakeholders are defined as follows:

"1.1 Shareowners as providers of capital.

1.2 Parties that contract with the enterprise either as providers of input to its various business processes and activities, or as purchasers of its output. This would include, for example, customers, employees, suppliers, sub-contractors and business partners.

1.3 Parties that have a non-contractual nexus with the enterprise but provide it with its licence to operate and thereby exercise an influence on its ability to achieve its objectives. This class could include, for example, civic society in general, local communities, non-governmental organisations ('NGOs') and other special interest groups whose concerns may be with issues such as market stability, social equity and the environment.

1.4 The State as policy maker, legislator and regulator of the economy generally and specific sectors of it. The State's power, as opposed to mere influence, over the activities of companies sets it apart from other parties with a non-contractual nexus." [46]

In summary, stakeholders can be described as those upon whose co-operation and creativity it depends for its survival and prosperity.

Whether section 309 of the English Companies Act allows the interests of employees to take precedence over those of shareholders is not entirely clear. The weight of opinion however, is that shareholders interests can never be subordinated to employee interests.[47] Nevertheless Parkinson argues that this

46 King Report II *97*-98.

47 Parkinson C*orporate Power and Responsibility* (1996) 84-85.

section will provide directors who have favoured employee interests over shareholder's interests with a defence.[48]

The wording in the King Report II appears to subordinate the interests of all stakeholders relevant to the company to the shareholders' interests since the directors "must act with enterprise for and on behalf of the company and *always* (my emphasis) strive to increase value, *while* (my emphasis) having regard for the interests of all stakeholders ..."[49]

Even though USA corporate law also provides for standard form fiduciary duties, USA law differs in that many states have introduced legislation that specifically permits corporate powers that go beyond profit maximization.[50] The first such piece of legislation was promulgated in Texas as early as 1917. Many other states subsequently followed suit.[51] Some states specify charitable, humanitarian and social goals for which contributions are permitted.[52] Generally companies are entitled to act for mixed profit and humanitarian purposes. It should be noted that this legislation is enabling in that it permits such conduct. It is not mandatory and does not enforce or oblige companies to make any contributions or perform any other form of charitable conduct.[53]

The duty to act in good faith is subjective. The courts will not look into the merits of directors' decisions but will look merely to their subjective intention. If their subjective intention was to pursue the interests (albeit long term interests), of the company, they will have satisfied the duty to act in good faith. It will be difficult to prove that a director's motivation was something other than maximisation of profits, even where maximisation of profits did not result from the action. For example, donations to charity can usually be defended on the basis that they contribute to

48 *Idem.*
49 (2002) 98.
50 For an overview of such legislation see Mangrum *op cit* 66-70.
51 *Ibid* 68.
52 *Idem.*
53 *Op cit* 70.

the goodwill of the company. The English and American court cases generally bear this out.[54] Some American cases however, have openly permitted and justified US corporations making charitable donations not on the basis of long-term profit maximisation, but rather on the basis of public policy arguments.[55] In contrast to these decisions the court in *Dodge v Ford*[56] (hereafter the *Dodge* case) ignored public policy arguments and implemented what has been termed the 'contract model' of corporate responsibility[57] where the corporation is exclusively responsible to shareholders who have contractual rights for profit maximisation. However Mangrum contends that as far as USA is concerned, "the strict contract version articulated in Dodge had little historical support then and has since been substantially revised by common law decisions and statutory reform."[58]

A number of English and American cases that were decided prior to the *Dodge* case permitted altruistic actions by corporations on the basis of economic and humanitarian justifications[59]. Although these decisions could be justified on the basis that the conduct complained of was conceivably beneficial to the long-term interests of the company, the language used by some of the judges indicates the pursuit of social purposes beyond profit maximisation.[60]
Mangrum[61] highlights how many of the post *Dodge* decisions in both England and USA display an even greater tolerance towards legitimate objectives besides the pursuit of profit maximisation. The conclusion arrived at is that some decisions

54 See Slaughter "Corporate Social Responsibility: A New Perspective" 1997 *The Company Lawyer* 316-324 for a survey of the English and United States cases.
55 *Ibid* 320.
56 204 Mich 459. 170 N.W. 668 (1919).
57 See Mangrum "In Search of a Paradigm of Corporate Social Responsibility" 1983 *Creighton Law Review* 50-55 for a detailed discussion of this model and *Dodge v Ford.*
58 *Op cit* 54.
59 *Ibid* 55-57.
60 See *Steinway v Steinway & Sons* 17 Misc. 43 40 N.Y.S. 718 1896; *People v Hotchkiss* 136 A.D. 150, 120 N.Y.S. 649 1909; *Hawes v Oakland* 104 U.S. 450 1881; *Taunton v Royal Ins. Co.* 71 Eng. Rep. 413 (1864).
61 *Op cit* 58-66

have paid lip service to the fiction of long-term benefit to the company.[62] Mangrum states: "Some courts revise the strictures of *Dodge* by considering what appear to be altruistic corporate acts as compatible with the long term economic interest of the corporation. These cases give descriptive credence to both the contract and economic models. At some point the liberality of the interpretation of economic interest transforms the profit maximisation constraint into a legal fiction which obscures the real justification for the decision."[63]

Carter,[64] having reviewed the US cases comes to a very different conclusion to that of Mangrum. He argues that the requirement that some kind of benefit be derived by the company, albeit indirect has remained constant. Slaughter and Parkinson[65] come to a similar conclusion concerning the English cases and suggests that the English courts insist on corporate benefit to legitimize corporate acts even though the benefit may not be immediate or calculable.

Although some decisions may have interpreted the profit maximization goal very liberally the fact remains that usually socially responsible conduct is good for business,[66] even though the extent of the benefit is often incapable of exact calculation. This is especially the case when socially responsible actions serve the purpose of public relations, advertising and the creation of general goodwill.[67]

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62 Parkinson *op cit* 280 comes to a similar conclusion concerning United States cases. See for example *AP Smith Manufacturing Co. v Barlow.* 39 ALC 2D 1179 (1953) 1187.

63 *Op cit* 54.

64 "The Limit of Corporate Social Responsibility" 1982 *Merc Law Review* 533.

65 Slaughter "Corporate Social Responsibility: A New Perspective" 1987 *The Company Lawyer* 316, and Parkinson *op cit* 272.

66 See Slaughter *op cit* 321-322 and Parkinson *op cit* 273-274 for discussion of *Evans & Brunner Mond and Co. Ltd* (1921).

67 For a discussion of socially responsible conduct as a response to consumer opinion, see Slaughter *op cit* 322-324.

Solomon[68] in analyzing two publicity held corporations that are noted for being socially responsible and having objectives other than profit maximization, namely, *Ben and Jerry's Homemade Inc.* and *The Body Shop International PLC,* actually demonstrates how the socially responsible conduct brought in great profits.

There are however, always exceptions to the rule, and socially responsible conduct might not always be in the best interest (albeit long-term interests) of the company. Charitable donations are the type of socially responsible conduct by companies which are the most difficult to reconcile with the profit maximisation object. This usually occurs where directors are motivated by self-interest in making donations with company funds. In the light of preceding discussion concerning the ease with which the duty to act in good faith is complied with and the liberal interpretation the courts have sometimes given to the end of profit maximisation, it might be argued that shareholders might be unable to prevent such self-interested acts by directors. In situations like this, the effect of market forces (which go beyond the scope of this article) might well step in to act as a restraint on management conduct.[69]

In short therefore, it appears that although the law is not mandatory and does not oblige companies to be socially responsible, the law usually does permit such conduct. The driving force behind such conduct is not any legal obligation but rather market forces that render such conduct good for business.[70] A rather ironic illustration of this is the *Dodge* case: Henry Ford was prevented from acting for the benefit of his employees and the community on the basis that this would not be in the best interests of the company. Ford subsequently paid out the minority shareholders (the *Dodge Brothers)* who had objected to this conduct and obtained

[68] Solomon "On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicity Held Corporations – A Critical Assessment" in Mitchell *Progressive Corporate Law* (1996) 78.

[69] Butler and McChesney "Why They Give at the Office – Shareholder welfare and Corporate Philanthropy in Contractual Theory of the Corporation" 2001 *Cornell Law Review* 1197-1202, argue that market fines have a much more profound effect than the law on managerial conduct.

[70] See Carter op cit 519; Slaughter "Corporate Social Responsibility: A New Perspective" 1997 *The Company Lawyer* 321.

the court order preventing it, and proceeded with his social policies that resulted in the company being more profitable than it had ever been.[71]

3.3 Duty to exercise Diligence, Care and Skill

Directors in England, South Africa and USA must exercise certain standards of care and skill. In all three countries the standards of care and skill are very low. The standards of the ordinary prudent man[72] have been constantly applied in England. The similar reasonable man test is applied in South Africa. This means that the care and skill required is that which "can reasonably be expected of a person with his knowledge and experience. A director is not liable for mere errors of judgement."[73]

Historically the courts have been reluctant to second-guess business judgments. Another reason that judges were reluctant in the past to interfere with managerial discretion is that the courts felt that shareholders could control management. Clearly today, particularly with large, public companies shareholder control is not always possible. Contributing to the particularly low standard of care and skill required by the courts has been the misconception that management is not a profession requiring specific skills.[74] Clearly this is not the case. The extensive literature and qualifications available on the topic of 'management' verify this.

Imposing a higher standard of care and skill on directors however, might result in reluctance on the part of directors to take risks. Risk-taking is, and always has been part of any successful business. Too stringent a standard therefore might hinder progress, productivity and profitability. It has been suggested[75] that courts should scrutinize decisions more closely from a procedural aspect in order to ensure that at least, the risk embarked upon was preceded by adequate research.

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71 Mangrum "In Search of a Paradigm of Corporate Social Responsibility" 1983 *Creighton Law Review* 54.

72 *Overend and Gurney v Gibb* (1872) LRS HL 480 HL.

73 Celliers *et al Entrepreneurial Law* (2000) 153.

74 For an illustration of this misconception by English courts see Parkinson *Corporate Power and Responsibility (*1996) 108.

75 *Ibid* 110-113.

The argument is that requiring directors to gather reasonably sufficient information before embarking on a risk will help insure that more calculated risks are taken without hampering risk-taking to too great an extent.

The King Report II[76] may require a slightly more stringent duty of care and skill expected of directors in terms of the common law. It states that directors "must, in line with modern trends worldwide, not only exhibit the degree of skill and care as may be reasonably expected from persons of their skill and experience (which is the traditional legal formulation), but must also:

(i) exercise both care and skill any reasonable persons would be expected to show in looking after their own affairs as well as having regard to their actual knowledge and experience; and

(ii) qualify themselves on a continuous basis with a sufficient (at least a general) understanding of the company's business and the effect of the economy so as to discharge their duties properly, including where necessary relying on expert advice"[77];

(iii) "must insist that board papers and other important information regarding the company are provided to them in time for them to make informed decisions";[78]

(iv) "must ensure that procedures and systems are in place to act as checks and balances on the information being received by the board and ensure that the company prepares annual budgets and regularly updated forecasts against which the company's performance can be monitored";[79]

(v) must be diligent in discharging their duties to the company, regularly attend all meetings and must acquire a broad knowledge of the business of the company so that they can meaningfully contribute to its direction".[80]

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76 These provisions are not legally enforceable.
77 *Ibid* ch 4 par 2.3.
78 *Ibid* par 2.6.
79 *Ibid* par 210.
80 *Ibid par* 211.

In line with Parkinson's suggestions[81] it appears that what was envisaged by the King Report II is an emphasis on procedural aspects with a more stringent obligation on the acquisition of knowledge and information. Nevertheless, it appears that there still would be no grounds for questioning an error of judgment provided it was preceded by the necessary accumulation of information and knowledge.

4 Conclusion

The forces of the market provide a greater incentive than the law to constrain management conduct that serves personal management interests as opposed to shareholder or company interests.[82] The forces of the market create the threat of management job losses through hostile take-overs, mergers and so forth. Capital markets, product markets, markets for managerial talent all act as incentives for directors to run a company in a professional, efficient, and productive manner.[83] However, since the constraints afforded by the markets might not be complete,[84] some argue that the law should be amended to provide for a more comprehensive duty of skill and care with more stringent liability for management.[85]

Such constraints however will also not necessarily be completely effective in controlling management conduct. Secondly more rigid legal constraints could easily result in the costs exceeding the benefits.[86] Thirdly such legal constraints might prevent socially responsible conduct that would normally result in increased profits for the company. Fourthly litigation and enforcement by the courts carries with it the following pitfalls:

81 *Supra.*

82 See Yoshiro Miwa "Corporate Social Responsibility: Dangerous and Harmful, Though Maybe not Irrelevant" 1999 *Cornell Law Review* 1195, 1227, 1232-1233.

83 For a detailed analysis of the likely effects of the various markets on management behaviour, see Parkinson *op cit 1*13-132 and Butler and McCherney "Why They Give at the Office – Shareholder Welfare and Corporate Philanthropy in Contractual Theory of the Corporation" 2001 *Cornell Law Review* 1197-1202.

84 Parkinson *op cit* 33 for a discussion of the inability of the markets to prevent inefficiency as a result of the imperfection of markets.

85 *Ibid* 132.

86 *Idem* and Butler and McChesney *op cit* 1206.

(i) It is expensive, disruptive to the company and can result in bad publicity.
(ii) The outcome is uncertain.
(iii) Damages are payable to the company not individuals thus significantly reducing the incentive to pursue a matter via the courts.
(iv) Minority shareholders do not always have *locus stand* to enforce liability.

In conclusion, it would be difficult to successfully challenge philanthropic acts of a company for the following reasons:
(i) The revision of ultra vires doctrine and the trend towards open-ended and general objects clauses.
(ii) The fact that the fiduciary duties of good faith and care and skill are easily met and hence seldom violated.
(iii) The liberal interpretation of long-term interest generally accorded by the courts.
(iv) The general refusal by the courts to interfere with management judgement and discretion.

This however, is not too disturbing in the light of the overall benefit that usually accrues to the company as a result of philanthropic conduct as well as the constraining effect on managerial discretion that market forces provide. A reliance on the effect of the market on management conduct is apparent in the King Report II in its recommendations for remuneration of directors and it reads: “Levels of remuneration should be sufficient to attract, retain and motivate executives of the quality required by the board” and “performance-related elements of remuneration should constitute a substantial portion of the total remuneration package of executives in order to align their interests with the shareowners, and should be designed to provide incentives to perform at the highest operational standards.”[87]

Reliance on market forces is not unfounded as it has been demonstrated that management controlled companies do not spend more on social expenditure than

[87] King Report II 61.

those under ownership control.[88] Ironically then, market pressure generally functions as a constraint on management conduct in that it ensures that the company is run efficiently, and at the same time, market pressure is an incentive for socially responsible conduct. This is also the view of the King Commission when it states: "Impetus for change will therefore come from market and society which will be the ultimate arbiters in corporate behaviour".[89]

It is clear therefore that in this view the pursuit of company interests is not incompatible with being socially responsible. The King Report emphasizes the importance of social, ethical and environmental issues and specifically states that they can "no longer be regarded as secondary to more conventional business imperatives".[90] The conclusion is that a company's long term survival and success is "inextricably linked to the sustainable development of the social and economic communities within which it operates"[91] and that "this inclusive approach (i.e. inclusion of other stakeholders) is the way to create sustained business success and steady, long term growth in shareowner value"[92] since "stakeholders have a direct bearing on ongoing corporate viability and financial performance".[93]

E Employees as Stakeholders of Corporate Governance

1 Introduction

"The 19th century saw the foundations being laid for modern corporations: this was the century of the entrepreneur. The 20th century became the century of management: the phenomenal growth of management theories, management consultants and management teaching (and management gurus) all reflected this pre-occupation. As the focus swings to the legitimacy and the effectiveness of the wielding power over corporate entities worldwide, the 21st century promises to be

88 Parkinson *Corporate Power and Responsibility* (1996) 64.
89 King Report II 97 par 23.
90 *Ibid* 92.
91 *Idem.*
92 *Idem.*
93 *Idem.*

the century of governance."[94] This is a reflection and manifestation of how the world of work has changed over the last three centuries. The entrepreneur of the 19th century usually owned his business. The business was usually small and the employer was also the individual who owned the business. Because there were only a few employees the relationship between employer and employee was usually a personal relationship. As the era of Fordism[95] emerged in the 20th century, the economies of scale dictated that in order for an enterprise to survive it had to be large (i.e. many employees) and production was dictated by post-war Keynesian economic policies. In order to exercise control over these many employees, they had to be arranged into a hierarchy beginning at the bottom with unskilled labourers going up through a number of levels of supervisors and eventually management. Management was also divided into various levels in a hierarchical structure, beginning at lower management, going through to middle management and eventually reaching top management.[96] This hierarchical structure resembling an army was typical of the large corporations of the 20th century. With such large enterprises, a natural consequence was the fact that the relationship between the employer (now usually a company and not an individual) was no longer a personal relationship. In the 20th century employee interests in the industrialized economies were generally protected by trade unions and collective bargaining.[97] Collective bargaining regulated employer-employee relations, institutionalized conflict and protected employees from "arbitrary management action".[98] The need to remain competitive in the global economy has resulted in a quest for flexibility. The result is *inter alia* flatter management structures,[99] an ever-increasing number of "atypical employees,"[100] decentralization of collective

94 King Report II 15 Par 24.

95 'Fordism' refers to an economy of mass production fuelled by mass consumption. (See Slabbert *et al The Management of Employment Relations* (1999) 87.)

96 Blanpain "Work in the 21st Century" 1997 *ILJ* 185,195.

97 Anstey "National Bargaining in South Africa's Clothing Manufacturing Industry: Problems and Prospects of Multi-employer Bargaining in an Industry under Siege" 2004 *ILJ* 1829.

98 Anstey *op cit* 1830.

99 Blanpain "Work in the 21st Century" 1997 *ILJ* 185.

100 See Theron "Employment Is Not What It Used to Be" 2003 *ILJ* 1247, and Cheadle *et al Current Labour Law* 2004 135-170.

bargaining,[101] the individualization of the employer employee relationship[102] and a general world-wide decline in union membership and power.[103] Given these facts it becomes necessary to look to alternate means to protect the employee against employer abuse of power in a relationship where the balance of power between the parties is inherently uneven. The possibility of corporate governance and acceptance of the stakeholder theory as a protector of employee interests is explored hereunder.

2 The Role of the Corporation in Society

No enterprise or corporation can survive without society. In fact business enterprises are a creation of society.[104] Society is made up of what has been referred to as the 'stakeholders' of business.[105] They include the community in which the corporation or business enterprise operates, its customers, employees and its suppliers. [106] Business and society are mutually dependent. In pursuit of wealth and profit maximization, companies utilize human and other resources and in doing so provide employment, investment, goods and services.[107] Business therefore forms part of the fabric of society. In fact as King explains: "In the current era, the company remains a key component of business. It is the chosen medium for entrepreneurs and business people to perform their tasks. It has more immediate presence for the citizens of a country than governments can ever hope to have while it is the legitimate agent for profit making activities."[108] Since "there

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101 Anstey 1831-1833; and ch 5 *supra.*

102 See in general Deery and Mitchell *Employment Relations: Individualisation and Union Exclusion* (1999) and ch 6 *infra*.

103 See Raday "The Decline of Union Power – Structural Inevitability or Policy Choice?" in Conaghan, Fischl and Klare *Labour Law in an Era of Globalization* (2002) and ch 5 *supra*.

104 Saxena *Taxman's Politics, Ethics and Social Responsibility of Business* (2004) 17.

105 Edward Freeman, Professor of Applied Ethics at the University of Virginia's Darden School, developed the 'stakeholder theory'. In terms of this theory managers should serve the interests of all those who have a stake in the company. These are employees, suppliers, customers and the community in which the company operates.

106 King Report II 8 par 5.3.

107 Saxena *op cit* note 9 at 17.

108 "Corporate Governance: Creating Profit with Integrity" *Management Today* May 2003 8.

can be no escape from sceptical consumers, activists and protestors,"[109] a company must support the wider societal values in performing the functions of wealth creation, economic growth and the creation of employment opportunities. Unfortunately the pursuit of profits has at times led to exploitation of human and other resources. As corporations became larger and more powerful, society began to place pressure on these corporations to conduct their business in a socially responsible manner. Since corporations are dependent on society for their survival the necessity to conduct their affairs in an ethical and fair manner taking the interests of society in general into account is apparent. [110]The need for the legitimacy of corporations becomes more relevant given the immense power that some corporations now wield.[111]

3 King Report II and Stakeholder Theory

The King Report II provides guidelines for South African companies wishing to implement good corporate governance practices.[112]It is the view of the King Commission that in this global economy no corporation can afford to run its business without due consideration of the interests of all the stakeholders.[113] This

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109 *Idem.*

110 See De Jongh "Know Your Stakeholders" 30 June 2004 *Finance Week* 34 where he states: "In today's CNN age everything we do as individuals and companies is exposed in seconds and therefore it's so important to understand exactly who all the stakeholders are that are affected by our business and how they again affect our business on a daily basis."

111 Crowther and Jatana *International dimensions of Corporate Social Responsibility* (2005) v–vi, explain: "Though the spectre of physical war has not vanished, it might be argued that the focus of war has shifted from imperialistic or ideological reasons to economic reasons – at least as far as governments and countries are concerned. But governments, as the epitome of nation states, are becoming less important because what is becoming more important than governments and nation states are the multinational companies operating in the global environment. Some of these multinationals are very large indeed – larger than many nation states and a good deal more powerful."

112 Corporate governance is defined as "the system by which companies are directed and controlled" by the Cadbury Report on Corporate Governance (UK). This is the meaning that is ascribed to the term in this article.

113 King Report II par 14 reads: "In the global economy there are many jurisdictions to which a company can run to avoid regulation and taxes or to reduce labour costs. But, there are few places where a company can hide its activities from sceptical consumers, shareowners or protestors. In short, in the age of electronic

view is commonly referred to as "stakeholder theory" in terms of which a company should be run in the interests of all its stakeholders rather than just the shareholders.[114] These stakeholders have been defined as "those whose relations to the enterprise cannot be completely contracted for, but upon whose co-operation and creativity it depends for its survival and prosperity".[115] As mentioned this includes the community in which the company operates, its customers, employees and suppliers.[116] Since business is dependent on society and does not work in isolation of it,[117] it follows that corporate decisions and actions that have a negative impact on stakeholders can in turn impact negatively on the corporation.[118]

A company's long term viability is dependent on its reputation.[119] Reputation in turn is dependent on a company's relationship with, and the way it treats anyone and everyone affected by it.[120] This includes employees. Relationships with all

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information and activism, no company can escape the adverse consequences of poor governance."

114 Vinten "Shareholder Versus Stakeholder – Is There a Governance Dilemma?" 2001 *Corporate Governance* January 36 at 37.

115 King Report II 98 par 1.4.

116 King Report II 8 par 5.3.

117 This is explicitly acknowledged, not only in the King Report II, but also in the *1994 King Report I*: The King Report II 7 par 4 reads: "In adopting a participative corporate governance system of enterprise with integrity, the King Committee in 1994 successfully formalised the need for companies to recognise that they no longer act independently from the societies and the environment in which they operate."

118 An extreme example of such lack of ethics on the part of a corporation is the lack of safety controls that caused a gas leakage at Union Carbide Limited (Bhopal, India) which led to thousands of deaths and led to another 200 000 to 300 000 suffering minor injuries, loss of employment, or found themselves destitute due to the loss of the only bread-winner in the family. The outcome was that the company lost the support of society, it had to pay heavy compensation and was forced to close down. See Ryan "Social Conscience Comes with a Price Tag" 2004 *Without Prejudice* 7-8.

119 See Hyman and Blum "Just Companies Don't Fail: The Making of the Ethical Corporation" 1995 *Business and Society Review* 48-50.

120 As stated in the King Report II 91 par 2: "In a corporate context, 'sustainability' means that each enterprise must balance the need for long-term viability and prosperity – of the enterprise itself and the societies and environment upon which it relies for its ability to generate economic value – with the requirement for short-term competitiveness and financial gain. Compromising longer term prospects purely for short-term benefit is counter-productive. A balance must be struck and

stakeholders, including employees must be actively managed in a manner that reflects integrity, trust and transparency, so that the company will gain the support and backing of its stakeholders which becomes even more important if things go wrong.[121] Companies should create a climate which not only attracts talented employees but which also motivates and is able to retain these employees. Employees have been described as forming part of a company's assets and competitive edge.[122] The ability of an enterprise or company to remain productive in an increasingly competitive global economy is dependent *inter alia* on its ability to develop and retain human talent.[123] In order to do this a company must conduct itself in an ethical manner towards its employees. In fact, as Rossouw concludes:"Ethics is no longer viewed as just another aspect of the organization that needs to be managed. On the contrary, it is regarded as an integral part of the company without which it would be unable to fulfil its purpose, mission and goals…Consequently, ethical behaviour is regarded as strategically important and unethical behaviour as jeopardising not only the business success of the organization, but also as undermining the very identity of the organization."[124] In short where a company treats individual employees with dignity and respect, the human potential necessary for competitive advantage and productivity in a global economy will be unleashed.[125]

failure to do so will prove potentially irreparable, and have far-reaching consequences, both for the enterprise and the societies and environment within which it operates. Social, ethical and environmental management practices provide a strong indicator of any company's intent in this respect."

121 De Jongh "Know your Stakeholders" 2004 *Finance Week* 30 June 34.

122 Rossouw "Unlocking Human Potential with Ethics" February 2005 *Management Today* 28 states: "The way that companies think about their people and what they choose to do (or not to do) in unlocking their human potential determines their future sustainability."

123 See Rossouw *op cit* where he identifies the results of various surveys that demonstrate that "companies that invest in their human capital, develop it and reward people for performance, make more money than those who place less emphasis on human capital."

124 Rossouw *op cit* 30.

125 *Idem.*

In terms of the Commonwealth Business Council Working Group[126] the defining characteristics of good corporate citizenship for the attainment of sustainability[127] with reference to employee relations are:

(i) Respect for the well-being of employees;
(ii) fair treatment of employees having due regard to cultural sensitivities;
(iii) development of employees' potential through skill and technology transfer;
(iv) sharing of the company's success with the employees;
(v) recognition of international agreements with reference to the freedom of association and collective bargaining; and
(vi) elimination of all forms of forced labour.

The above guidelines will automatically be implemented where a company is aware of the immense value of human capital[128] and consequently treats its employees with dignity and respect. In terms of King Report II: "nurturing, protecting, capturing, retaining and developing human capital can therefore be seen as a vital ingredient for the sustainable economic performance of any company. A focus on developing human capital represents a focus on breathing life into the oft-quoted statement that 'our people are our most important asset'." [129]

126 *Draft Principles for Best Practice on the Relationship Between International Enterprises and Countries to Encourage Foreign Direct Investment*; CBC survey "A Good Environment for Business Development and Investment"; "CAGC Guidelines on Corporate Governance"; "The UN Global Compact", the Work of Prince of Wales Business Leaders' Forum; and the World Business Council for Sustainable Development. See King Report II 92 footnote 22.

127 The concept of sustainability in the business context and in terms of the King Report II refers to the "achievement of balanced and integrated economic, social and environmental performance- now universally referred to as the triple bottom line." See Khoza "Corporate Governance: Integrated Sustainability Reporting" *Management Today* May 2002 18.

128 King Report II 118 par 2 defines human capital as "the latent, or potential, value that employees at all levels – individually and collectively - represent for a company. This is a function of their knowledge, learning, intuition, skill, expertise and experience, both existing and, importantly, latent."

129 Pg 118 par 2.

4 King Report II and Ethics

4.1 Introduction

The link between corporate governance and ethics has already been established in discussing the value of human capital and an organization's need for the support of all stakeholders. This link is inevitable in terms of the King II Report given the fact that it takes an inclusive approach with reference to stakeholders.[130] The necessity for corporate ethics and morality has been expanded upon in the King Report II by the introduction of seven characteristics or principles which must be adhered to for good corporate governance.[131] These principles serve to guide and govern the moral conduct of individuals in carrying on the business activities of the company. If adhered to by employers, the natural consequence is that employees will be treated with dignity and respect, thus providing the acceptable working conditions and protection of employee interests otherwise provided by collective bargaining. These principles are discussed below.

4.2 Discipline

According to the King Report II "[c]orporate discipline is a commitment by a company's senior management to adhere to behaviour that is universally recognized and accepted to be correct and proper. This encompasses a company's awareness of, and commitment to, the underlying principles of good governance, particularly at senior management level."[132] An international survey found that 85% of South African "senior managers have at some stage overridden controls to perpetuate fraud."[133] If this finding is accurate the need for discipline is

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130 The inclusive approach to stakeholders (also referred to as a "participative corporate governance system," page 7 of King Report II), contradicts the view that companies have no other obligation than to make as much profits as possible for the shareholders, but contends that corporations have moral obligations to a wide range of stakeholders. See Rossouw "Business Ethics and Corporate Governance in the Second King Report: Farsighted or Futile?" 2002 *Koers* 405 at 410.

131 See King Report *II* par 18.

132 Par 18.1.

133 "King II Report – The Expectation Gap: Corporate Governance" 2002 *Enterprise* Issue 68, 63.

manifest. The King Report II also refers to a "license to operate".[134] This means that a company needs to do more than what is legally required of it. It needs to win the approval of all stakeholders and thereby be 'legitimised' by them.[135] Amongst the stakeholders from whom a company must earn its license to operate are employees. Effective communication with all stakeholders including employees is the way to achieve this. Employees should be provided with *inter alia* information concerning employment, retrenchments, training and affirmative action.[136]

4.3 Transparency

The Report defines 'transparency' as follows: "Transparency is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to that business. This is a measure of how good management is at making necessary information available in a candid, accurate and timely manner – not only the audit data but also general reports and press releases. It reflects whether or not investors obtain a true picture of what is happening inside the company." It will no longer suffice for a company to provide information on an ad hoc need to know basis. Directors will be held accountable for the accuracy of the content of the information provided to outsiders.[137] The King Report stresses the importance of reporting as it is "the real measure of organizational integrity – and the basis of sound relationships with stakeholders."[138] In fact transparency has been described as the cornerstone of corporate governance.[139] The Report provides guidelines for both financial and non-financial reporting.[140] It states that a company should be guided by the

134 King Report II 8 par 5.2.

135 Rossouw *op cit* 411.

136 Rigby "Tell It All" February1997 *Enterprise* 72.

137 S 251 of Companies Act 61 of 1973 states: "Every director or officer of a company who makes, circulates or publishes or concurs in making, circulating or publishing any certificate, written statement, report or financial statement in relation to any property or affairs of the company which is false in any material respect shall be guilty of an offence."

138 99 par 11.

139 Khoza "Corporate Governance: Integrated Sustainability Reporting the Key Principle" May 2003 *Management Today* 18 at 21.

140 99-100.

principles of "reliability, relevance, clarity, comparability and verifiability."[141] Secondly the Report states that in order for reporting to be effective there must be an integrated approach.[142] It suggests that one way of achieving such integrated approach would be to "categorise issues into different levels."[143] The suggested levels are: Firstly the disclosure of company principles and codes of practice. The second level would concern itself with the disclosure of information concerning the practical implementation of these codes and principles. "This will involve a review of whether the company has taken steps to encourage adherence to those principles as may be evidenced in the form of board directives, designated policies and communiqués, supported by appropriate non-financial accounting mechanisms."[144] The final level would include the investigation and reporting or demonstration of changes and benefits as a result of the implementation of these codes of conduct and principles.[145] Not only the Companies Act[146] but also the King Reports are relevant to the principle of transparency. One of the objectives of the Promotion of Access to Information Act[147]is the promotion of "transparency, accountability and effective governance of all public and private bodies."

The value of transparency has also been acknowledged by the OECD[148] when it stated: "The disclosure of the corporation's contractual and governance structures may reduce uncertainties for investors and help lower capital costs by decreasing related risk premiums. Such transparency may also encourage a common understanding of the 'rules of the game', and provide employees with information that may help reduce labour friction."[149]

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141 99 par 12.
142 99 par 14.
143 *Idem.*
144 *Idem.*
145 *Ibid.*
146 61 of 1973.
147 2 of 2000.
148 Organisation for Economic Cooperation and Development.
149 1998b.

Transparency is of paramount importance for investor confidence and corporate governance rating systems include transparency and disclosure as important aspects of scoring for investor confidence.[150]

4.4 Independence

The King Report provides "that measures should be put in place so as to avoid possible conflicts of interest such as dominance by a large shareholder or strong chief executive."[151]

4.5 Accountability

Individuals or groups who make decisions and take action on behalf of the company must be accountable for these actions and decisions. Furthermore mechanisms must be put in place to allow for "effective accountability".[152] A distinction is made between 'accountability' and 'responsibility'. "One is liable to render an account when one is accountable and one is liable to be called to account when one is responsible."[153] In other words, when one is accountable there is an obligation to explain the reasonableness and appropriateness of one's actions if called upon to do so.[154] Being accountable to employees as stakeholders renders company decisions and actions that affect employees open to question. This also emphasizes the need for transparency and effective communication with employees.

4.6 Responsibility and Social Responsibility

If management does not conduct itself in a responsible manner with regard to stakeholders' penalties and corrective action will be enforced.[155] Responsible behaviour does not only entail abiding by laws, refraining from acting in a discriminatory manner and respecting human rights, but requires companies to be

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150 Editorial: "The Relationship between Corporate Governance, Transparency and Financial Disclosure" October 2002 *Corporate Governance* 253.

151 12 par 18.3.

152 King Report II ch 12 par 18.4.

153 King Report II ch7 par 5.

154 Saxena Taxmann *Politics Ethics and Social Responsibility* (2005) 91.

155 King Report II ch12 par 18.5.

pro active and to take positive steps in becoming involved in developmental issues.[156] Within the South African context three areas of social responsibility relevant to employees as stakeholders are Black economic empowerment, the health of employees particularly with reference to HIV/Aids and human development.[157] As seen the King Report II considers the development of human development of paramount importance not only because of our legacy of apartheid but also because of the intrinsic value of well trained and skilled employees for companies. The result of implementation of social responsibility is increased productivity and a good reputation or public image, which in turn have economic benefits.[158]

4.7 Fairness

Fairness is not a concept that can easily be defined. In articulating the principle of fairness the report refers to taking into account the interests of all those who have an interest in the company in a balanced way.[159] The Report goes on to state: "The rights various groups have to be acknowledged and respected."[160] Amongst these groups are employees. There should be more balanced relations between the organization and its employees so that fairness is acquired. Even though a company may be acting in a lawful manner such conduct may not necessarily be fair. The adoption of the principle of fairness is therefore important. With reference to employees it is in line with everyone's constitutional right to fair labour practices.[161]

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156 Rossouw "Business Ethics and Corporate Governance in the Second King Report: Farsighted or Futile?" 2002 *Koers* 412.

157 *Idem.*

158 As King "Corporate Governance: Adopting an Inclusive Approach" May 2002 *Management Today* 28 states: "When investors scan the market to establish where they need to make their next investment, they now look first at corporate governance practices in their target market and only thereafter investigate the financial situation."

159 King Report II ch12 par 18.6.

160 *Idem.*

161 S 23(1) of the Constitution provides that everyone has the right to fair labour practices.

4.8 Ubuntu

This is an African value system which the King Report II suggests should be used as a guideline by companies for the application of the ethical principles outlined in the King Report II in order to achieve sustainability. It signifies "a commitment to co-existence, consensus and consultation."[162] It is encompassed in the phrase '*ubuntu nguumuntu ngabantu*' which means: "I am because you are, you are because we are". In other words the interdependence of humanity and community of society is the basis of this principle.[163] In terms of the King II Report "*Ubuntu* has formed the basis of relationships in the past and there is no reason why it could not be extended to the corporate world. International experience, which reveals a growing tendency towards an emphasis on non-financial issues, is a wake-up call to all Africans not to abandon their cultures when they become part of the business sector, but to import and infuse these practices into the corporate world."[164] Khoza has identified the following characteristics of African values and hence *Ubuntu:*

(i) humility;
(ii) respect (social obligation, personal dignity, ancestral value and essence of a person);
(iii) community and sense of belonging;
(iv) responsibility and concern for others;
(v) generational responsibilities; respect for the social obligation/ contract;
(vi) respect for personal dignity;
(vii) neighbourliness; and
(viii) spirit of inclusion and general consensus.[165]

Application of these values by companies is a guarantee that the inherent imbalance of power between employers and employees will not be exploited by employers. Since investors are increasingly placing more importance on a

[162] Rossouw *op cit* 413.
[163] De Kock and Labuschagne "Ubuntu as a conceptual directive in realising a culture of effective human rights" 1999 *THRHR* 114 at 118 par 3.1.
[164] 94 par 7.
[165] "Corporate Governance: Integrated Sustainability Reporting" May 2002 *Management Today* 2002 18. See also De Kock and Labuschagne *op cit* par 4.1.

company's ethical conduct[166] in their evaluation of companies, the corporate application of the concept of *ubuntu* can go a long way to achieve the primary objective of the implementation of a system of good corporate governance, namely, the attraction of foreign investment.[167]

4.9 Conclusion

Company adherence to these principles with regard to employees, and even workers who do not necessarily qualify as employees in terms of labour legislation, such as for example independent contractors, will result in the protection and upholding of the interests of all workers (both typical and atypical employees). In summary: Unfair treatment of employees is bad for business and the best means of enforcing ethical conduct towards employees are the forces of the market.[168]However, the mere statement that these principles are applicable is no guarantee of a company's adherence thereto and consequently no guarantee of the fair and ethical treatment of employees by companies. Companies need to have guidelines on how to apply these principles in practice and application of these principles must be monitored. These are provided by the King Report II and are discussed below.

5 Enforceability of Good Corporate Governance

The Board of directors is ultimately responsible for good corporate governance. The chief executive officer has a key role to play in this regard. In terms of the King Report II, with particular reference to the management of human capital, the chief executive officer has the following responsibilities: [169]

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166 According to a survey of opinions undertaken by McKinsey (see Armstrong "Corporate Governance: The Way to Govern Now" May 2003 *Management Today* 10) a premium of 22% would be paid for a well-governed South African company.

167 Rossouw "Business Ethics and Corporate Governance in the Second King Report: Farsighted or Futile?" 2002 *Koers* 406.

168 It is my view that the market is the best means of enforcement despite the fact that a chief executive officer can be dismissed for failure to ensure that employees are treated fairly.

169 53 par 2 and 3.

- "develop and recommend to the board a long term strategy and vision for the company that will generate satisfactory levels of shareowner value and positive, reciprocal relations with relevant stakeholders;
- ensure the company has an effective management team and to actively participate in the development of management and succession planning (including the chief executive officer's own position);
- maintain a positive and ethical work climate that is conducive to attracting, retaining and motivating a diverse group of top-quality employees at all levels of the company. In addition, the chief executive officer is expected to foster a corporate culture that promotes ethical practices, encourages individual integrity, and fulfils the social responsibility objectives and imperatives."

Failure to adequately perform these duties amounts to incompetence or poor work performance and since the chief executive officer is an employee of the company, this could result in a valid dismissal.[170] This is an indirect form of enforcing the fair treatment of employees.

South Africa like many other countries has chosen not to legislate on reporting requirements concerning good corporate governance and sustainability.[171] Khoza argues that lack of legislative imperatives[172] is not the cause of corporate collapses and the type of unethical conduct that was seen in for example the case of the highly publicized collapse of Enron.[173] Khoza's view is that this kind of unethical conduct and consequent collapse of companies emanates from a lack of

170 Schedule 8 –Item 9 of *Code of Good Practice: Dismissal* of the Labour Relations Act 66 of 1995 recognises poor work performance of an employee as a valid and acceptable reason for dismissal.

171 Khoza "Corporate Governance: Integrated Sustainability Reporting the Key Principle" May 2003 *Management Today* 21.

172 The discussion concerning lack of legislative imperatives referred to in this context is limited to legislation concerning the disclosure and monitoring of non-financial issues. See Konar "Legislation Reviewed as a Result of Corporate Misdemeanours" May 2003 *Management Today* 16 concerning the regulatory framework for accountants and auditors.

173 See King "Corporate Governance: Creating Profit with Integrity" May 2003 *Management Today* 8.

commitment to good corporate governance practices rather than from a lack of rules.[174] He explains his preference for voluntarism as follows: "It is my view that this is a particularly difficult area to legislate and the promulgation of legislation will only contribute to a tick box approach to compliance rather than to instil a sense of *ubuntu* amongst leaders in the corporate sector. It is my belief that we should continue to rely on voluntary mechanisms to lift the standard of corporate behaviour in this regard. These voluntary mechanisms, I might add are not without teeth. If one takes the community or the market as an arbiter…any company that is engaged in undesirable practices will find that this negatively impacts its bottom line through consumer and market power…Guidelines that enjoy some measure of moral authority and wide support – from peers, customers or other stakeholders – will become difficult to ignore."[175] In line with this view it is clear that inappropriate and unfair treatment of employees will not only result in loss of support from consumers and possibly the community at large but will also result in lack of commitment from employees which in turn translates into a loss of productivity.[176]

Although the King Report II does not provide for enforcement legislation it provides guidelines for the implementation of good corporate governance.[177] In terms thereof the following core ethical principles should be adopted: fairness, transparency, honesty, non-discrimination, accountability and responsibility and respect for human dignity, human rights and social justice. The report then goes on to state that the formulation of these core principles is meaningless without "demonstrable adherence".[178] It therefore suggests the following measures to ensure adherence:

- "regular formal identification of ethical risk area;
- development and strengthening of monitoring and compliance policies, procedures and systems;

174 *Op cit* 21.
175 *Idem.*
176 See in general Rossouw "Unlocking Human Potential with Ethics" February 2005 *Management Today* 28.
177 103 par 7 and 8.
178 103 par 8.

- establishment of easily accessible safe reporting (e.g. "whistle-blowing") channels;
- alignment of the company's disciplinary code of ethical practice, to reinforce zero-tolerance for unethical behaviour;
- integrity assessment as part of selection and promotion procedures;
- induction of new appointees;
- training on ethical principles, standards and decision-making;
- regular monitoring of compliance with ethical principles and standards, e.g. using the internal audit function;
- reporting to stakeholders on compliance; and
- independent verification of conformance to established principles and standards of ethical behaviour." [179]

F Directors' Fiduciary Duties Towards Employees in Terms of Entrepreneurial Law

1 Introduction

For the purpose of this thesis the duties of directors in terms of entrepreneurial law[180] are treated separately from their other "duties" such as in terms of the King Report II. The King Report is a voluntary code and is consequently not legally enforceable. Its provisions are only negatively enforced under certain circumstances. This negative enforcement is achieved in terms of the the JSE Securities Exchange listing requirements which provide that a company must report in its annual financial statements as to the extent of compliance with the King Report II, the extent of non-compliance and, explain the reasons for such non-compliance.[181]

As has been discussed above,[182] many employees do not enjoy representation by trade unions, and consequently their interests are not represented on a collective

179 *Idem.*
180 Entrepreneurial law is the law that governs business organisations.
181 *JSE Securities Exchange Listing Requirements* (2003) par 8.63.
182 See ch 6 sub-section F *supra.*

basis either at plant level or at industrial level.[183] From their perspective the possibility of the extension of directors' fiduciary duties to them as employees becomes most relevant. The possibility of extending directors' fiduciary duties to employees will be discussed in this section. Since these fiduciary duties, if so extended, unlike the King Report II, will be legally enforceable in terms of entrepreneurial law, they can potentially play a very important role in the protection and promotion of employee interests.

2 Directors' Duty to Act in the Best Interests of the Company

As seen,[184] directors have a duty to act in the interests of the company.[185] The question as to what constitutes "the interests of the company" is far from settled.[186] Traditionally, this duty has been limited to a duty towards shareholders.[187] However, the notion that directors should also act in the interests of other stakeholders (aside from shareholders), including employees, has gained relevance since the late 1980's and early 1990's on a worldwide scale.[188] Since the intricacies of this debate are beyond the scope of this thesis, suffice it to say that the latter view is supported by a "considerable body of opinion."[189]This view can take two forms:[190]

(i) In terms of the "enlightened shareholder value approach" directors should consider the interests of other stakeholders apart from shareholders where this would be for the long-run benefit shareholders. In short therefore,

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183 See Du Plessis "Werksdeelname in die Bestuursorgane van 'n Maatskappy" 1981 *THRHR* 380 where the possibility of worker's participation in the management of a company is discussed. At the time of writing the LRA had not yet been drafted. As discussed in ch 5 sub-section D 7 the LRA has provisions in place for such worker participation at plant level which unfortunately have not been successful.

184 Subsection D 3 *supra*.

185 See Naudé *Die Regsposisie van die Maatskappydirekteur met Besondere Verwysing na die Interne Maatskappyverband* (1969) doctoral thesis 154-158 for a detailed discussion of what this duty entails.

186 GG No 26493 23 June 2004 19-24.

187 *Ibid* 20.

188 *Ibid* 21.

189 *Idem.*

190 See UK's DTI Consultation Paper 2001 entitled "Modern Law for Competitive Economy: The Strategic Framework".

shareholder interests retain primacy even though due regard to the interests of other stakeholders is not prohibited.

(ii) In terms of the "pluralist" approach the interests of shareholders do not retain primacy over the interests of other stakeholders. The interests of other stakeholders have independent value to the extent that, where appropriate, they can take precedence over shareholder interests.[191]

It has been proposed that South African entrepreneurial law be amended to reflect the "pluralist" approach.[192] In fact "employee welfare" has been identified as an "end in itself".[193]

3 Conclusion

Should these proposals be included in new legislation, employees will have another legally enforceable means (aside from those discussed in ch 7 and 8 *infra*) of ensuring that their legitimate interests are protected.

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191 See GG 26493 23 June 2004 23.

192 *Ibid* 26.

193 *Op cit* 25-26 it is stated: "This means that unlike the traditional company law position, under the constitutional framework, stakeholder interests in addition to those of shareholders, have independent value in certain instances. Directors may, in certain situations, have a specific duty to promote the stakeholders' interests as ends in themselves. For example, a company may find itself forced to provide access to information to an employee in accordance with the legislation, which advances the Constitutional right of access to information, even though this may be prejudicial to shareholder value maximisation. Further, promoting employee welfare (in certain situations) may be an end in itself, and not only a means to promoting shareholder welfare. Expressed differently, advancing the interests of other stakeholders is not invariably a subordinate consideration to the primary goal of directors to act in the best interests of the shareholders as a body."

G Conclusion

Most socially responsible behaviour is also for the benefit of the company. Market forces have been the driving impetus for the advent and growth of corporate social responsibility and good corporate governance. Amongst these market forces have been the inability of governments to provide adequate social security, moves towards privatisation, growing public concerns for the environment, the positive effects to the company of a good corporate image and so on. The judicial trend toward allowing companies to benefit society and other stakeholders such as employees is merely an illustration of how the common law will adapt to suit the current socio-economic environment within which it operates.

The code of conduct provided for in the King Report II provides useful and practical guidelines for employers to benchmark their conduct. Adoption of these guidelines will ensure the fair treatment of employees in respect of their conditions of employment when they are not in a position to rectify it by way of consultation or collective bargaining.

As far as enforcement of good corporate governance is concerned Mervyn King, the author of the King Report II is quoted as saying “The report is a set of guidelines and I would resist any attempt to have these recommendations legislated. Global market forces will sort out those companies that do not have sound corporate governance”.[194] However, even if King is wrong about the effectiveness of market forces in forcing companies to adhere to the King Report II guidelines, if the proposals for the amendment of South Africa’s entrepreneurial laws are accepted, [195] the law will force employers to consider employee interests.

194 *Sunday Times Business Times* 18 August 2002 14.
195 See subsection F *supra*.