

Towards a hybrid approach to corporate social responsibility in South Africa: Lessons from India*

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OPSOMMING

Die strewe na 'n hibriede benadering vir korporatiewe sosiale verantwoordbaarheid in Suid-Afrika: Lesse vanuit Indië

Die korporatiewe landskap in Suid-Afrika het heelwat verander vanaf 1994. Daar was tot dusver baie ontwikkelinge, nie net in die korporatiewe reg en korporatiewe bestuur nie, maar ook in verband met korporatiewe sosiale verantwoordbaarheid. Die rol van maatskappye in die gemeenskap het verander. Daar word van hulle verwag om nie alleenlik aandeelhouers se belange in ag neem nie, maar ook die belange van ander groepe. Hierdie bydrae ondersoek ontwikkelinge in die korporatiewe reg, korporatiewe bestuur en korporatiewe sosiale verantwoordbaarheid. Die posisie in Suid-Afrika word vergelyk met dié van Indië ten einde te bepaal of Suid-Afrika 'n hibriede benadering kan aanneem en lesse van die ontwikkelinge in Indië kan leer.

1 INTRODUCTION

As the world of work and business deals with the challenges and opportunities presented by the Fourth Industrial Revolution, we have seen the rise of a powerful corporate community which is mostly concerned with the “bottom line” (profit-making).¹ It is argued that the relentless pursuit of this bottom line without regard to the interests of all stakeholders has a negative impact on society.² For centuries business has been conducted without consideration for all its stakeholders.³ A discussion on the role of corporations in society cannot be complete without reference to Milton Friedman's (a renowned economist, Nobel laureate and proponent of the shareholder primacy model) and his oft-quoted

* This contribution is based on research conducted by the second author for her masters dissertation in corporate law titled *Corporate social responsibility in South Africa and India: A comparative analysis* (LLM dissertation UP 2019), completed under supervision of the first author.

1 Bakan *The corporation: The pathological pursuit of profit and power* (2004) 37.

2 Crowther and Jatana *Representations of social responsibility* (2005) 3.

3 *Ibid.*

remark that “[t]here is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game”.⁴ The argument has been made that “only people have responsibilities, corporations are artificial persons, and in this sense, they may have artificial responsibilities...”⁵ This position has changed drastically and proves that such an argument is outdated in the context of developments in corporate governance and corporate social responsibility (CSR) jurisprudence.

Previously, corporate law was concerned primarily with shareholders,⁶ but it is evident that developments in corporate law and corporate governance⁷ grapple with the shareholder-stakeholder debate and whether other stakeholders should be considered by corporations.⁸ Even South African company law has had to grapple with corporate governance developments and, fairly recently, underwent a dramatic overhaul with the introduction of the Companies Act 71 of 2008. Botha summarises this development as follows:

“The Companies Act 61 of 1973 was, to the extent that it is applicable here, repealed by the 2008 Act – the 1973 Act did not deal adequately with matters of corporate governance. Developments in corporate governance in South Africa are reflected in the reports of *King I* in 1994 and *King II* in 2002⁹ and, because of changes in international governance trends and the need to reform South African company law, *King III*¹⁰ saw the light.¹¹ These developments paved the way for the eagerly anticipated Companies Act: the product of the Department of Trade and

4 See Friedman *New York Times Magazine* (1970) as quoted in Olson “South Africa moves to a global model of corporate governance but with important national variations” 2010 *Acta Juridica* 222.

5 *Ibid.* See also Ally *Corporate social responsibility: Practices, trends and developments* (LLM dissertation, University of Cape Town) 2013 26.

6 Zumbansen “The parallel worlds of corporate governance and labor law” 2006 *Ind J Global Legal Studies* 277.

7 See, for example, *The Report of the Committee on the Financial Aspects of Corporate Governance 1992* (The Cadbury Report) available at <https://ecgi.global/sites/default/files/codes/documents/cadbury.pdf> (accessed on 10-09-2019); as well as Institute of Directors of Southern Africa *King Report on corporate governance I* (1994) (hereafter *King I*) available at <https://www.iodsa.co.za>. See also du Plessis “Corporate law and corporate governance lessons from the past: Ebbs and flows, but from ‘The end of history ...’ (Part 1)” 2009 *Company Lawyer* 45–53 as well as du Plessis, Hargovan and Harris *Principles of contemporary corporate governance* (2018) 6–13 for an in-depth analysis and discussion on the historical developments of corporate governance and corporate law theories. She also points out that “[t]he concept of ‘corporate governance’ defies an exact definition. This is the case because the concept not only refers to what should be done, for example duties and powers of those entrusted with governance ... but also to the outcomes of such governance” (Delpont *et al Henochsberg on the Companies Act 71 of 2008* (2018) 54(1)).

8 See Botha “The different worlds of labour and company law: Truth or myth?” 2014 *PELJ* 2042.

9 Institute of Directors of Southern Africa *King Report on corporate governance II* (2002) (hereafter *King II*).

10 Institute of Directors of Southern Africa *King Report on governance for South Africa 2009* (2009) (hereafter “*King III*”) 8.

11 See Esser and Delpont “The South African King IV Report on corporate governance: Is the crown shiny enough?” 2018 *The Company Lawyer* 380. See The Institute of Directors of Southern Africa *King IV Report on corporate governance for South Africa* (2016) (hereafter “*King IV*”) 36 in this regard.

Industry's ("DTP") policy paper,¹² which envisaged the development of a "clear, facilitating, predictable and constantly enforced governing law."¹³

Due to developments elsewhere as well as governance changes and enhancements worldwide the need arose to re-evaluate and further enhance the corporate governance framework in South Africa and hence in 2016, the *King IV* was published.¹⁴

Against this backdrop it should be noted that as the objective of corporations is to maximise or increase profits, this objective contrasts starkly with the objective of assisting with social problems. Corporations, especially those in the private sector and multinational companies, are an integral piece of the puzzle to help solve poverty and protect the environment from pollution and other ills.¹⁵ Government does not have enough resources to address all socio-economic challenges alone and relies on contributions from companies to assist in eradicating social issues.¹⁶ CSR practices encourage corporations to embrace social concerns and consider all stakeholders when making decisions.¹⁷ Capitalists erroneously believe that in order to support CSR one must necessarily be an anti-capitalist; however, it has been proven that there is a profit link, though small, between a company's financial performance and its social responsibility strategy.¹⁸ It is because of this very reason that capitalists should embrace CSR as part of their business structure. The fact that CSR is a business strategy can no longer be denied.¹⁹ It is thus evident that corporations should care about more than just profit and loss as "*they feel responsible to society as a whole*"²⁰ and not only their shareholders.²¹

12 *South African company law for the 21st century – Guidelines for corporate law reform* (GG 26493 of 23 June 2004).

13 Botha Ch 2 "First do no harm! On oaths, social contracts and other promises: How corporations navigate the corporate social responsibility labyrinth" in Botha and Barnard (eds) *De serie legenda developments in commercial law 2019 Entrepreneurial Law* 14–15.

14 *King Report IV* came into force on 1 April 2017. *King IV* applies to all organisations, regardless of the form of incorporation; *King IV* 35. Disclosure on its application is effective in respect of financial years starting 1 April 2017; *King IV* 38. If a company is listed on a South African stock exchange the listing requirements may prescribe that such companies must apply *King IV*. *King IV* excludes application to non-listed companies as well as other organisations such as municipalities, non-profit organisations, retirement funds, state-owned entities (not state-owned companies whom *King IV* is applicable to), voluntary organisations, universities and trusts. See in this regard also Esser and Delpont 384. Esser and Delpont articulate that the onus to "enforce" *King IV* would then lie with investors and other stakeholders or the organisation or company. They add that these investors and stakeholders should "through potential disinvestment or failure to invest, be the incentive for the company or organisation to comply with King IV".

15 Kloppers "Introducing CSR-The missing ingredient in the land reform recipe?" 2014 *PELJ* 712.

16 *Ibid.*

17 *Idem* 713. Hilton and Gibbons, for example, mention that the capitalists and anti-capitalists of the world should unite (Hilton and Gibbons *Good business-your world needs you* (2005) 238).

18 Stoop "Towards greener companies - sustainability and the Social and Ethics Committee" 2013 *Stell LR* 49.

19 *Ibid.*

20 Emphasis added. According to *King IV* 17 society refers "principally to the broader society or community as part of the triple context in which the organisation operates, and the social and relationship capital that the organisation uses and affects. Society includes the organisation's internal; and external stakeholders, which in turn form part of the broader society as a whole".

21 Bakan *The corporation: The pathological pursuit of profit and power* (2005) 28.

The article considers whether the South African company law framework encourages or inhibits corporations from freely engaging in CSR activities. It embarks on a comparative analysis of CSR in South Africa and India. The article analyses the 2008 Companies Act to establish to what extent the introduction of a social and ethics committee (SEC) has changed the face of CSR participation in South Africa. The article further considers the CSR requirements of *King IV* and the JSE listing requirements and juxtaposes the voluntary nature of CSR in South Africa with the mandatory CSR position in India.²²

2 CORPORATE GOVERNANCE AND CSR DEVELOPMENTS IN SOUTH AFRICA

2.1 Historical development

In 1992, the Institute of Directors formed the King Committee in South Africa. The Committee published the King Report on Corporate Governance in 1994 which applied to listed companies, state-owned companies and banks. The King Report contained a set of voluntary principles and guidelines for good governance.²³

When one thinks about the history of corporate governance in South Africa, the well-known collapse of LeisureNet (Health and Racquet Club) comes to mind: LeisureNet was a South African publicly-listed company that held over eighty-five Health and Racquet Clubs across the country. Its financial statements for 1999 were a gross misrepresentation of its actual financial position. The LeisureNet collapse brought corporate governance into renewed focus and the King Committee released the *King II* report in 2002.²⁴ *King II* encouraged a triple context (environment, social and economic) and advised against the single bottom line (profit only) approach when running a company.²⁵

Fast forward to the 2008 global financial crisis which once again placed good corporate governance in the spotlight.²⁶ A third King report proved necessary after the enactment of the Companies Act of 2008 and the constant change in governance regulation: *King III* is applicable to all business forms – whether

22 Yan notes that it is interesting that developing countries are more likely to adopt the more radical form of the hard-law approach which includes legislating CSR laws, while Western and developed countries prefer using other bodies of law as side-constraints or imposing mandatory disclosure. The reason for this is that Western and developed countries want “to push corporations to act toward more socially desirable ends” which may partly be related to the fact that these countries have developed market mechanisms that are able to enforce soft-law constraints more easily compared to developing countries where these mechanisms are not in place. The result of this is that when market forces cannot effectively discipline corporate behavior, governmental and regulatory forces “may then play a larger role and become the dominant drive for CSR development” (Yan “Corporate social responsibility versus shareholder value maximization: Through the lens of hard and soft law” 2019 *NW J Intl L & Bus* 84)

23 *Ibid.* du Plessis, Hargovan and Harris (2018) 4 point out that issues in corporate governance gained international prominence in the late 1990s and early 2000s in the wake of well-publicised scandals.

24 *Ibid.*

25 Luiz and Taljaard “Mass resignation of the board and social responsibility of the company: *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd*” 2009 *SA Merc LJ* 424.

26 *Ibid.*

incorporated, listed or not. *King III* specifically provided for the “apply or explain” principle that had to be applied by directors when acting on behalf of the company. Directors were required to act in good faith, in that they had to be honest, act in the best interests of the company, not receive secret profits and had to promote the purpose for which the company was established.

Following the developments post-*King III* and the Companies Act of 2008, the drafting of *King IV* was necessitated by the changing role of business and society in the Twenty-first Century. Nevertheless, the philosophical foundations of *King III* were retained. *King IV* moved away from the “apply or explain” approach in *King III* to an “apply and explain” approach and reduced the 75 principles in *King III* to 17 basic principles.²⁷ Principle 16 of *King IV* states that “in the execution of its governance role and responsibilities, the governance body should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interest of the organisation over time”.²⁸ *King IV* is a voluntary code of good corporate governance; however, the JSE regards as mandatory the *King IV* report’s principles for all listed companies as per its listing requirements.²⁹ Failure to comply can lead to a suspension of the listing.³⁰ While this is a good enforcement measure, it applies only to large public companies listed on the JSE and not all corporations.

2.2 Courts’ approach to corporate governance

The South African courts have given legal legitimacy to King reports and codes on corporate governance. In *Stilfontein Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd*³¹ the court had to determine if the five directors of the first Respondent were in contempt of court. The court seemed to effectively address two pertinent issues pertaining to the conduct of the second to fifth Respondents:³² Firstly, their simultaneous resignation and abandonment of the company and, secondly, the issue of CSR and the fact that directors must act socially responsible.³³ The directors left the company without a captain at the helm. Hussain J states that:³⁴

“Practising sound corporate governance is essential for the well-being of a company and is in the best interest of the growth of a country’s economy especially in attracting new investments. To this end, the corporate community within South Africa has widely, and almost uniformly, accepted the findings and recommendations of the King Committee on Corporate Governance...”

Hussain J held that the directors’ conduct “flies in the face of everything recommended in the code of corporate practices and conduct recommended by the King Committee and that they should be held responsible for abandoning the company”.³⁵ The directors were held liable for breaching their fiduciary duty of not acting in the best interest of the company by their simultaneous resignation.³⁶

²⁷ For a detailed discussion, see Esser and Delpont 2018 *The company lawyer* 383–384 and *King IV* 36.

²⁸ *Ibid.*

²⁹ JSE listing requirements.

³⁰ *Ibid.*

³¹ 2006 5 SA 333 (W).

³² Esser and Delpont 2011 *THRHR* 449.

³³ *Ibid.*

³⁴ 351.

³⁵ *Ibid.*

³⁶ Luiz and Taljaard 2009 *SA Merc LJ* 423.

Hussain J then seemed to address the second issue without linking same to the first issue of resignation. He points out that the King Committee correctly stressed that “one of the characteristics of good corporate governance is social responsibility”.³⁷ Hussain J seems to hold the five directors liable for the second CSR issue without expressly stating so.³⁸ In this regard, Delpont submits that the court in *Stilfontein* referred to principles of good governance and:³⁹

“it would appear that these principles (which are not contained in legislation or which are not mere restatements of common law principles) are not always mere recommendations. Instead, directors may have to adhere to these recommendations to prevent liability for breaching their legal duties”.

Esser states that if the directors did not resign simultaneously but only failed to comply with the environmental directives, the court would still have held them liable based on the second issue of CSR.⁴⁰ This is evident from Hussain J’s use of the words “for this reason too” and “notwithstanding their sudden resignation”. Hussain J thus used the King report to determine the extent of directors’ fiduciary duties and duties of care and skill and whether they were in breach thereof.⁴¹ It should be noted that the *Stilfontein* judgment may have profound and overarching implications for directors of all corporations to which *King III* (and now *King IV!*) applies,⁴² and thus, the failure by directors to adhere to the principles in King will possibly result in a court making an adverse finding against directors based on a breach of their duty of care and skill.⁴³ It should therefore (and in this context) be noted that third parties can hold directors liable through section 218(2) of the Act which makes provision for third parties to institute a civil action and hold any person liable for any loss or damage suffered by that person as a result of that contravention.⁴⁴ A director may also be held liable for a breach of his fiduciary duties in terms of section 77 of the Act.⁴⁵

Other judgments have also referred to the King reports. In the matter of *South African Broadcasting Corporation Ltd v Mpofo*⁴⁶ which involved an impugned board resolution by the SABC, as well as in *De Villiers v Boe Bank Ltd*,⁴⁷ Navsa JA refers to the principles of good corporate governance.⁴⁸ The *Stilfontein* judgment sets a precedent for a third party to hold a director of a company liable for breaches of fiduciary duties or duties of care and skill for not complying with *King IV*.⁴⁹ *Stilfontein* was based on *King II*, which at the time was only applicable to

37 352.

38 *Ibid.*

39 Delpont “The duty of care, skill and diligence: The King Report and the 2008 Act” 2011 *THRHR* 449.

40 Esser “Corporate social responsibility: A company law perspective” 2011 *SA Merc LJ* 329.

41 *Ibid.*

42 Esser and Delpont 2011 *THRHR* 450.

43 See, for example, Esser and Delpont 2017 *De Jure* (part 1) 106 in this regard.

44 Esser and Delpont 2011 *THRHR* 454. See also Botha 2015 *THRHR* 2 and Esser 2011 *SA Merc LJ* 324 in this regard.

45 See, regarding liability of directors, *Oranisation Undoing Tax Abuse v Myeni* [2020] ZAGPPHC 169; *Hlumisa Investment Holdings RF Ltd v Kirkinis* 2019 4 SA 569 (GP); *Rabinowitz v Van Graan* 2013 5 SA 315 (GSJ) and *Chemfit Fine Chemicals (Pty) Ltd v/a SA Premix v Maake* [2017] ZALMPPHC 27.

46 2009 4 All SA 169 (GSJ).

47 2004 2 All SA 457 (SCA).

48 Esser 2011 *SA Merc LJ* 330.

49 Esser and Delpont 2011 *THRHR* 455.

listed companies, whereas *King IV* is applicable to all entities.⁵⁰ The net is thus cast wider than before and the *Stilfontein* judgment has given the *King IV* report and codes on corporate governance legal clout despite its voluntary nature. In this regard, Du Plessis notes that the South African courts will most likely use *King IV*'s adoption

“that directors owe their duty to act in the best interests of the company as separate legal entity, and that it means a blend of several interests, to be taken into consideration, when acting in the best interests of the company as a separate legal entity in mind. It also means that South African courts would be guided by the fact that interests that may be primary at one particular point in time in the company's existence, may well become secondary at a later stage”.⁵¹

It will be interesting to see how the common law on this aspect develops in future and if the *Stilfontein* judgment will be overturned by the SCA.

2.3 Social and ethics committee

In South Africa, directors have a fiduciary duty to act in the best interests of the company.⁵² The word “company”⁵³ is not defined in the Act and the common law meaning refers to the collective body of shareholders.⁵⁴ Directors cannot legally take the interest of any other stakeholders (environment, employees and anybody directly or indirectly impacted by the company's decisions) into account unless it is in the interests of the shareholders.⁵⁵ Although the Companies Act does not specifically refer to CSR, an indirect reference to CSR can be found in section 72(4)(a) of the 2008 Act.⁵⁶ It should be noted that there is no legal obligation or mandate on South African companies to act socially responsible when making business decisions.⁵⁷ The legislature has, through the introduction of the SEC, taken cognisance of CSR without expressly referring to the term.⁵⁸ This can be seen as a legitimate attempt by the government to force corporations to be good corporate citizens.⁵⁹ Section 72(4) makes provision for the Minister, by regulation,⁶⁰ to prescribe that certain categories of companies must have a

⁵⁰ *Ibid.*

⁵¹ Du Plessis in Botha and Barnard (eds) (2019) 46.

⁵² Davis and Le Roux “Changing the role of the corporation: A journey away from adversarialism” 2012 *Acta Juridica* 309, Cilliers *et al Corporate law* (2000) 130.

⁵³ See Oosthuizen Ch 11 “The nature and purpose of a company” in Botha and Barnard (eds) (2019) 207–209 for a discussion on the historical evolution of the company.

⁵⁴ Davis and Le Roux 2012 *Acta Juridica* 309.

⁵⁵ *Ibid.*

⁵⁶ See Kloppers “Driving corporate social responsibility (CSR) through the Companies Act: An overview of the role of the Social and Ethics Committee” 2013 *PELJ* 167; Esser “Stakeholder protection: The position of employees” 2007 *THRHR* 325 and Botha “Responsibilities of Companies towards employees” 2015 *PELJ* 47 in this regard.

⁵⁷ Johannes *Corporate Social Responsibility in South Africa: How corporate partnerships can advance the sustainability agenda* (unpublished LLM dissertation, UWC 2016) 46.

⁵⁸ See also s 7(a)–(b)(iii) as well as Botha “Evaluating the social and ethics committee: Is labour the missing link (1)” 2016 *THRHR* 588.

⁵⁹ Kloppers 2013 *PELJ* 168.

⁶⁰ The Minister may by regulation prescribe the duties and rules of the SEC (s 72(2)(4)(b)). The company regulations were published on 26 April 2011. Delpont recently commented that the Minister uses regulations to make primary law and that the regulations are probably *ultra vires* (Public LLM lecture by Delpont at UP on Mergers and Acquisitions (October 2018)).

SEC if it is in the public interest.⁶¹ These categories of companies depend on their annual turnover, workforce size or the nature and extent of the activities of such companies.⁶² Companies that fall within the categories requiring a SEC may apply to the Tribunal for exemption⁶³ if the company has another mechanism (for instance if the holding company has a SEC then it is not necessary for the subsidiary to also have a SEC) that performs the same functions as the SEC or if it is not reasonably necessary in the public interest to require a company to have a SEC.⁶⁴

The SEC has a dual function of monitoring the company's activities⁶⁵ as well as reporting their findings to the Board and shareholders.⁶⁶ Botha proposes that the SEC Committee must be given greater authority and should not only fulfil a monitoring and reporting role.⁶⁷ Delpont states that the SEC is not a board committee but a committee appointed by the shareholders of the company,⁶⁸ and as such, it is a "separate organ of the company".⁶⁹ Botha further states that the SEC is a "troublesome organ" of the company due to the uncertainty surrounding the relationship between the Board and the SEC.⁷⁰ It is, however, essential to determine whether the SEC is a board or company committee as this has various consequences and will determine the liability of the members of the committee.⁷¹ If the SEC is a board committee, then the members thereof will also be subject to

61 Reg 43(1) of the Act states that the regulations pertaining to the SEC applies to every state-owned company, listed public company and any other company that has in two of the previous five years, scored above 500 points in terms of regulation 26(2) (public interest score). Reg 43(4) further states that the SEC must consist of no fewer than three directors or prescribed officers and that at least one of the directors must not be a director that takes part in the day-to-day running of the company and must not have been so involved within the previous three financial years. S 30(2)(b)(i) of the Act provides that a formal audit of the financial statements is required for public companies. It further provides that an audit could be required for other profit or non-profit companies if "it is desirable in the public interest, having regard to the economic or social significance of the company". Esser points out that the SEC is applicable in certain instances and thus a process based approach is used in *King IV* (Esser Ch 4 "Regulating ESG issues: A comparison of South Africa and the United Kingdom" in Botha and Barnard (eds) (2019) 79).

62 S 72(2)(4)(a).

63 Any exemption granted by the Tribunal is valid for a period of five years or less, as determined by the Tribunal at the time of granting the exemption (S 72(2)(6)).

64 S 72(2)(5). If the board fails to appoint a SEC the committee can convene a shareholders meeting for the purpose of such appointment (S 84(6) and (7)).

65 The functions of the social and ethics committee include the monitoring of the company's activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice relating, *inter alia*, to matters such as social and economic development; good corporate citizenship; labour and employment.

66 Havenga "The social and ethics committee in South African company law" 2015 *THRHR* 288.

67 Botha "Evaluating the social and ethics committee: Is labour the missing link" (part 2)" 2017 *THRHR* 17.

68 Esser, however, points out that it is not clear if the board or the shareholders appoint the SEC (Esser 2011 *SA Merc LJ* 326).

69 Delpont *The new Companies Act manual* (2011) 88. Stoop argues that if this is indeed the case, then it is uncertain whether the board must comply with instructions from the SEC (Stoop 2013 *Stell LR* 577).

70 Botha 2016 *THRHR* (part 1) 590.

71 Esser and Delpont "The protection of stakeholders: The South African social and ethics committee and the United Kingdom's enlightened shareholder value approach (part 2)" 2017 *De Jure* 232.

directors' fiduciary duties as set out in section 76.⁷² However, if the SEC is a company committee then the members are not subject to fiduciary duties.⁷³ It has been argued that this essentially means that the SEC can report on matters to the shareholders that are not in the interest of the company as they are not subject to fiduciary duties and don't have to act in the best interests of the company.⁷⁴ Should the board, who are bound by fiduciary duties, fail to implement the SEC's recommendations because it is not in the interest of the company, the committee can report back to the shareholders and the shareholders can then effectively remove the board in terms of section 71.⁷⁵ The board can, therefore, implement recommendations from the SEC that are not ultimately in the interest of the company for fear of being removed from the board by the shareholders.⁷⁶ The shareholders can thus indirectly enforce CSR as they have the ultimate power of election and removal of the board.⁷⁷ This potentially can cause enormous strain between the board, SEC and the shareholders.⁷⁸ It should be noted that it is unfortunate that no provision is made in the Act for employees to be representatives of the SEC Committee⁷⁹ as employees are particularly well placed to provide meaningful input on health, public safety, labour and employment issues.⁸⁰ It is submitted that the legislature missed out on a golden opportunity to expand on employees' participation rights⁸¹ and, in this regard, Botha proposes an amendment to the Act by including employees as members of the SEC Committee, similar to the position in Germany.⁸² It has also been pointed out that the regulations do not advise in which manner the SEC must report to the shareholders at the AGM and that there is no external auditing of the report. When monitoring the company's activities, the SEC must have regard to two international instruments, the principles set out in the United Nations Global Compact Principles and the OECD recommendations regarding corruption.⁸³ It is argued that it is unfortunate that the legislature failed and/or neglected to refer to national codes of good corporate governance such as the Guidance of Social Responsibility and the King reports.⁸⁴ It thus appears that the legislature missed out on an opportunity to incorporate the King reports in the regulations, thereby effectively giving legitimacy to soft law by way of incorporation through reference,⁸⁵ and the argument can therefore be made that the regulations are vague and that the legislature failed to provide more unambiguous requirements.⁸⁶ It should be noted in this context that neither the regulations nor the Act provides for sufficient enforcement measures of the SEC⁸⁷ and that neither the

72 *Idem* 224.

73 *Idem* 229.

74 *Idem* 230.

75 *Idem* 231.

76 *Ibid.*

77 *Idem* 251.

78 *Idem* 232.

79 *Idem* 48.

80 *Ibid.*

81 *Ibid.*

82 Botha 2017 *THRHR* (part 2) 17. See also Havenga 2015 *THRHR* 287 in this regard.

83 Reg 43(5)(a)(i)(aa) and (bb).

84 Kloppers 2013 *PELJ* 172.

85 *Idem* 173.

86 *Idem* 187/536.

87 Gwanyanya "The South African Companies Act and the Realisation of Corporate Human Rights Responsibilities" 2015 *PELJ* 3114.

Act nor the Regulations provide stakeholders with the right to compel companies to act socially responsible.⁸⁸ It appears that regulation 43(5) provides no legal duty or legal recourse to stakeholders unless stakeholders institute a claim by way of a derivative action in terms of section 165.⁸⁹ Section 165(5)(b) states that a court may grant leave to an applicant to institute a claim if the court is satisfied that it is in the best interest of the company that leave be granted to commence the proceedings.⁹⁰

3 CORPORATE GOVERNANCE AND CSR DEVELOPMENTS IN INDIA

3.1 Historical development

India has one of the fastest-growing economies in the world, yet two-thirds (over 800 million people) of the population live in complete poverty, making India one of the poorest countries in the world.⁹¹ Historically, India's company law is inherited from English Company Law, staying true to its colonial roots as a British colony.⁹² The English corporate law system has always been based on a shareholder-centric or enlightened shareholder-value approach which India adopted after its decolonisation in 1947.⁹³ As time passed, the government and policy-makers became increasingly sceptical of capitalism and the unregulated free-market.⁹⁴ Despite their general mistrust of *laissez faire* policies, the Companies Act of 1956 was entirely based on the English Companies Act of 1948.⁹⁵ Only from the 1960s did India start breaking ties with its colonial past and socialistic ideals were weaved into the fabric of the almost thirty amendments to the Companies Act of 1956.⁹⁶ An expert committee chaired by Mr JJ Irani (Irani Committee) was responsible for the reform of the Companies Act of 1956.⁹⁷ During this period, India was affected by the biggest corporate scandal in its history, akin to America's Enron and South Africa's Steinhoff scandals.⁹⁸ The Satyam scandal tarnished India's corporate image and left

88 Kloppers 2013 *PELJ* 188.

89 Stoop "The derivative action provisions in the Companies Act 71 of 2008" 2012 *SALJ* 627.

90 S 165(2) also provides that a registered trade union that represents employees of the company, or another representative of employees of the company have the right to initiate a statutory derivative action. See also *Lazarus Mbethe v United Manganese of Kalahari* [2017] ZASCA 67 para 33.

91 Anonymous "Poverty in India: Facts and figures on the daily struggle for survival" available at <http://www.soschildrensvillages.ca/news/poverty-in-india-602> (accessed on 17-03-2019).

92 Varottil "The evolution of corporate law in post-colonial India: From transplant to autochthony" working paper (2015/001) 7 available at <http://law.nus.edu.sg/wps> (accessed on 15-09-2019).

93 *Ibid.*

94 *Idem* 22.

95 *Ibid.*

96 *Idem* 28. See, for example, *National Textile Workers' Union v P.R. Ramakrishna* 1983 AIR 75 para 4 in this regard.

97 Varottil "Analysing the CSR spending requirements under Indian Company Law" (2016) 7, a paper presented at the 2016 ICGL Forum on 'Globalisation of Corporate Social Responsibility and its Impact on Corporate Governance: A Chinese Approach and International Experiences' held at Beijing on 14–15 December 2016.

98 *Ibid.*

extensive socio-economic damages in its corporate wake.⁹⁹ The Parliamentary Standing Committee re-assessed the newly submitted Companies Bill of 2009 in light of the recent Satyam scandal and made extensive recommendations which included incorporating voluntary corporate governance codes into statute.¹⁰⁰ The Standing Committee redefined the purpose of the company to be aligned with a pluralist model and finally severed ties with the enlightened shareholder-value approach preferred by its colonial past.¹⁰¹ The report by the Standing Committee made provision for stakeholder interests under directors' fiduciary duties and further paved the way for the controversial two per cent law.¹⁰² The Companies Bill of 2011, largely based on the Standing Committee's suggestions, was re-introduced to Parliament following which the Companies Act of 2013 was passed by Parliament and assented to on 31 August 2013.¹⁰³

India's governance codes developed from a voluntary code on the basis of "comply or explain" in 1998, to a mandatory listing requirement in 2000, to a penalty clause in 2004 and finally a codification of their corporate governance principles in the Companies Act, 2013.¹⁰⁴ A considerable part of the corporate governance codes was included in the Companies Act of 2013, similar to America's codification of their corporate governance principles in the SOX Act.¹⁰⁵ Varotill argues that India's securities market is not suited to a voluntary approach to corporate governance.¹⁰⁶ Despite Varotill's criticism, he goes on to state that voluntary codes are still best suited to countries like the United Kingdom and he suggests that the Companies Act of 2013 be amended to only include broad governance provisions while comprehensive rules should be excluded from legislation and be left to the discretion of the Securities and Exchange Board of India (SEBI).¹⁰⁷ While South Africa's *King IV* is still regarded as soft law, India has gone further by incorporating their governance principles in primary company legislation.

The corporate law reform process replaced the shareholder-centric Companies Act of 1956 which existed for nearly 60 years and represents the dawn of a new corporate social responsible era in India.¹⁰⁸ The Companies Act of 2013 has been hailed the "single most important development in India's history of corporate legislation".¹⁰⁹ The Act is unique to India and pays tribute to Mahatma Gandhi's

99 Varotill "Corporate governance in India: The transition from code to statute" 2016 14, a paper presented at the 2016 ICGL Forum on 'Reflections on Voluntary Corporate Governance Codes: Is it now time to move on from a 'soft law' approach to a 'hard law' approach?' 25–26 April in Hong Kong.

100 *Ibid.*

101 Varotill 2016 7.

102 *Ibid.*

103 *Idem* 9.

104 Varotill 2016 10.

105 Varotill 2015 70.

106 Varotill 2016 10.

107 *Idem* 18.

108 Singh and Verma "CSR@2%: A new model of corporate social responsibility in India" 2014 *International JI of Academic Research in Business and Social Sciences* 457.

109 Afsharipour "Redefining Corporate Purpose: An International Perspective" 2017 *Seattle U LR* 466.

socio-economic philosophy of trusteeship whereby wealth is managed for the benefit of society as a whole.¹¹⁰

3.2 Directors' duties through the lens of section 166(2) of the Companies Act

India's Companies Act does not specifically state what is the purpose of a company, except to say that it may be formed for any lawful purpose;¹¹¹ whereas section 1 of the South African Companies Act of 2008 specifically describes a for-profit company as a company incorporated for financial gain for its shareholders.¹¹² It is submitted that while India's Companies Act of 2013 does not define the purpose of the company, it is clear from the provisions and wording in the Act that the single bottom line of profit-maximisation no longer is the preferred approach.¹¹³

Similar to South Africa's partial codification of directors' fiduciary duties in the Companies Act of 2008, India's common law directors' duties were also codified in the Companies Act of 2013. Section 166(2) of the Act states that "[a] director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment".¹¹⁴ The insertion of stakeholders' interests shows the legislature's intent to change the colonial corporate law model from the enlightened shareholder-value approach to a pluralist model.¹¹⁵ Some argue that the Companies Act of 2013 does not create two separate and independent duties to act in the best interest of the stakeholders and shareholders, but a positive duty is placed on directors to act in the best interests of stakeholders and shareholders in proportionate degrees.¹¹⁶ This is juxtaposed to the South African legal position where directors do not have to take stakeholders' interests into account unless there is a direct or indirect benefit for the "owners" of the company.¹¹⁷ Stakeholders also are not clearly defined in the Act except for employees.¹¹⁸ The Act fails to provide any guidance as to who is included under "community" and "the environment" and its visionary inclusion of stakeholders' interests fails at the implementation stage thereof and is not without criticism.¹¹⁹ Many of the remedies provided to shareholders for the breach of fiduciary duties unfortunately are not available to stakeholders.¹²⁰ The benefit of the pluralist approach is also questionable, especially if the Act fails to provide adequate remedies to

110 Jain "Is the Companies Act 2013 forcing corporates to do charity? A critical analysis of CSR regime of new corporate legislature of India" 2015 *Int J of Multidisciplinary Approach and Studies* 216.

111 Afsharipour 2017 *Seattle U LR* 467.

112 Esser and Delport 2017 *De Jure* (part 1) 108.

113 Afsharipour 467. See also *Shahzada and & Sons v CIT CIT* [1977] 108 ITR 358 in this regard.

114 Indian Companies Act 2013.

115 Naniwadekar and Varottil 2016 8.

116 *Idem* 12.

117 Nomadwayi *The directors' fiduciary duty to act in the best interest of the company: The possible development of common law by statute and how they affect human rights* (LLM dissertation University of Kwazulu-Natal 2018) 12.

118 Naniwadekar and Varottil 2016 14.

119 Afsharipour 2017 *Seattle U LR* 470.

120 *Ibid.*

stakeholders.¹²¹ Directors are furthermore not provided with any proper guidance on how to balance the myriad interests of both stakeholders and shareholders.¹²² The Companies Act of 2013 causes a conundrum as it includes both stakeholder and shareholder interests without indicating primacy to either.¹²³ Despite South Africa and India following two distinct models, both countries struggle to adequately protect stakeholders due to the lack of availability of enforcement remedies.¹²⁴ While India's inclusion of stakeholders under the umbrella of fiduciary duties is commendable, the legislature will have to make certain amendments to the Companies Act of 2013 to rectify its implementation issues.¹²⁵

3.3 Analysis of the two per cent law under section 135 of the Companies Act

The two per cent law is an innovative concept born from India's need to rein in corporate powers to meet socio-economic objectives.¹²⁶ CSR in India has obtained greater legal standing than in any other jurisdiction.¹²⁷ Whilst India initially introduced voluntary CSR guidelines in 2009, the overhaul of the Companies Act saw the introduction of mandatory CSR provisions.¹²⁸ Initially, there was extensive push-back from India Inc (the collective term for corporations in India) regarding mandatory CSR provisions. The negotiations led to a "quasi-mandatory approach"¹²⁹ as government subsequently capitulated and softened their approach to a "comply or explain" basis.¹³⁰ While there is no duty on companies to spend two per cent of their average net profit, there is a mandatory requirement to explain and furnish reasons for non-compliance with the provision.¹³¹

In section 135(5) the legislature uses the words "*shall ensure that the company spends*".¹³² It can thus be argued that the wording of section 135 functions as a mandate.¹³³ The criticisms against section 135 are, firstly, that expenditure on

121 Naniwadekar and Varottil 2016 16.

122 Afsharipour 2017 *Seattle U LR* 484. See also Yan 2019 *NW J Intl L & Bus* 85, Esser and Delpont 2016 *THRHR* 18, King IV 25–26 as well as Libson "Taking shareholders' social preferences seriously: Confronting a new agency problem" 2019 *U C Irvine Law Review* regarding stakeholder inclusivity.

123 Varottil and Naujoks "Corporate Governance in India: Law and Practice" 2016 19. The final version of this paper has been published in Spedding (ed.) *India: The business opportunity* (2016) 289–342.

124 Naniwadekar and Varottil 2016 21.

125 *Ibid.*

126 Sharma "A 360-degree analysis of Corporate Social Responsibility (CSR) Mandate of the New Companies Act 2013" 2013 *Global J of Management and Business Studies* 758.

127 Varottil 2016 7.

128 Majumdar "India's Journey with Corporate Social Responsibility" 2015 *Journal of Law and Commerce* 188.

129 Varottil 2016 8.

130 Varottil and Naujoks 2016 50.

131 *Ibid.*

131 Majumdar "India's Journey with Corporate Social Responsibility" 2015 *J L and Commerce* 188.

132 Empahasis added.

133 Varottil and Naujoks 2016 50. Yan notes that as soon as this mandatory CSR spending is mandated by law, it will be more appropriate to categorise it "into legal responsibility rather than social responsibility" as such obligatory duty, "may no longer be treated as CSR initiatives, although this has no material effect on the intended outcome especially if cognisance is for example taken in a CSR definition of the European Commission from "social and environmental activities that companies adopt on a voluntary basis" to "the responsibility of enterprises for their impacts on society," which provides room for mandatory regulation to be included in the CSR (see Yan 2019 *NW J Intl L & Bus* 72 in this regard).

CSR activities is akin to corporate philanthropy and not CSR; secondly, that it smacks of disguised corporate tax; and, thirdly, that corporations are burdened with the state's responsibilities to society.¹³⁴ It is also argued that philanthropic contributions are one of the quickest methods used to grow societies in developing countries.¹³⁵ One of the advantages put forward for mandating CSR-spending instead of levying additional taxes is that companies have *carte blanche* (although restricted to the activities in Schedule VII) to decide on which activities they will spend their money.¹³⁶

Section 135 requires certain companies to appoint a CSR Committee of the Board which must consist of at least three directors, one of which must be an independent director.¹³⁷ This is similar to South Africa's Companies Act where regulation 43(4) states that the SEC must consist of no fewer than three directors or prescribed officers and that at least one of the directors must not be a director that takes part in the day-to-day running of the company and must not have been so involved within the previous three financial years. The Committee's duties are to submit a board report which recommends a CSR Policy that includes prescribed activities, recommended expenditure amounts, and the monitoring thereof.¹³⁸ The legislature has cast its net wide. It is estimated that approximately six thousand companies will have to comply with the two per cent law.¹³⁹ Section 135¹⁴⁰ applies to companies with (a) a net worth of 5 billion rupees (circa \$78 million, £60 million) or more per financial year; (b) turnover of 10 billion rupees or more per financial year; and (c) a net profit of 50 million rupees or more per financial year.

Non-compliance with section 135 and failure to provide reasons for non-spending will result in penalties under section 460 of the Companies Act of 2013; however, it is argued that the quantum of the penalty amounts (ranging from \$900–\$46 000.00) is low.¹⁴¹ The directors responsible for non-compliance can also be sentenced to imprisonment for a maximum term of three years and/or a fine of no more than approximately 2.5 million rupees.¹⁴² The Companies Act of 2013 does not state what will be accepted as a valid reason for non-compliance.¹⁴³ Despite the various implementation and enforcement issues as well as objections, the two per cent law should not be so readily rejected by the international community, but it should rather be closely monitored as a potential solution (albeit in its infancy) available to other developing countries.¹⁴⁴

134 *Ibid.*

135 Kabir, Mukuddem-Petersen and Petersen "Corporate social responsibility evolution in South Africa" 2015 *Problems and Perspectives in Management* 287.

136 Van Zile "India's mandatory corporate social responsibility proposal: Creative capitalism meets creative regulation in the global market" 2012 *Asian-Pacific L & Policy J* 299.

137 Varottil and Naujoks 2016 49.

138 *Ibid.*

139 Afsharipour "Redefining Corporate Purpose: An International Perspective" 2017 *Seattle U L R* 485.

140 Varottil and Naujoks 2016 49.

141 Varottil 2016 11.

142 Afsharipour and Rana "Corporate Social Responsibility in India" 6 US Davis Legal Research Paper Series, research paper 399, October 2014 available at <http://ssrn.com/abstract=2517601> (accessed 15-09-2019).

143 *Ibid.* The Achilles heel of s 135 seems to be the inadequate disclosure and enforcement requirements. The government will have to step in and introduce other measures to ensure proper compliance as envisaged by the legislature (Varottil 2016 13–14, 25).

144 *Ibid.*

4 CONCLUDING REMARKS: TOWARDS A POSSIBLE HYBRID APPROACH TO CSR IN SOUTH AFRICA?

In light of the forgoing discussion, it is suggested that changes should be effected in order to facilitate CSR in South Africa. These are proposed below.

Firstly, an amendment to directors' fiduciary duties is proposed. As directors' duties were only partially codified in the Act, the common law will remain applicable for interpretation purposes and to supplement the Act where necessary. As there is no mention of stakeholders in section 76(3)(b), the meaning of "company" must be interpreted in accordance with common law. The common law meaning of "company" is narrowly interpreted and effectively excuses directors from taking stakeholders' interests into account unless there is a direct or indirect benefit for the "owners" of the company. It is proposed that the 2008 Companies Act be amended to make provision for stakeholders' interests similar to section 172 of the United Kingdom's Companies Act of 2006 which provides for:¹⁴⁵

- “(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –
- (a) the likely consequences of any decision in the long term;
 - (b) the interests of the company's employees;
 - (c) the need to foster the company's business relationships with suppliers, customers and others;
 - (d) the impact of the company's operations on the community and environment;
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
 - (f) the need to act fairly between members of the company.”

Some may argue that an amendment to fiduciary duties is uncalled for due to the stakeholder-inclusive approach recommended by *King IV*. However, it remains largely a voluntary code on good corporate governance and only becomes mandatory for listed companies as per the listing requirements of the JSE. A statutory system will furthermore create legal certainty. Section 172 of the UK Act still follows the enlightened-shareholder approach but obliges directors to also consider stakeholder interests. Directors still ultimately are required to act in good faith to promote the overall success of the company, but in making decisions they can and should have regard to other factors besides the company's bottom line. The quintessence of the argument is that at any given time a specific stakeholder's interest will carry more weight than another and *vice versa*. The specific inclusion of stakeholders' interests under fiduciary duties will also be more consistent with the purpose (economic and social) of the Companies Act of 2008 as envisaged by section 7. The same hurdle will prevail even after an amendment has included stakeholders' interests under fiduciary duties. As

¹⁴⁵ In this regard, see Esser and Delpont 2017 *De Jure* (part 2) 238–239.

such, it is imperative that proper enforcement remedies¹⁴⁶ are made available to stakeholders to ensure that the amendment does not create a “right without a remedy”.¹⁴⁷ The latter (as mentioned earlier) can, for example, include penalties, personal liability and deregistration.

Secondly, a codification of our broad corporate governance principles in primary company legislation is recommended. The *King IV* report is a largely voluntary code of good corporate governance although the *King IV* report’s principles are made mandatory by the JSE for all listed companies as per its listing requirements. Failure to comply with these principles may lead to a suspension of the listing. While this is a good enforcement measure, it applies only to large public companies listed on the JSE and not to all corporations. The *Stilfontein* judgment sets a precedent for a third party to hold a director of a company liable for breach of fiduciary duties or duties of care and skill for not complying with *King IV*. A considerable part of the corporate governance codes was included in India’s 2013 Act, similar to America’s codification of their corporate governance principles in the SOX Act of 2002. While South Africa’s *King IV* is still regarded as soft law India has gone further by incorporating their governance principles in primary company legislation. The South African legislature has, through the introduction of the SEC, taken cognisance of CSR without expressly referring to the term. Needless to say that may be seen as a legitimate attempt by the government to force corporations to be good corporate citizens. It should also be noted that the objectives of section 72(4), although commendable, are limited in their application as section 71(4) applies only to certain categories of companies dependent on their annual turnover, workforce size or the nature and extent of the activities of such companies.

The voluntary nature of CSR in South Africa can also be criticised: can we trust that corporations will regulate themselves? Communities require legislative rules and subsequent enforcement measures to co-exist peacefully; the same holds true for the corporate world. The law is ultimately able to reach where self-regulation is unable to do so. It is proposed that South Africa’s broad corporate governance principles as set out in *King IV* be incorporated in primary company legislation. The partial codification of *King IV* will give the voluntary governance code proper legal status, certainty and statutory enforcement measures that have greater enforcement powers.

Lastly, it is submitted that the current form and content of section 72(4) are inadequate and a complete overhaul of section 72(4) is proposed. This should be

146 See, in this regard, s 72(5) of the Companies Act read with reg 43 and reg 26(2), as well as JSE *listing requirements* para 3.84(c). From an enforcement perspective it is also important to reference the Code for responsible investment in South Africa (CRISA) as well as the FTSE/JSE responsible investment index, which has been designed to identify South African companies with leading environmental, social and governance (ESG) practices. CRISA is linked with principle 17 of *King IV*, which provides that the governing body of an institutional investor should ensure that responsible investment is practised by the organisation. In this regard institutional investors can make sure that companies not only enforce CSR matters but also comply with them and thus their benefits are not only financial but also “social” and “will be seen to be a responsible ‘citizen’” (see Esser and Delpont 2018 *The Company Lawyer* 364 and Botha in Botha and Barnard (eds) (2019) 34).

147 Fisher “The enlightened shareholder-leaving stakeholders in the dark: will section 172(1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?” 2009 *ICCLR* 6.

done by the inclusion of a provision similar to that of India's two per cent CSR-spending requirement. As opposed to the position in India, CSR activities as defined must additionally include activities that exclusively benefit employees and their families as employees are regarded as stakeholders. Such a system will require adequate disclosure and enforcement requirements and thus appropriate measures will have to be put in place to ensure proper compliance of such a CSR initiative. The JSE makes CSR disclosure mandatory for all listed companies as per its listing requirements.

It is evident that South Africa is able to follow suit and implement these changes as a matter of urgency in order to prioritise the importance of CSR initiatives in the already-existing governance structures. This will enhance and showcase us as a frontrunner in CSR initiatives. In this regard a mandatory CSR model coupled with the "apply and explain" approach to corporate governance can elevate South Africa's position in this regard even further.