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‘REGULATION OF EXECUTIVE DIRECTORS REMUNERATION IN SOUTH AFRICA: THE ROAD TO ACHIEVING GOOD CORPORATE GOVERNANCE.’

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I hereby declare that I have read and understood the regulations governing the submission of Master of Laws dissertations, including those relating to length and plagiarism, as contained in the rules of the University, and that this dissertation conforms to those regulations.

Signature Marang Asafo-adjei   Date: 9 February 2015

ACRONYMS AND ABBREVIATIONS

AGM	-Annual General Meeting
ASX	-Australian Stock Exchange
CEO	- Chief Executive Officer
CFO	- Chief Financial Officer
FDI	-Foreign Direct Investment
IoD	- Institute of Directors
JSE	-Johannesburg Stock Exchange
OECD	- Organisation for Economic Co-operation and Development
LTIs	-Long-Term Incentives
STIs	-Short-Term Incentives
UKCGC	-United Kingdom Corporate Governance Code

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CHAPTER 1 OVERVIEW OF THE DISSERTATION

1.1 Introduction

Executive remuneration has become one of the key issues in corporate governance[1] and it is regarded as an important topic as it provides a classic illustration of the agency problem that arises in the corporate governance debate.[2] The agency problem essentially arises where there is a divergence of goals by company directors (the agents) who are hired to take risks and decisions that will raise the capital invested in the company by the shareholders (the principals).[3] In relation to executive remuneration the agency problem arises where the executives shirk their responsibilities and take risks and decisions which are aimed at increasing their own remuneration to the detriment of the profit attributable to the shareholders.[4]

The Organisation for Economic Cooperation and Development (OECD), an international organization that brings together the governments of countries committed to democracy and the market economy to support sustainable economic growth, boost employment, raise living standards, maintain financial stability, assist other countries' economic development, and contribute to growth in world trade, expressed the agency problem in the following extract;

> 'What makes corporate governance necessary? Put simply, the interests of those who have effective control over a firm can differ from the interests of those who supply the firm with external finance. The problem, commonly referred to as a principal-agent problem, grows out of the separation of ownership and control and of corporate outsiders and insiders. In the absence of the protections that good governance supplies, asymmetries of information and difficulties of monitoring results in capital providers, who lack control over the corporation, finding it risky and costly to protect themselves from the opportunistic behaviour of managers and controlling shareholders.'[5]

[1] JG Hill 'Regulating Executive Remuneration: International Developments in the Post Scandal Era' (2006) 3 *ECL* 64 at 64.
[2] K Massie et al *Executive Salaries in South Africa: Who Should Have Say on Pay?* 1ed (2014) 54.
[3] S Blanche et al 'Separation of Ownership and Control in South African-Listed Companies' (2013) 16 *SAJEMS* 316 at 320.
[4] Ibid.
[5] OECD Principles of Corporate Governance, (OECD, April 1999) available at http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed on 3 August 2014.

Executive remuneration became one of the prominently featured corporate governance issues globally after the collapse of many international corporations[6] like Enron, for example. Despite the Enron collapse being predominantly caused by serious accounting or financial reporting irregularities,[7] reports conducted by the US Senate[8] found that there were some key areas where the board had failed in its duties to the company, in particular, in its fiduciary duties and the duty to avoid conflict of interest. Excessive director compensation was also found to be one of the key areas where the board had failed in its duties because the board had failed to monitor cumulative cash drain and abuses by the Board chairman and Chief Executive Officer (CEO). The Report also disclosed that in 2000 Enron's CEO, Kenneth Lay, earned a total compensation which exceeded US$ 140 million, including US$ 123 million in exercising stock options. After the company's collapse, it was further discovered that Enron paid its executives large performance-based bonuses in 2001, based upon their success in achieving certain stock price targets. It was later discovered that these targets had been reached through massive account manipulation. The Enron case shed light on how the Board, its chairman and executives can use their position of power to control the company to the detriment of the shareholders.

The 2008 financial crisis further fuelled more interest on executive remuneration as a corporate governance issue and the need for better regulation because although executive remuneration did not have a direct impact on the financial crisis, it was the flaws that existed in the remuneration practices in the investment banking sector that played a role in promoting the accumulation of risks that lead to the crisis.[9] For example, the bonus driven remuneration structures encouraged reckless or excessive risk taking which were not aligned with shareholder interest nor long term sustainability of banks.[10]

In South Africa the need to address the issue of executive remuneration has been largely influenced by the agency problem coupled with the above-mentioned international developments. Additionally, public outrage towards directors who continue to pay

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[6] Hill op cit (n1) 64.
[7] Ibid.
[8] US Senate Report Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the United States Senate "The Role of the Board of Directors in Enron's Collapse" (2002).
[9] E De Jongh et al 'A review of operational risk in banks and its role in the financial crisis' (2013) 16 *SAJEMS* 364 at 368.
[10] Ibid.

themselves more despite the large income disparities between the executives and the average workers led to more interest on the issue.[11] The reality of the problems associated with income inequality in the country have been compelling given the high levels of crime, violence and strikes that have swept the country in recent years. The 2012 Lonmin platinum mine strike in Marikana provides a classic example of the problems associated with the income disparity problem. The strike was essentially a dispute about remuneration and living conditions of the mine workers. Whilst the mine workers were demanding an income increase from about R4000 to R12 500 per month, company reports, on the other hand, showed that former Lonmin CEO, Ian Farmer, earned an alarming R24-million.[12] According to the Labour Research Service the 2011 wage gap between the CEO and the average worker in the mining industry was 390 to 1 which meant that an average worker would have to work 325 years to earn the value of the CEO's remuneration in 2011.[13] These large income disparities emphasize the importance of having strong regulatory and enforcement mechanisms that promote fair and responsible remuneration policies.

1.2 Problem Statement

Executive remuneration when in excess, also known as 'fat cake packages',[14] has negative effects because it erodes company capital and dividend return to shareholders which subsequently leads to employment cut backs, strikes, crime and other negative effects on a country as a whole. Therefore, regulating executive remuneration is important for curbing these adverse effects and enhancing the principles of good corporate governance. Different ways have over the years been employed to address the issue of excessive executive pay and these have included: ensuring proper disclosure, appointment of remuneration committees comprising of independent persons who are tasked with determining executive pay packages, packages that link pay to performance in an attempt to align the interest of

[11] HE Scholtz 'Executive remuneration and company performance for South African companies listed on the Alternative Exchange (AltX)' (2012) 16 SABR 22 at 23.
[12] C Molefe et al 'National Pay Disparity Blamed for Mine Unrest' Mail Guardian, 14 September 2012, available at *http://mg.co.za/article/2012-09-14-00-pay-disparity-blamed-for-unrest*, accessed 16 August 2014.
[13] M Taal et al 'A Mineworker's Wage: The only argument against the R12 500 is greed.' Labour Research Service, 28 August 2012, available at *www.lrs.org.za/docs/A%20Mine**workers**%20Wage.pdf*, accessed 16th August 2014.
[14] JEO Abugu 'Monitoring directors' remuneration, fat cat packages and perks of office' (2011) 19 *J.F.C* 6.

the manager and executive with those of the shareholders, and giving shareholders a vote on the matter.[15] Despite these methods there is still an ever increasing gap between the levels of executive remuneration and the remuneration of the average South African worker which consequently results in vast unequal income distribution and many social ills like crime within the country.

Research done by Professor Murray Leibbrandt and others in 2010 on income inequality revealed that between 1993 and 2008 South Africa's Gini coefficient – a measure of inequality where zero indicates perfect equality and 1 the highest level of inequality –had increased from 0.66 to 0.70.[16] Additionally, the research revealed that South Africa had a very high Gini coefficient even when compared with other high-scoring countries like Chile, Mexico and Turkey.[17]

This information raises the question; is South Africa doing enough to regulate executive pay and curb the adverse effects of excessive pay or does more need to be done? By embarking on an evaluative analysis of the current regulatory frameworks in South Africa and comparing them with those of developed jurisdictions, the question above is answered. Furthermore, suggestions for improvement are developed where the evaluative analysis reveals that South Africa is not doing enough.

1.3 Background

Corporate governance in its simplest form is defined as 'the system by which companies are directed and controlled'.[18] Its main objective is to address the agency problem that arises in company law where the owners who are not in control have to rely on the board of directors to govern their company competently and in their best interests.[19] Corporate governance addresses this problem by setting out best practice and principles that are aimed at ensuring that directors discharge their duties, namely the duty of care, skill, diligence and fiduciary duties, in a manner that is characterised by the governance principles of fairness, accountability, responsibility and transparency.[20] The board of directors, referred

[15] S Luiz ''Executive Remuneration and Shareholder Voting'' (2013) 25 *SA MERC LJ* 267 at 269.
[16] Massie op cit (n2) xxii.
[17] Ibid.
[18] Financial Aspects of Corporate Governance (Cadbury Report) (1992), available at *http://www.ecgi.org/codes/documents/cadbury.pdf*, accessed 16 August 2014 at 14.
[19] C Kneale *Corporate Governance in Southern Africa* 1ed (2012) 14.
[20] FHI Cassim et al *Contemporary Company Law* 2ed (2012) 403.

to as the epicentre of a company, are responsible for managing the affairs of the company and taking vital decisions relating to the running of the company. The individual directors, in particular, hold positions of trust and are accordingly expected to act as such.[21] They owe fiduciary duties to the company and are expected to act in utmost good faith in all their dealings with, for, and on behalf of the company, to be loyal to the company and to avoid conduct that amounts to conflict of interest and duty.[22]

Millet LJ in *Bristol and West Building Society v Mothew*[23] summarized the director's fiduciaries duties as follows:

> 'The distinguishing obligation of a fiduciary is the obligation of loyalty. The principle is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations. They are the defining characteristics of the fiduciary.'

It is to this end that executive directors in the discharge of their duties are expected to take risks and decisions which are aimed at boosting short and long-term company performance.[24] However, they are not expected, as fiduciaries charged with a vast amount of responsibility, to take risks and decisions that are self-serving or those which may cause them to manage the company in a manner that increases their remuneration to the detriment of the profit attributable to the shareholders.[25] This is because director's remuneration is a company expense, which directly influences the determination of profit attributable to the shareholders.[26]

When directors deviate from their responsibilities and take risks and decisions which increase their salaries as opposed to increasing company capital and dividend return to shareholders, concerns over director remuneration are raised, particularly when it is excessive. These concerns over high levels of remuneration are justified for a number of

[21] Abugu op cit (n14) 6.
[22] Ibid.
[23] Bristol and West Building Society v Mothew 1996 4 ALL ER 698 (CA) 711.
[24] Kneale op cit (n19) 15.
[25] Blanche op cit (n3) 319.
[26] Ibid.

reasons including that: - (1) High levels of remuneration go against the principles of good corporate governance. In particular they go against the corporate governance principles requiring executive remuneration to be fair and responsible, to be linked to individual performance and that remuneration policies be in the best interests of the company.[27] (2) High remuneration also goes against the director's duties owed to the company, namely the fiduciary duties and duty to avoid conflict of interest. (3) Excessive director remuneration has damaging effects on the stock market, as it deters private investors because they will be reluctant to invest in companies that reward their leaders far more than they deserve especially when the company is performing badly.[28] (4) Excessive remuneration stirs public outrage particularly when the gap between the levels of executive remuneration and the remuneration of the average worker is growing yearly.[29] (5) As an agency problem concerns over executive remuneration are raised on the grounds that it enables the directors to take advantage of their position of power to control the company to the detriment of the shareholders who own it.[30]

As a means of achieving good corporate governance by ensuring that directors are held accountable, and restricting their ability to remunerate themselves excessively, it is important that director's remuneration is adequately regulated. Adequate regulation is vital as it promotes better adherence with the corporate governance principles and the legislatively protected director's fiduciary duties. This subsequently results in having boards, directors and in general companies which are more accountable, transparent, responsible and fair, the principles underlying the very essence of corporate governance.[31]

South Africa has significantly strengthened its corporate governance regulatory framework by reforming its corporate laws through the amendments and improvements made to the Companies Act 71 of 2008, King III and Johannesburg Stock Exchange Listings Requirements. These legal and regulatory instruments have been influential in regulating the way in which directors are remunerated as a way of achieving good corporate governance and compliance with the law. For example, under the Companies Act 61 of

[27] King Report on Corporate Governance for South Africa 2009 Chapter 2 (hereinafter referred to as King III).
[28] Kneale op cit (n19) 176.
[29] Luiz op cit (n15) 293.
[30] Blanche op cit (n3) 319.
[31] S Kopel *Guide to Business Law* 5ed (2009) 440.

1973 the shareholders through Annual General Meetings (AGM) had the power to from time to time determine the remuneration of directors.[32] The Act, however, did not make it an offence to not hold AGMs and in many cases director remuneration was decided based on the guides stipulated in the articles and memorandum, which guides had no binding effect.[33] This therefore meant that directors' remuneration was easily open to abuse by the directors because they could use their power and position to give themselves high salaries. An improvement was made under the new Companies Act 71 of 2008 because it specifically, under s 66(9), requires a special resolution approved by the shareholders within the previous two years, for director's remuneration to be paid. This condition requiring a special resolution means that the shareholders are mandated to approve the payment of remuneration and where they have not the directors will not be entitled to receive such remuneration. This is important as it curtails abuse of power and excessive remuneration.[34]

1.4 Research Objective

The purpose of this dissertation is thus to evaluate the extent to which the existing legal and regulatory instruments in South Africa have effectively regulated director's remuneration as a means of ensuring that those in control are accountable to the owners and do not remunerate themselves excessively with the owners' money. The research will embark on a comparative analysis with international jurisdictions being Australia and the United Kingdom with the objective of determining how these countries have regulated executive director remuneration and the lessons that South Africa can learn from them. Lastly, the research will provide recommendations on how the existing frameworks can be improved to ensure adequate and effective regulation of executive director remuneration.

[32] Article 54 of Table A and Article 55 Table B Companies Act 61 of 1973.
[33] N Schoeman 'Directors Remuneration: The new Companies Act of 2008', available at *https://www.findanattorney.co.za/content_directors-remuneration,* accessed 12 August 2014.
[34] Cassim op cit (n20) 455.

1.5 Methodology and Outcomes

1.5.1 Research questions

The main question that the research will endeavour to answer is: Is South Africa doing enough, in terms of its legislative governance (ie Companies Act 71 of 2008) and regulatory codes of best practice such as the JSE Listings Requirements and King III, to regulate executive director remuneration? The above question gives rise to a number of sub-questions which will be answered in the dissertation. The sub-questions are as follows:

(a) What is good corporate governance and why is it important?

(b) Why has executive director remuneration become an important corporate governance issue in South Africa?

(c) How is South Africa currently regulating executive director remuneration?

(d) How have the United Kingdom and Australia regulated executive director remuneration?

(e) Is South Africa doing enough to regulate executive director remuneration?

(f) What lessons can South Africa learn from the United Kingdom and Australia (if any)?

1.5.2 Research Methodology

The methodology of the dissertation is to mainly look at the legal and regulatory frameworks governing the remuneration of directors in South Africa and employ a comparative approach. The methodology adopted is appropriate on account that director's remuneration is a global issue affecting all countries and the rules and principles dealing with the issue can be different or similar from country to country. As a science or in its theoretical-descriptive form, comparative law aims to acquire better knowledge of law and attempts to discover to what degree the rules are similar or different and help us discover other methods for resolving the same problems.[35] From the comparative approach

[35] R Sacco 'Legal Formants: A dynamic Approach to Comparative Law' (1991) 39 *Am J Comp 1* at 5. See also generally J Gordley 'Comparative Legal Research: Its Function in the Development of Harmonized Law' (1995) 43 *Am J Comp* 555 at 555.

perspective, the dissertation critically examines the research topic by analysing the relevant statutes and other legal instruments such as the King Code on Corporate Governance 2009 and Johannesburg Stock Exchange Listing Requirements. In addition, secondary sources such as textbooks, journal articles and, where appropriate, internet sources will also be used.

1.6 Structure of the Dissertation

The dissertation is organised into five chapters as outlined below.

Chapter One provides the general overview of the dissertation.

Chapter Two lays down the foundations of good corporate governance by discussing its meaning, importance and relevance in the world. It will also briefly discuss the development of corporate governance in South Africa over the years. It will highlight the corporate governance enforcement mechanisms in South Africa in order to gain a better appreciation of how executive remuneration is regulated in South Africa. Executive remuneration as a corporate governance issue in South Africa will also be discussed.

Chapter Three evaluates the existing regulatory frameworks in South Africa regarding executive director's remuneration. It will look at the different ways in which executives' remuneration packages are structured and the manner of regulation provided under the King Code on Corporate Governance 2009, the Companies Act 71 of 2008 and JSE Listings Requirements.

Chapter Four compares and contrasts the United Kingdom and Australia's corporate governance laws and regulations in as far as executive director's remuneration is concerned with the objective of finding out the lessons that can that can be drawn by South Africa in order to improve its own regulation.

Chapter Five is the concluding chapter. It summarizes the key findings from the dissertation and proposes recommendations towards achieving better regulation of executive director's remuneration.

CHAPTER 2 CORPORATE GOVERNANCE IN SOUTH AFRICA

2.1 Introduction

To fully appreciate and understand the importance and relevance of the issues relating to regulation of executive pay, corporate governance, its principles and the objectives it seeks to achieve must first be understood. Corporate governance is unique field of study because of its evolutionary nature meaning that the issues and principles relating to it are constantly changing and improving in response to the current global trends and developments.[37] This can be seen in the number of good governance practice codes that have been released globally since the United Kingdom's Cadbury Report in 1992. South Africa alone, which has set international standards of best practice[38] and is considered by many to be among the best in the world,[39] has issued three King Codes of Governance Principles since 1994 and over 30 Practice Notes since the release of the King III Report on Corporate Governance in 2009.

The purpose of this chapter, therefore, is to discuss the importance of corporate governance, what it seeks to achieve and how it seeks to achieve it. As a system that sets out the best principles and practices that guide directors and other officers in a corporation, corporate governance seeks to enforce leadership that is characterised by the four ethical values of accountability, responsibility, fairness and transparency. In order to ensure that these principles and practices are upheld codes of governance and other supplementary enforcement mechanisms such as the JSE Listings Requirements and the Companies Act 71 of 2008[40] have been put in place to ensure compliance. This Chapter will therefore briefly discuss these regulatory mechanisms and also seek to demonstrate the problems associated with executive remuneration in relation to South Africa.

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[37] King III Introduction and Background at 5.

[38] J Schulschenk 'Interview Summary Report: Corporate Governance Research Programme' Albert Luthuli Centre for Responsible Leadership, August 2012, available at *https://web.up.ac.za/.../2013_alcrl_**Interview**%20**summary**%20**report**%20web.pdf*, accessed 6 August 2014, 4.

[39] Ibid.

[40] Hereinafter referred to as Companies Act 2008.

2.2 Defining Corporate Governance

One important aspect about corporate governance is that it has no generally accepted definition.[41] In its initial development stages the definition adopted was that corporate governance is 'the system by which companies are directed and controlled'.[42] This definition, narrow as it may be and having its origins from the 1992 Cadbury Report, is still considered by many as the most authoritative description of what corporate governance really is. However, with the constant evolving world developments and the general non-static nature of corporate governance, this definition has evolved through the years and has become much broader to include concepts such as accountability, sustainability, ethical leadership and corporate citizenship. Corporate governance has over the years also recognized the need for building relationships and developing interests with the various stakeholders, such as shareowners, employees and lenders.[43]

The OECD, defines corporate governance as follows:

> 'Corporate governance…involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.'[44]

King III defines corporate governance as the establishment of structures and processes, with appropriate checks and balances to enable directors to discharge their legal responsibilities, and ensure compliance with legal and regulatory obligations.[45]

From the definitions above it can be concluded that corporate governance is essentially about ensuring that there are structures, procedures and principles in place that are aimed at ensuring that an organisation is able to achieve its long-term goals whilst also taking into account the needs and interests of all relevant stakeholders. It is also about

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[41] JJ Du Plessis et al Principles of Contemporary Corporate Governance 1ed (2005) 1.
[42] Financial Aspects of Corporate Governance op cit (n18) 15.
[43] Kneale op cit (n19) 4.
[44] OECD Principles of Corporate Governance op cit (n5).
[45] King III Introduction and Background at 6.

ensuring that those exercising power (the board) discharge their legal duties in a manner that is in the best interests of the company and in line with the relevant laws and regulatory mechanisms. Lastly, corporate governance is also about ensuring responsible behaviour by corporations.

Governance of corporations is sometimes mistaken to be concerned with the day to day running of a company by the business executives, however, it is rather concerned with how power of these executive managers is shared and exercised to direct business operations. It's also not concerned with formulating business strategy but rather encourages board directors to take strategic decisions.[46]

2.3 Importance of Corporate Governance

Companies today play a very important role in today's society because in addition to providing goods and services they are also economic institutions[47] creating wealth for shareholders, employees, customers and the society at large. For shareholders wealth is created when the company is able to generate profits and increase shareholder wealth, for employees wealth is generated when employment is available and employees are able to earn an income, for consumers it means a wide range of choice in the products and services offered and for the society at large it means a stronger economy, particularly, when the business sector of a country is healthy and diverse.

In addition to the economic impact that they have on society, companies are also regarded as corporate citizens and as such they have to consider the impact of their decisions, operations and actions on the social, economic and environmental life of the community within which they operate[48] as well consider its own reputation, sustainability and longevity.[49]

Ramani Naidoo explains the corporate citizen's concept as follows:

> 'Corporate citizenship entails companies fulfilling obligations to the broader society within which they operate and being responsible for their actions in society. It goes beyond satisfying mere legal or regulatory standards; it demands

[46] Kneale op cit (n19) 5.
[47] R Naidoo Corporate Governance: An Essential Guide for South Africa Companies 2ed (2009) 241.
[48] Massie op cit (n2) xx.
[49] Naidoo op cit (n47) 316.

that companies that are good corporate citizens are sensitive to their impact on all their internal and external stakeholders.'[50]

Though companies are recognized as juristic persons they nonetheless require the collective effort of different individuals to govern them for their sustainability and longevity.[51] The board of directors, who are entrusted with this responsibility of directing and controlling the company, have to ensure that when exercising their duties their personal interests are kept separate from those of the company and its owners. Good corporate governance thus exists to ensure that the interests of the shareholders, directors and other interest groups are sufficiently satisfied.[52]

Good corporate governance is a virtue that advocates for leadership that is effective and responsible. Leadership is said to be effective and responsible when it is characterised by the ethical values of responsibility, accountability, fairness and transparency.[53] Responsibility requires the board to be able to take care of the assets and actions of the company and be willing to take corrective action to keep the company on a strategic path that is ethical and sustainable. Accountability requires the board to be able to justify decisions and actions to shareholders and other stakeholders. Fairness requires the board to ensure that it gives fair consideration to the legitimate interest and expectations of all stakeholders of the company. Transparency requires the board to disclose information in a manner that enables stakeholders to make informed analysis of the company's performance, and sustainability.[54]

Good governance is also said to make 'good business sense'[55] because when applied correctly it provides numerous benefits including, inter alia, the following; Firstly, companies that are well governed and provide high levels of disclosure tend to have easier access to and lower costs of capital because investors have improved knowledge of the company's business strategy and performance.[56] Secondly, good corporate governance systems encourage increased foreign direct investment (FDI), which subsequently leads to

[50] Ibid at 241.
[51] Kneale op cit (n19) 6.
[52] Ibid and see section 7(i) Companies Act 2008.
[53] Kopel op cit (n31) 440.
[54] Ibid at 441.
[55] Naidoo op cit (n47) 10.
[56] The Case for Corporate Governance: What is Corporate Governance?, available at *http://go.worldbank.org/LHV3EZQV10*, accessed 3 August 2014.

greater efficiencies in the financial and banking sectors.[57] Thirdly, the company's overall performance improves because there is efficient management in place, better asset allocation, innovation is encouraged and improvements in productivity.[58]

Fourthly, companies with sound corporate governance practices have better risk management system, and are more likely to cope with corporate crises and scandals, than those without. These risk management systems include enterprise risk management, disaster recovery systems, medium management techniques and lastly business continuity procedures.[59] Lastly, it encourages competitive advantage which is used to maximize a company's performance, increase a company's potential to encourage capital investment, and positively influence a country's ability to attract foreign investment.[60]

2.4 South African Developments in Corporate Governance

During the apartheid era South Africa was an almost entirely isolated economy due to the international sanctions imposed on it. A common feature that existed amongst many of the large corporations at the time was that many of them were family owned conglomerates with little to no corporate governance practices in place.[61] These companies were essentially characterized as being complacent and ineffectively managed.[62]

As South Africa was preparing to enter the global market as a newly democratic nation, the King Committee was called upon in 1992 , at the instance of Institute of Directors (IoD) and headed by former Judge and Professor Mervyn King, to establish a code of corporate governance which would promote the highest standards of corporate governance in South Africa whilst taking into account global trends, the need to enable successful business environments for emerging business men and women entering into the South African economy, and the importance of ensuring South Africa's competitiveness in the global market.[63]

The end product of the Commission was the release of South Africa's very first King Code of Corporate Governance (King I) in 1994. King I provided the financial and

[57] Ibid.
[58] Ibid.
[59] Ibid.
[60] Ibid.
[61] Schulschenk op cit (n38) 6.
[62] Ibid.
[63] Ibid.

regulatory aspects of corporate governance but also went a step further then its international counterparts at the time by strongly advocating for an integrated approach to corporate governance having regard to good social, ethical and environmental practices. In addition, King I also advocated for the inclusivity and centrality of the stakeholder.[64] This meant that King I recognised that the needs, interests and expectations of the shareholders and also those of the stakeholders such as the community in which the company operates, its employees, investors, customers, environment etc. need to be considered when developing company strategy.

Following the international and local developments in corporate governance coupled with the growing awareness of the need for sustainable development,[65] the second King Code of Corporate Governance (King II) was released in 2002. It was primarily aimed at providing a comprehensive assessment on corporate governance before defining practical principles to guide companies.[66] King II saw the introduction of a number of new concepts and principles relating to corporate governance. These included, inter alia, the introduction of the concept of sustainable triple bottom line reporting, risk management and internal auditing.

King III was released on 1 September 2009 and its release was prompted by the changes to the company law regime within the country, in particular, the enactment of the Companies Act 2008, which had incorporated aspects of King I and II into law.[67] Its release was also based on the need to align the report with international governance trends, for example director remuneration.[68] King III advocates for the need to produce integrated reports in place of annual financial reports and a separate sustainability report. It also strongly advocates for ethical leadership, sustainability and corporate citizenship.[69] In contrast to its predecessors, King III is applicable to all companies public, private and non-profit.[70] It saw a shift from the 'comply and explain' approach, adopted in King I and II, to the 'apply or explain approach.[71] The report incorporated a number of global emerging

[64] Kneale op cit (n19) 226.
[65] Schulschenk op cit (n38) 9.
[66] Ibid.
[67] Naidoo op cit (n47) 34.
[68] Ibid.
[69] King III Introduction and Background at 10.
[70] King III Introduction and Background at 17.
[71] Schulschenk op cit (n38) 12.

trends, such as, alternative dispute resolution, risk based internal audit etc. It also addressed issues previously not included in King Reports I and II, including IT governance, business rescue and fundamental and affected transactions in terms of director's responsibilities during mergers, acquisitions and amalgamations.[72] In addition to the codes of principles and practices, the King Committee issues intermittently Practice Notes in order to keep King III relevant. These Practice Notes are aimed at providing guidance on how the principles should be applied.[73]

Despite the changes and improvements made over the years the three King Reports have all shared some common features. These include the fact that they all contain a Code of Corporate Practices and Conduct which are read together with the Reports.[74] The Codes aim at setting out key corporate governance principles, whilst the Reports set out best practice recommendations on how to carry out each principle. Also, the reports have all consistently adopted the principle-based approach which means that the codes are a set of principles and not law or regulation.[75]

A crucial step to the evolution of corporate governance in South Africa was made when certain aspects of King II became part of the Johannesburg Stock Exchange (JSE) Listings Requirements.[76] This meant that listed companies were now required to comply with the provisions of the King Code as well as include in their annual reports the extent of and reasons for any non-compliance.[77] JSE Listings Requirements currently still require listed companies to comply with King III and failure to do so amounts to breach of the listings requirements as companies are contractually bound to comply.[78]

South Africa is described as having a hybrid corporate governance system because enforcement of governance obligations is comprised of a combination of both the legislature and codes of principles and practices.[79] Whilst the governance obligations are aimed at setting appropriate standards of conduct for the directors as to how they should

[72] Ibid at 275.
[73] King III Practice Notes, available at *http://www.iodsa.co.za/?king3*, accessed on 7 September 2014.
[74] Cassim op cit (n20) 474.
[75] Schulschenk op cit (n38) 8.
[76] Ibid at 8.
[77] Ibid at 36.
[78] JSE Listings Requirement 1.11.
[79] TH Mongalo et al Modern Company Law for a Competitive South African Economy 1ed (2010) 447.

direct the business of the company and take decisions, the law, on the other hand, sets the framework in which the companies should operate by imposing legal obligations backed with sanctions for non-compliance.[80] The combined effect of the two leads to a country with good governance structures and better compliance with the law.

In terms of legislature in South Africa there are various statutory instruments which impose certain governance obligations on companies and its directors, though sometimes they do so indirectly. These statutory instruments include the Labour Relations Act 66 of 1995, Competition Act 89 of 1998, Public Finance Management Act 1 of 1999, just to name a few. However, the main statute providing for most governance provisions is the Companies Act 2008 which aims, inter alia, to encourage transparency and high standards of corporate governance within South Africa, given the significant enterprises play within the social and economic life of the nation.[81] The Act has partially incorporated some of the principles and recommendations from King II and the common law into legislature as means of achieving high standards of corporate governance within the country.[82] An example of one of the governance principles that have been codified relates to the production of annual financial statements which must disclose the directors' remuneration and benefits.[83] The rationale for codifying this principle is to ensure transparency with regards to director's remuneration thereby enabling stakeholders to make informed analysis of the company's performance, and sustainability.

2.5 Executive Remuneration

Due to immense media pressure, executive remuneration as a contemporary corporate governance issue in South Africa was addressed in the 2002 King II,[84] through the introduction of the principle of full disclosure of director remuneration. Prior to that executive remuneration as a corporate governance issue was addressed and regulated but not to the extent as it is regulated today. For example, under King I director remuneration was addressed in a very limited manner because the recommendations provided only for the establishment of a remuneration committee, comprising of non-executive directors, and

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[80] Ibid.
[81] Section 7 (b) (iii) Companies Act 2008.
[82] Cassim op cit (n20) 507.
[83] Section 30 (4) (a) Companies Act 2008.
[84] Ibid

for full and clear disclosure of the total of executive's earnings.[85] King II and III, on the other hand, took further steps and introduced new concepts like recommending that levels of remuneration be sufficient to attract, retain and motivate executives of the quality required by the board and introducing the concept of performance related pay.[86] The key difference between the two codes of governance is that whilst King II laid the foundations for governance of executive remuneration, King III built on those foundations by taking into account the direction in which the global market is moving as well as the demands of the institutional investors.[87]

Generally it is accepted that directors are greatly motivated to perform their duties well if they are adequately remunerated and it is also widely accepted that high remuneration for directors, be largely dependent on company performance.[88] Traditionally, the justifications for the high income levels for executives in South Africa were based on economic perspectives, namely that compensation, as the cost of executive skill , is driven by supply and demand and in particular shortages of skill at this level within the South African market. Another factor included enhanced mobility of executives-particularly after South Africa became a democratic nation in 1994. This meant that international executives could now come into the country and work, South African executives were also accepted into the international market and South African companies could now compete in the world economy.[89] All these changes meant that the salaries of executives had to be at a competitive level with other countries in order for the South African companies to be able to retain these individuals.

King III in recognition of the overall legal and moral obligation that a company has to the economic, social and natural environment consequently advocates for companies to be corporate citizens.[90] This means that companies should take into account the impact of their operations and actions on the social, economic and natural life of the community within which they operate. However, research conducted on the levels of executive pay and

[85] King Code I of Corporate Practices and Conduct Chapter 20 Principle 6.1 and 6.2 respectively.
[86] King Code II of Corporate Practices and Conduct Principle 2.5.1 and 2.5.5 respectively and King III Principle 2.25.
[87] A Brink 'Corporate governance and the Companies Act' (2009) 25 *Management Today* 6 at 19.
[88] Kneale op cit (n19) 178.
[89] W Martin 'Executive pay: moral dilemma?' (2006) 22 *Management Today* 10.
[90] King III Introduction and Background at 10.

income inequality in South Africa[91] suggests that companies are not fulfilling their duties as corporate citizens because as the levels of executive pay rise so does the income gap between the executives and average workers resulting in negative impacts on the social and economic life of South Africans.

In terms of the impact on social life, high executive pay in South Africa has contributed to income disparities. The research conducted by the Labour Research Service,[92] found that of the 296 executive directors in 83 companies and across 14 economic sectors, the average annual remuneration for the executive director was R7 739 970 and that of the chief executive officers was on average R11 902 463. This means that it would take 15 years, 174 years, and 267 years of work for a low average worker to earn what an average non- executive director, executive director and CEO respectively earned in 2012.[93] The problem then associated with these large income disparities is that it brings along with it many health and social problems to the country including high levels of crime and violence, corruption, low levels of trust for both interpersonal relationships and the government, it brings about division in society, decreased life expectancy and high levels of strike action.[94]

The economic impact of high executive pay on South Africa's economy is that it hampers economic growth as private investors become reluctant to invest their money in companies that reward their leaders far too much. This is true because high pay erodes company capital and dividend returns to shareholders. Additionally, social problems, like corruption, have an impact on economic growth because they deter potential investors who need accountability and transparency in the way their money is being used by a company.[95] Therefore, if corruption levels are high in a country then investors become discouraged to invest in such a country.

The disparities in income levels coupled with the adverse economic and social problems they bring to a country demonstrate the importance of regulating executive

[91] See generally Massie op cit (n2).
[92] Directors' Fees 2013 (Covering the 2012 Financial Year) - Double digit increases for a double digit fall in profits.
[93] Massie op cit (n2) xx.
[94] Ibid at xxxiii.
[95] Naidoo op cit (n47) 16.

remuneration in South Africa, especially as a middle income developing country whose plans include reducing inequality from 0.7 to 0.6 by 2030.[96]

2.6 Conclusion

The above discussion has shown the strides South Africa has made in attempting to resolve the agency problem by setting up structures and processes which are essentially aimed ensuring that there is sufficient division of power, transparency, discipline, responsibility and accountability in a company. The chapter has also shown the importance of regulating executive remuneration in South Africa. The next chapter will look in detail at how South Africa has attempted to resolve the problems associated with executive remuneration through its various regulatory mechanisms.

[96] National Planning Commission; Governments National Development Plan: Vision for 2030.

CHAPTER 3 REGULATION OF EXECUTIVE REMUNERATION IN SOUTH AFRICA

3.1 Introduction

The previous chapters have outlined the problems associated with excessive executive remuneration, particularly with regard to South Africa, and how excessive executive remuneration is linked to the corporate governance debate. The objective of this chapter is to discuss the different regulatory frameworks within South Africa and how they regulate executive director remuneration. The chapter will do so in two parts whereby the first part of the chapter will focus on discussing who executive directors are, what their remuneration package consists of and how they are structured. The second part of this chapter will then go on to look at how the remuneration of executives is regulated in South Africa with particular reference to King III, the Companies Act 2008 and the JSE Listings Requirements.

3.2 Who are Executive Directors?

The Companies Act 2008 makes no distinction between executive and non-executive directors,[96] it does however, under s 66 (4), recognize for four types of directors; a director appointed in terms of the Memorandum of Incorporation,[97] an *ex officio* director,[98] an alternative director[99] and a director elected by the shareholders.[100] The Act defines directors in general terms by regarding them as members of the board or alternate directors.[101] King III, on the other hand, makes a clear distinction between the executive and non-executive directors and it describes the executive directors as those directors who are involved in the day-to-day management of the company.[102] They are also considered to be salaried full-time employees of the company, having specific functional duties and generally under a contract of service with the company.[103] Executive directors are described as having a

[96] E Retief 'Directors' Remuneration: Companies Act' (2011) Aug/Sep *Professional Accountant* 10 at 10.
[97] Section 66(4) (a) (i) Companies Act 2008.
[98] Section 66(4) (a) (ii) Companies Act 2008.
[99] Section 66(4) (a) (iii) Companies Act 2008.
[100] Section 66(4) (b) and 68(1)) Companies Act 2008.
[101] Section 1 Companies Act 2008.
[102] King III Annex 2.2 at 53.
[103] Ibid.

dichotomy of roles[104] because whilst on one hand they exercise a fiduciary role as directors of the company, in which capacity they are expected to attend board meetings and exercise control over management, on the other hand, they exercise their role as senior managers, in which capacity they are answerable to the company's board of directors. Examples of executive directors include the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO). Non-executive directors are regarded to be part-time directors and are not employees of the company. Instead of being involved in the day to day management of the company, non-executive directors rather provide objective and independent judgement on issues facing the company.[105]

3.3 Remuneration Packages of Executive Directors

The remuneration packages of executive directors can comprise of either fixed or variable elements.[106] The fixed component of the executive's remuneration is paid to them irrespective of company or individual performance and the variable component of the remuneration is directly linked with performance of the company or the individual. Generally the remuneration packages are structured in three main ways which may consist of a combination of the following: the guaranteed packages, which are fixed, the short-term incentives and long-term incentives, which are both variable. The short and long-term incentives are a part of the remuneration package for the executives which are intended to offer incentives to the executives for achieving performance targets, and should comprise a substantial element in the total remuneration package.[107]

The guaranteed package of the remuneration is the portion of an executive's remuneration that is guaranteed every year irrespective of the executive's or company's performance.[108] This means that it is not in any way linked to the executive's performance or the company's and it may even be subject to annual increases. Guaranteed packages include annual basic salaries, company pension contributions, medical benefits and allowances that an executive may be entitled to by virtue of his job.[109] The guaranteed

[104] Naidoo op cit (n47) 114.
[105] King III Annex 2.3 at 53.
[106] Kneale op cit (n19) 179.
[107] Ibid at 188.
[108] Massie op cit (n2) 2.
[109] Ibid.

package is paid to the executive directors in recognition of them being salaried full-time employees.

Short-term Incentives (STIs) are described as being 'risk-based' as they are not guaranteed in any way and are wholly dependent on whether the executive or the company is performing as expected, meaning that they are performance related payments.[110] Similar to guaranteed packages, short-term incentives are also paid yearly. Examples of short-term incentives include annual lump sum bonuses which may be tied to annual financial performance of the company as well as various other perks like private use of company jets or boats.[111] The purpose of the short-term incentives is to give executive directors an incentive to achieve performance targets.[112]

Long-term Incentives (LTIs) refer to all cash and equity-based awards that are paid to the executives based on company performance over a period longer than 12 months and may be subject to vesting conditions.[113] The cash-based rewards include cash payments that are guaranteed only once the vesting conditions have been met. Equity-based rewards provide a reward based on a market driven equity[114] and they can come in one of two ways. Either they will be performance-based meaning that they will be granted for the purpose of awarding the executive for reaching or exceeding their individual or company performance targets or they will be retention-based meaning they will be granted solely to promote retention of the executive whilst they remain employed by the company. The main difference between long-term incentives and the other pay packages is that the former vests over a specified period of time, usually between one to five years. In addition, they are capable of being sold or transferred by the executive where they have vested and all of the performance criteria and conditions associated with it have been met.[115]

The purpose of the long-term incentives is to align the interests of executive directors and shareholders by giving the executives a stake in company's future.[116] Share-options are a typical example of LTIs that align the interests of executive directors and

[110] Ibid at 3.
[111] Kneale op cit (n19) 179.
[112] Ibid at 177.
[113] Massie op cit (n2) 3.
[114] Ibid.
[115] Ibid.
[116] Massie op cit (n2) 6.

shareholders. They are aimed at giving their holders the right to purchase shares in the company at a fixed price, which is called the strike price, at any time between two future dates.[117] While share-options are intended to align the interests of executives with the shareowners, the problem associated with them is that while executives have their options, they also have personal interests in seeing the share price go up because the larger the increase, the bigger the personal profit to the option holder.[118]

In addition to the above-mentioned pay structures executive directors are often also paid compensation for loss of office, commonly referred to as severance payments, which are generally paid when the executive is dismissed from office for unsatisfactory performance or any other related reason. Actual compensation amounts paid for loss of office is often negotiated, involving industrial relations experts and lawyers. Good corporate governance principles require that confidentiality agreements should not apply to the details of any compensation agreement.[119]

3.4 Regulation of Executive Remuneration

3.4.1 King Code of Corporate Governance (2009)

3.4.1.1 Remuneration Policy

The general principle with respect to the setting out of executives' remuneration is that companies must offer remuneration packages that are sufficient to attract, retain and motivate individuals of the required calibre.[120] At the same time companies also have to be careful and protect their own interests and those of the relevant stakeholders by not paying excessive remuneration. In recognition of a company's position in attempting to balance out the two interests above, King III recommends that companies remunerate their executives' fairly and responsibly.[121] Whilst King III does not define what fairly and responsibly means, it nonetheless requires that the remuneration policies and practices for the executives' be aligned with the strategy adopted by the company.[122] Additionally, King III recommends the appointment of a special committee, called the remuneration

[117] Kneale op cit (n19) 183.
[118] Ibid.
[119] Ibid at 185.
[120] Kneale op cit (n19) 178.
[121] King III Principle 2.25.
[122] King III Principle 2.25.1.

committee, which will review the remuneration policy regularly and ensure that it is linked to the director's contribution to company performance.[123]

3.4.1.2 Remuneration Committee

The responsibility of setting up and administering the remuneration policies of executive directors is the duty of the remuneration committee as duly appointed by the board of directors.[124] The rationale for establishing the remuneration committee for the purpose of assisting the Board is that, since it is comprised of a majority of non-executive directors of which the majority must be independent non-executive directors,[125] then objective judgment will be exercised by it when setting out and administering the remuneration policies of the executive directors. Additionally, the establishment of the remuneration committee enhances the effectiveness of the board of directors because the committee advises the board on matters specifically delegated to it in terms of the remuneration committee's terms of reference.[126] To further enhance objective and independent judgement, the chairman of the remuneration committee should not be the chair of the board because it is the board that appoints the committee.[127] However, the board chairman may be a member of the committee and the committee should always obtain the input from the board chairman on the performance of the CEO regardless of whether or not the board chair is a remuneration committee member. The composition of the remuneration committee must be disclosed in the annual integrated report[128] which provides a holistic and integrated report of the company's financial and sustainability performance.[129]

When setting out the remuneration policy, the remuneration committee should ensure that the policy is a balance between the fixed and the variable components of the total remuneration of executives.[130] This means that the policy should address base pay and

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[123] King III Paragraph 147 at 48.
[124] King III Principle 2.25.2.
[125] See King III Principle 2.23 para 131 and Cassim op cit (n19) 487
[126] Remuneration Committee Forum 'A framework for remuneration Committees (May 2013), available at http://www.iodsa.co.za/resource/collection/57F28684-0FFA-4C46-9AD9-EBE3A3DFB101/Position_Paper_1_A_framework_for_remuneration_committees.pdf, accessed 10 September 2014 at 5.
[127] Ibid at 6.
[128] King III Paragraph 127 at 46.
[129] King III Paragraph 1 at 108.
[130] King III Paragraph 157 at 49.

bonuses, employee contracts, severance and retirement benefits as well as share-based and other long-term incentive schemes.[131]

In relation to base pay and bonuses, the remuneration committee should ensure that remuneration levels reflect the contribution of the executive to the company,[132] in particular yearly bonuses should clearly relate to performance against yearly objectives consistent with the long-term value for shareholders.[133] In an effort to ensure that director pay is indeed linked to performance, employment contracts should not provide for payment or allow automatic entitlement to bonuses or share based payments in the event of a termination arising from the executive's failure or early termination.[134] Furthermore, in relation to share-based incentives, the remuneration committee is required to review incentive schemes regularly in order to ensure their continued contribution to shareholder value, and guard against unjustified windfalls and inappropriate gains from the operation of share-based incentives.[135] To ensure that share-based incentives are aligned with the interests of both the executives and the shareholders and that they reward performance, participation in share-based incentives should be restricted to employees and executives only.[136] Additionally, share-based incentives, including any proposals to such or employee share schemes, must be subjected to shareholder approval whereby the remuneration committee will explain clearly the intended application of the scheme, the relationship to the overall remuneration policy and the cost of the scheme to the company.[137]

Overall the remuneration committee should ensure that it scrutinizes all the benefits paid to directors, including pensions, benefits in kind and other financial arrangements in order to ensure that they are justified, correctly valued and suitably disclosed.[138]

Once the board and the remuneration committee have settled on the remuneration policy and its implementation thereof, the policy is then subjected to shareholder approval by way of a non-binding advisory vote at the shareholders AGM, before it is

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[131] King III Principle 2.25.3.
[132] King III Paragraph 157 at 49.
[133] Ibid at 158.
[134] King III Paragraph 161 and 163 at 50.
[135] Ibid at para 166.
[136] Ibid at 167.
[137] Naidoo op cit (n47) 154.
[138] King III Paragraph 152 at 49.

implemented.[139] The non-binding advisory vote will essentially require shareholders to take a vote at the AGM on the remuneration policy and although it will not be binding on the board, it will nonetheless give an indication as to whether the shareholders are in support of the remuneration practices adopted by the company or not.[140] As this particular vote is not a statutory requirement, there is strictly no legal minimum threshold that needs to be achieved. However King III recommends reaching an approval minimum of 50% plus one vote. These recommendations are intended to ensure that the remuneration that is paid to directors is subjected to some form of scrutiny and does not go unchecked before implementation.

3.4.1.3 Disclosure of Executive Remuneration

In an effort to promote the governance principles of transparency and accountability companies are required to disclose the remuneration of each individual director and prescribed officer in the annual remuneration report,[141] which is included in the annual integrated report.[142] The remuneration report should disclose details of all benefits paid to directors including: policy on base pay, participation in share incentives schemes, the use of benchmarks, incentive schemes to encourage retention, justification of salaries above the median, material payments that are ex-gratia in nature, policies regarding executive employment, and the maximum expected potential dilution as a result of incentive awards.[143] In addition, the company is also required to explain in the annual remuneration report the remuneration policies followed throughout the company, how the said policies will be implemented and the strategic objectives that the company seeks to achieve.[144]

The rationale for requiring such extensive disclosure is to deter directors from committing acts that amount to misconduct or derogation from their duties which effectively reduces malpractice or excessive executive compensation. It is also necessary

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[139] King III Principle 2.27.

[140] A Van Der Merwe 'Guidance Note on Remuneration Philosophies and Policies' July 2014, available at *http://www.ithembaonline.co.za/news_docs/56_iTHEMBA_GUIDANCE_NOTE_ON_REMUNERATION_PHILOSOPHIES_AND_POLICIES_July_2014.pdf*, accessed 7 January 2015 at 1.

[141] King III Principle 2.26.

[142] King III Paragraph 181 at 52.

[143] King III Principle 2.26.1-2.26.10.

[144] King III Paragraph 181 at 52.

as it brings to light any form of misconduct and non-compliance by the executives enabling shareholders and other interested parties to take appropriate corrective action.

3.4.1.4 Shareholders Approval of Remuneration

As mentioned earlier, the company's remuneration policy is expected to be tabled to the shareholders annually for a non-binding advisory vote at the AGM before it is implemented.[145] The rationale for this requirement is to afford the shareholders an opportunity to express their views on the proposed remuneration policy before it is actually implemented. Some commentators suggest that the vote by shareholders could potentially be binding on the company in that where the shareholders vote against a remuneration policy, the remuneration committee would have to devise a new policy.[146] However, because the vote is non-mandatory in nature the potential of it being binding on the company is unlikely. After the remuneration policy is put to the shareholders vote, the board should then determine the remuneration of executives in accordance with the policy put to the shareholders vote.[147]

3.4.2 Companies Act 71 of 2008

3.4.2.1 Memorandum of Incorporation and Shareholder Approval

The Companies Act 2008 does not provide directors with an automatic right to be remunerated for their services as directors[148], and unless the Memorandum of Incorporation and a special resolution approved by the shareholders voting at a general meeting within the previous two years expressly provide for the payment of remuneration, the said remuneration will not be paid.[149]

The Act provides as follows at s 66 (8) and (9):

> '(8) Except to the extent that the Memorandum of Incorporation of a company provides otherwise, the company may pay remuneration to its directors for their service as directors, subject to subsection (9).
> (9)Remuneration contemplated in sub-section (8) may be paid only in accordance with a Special Resolution approved by the Shareholders within the previous two years.'

[145] King III Principle 2.27.
[146] Kneale op cit (n19) 191.
[147] King III Principle 2.27.2.
[148] Cassim op cit (n20) 454.
[149] Section 66 (8) and (9) Companies Act 2008.

This section must be read with s 65 which deals with shareholders resolutions, in particular, ss (11) which sets out instances within which a special resolution will be required. Section 65 (11) (h) reads as follows: 'authorize the basis for compensation to directors of a profit company, as required by section 66 (9);'

The effect of s 66(8) and (9) is such that, payment of directors' remuneration under the Act, is dependent on the Memorandum of Incorporation providing for it, and then actual payment being effected because there is a special resolution in place which has been approved by the shareholders within the previous two years. Should the Memorandum of Incorporation not provide for director remuneration, the board of directors may not cause the company to remunerate the directors nor can the directors remunerate themselves out of the company funds as this would amount to a breach of their fiduciary duty and render them liable to pay damages.[150] In addition, for directors to be entitled to payment, the shareholders must approve the payment of the remuneration within the previous two years meaning that approval may not be given retrospectively.[151] If such remuneration is paid without the special resolution, then the remuneration is invalidly paid and thereby recoverable by the company or liquidator.[152]

Section 66(8) further provides that a company may pay remuneration to its directors for their 'service as directors', subject to the Memorandum of Incorporation. The use of the words 'service as directors' in this context is not clear as to whether it refers to the directors' service in their capacity as directors, such as fees for attending board meetings, or in any other capacity, for example as an employee.[153] This confusion is further heightened by the lack of a distinction between the executive and non-executive director under the Act and the absence of a clear contractual term. The effect of the lack of clarity over the use of the words 'service as directors' is that if s 66(8) is narrowly interpreted it means that shareholders would only have a say on the amounts paid to persons acting as directors and would not have any input in relation the remuneration packages of executive directors in their capacity as employees of the company.[154]

[150] Cassim op cit (n20) 454 and s 77 (2) (a) Companies Act 2008.
[151] Ibid at 455.
[152] Ibid and s 77(2) (a) Companies Act 2008.
[153] Ibid.
[154] Luiz op cit (n15) 293.

3.4.2.2 Disclosure of Remuneration

In order to ensure transparency and accountability, the Act under s 30 (4)-(6) requires companies to disclose the remuneration and benefits received by directors by including it in the annual financial statements for any company that is to be audited. The Act further requires that the information that is to be disclosed under s 30 (4) to satisfy the prescribed standards, and must show the amount of any remuneration or benefits paid to or receivable by persons in respect of services rendered as directors or services rendered while being directors of the company.[155] The term remuneration under the Act[156] is defined broadly to include, inter alia, fees paid to directors for services rendered by them, salaries, bonuses and performance-related payments, expense allowances, pension scheme contributions, value of any option, loans etc. The rationale for the provisions requiring disclosure is to enhance financial discipline, transparency and accountability as well as to ensure that the detailed information provided is clear and understandable to those that are interpreting it. There is also a belief that increased disclosure and scrutiny shames the executives into accepting lower remuneration.[157]

In an effort to ensure that there is accurate disclosure of remuneration and benefits paid to directors as well as to hold directors accountable, the Act imposes liability on directors who sign, consent to, or authorise the publication of any financial statements that are false or misleading in a material respect particularly when the company suffers any loss, damages or costs as a result of the directors actions.[158]

The Companies Act 2008 empowers the board to appoint committees and delegate authority to such committees,[159] however, unlike King III, it does not specifically require the appointment of remuneration committees to make decisions or recommendations as to the remuneration of executives. The Act also doesn't expressly require the remuneration of directors to be contingent on company earning sufficient profits.[160] However, the *Markham*

[155] Section 30 (5) Companies Act 2008.
[156] Section 30 (6) Companies Act 2008.
[157] D Collier et al 'Income Inequality and Executive Remuneration: Assessing the Role of Law and Policy in the Pursuit of Equality' (2010) 34 *SAJLR* 84 at 94.
[158] Section 77(3) (d) (i) Companies Act 2008.
[159] Section 72 Companies Act 71 2008.
[160] Cassim op cit (n20) 456.

v South Africa Finance & Industrial Co Ltd[161] case provides that should a director be entitled to be remunerated, that remuneration is a debt owed by the company and should the company be wound up, the director will be entitled to claim the remunerations owed to him or her in competition with the companies ordinary creditors. Additionally, the Companies Act 2008 has does not impose any specific condition requiring the preparation of a remuneration policy and its explanation. It only requires the preparation of annual financial statements and a directors report which are to be audited.[162]

3.4.3 Other Legislation

In addition to the Companies Act 2008, there are other statutes which regulate executive remuneration to a certain extent. Examples of these statutes include the Employment Equity Act 55 of 1998, Income Tax Act 58 of 1962 and the Public Finance Management Act 1 of 1999.

3.4.3.1 Employment Equity Act 55 of 1998.

This Act is primarily aimed at achieving equity in the work place[163] and it contains a provision imposing an obligation on employers to submit a statement to the Employment Conditions Commission, on the remuneration and benefits received in each occupational category and level[164] of that employer's workforce.[165] Where the reporting levels reveal disproportionate income differentials, the employer is required to take measures to reduce the differentials.[166] However, certain payments, including share-incentive schemes and discretionary payments not related to an employee's hours of work or performances (for example, discretionary profit-sharing schemes) are, however, excluded from the calculation of remuneration for the purposes of section 27 reporting (EEA4 form).[167]

This provision is relevant to executives because they are not just directors of a company but are also full time salaried employees. Therefore, by requiring employers to disclose the remuneration of its entire workforce, transparency in the remuneration levels

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161 Markham v South Africa Finance & Industrial Co Ltd 1962 (3) SA 669 (A).
162 Section 30 (2) (a) and (3) Companies Act 2008.
163 Section 2 Employment Equity Act 55 of 1998.
164 Occupational levels are identified in form EEA9 of the Employment Equity Act and include top and senior management e.g. executive directors.
165 Ibid at Section 27 (1) Employment Equity Act 55 of 1998.
166 Ibid at Section 27 (2) Employment Equity Act 55 of 1998.
167 Collier op cit (n157) 91.

of all employees is encouraged. Additionally, the income differentials gap is narrowed because the employer is under an obligation to take the measures outlined under s 27(3) of the Act.

3.4.3.2 Income Tax Act 58 of 1962

In an effort to curb excesses in executive pay, certain aspects of the executive's remuneration and benefits are subjected to the payment of income tax. By virtue of executive directors being salaried full time employees, their remuneration is subject to the withholding of employees' tax on a monthly basis in the same manner as any other employee.[168] The provisions of paragraph 11C of the Fourth Schedule of the Act takes into consideration the total remuneration the director received in the previous year, including the incentive elements, so that adequate employees' tax is withheld during the course of the tax year. The total remuneration includes, for example, salaries, bonuses, fringe benefits and most type of allowances. Section 8C further subjects share-incentives to taxation on the gain made on the instrument at the time that instrument vests and any restrictions on its exercise are removed. The executive in this instance will be taxed as soon as the instrument vests without restrictions.[169]

3.4.3.3 Public Finance Management Act 1 of 1999

This Act applies to all state owned enterprises and it aims to promote the objective of good financial management through effective and efficient use of the limited resources as well as to govern the responsibilities of the officials of the state owned enterprises.[170] As a way of promoting transparency and ensuring that state finances are managed effectively and efficiently, the Act requires state owned enterprises to disclose the remuneration and benefits of their executive management teams in all their annual reports.

3.4.4 JSE Listings Requirements

The JSE Listings Requirements are a set rules and procedures which are aimed at governing new applications, all corporate actions and continuing obligations applicable to issuers and issuers of specialist securities[171] for the purpose of ensuring an orderly place for trading in

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[168] J La Grange 'Directors' remuneration and the concomitant tax issues' (2012) *Taxtalk* 20 at 20.
[169] Collier op cit (n157) 136.
[170] Public Finance Management Act at 1 and section 2.
[171] Johannesburg Stock Exchange JSE Listings Requirements, available at *https://www.jse.co.za/content/JSESpecificationsItems/Service%20Issue%2017.pdf*, accessed on 15 September 2014 at 1.

securities and to regulate the market. They are furthermore aimed at ensuring that the business of the JSE is carried out with due regard to the public interest.[172] The listings requirements are applicable to all entities listed on the JSE and for such entities compliance with the King III is mandatory.[173] This means that companies that are listed on the JSE have to comply with the recommendations under King III and disclose their compliance therewith in their annual reports, failing which will result in fine charges by the JSE.[174] Companies that are not listed on the other hand are subject only to the 'apply or explain' recommendation under King III.[175]

In addition to companies complying with the King III requirements relating to disclosure of director remuneration, the JSE Listings Requirements also require listed companies to disclose in the annual report and annual financial statements the individual director's remuneration and benefits, including those of any director who has resigned during the reporting period.[176] The remuneration and benefits which are to be disclosed include: fees for services as a director, basic salary, bonuses and performance-related payments, sums paid by way of expense allowance, any other material benefits received (with an explanation as to what this includes), contributions paid under any pension scheme, any commission, gain or profit-sharing arrangements, and share options or any other right given.[177] In addition, the listings requirements provide that the above-mentioned declaration of earnings of each director be also required in respect of all earnings from a holding company, subsidiaries, associates of holding or subsidiary companies, joint ventures of the group, and any entities that provide management or advisory services to the company.[178]

Furthermore, all shareholding by directors is expected to be disclosed[179] and companies are required to keep a policy in place in terms of which dealings in its shares is

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[172] Ibid.
[173] Naidoo op cit (n47) 36.
[174] Listings Requirement 1.20 (c).
[175] Massie op cit (n2) 86.
[176] Listings Requirement 8.63 (k).
[177] Ibid at 8.63 (k) (i)-(x).
[178] Ibid at 8.63(xi).
[179] Listings Requirement 3.83.

regulated.[180] Directors are prohibited from trading in company securities without first obtaining clearance in accordance with such policy.[181]

The listings requirements further require the appointment of a remuneration committee for listed companies, whose membership and number of meetings held must be disclosed in the annual report.[182]

In terms of the listings requirements directors are held liable both in their capacity as directors and personally for not applying the listings requirements.[183] This means that if a director fails to apply any of the requirements, including those relating to remuneration, such director will be in breach of the listings requirements and liable to any of the prescribed penalties.[184] The purpose of this requirement is to ensure that the directors discharge their obligations in a responsible manner and to hold them accountable for their actions and in this case their lack thereof. Despite the existence of this requirement there is a great possibility that some of the prescribed penalties, for example fines, may not be effective in achieving the above-mentioned purpose because directors could easily pay them off as they have more than enough money to pay.

3.8 Conclusion

From the discussion above it can be seen that the various regulatory frameworks governing director remuneration in South Africa, that is the King III recommendations, the Companies Act 2008 and the JSE Listings Requirements, are in unison with respect to the disclosure requirements. This is because they all require executive's remuneration and benefits to be disclosed in the annual financial statements. Although the Act makes no specific reference to the remuneration policy, King III requires its preparation and disclosure in the integrated report. With respect to shareholder approval the regulatory frameworks take different approaches. Whilst King III requires the remuneration policy to be put to a shareholder non-binding vote at the AGM before it is implemented, the payment of remuneration in the Act is subject to the conditions contained in s 66 (8) and (9).

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[180] Listings Requirement 3.66.
[181] Ibid.
[182] Listings Requirement 3.34(d).
[183] Listings Requirement 3.62.
[184] See para 1.20(a)-(f) of the JSE Listings Requirements. Penalties include a private censure of the company or the directors, a fine not exceeding R500 000 as well as the disqualification of directors from holding the office of a director.

Meaning that the payment of remuneration to directors is provided only if the Memorandum of Incorporation provides for it and where a special resolution of shareholders passed within the previous two years provides for the payment of such remuneration to directors for their service as directors. The JSE Listings Requirements are silent on this requirement. With respect to the remuneration committee, though there is no specific obligation requiring its appointment in the Companies Act 2008, King III and the JSE Listings Requirements require its appointment for purposes of drafting remuneration policies, considering issues relating to director pay and to advise the board on remuneration issues. King III and the JSE Listings Requirements go a step further by requiring companies to disclose the membership of the remuneration committee in the annual integrated report. The Companies Act 2008 and the JSE Listings Requirements also contain vital requirements which impose personal liability on directors where there are infringements of certain provisions. This is important because it ensures that directors perform their responsibilities and are held accountable for their actions.

Despite King III containing a number of important principles and recommendations regarding executive remuneration it is however not binding except in respect of listed companies which are obliged to comply because the JSE Listings Requirements include compliance with King III. Companies that are not listed are not obliged to comply with King III as it is principle-based.

CHAPTER 4 REGULATION OF EXECUTIVE REMUNERATION IN THE UNITED KINGDOM AND AUSTRALIA

4.1 Introduction

In Chapter One it was mentioned that the regulation of executive remuneration is not a new phenomenon peculiar to South Africa only. Concerns over excessive executive remuneration have been one of the underlying international governance issues since the occurrence of the corporate scandals and the 2008 financial crisis.[185] In response to these global scandals, a number of jurisdictions have undertaken various regulatory responses as a means of regulating pay practices. These have included adopting strategies aimed at linking pay to performance, making shareholder say on pay votes binding, introducing more stringent disclosure requirements as well as adopting practices and principles aimed at making the remuneration committee more independent and enhancing their role.

The aim of this chapter is to examine how executive remuneration is regulated in the United Kingdom and Australia and to compare them with the South African regulatory practices. The underlying objective of the comparative analysis is to compare and contrast South Africa's corporate governance standards regarding remuneration with the United Kingdom and Australia with a view of assessing whether South Africa's remuneration practices are in line with international best practices. This chapter will undertake the comparative analysis by specifically focusing on the United Kingdom Companies Act 2006 and the UK Corporate Governance Code and then compare them with the South African position. Following this the chapter will then look at the position in Australia and it will focus on the Corporations Act 2001, including the amendments to the Corporations Act 2001 found in the Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Act 2004 also called CLERP 9 Act of 2004, and the Australian Stock Exchange (ASX) listing rules and corporate governance principles. Lastly, a comparison is made between the Australian manner of regulation and the South African.

[185] See Hill op cit (n1) 64 and De Jongh op cit (n9) 368.

4.2 United Kingdom

4.2.1 Background

Executive remuneration was not much of a concern in the United Kingdom until the late 1980s when corporations like Polly Peck International, Maxwell and the Bank of Credit and Commerce collapsed and executive remuneration became more of a salient issue in the corporate governance debate.[186] The collapse of these companies brought awareness to the fact that some CEOs, whom at the time served as both CEO and board chairman, were excessively paying themselves particularly when the companies were not performing well.[187]

The corporate scandals led to a process whereby the United Kingdom embarked on a journey aimed at addressing the various governance issues, including executive remuneration, through the release of various governance Reports. The Report which mainly focused on executive remuneration in the United Kingdom was the Greenbury Report 1995[188] and its release was prompted by the growing shareholder and public concerns over excessive executive pay and more specifically over 'gains from share options in the recently privatized utility industries [which] sometimes coincided with staff reductions, pay restraint for the officers and pay increases.'[189] The recommendations provided in the Report primarily focused on the establishment, role and function of the remuneration committee for listed companies. Additionally, it made recommendations regarding the disclosure of executive remuneration and the remuneration policy to be adopted by listed companies. It also recommended that shareholders be invited to approve all long-term incentive schemes available to directors and executives. However, it provided that only under exceptional circumstances should the remuneration committee's annual report be placed on the agenda of annual shareholder meeting. Additionally, the Greenbury recommendations dealt with service contracts and the entitlements directors would have in the event of early termination.

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[186] SL Suarez 'Reciprocal Policy Diffusion: The Regulation of Executive Compensation in the UK and US' (2012) 12 *JPA* 303 at 307.
[187] Ibid.
[188] JJ du Plessis op cit (n41) 304.
[189] Greenbury Report 1995 Introduction, available at *http://www.ecgi.org/codes/documents/greenbury.pdf*, accessed 11 October 2014 at para 1.6.

Subsequent reports were released after the Greenbury Report[190] and they mainly focused on other governance issues as opposed to executive remuneration. All the reports released were later consolidated into one report called the UK Combined Code[191] which was revised after the financial crisis and renamed to the UK Corporate Governance Code ('UKCGC'). The latest version of the code was published in September 2014. The UKCGC applies to all companies having premium listing of equity shares on the London Stock Exchange on a 'comply or explain' bases.[192] It has 18 main principles dealing with various areas of governance, remuneration being dealt with at section D.

4.2.2 UK Corporate Governance Code

In terms of the UKCGC, the underlying principle with respect to remuneration is that it should be sufficient to attract, retain and motivate directors of a suitable quality and at the same time it should be structured in such a way that it is linked to company and individual performance.[193] Under the Code the board is given the responsibility of establishing the remuneration committee[194] and delegating the responsibility of setting the remuneration for all executive directors.[195] The remuneration committee should comprise of at least three independent non-executive directors and in the case of small companies two independent non-executive directors.[196] The chairman of the board may be a member of the committee, though cannot be a chair of the committee, provided he or she is independent at the time of appointment.[197] Additionally, the UKCGC recommends that the remuneration committee appoint remuneration consultants,[198] provided the identity of the remuneration consultants is disclosed in the annual report and a statement is made as to whether they have any other connection with the company.[199] The purpose of appointing remuneration consultants is to

[190] Hampel Report (1998) was a consolidation of the Cadbury and Greenbury Report. Tunbull Report (1999) provided guidance to directors on the internal finances and audit controls seen as necessary to manage risk in organisations. Higgs Report (2003) primary focus was on the role and effectiveness of non-executive directors. See generally du Plessis op cit (n40) 301-306.
[191] Du Plessis op cit (n41) 306.
[192] Ibid.
[193] Financial Reporting Council, The UK Corporate Governance Code, Section D: Remuneration, September 2014, available at *https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf*, accessed on 10 October 2014.
[194] Principle D.2.1 UK Corporate Governance Code.
[195] Principle D.2.2 UK Corporate Governance Code.
[196] Principle D.2.1 UK Corporate Governance Code.
[197] Principle D.2.1 UK Corporate Governance Code.
[198] Principle D.2 UK Corporate Governance Code.
[199] Principle D.2.1 UK Corporate Governance Code.

ensure that their recommendations are free from bias and they provide independent judgement on the remuneration of executives.

In setting the remuneration of executives, the remuneration committee should ensure that the remuneration is designed in such a way that it promotes the long-term success of the company.[200] As a way of ensuring that the design of performance related remuneration of executive directors is transparent and rigorously applied, Schedule A of the UKCGC[201] sets out guidelines for the remuneration committee. Schedule A recommends the remuneration committee to determine an appropriate balance between fixed and performance related remuneration.[202] With respect to share based remuneration, the remuneration committee should require directors to hold a minimum number of shares and to hold shares for a further period after leaving the company, subject to the need to finance any costs of acquisition and associated tax liabilities. Furthermore, shares and other incentives should not vest for at least three years.[203]

The Code further requires the remuneration committee to avoid rewarding poor performance when making termination payments to directors.[204] It recommends that the remuneration committee carefully consider what compensation commitments director's terms of appointment would entail in the event of early termination.[205] The remuneration committee should also ensure that notice and contract periods are set at one year or less.[206] Lastly the Code recommends that shareholder approval be obtained for all new long-term incentives and any significant changes to existing schemes.[207]

The UKCGC recommends the remuneration committee to judge the remuneration policies of the company with that of other companies, however doing so cautiously in order to avoid paying excessively.[208] The Code recommends this in recognition of the effects of

[200] Principle D.1 UK Corporate Governance Code.
[201] See UK Corporate Governance Code Schedule A: The design of performance-related remuneration for executive directors at 24.
[202] Ibid.
[203] Ibid.
[204] Principle D.1.4 UK Corporate Governance Code.
[205] Ibid.
[206] Principle D.1.5 UK Corporate Governance Code.
[207] Principle D.2.4 UK Corporate Governance Code.
[208] Principle D.1 UK Corporate Governance Code.

reporting and disclosing executive remuneration, which has in the past led to an upward ratchet of remuneration levels.[209]

4.2.3 Companies Act 2006

In 2013 the United Kingdom government introduced the Enterprise and Regulatory Reform Act 2013 which amended certain provisions of the Companies Act 2006 relating to directors remuneration for quoted companies. The key changes came into effect on 1 April 2014 and essentially require every United Kingdom quoted company,[210] to produce a detailed directors' remuneration report for each financial year that includes the company's policy on directors' remuneration and an explanation of how it was implemented during the year.[211] The Act makes it an offence not to do so.[212] The rules on the detailed contents of the report and how remuneration is to be calculated are prescribed in the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendments) Regulations 2013 no. 1981.

In terms of the regulations, the remuneration reports are split into two sections. One section, called the remuneration policy report, is forward looking because it sets out the company's policy on remuneration for future financial years, it also explains the company's plans to pay directors and how the approach taken is consistent with the company's long term performance.[213] This section of the report is subject to a binding shareholder vote at least every three years. The second section of the report, called the annual implementation report, is backward looking as it contains details of directors pay, as per the implemented pay policy, for the year that is being reported on and it also details how the policy will be implemented in the next financial year. This section of the report is subject to an annual shareholder advisory vote which is made through an ordinary resolution.[214] The purpose of the advisory vote is to give shareholders a formal opportunity to indicate whether they support the disclosed executive's pay and although it's not binding upon the board, the

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[209] Ibid.
[210] Section 420 (1) Companies Act 2006.
[211] Massie op cit (n2) 96.
[212] Section 420 (2) and (3) Companies Act 2006.
[213] See Department for Business, Innovation & Skills 'Directors' pay: Consultation on the revised reporting regulations', June 2012, available at *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31652/12-888-directors-pay-consultation-remuneration-reporting.pdf*, accessed 12 October 2014.
[214] Ibid.

board will take the results of the vote into account, as appropriate, when considering future compensation policies, procedures and decisions.

The remuneration policy report encourages companies to take a holistic approach to remuneration by requiring companies disclose in the report the following:[215]

- The remuneration policy for all directors which has to be done in a table form, setting out each element of the pay package and how it works, including how the pay policy supports the company's strategy and objectives.[216]
- A bar chart that indicates the minimum remuneration that could be paid to a director, the amount that would be paid if the director meets company expectations with respect to performance targets and the maximum amount of remuneration receivable.[217]
- The policy must summarise and explain the loss of office payment policy, including notice periods, calculation of termination payments as well as an explanation of how the director's performance during his office will affect his termination payment.[218]
- Information on how the pay and employment conditions of other employees were taken into account in setting directors' remuneration.[219]
- Information on whether employees were consulted on the policy.[220]
- Information on how shareholder views were taken into consideration.[221]

The annual implementation report, on the other hand, will contain details of the following information:

- A single figure for the total pay for each director, and the figure for the preceding financial year.[222]

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[215] Massie op cit (n2) 98.
[216] Regulation 25 and 26 Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendments) Regulations 2013 no. 1981.
[217] Ibid Regulation 34 (1) (a)-(c).
[218] Regulation 36-37.
[219] Regulation 38.
[220] Regulation 39.
[221] Regulation 40.
[222] Regulation 7.

- Payments to past directors, but not payments below a de minimus threshold set by the company, payments previously disclosed, payment for services provided or termination, pensions, or dividends on incentive awards.[223]
- Full details of payments for loss of office.[224]
- An explanation of how executive pay compares to other costs such as tax, dividends, share buy backs and retained profits.
- Percentage increase in the chief executive officer's (CEO) pay relative to employees' total remuneration since previous financial year.[225]
- Details of directors' shareholding requirements.[226]
- A statement describing how the company intends to implement the approved directors' remuneration policy in the financial year following the relevant financial year.[227]
- Details of the remuneration committee including the name of each director who was a member of the committee at any time when the committee was considering any director remuneration matter.[228]
- How shareholders have voted on both sections of the remuneration report in the previous financial year, including number of abstentions, reasons for shareholder dissent if known and any resulting action which the remuneration committee has taken.[229]

As mentioned earlier, the director's remuneration policy must be put to a binding shareholders vote once every three years,[230] whereas the annual implementation report will be put to a shareholders annual advisory vote.[231] In terms of the Companies Act 2006, if there are any changes to the remuneration policy they must be approved by the shareholders first before they can take effect.

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[223] Regulation 15.
[224] Regulation 16.
[225] Regulation 19.
[226] Regulation 17.
[227] Regulation 21.
[228] Regulation 22.
[229] Regulation 23.
[230] Section 439A (1) Companies Act 2006 (as amended by the Enterprise and Regulatory Reform Act 2013)
[231] Section 439 Companies Act 2006.

In the event that the remuneration policy fails two options are available: (1) the company can continue to operate in accordance with the most recent policy that has passed shareholder approval;[232] or (2) the company can call a general meeting to put the new or amended remuneration policy to another shareholder vote.[233]

In terms of the Act, directors who know, or are reckless as to whether, a statement in the remuneration report is untrue or misleading or know an omission is a dishonest concealment of a material fact, will be liable to compensate the company for any loss suffered by it as a result. In addition, directors are liable to fines for failure to prepare the report, provide information for the report, sign the report, give notice to shareholders of the vote on the report or put the report to a vote.[234] Furthermore, if an unlawful payment is made, it is held by the recipient and the directors can bring an action to recover it.[235] If the shareholders are unable to recover the payment, the directors who authorised the payment can be held liable.[236]

4.3 Comparison with South African Regulation

There are a number of similarities that exist between South Africa's manner of regulating executive pay and that of the United Kingdom. These similarities tend to relate more to the general corporate governance principles and can be summed up as follows;

- Both countries require remuneration levels to be sufficient enough to attract, retain and motivate individuals of a suitable calibre whilst at the same time taking into consideration the interests of the company and stakeholders by linking pay to the company long term strategy and performance.
- Both countries recommend the establishment of remuneration committees for purposes of determining the remuneration policy of executives. The said committee must comprise of mainly independent non-executive directors and the chair of the board may be a member of the committee but not the chair of the

[232] Section 439A (2) (a) Companies Act 2006 (as amended by the Enterprise and Regulatory Reform Act 2013).
[233] Ibid 439A (2) (b).
[234] Section 463 Companies Act 2006.
[235] Section 226E (2) (a) Companies Act 2006 (as amended by the Enterprise and Regulatory Reform Act 2013).
[236]Section 226E (2) (b) Companies Act 2006(as amended by the Enterprise and Regulatory Reform Act 2013).

committee.[237] In setting the remuneration, the remuneration committee should ensure there is an appropriate balance between the fixed and variable elements.

- Failure to comply with either country's statutory requirements will result in a director being held personally liable for infringement.[238]

Despite the existence of the above similarities there are a number of differences that can be identified between the United Kingdom's and South Africa's manner of regulating of executive pay. Firstly, the United Kingdom's disclosure requirements are more detailed in comparison to South Africa's and this is mainly due to the split of the remuneration report into two sections, that is the remuneration report policy and the annual implementation report, in the United Kingdom regulations.[239] Whilst South Africa requires full disclosure of the total earnings of directors in the remuneration report as well as an explanation of the remuneration policy, and how it was implemented throughout the year,[240] the United Kingdom provides detailed descriptions of the information that must be contained in the split reports. The United Kingdom also provides more detailed requirements of how particular components of remuneration should be calculated, what must be included in the calculation for total remuneration in order to allow comparison across companies and prescribes how remuneration is to be disclosed graphically in bar graphs and tables.[241] Furthermore, the United Kingdom requires companies to report on the considerations the company took into account when drafting the remuneration policy, for example, any shareholder or employee interests.[242] South Africa does not require the same requirements. Another noteworthy difference is that whilst United Kingdom companies are legally bound to disclose the remuneration policy South African companies do it on recommendation or an 'apply or explain' basis.

In an effort to enhance independent judgment and avoiding executive director conflict of interest when it comes to the setting of remuneration, the UKCGC recommends that the remuneration committee be responsible for appointing outside remuneration

[237] Principle D.1 UK Corporate Governance Code and Principle 2.23 para 131 King III.
[238] Section 463 Companies Act 2006 and Section 77(3) (d) (i) of the Companies Act 2008.
[239] Massie op cit (n2) 99.
[240] See Principle 2.26 King III and section 30 (4)-(6) Companies Act 2008.
[241] Massie op cit (n2) 99.
[242] Ibid.

consultants. Furthermore, the remuneration committee must disclose in the remuneration report whether any consultants were used, who appointed the consultants, how much they were paid and how the committee ensured that the advice of the consultant was independent and objective.[243] The South African King III Code and Companies Act of 2008 do not provide much information on the use of remuneration consultants, save for the fact that King III allows external advisers to be present at the committees meetings provided that this is done by invitation and they do not vote at the committee meeting.[244] Furthermore, King III recommends board committees to take independent professional advice provided it is within the scope of the committee's terms of reference.[245]

Additionally, the United Kingdom through the regulations require the legal appointment of the remuneration committee and this can be seen in regulation 22 which requires the annual implementation report to provide details about members of the committee. The South African Companies Act of 2008 imposes no statutory obligation for the establishment of the remuneration committee.

In terms of shareholder say on pay, South Africa requires a non-binding advisory shareholder vote before the policy may be implemented.[246] Additionally, South African shareholders do not have an adequate say on pay voice due to the lack of clarity in the use of the words 'service as directors' in s 66(8) of the Companies Act 2008.[247] The effect of the lack of clarity is that if the words 'service as directors' is narrowly interpreted it means that shareholders would only have a say on the amounts paid to persons acting as directors and would not have any input over the remuneration packages of executive directors in their capacity as employees of the company.[248]

The position in United Kingdom is different because the regulations require a binding vote for the director's remuneration policy once every three years as well as an annual advisory vote for the implementation report.

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[243] Regulation 22 (1) (b) and (c).
[244] Paragraph 132 at 46 King III.
[245] Principle 2.23 para 138 King III.
[246] King III Principle 2.27.
[247] Companies Act 2008.
[248] Luiz op cit (n15) 293.

4.4 Australia

4.4.1 Background

Excessive executive remuneration became a central issue in the corporate governance debate in Australia after the collapse of large corporations like One.Tel in 2001 and HIH Insurance in 2003.[249] Despite the firms operating in different sectors of the economy[250] both companies had a number of similar corporate deficiencies that contributed to their eventual downfall. For example, in terms of the executive remuneration practices both companies engaged in excessive pay practices particularly at a time when the companies were performing poorly.[251] For instance, the co-founders of One.Tel, Jodee Rich and Brad Keeling, each received A$ 560,000 in salary and an astounding A$ 6.9 million in bonuses a few months before the company became insolvent and at HIH the company founder, Raymond Williams, received a salary increment of 44 per cent from A$ 775,000 to A$ 1.2 million from early 1997 to March 1999, a period when the financial strength of the company was fading.[252]

Following the collapse of HIH Insurance, the HIH Royal Commission was set up, at the instance of the Australian law makers, to investigate the company and the reasons for its downfall.[253] This consequently led to a series of governance-related recommendations to Australian legislature, regulators, and the ASX and as a result of these recommendations, two significant developments arose.[254] Firstly, there was the release of the Corporate Law Economic Reform Program Act ('CLERP 9') of 2004, which introduced s 300A to the Corporations Act 2001. Secondly, there was the release of the ASX Corporate Governance Council's Principles of Good Corporate Governance Practice and Best Practice Recommendations ('ASX Corporate Governance Principles') in 2003.[255] Both the CLERP 9 Act and the ASX Corporate Governance Principles contain substantial guidance on executive remuneration. Whilst some of the guidance in the CLERP 9 Act is mandatory

[249] Hill op cit (n1) 65.
[250] One. Tel was a telecommunications company whilst HIH was an insurance company.
[251] JL Barney 'Corporate Scandals, Executive Compensation, and International Corporate Governance Convergence: a U.S.-Australia Case Study' (2009) 23 *Temp Int'l & Comp L J* 231 at 243.
[252] Ibid at 244.
[253] Ibid.
[254] Ibid.
[255] Ibid.

and contains provisions which have enhanced the remuneration disclosure requirements under s 300A of the Corporation Act, the guidance promulgated by the ASX corporate governance principles is on a 'comply or explain' basis and advocates for companies to remunerate executives fairly and responsibly.[256]

Essentially there are two main sources regulating executive pay in Australia which are the Corporations Act 2001, with the necessary amendments found in CLERP 9 and the ASX listing rules and corporate governance principles.

4.4.2 Corporations Act 2001

The Corporations Act 2001 stipulates that directors be paid remuneration that the company determines by resolution[257] although it can be altered by a provision in the constitution.[258] The company's board is expected to disclose the said remuneration paid to directors.[259] Australia is considered to have one of the most extensive disclosure requirements in the world with respect to director's remuneration which are mainly provided for under s 300A of the Corporations Act 2001.[260] In terms of the Act companies are required to disclose each of the director's remuneration if it is requested to do so by either 100 members who are entitled to vote at a general meeting of the company or by members with at least 5 per cent of the votes.[261] The remuneration of the directors will be disclosed in the company's annual directors' report[262] which must include, inter alia, specific information required under s 300 including disclosures regarding dividends and distributions, information on the identity of directors and on options granted and exercised. Additionally, the directors' report must contain an annual remuneration report which must appear as a separate section of the directors' report and be headed 'Remuneration Report'.[263] The remuneration report essentially contains certain information relating to the remuneration of key management personnel who have authority or responsibility for planning and controlling the company's activities. The following must be disclosed in the remuneration report:

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[256] Ibid.
[257] Section 202A Corporations Act 2001.
[258] Section 135 Corporations Act 2001.
[259] Section 202A and 202B (1) Corporations Act 2001.
[260] JJ du Plessis et al *Principles of Contemporary Corporate Governance* 2ed (2011) 128.
[261] Section 202B (1) Corporations Act 2001.
[262] Section 292 Corporations Act 2001.
[263] Luiz op cit (n15) 270.

- an explanation of the board's policy on executive remuneration;[264]
- a discussion of the relationship between the policy and the performance by the company;[265]
- details of remuneration of key management personnel such as directors and members of management;[266]
- the reasons for failing to subject to performance conditions any remuneration made through shares or options;[267]
- the relative proportion of remuneration related to performance, value of options granted and aggregate and percentage values of remuneration through options;[268]
- the duration of any executive employment contract, periods of notice and termination payments;[269] and
- whether remuneration consultants were used, what kind of advice they provided to the company as well as the amount and nature of consideration paid to them.[270]

Failure to disclose directors remuneration as required by s 202B (1) results in an offence of strict liability.[271]

In addition to the disclosure requirements the Act also imposes an obligation on listed companies to put the remuneration report to a shareholders advisory vote at the AGM.[272] The advisory vote in Australia has far reaching consequences should there be a significant number of shareholders who vote against the adoption of the report. If the remuneration report receives a 25 per cent vote or more against its adoption at the AGM, the report is given a 'first-strike',[273] whereupon the board is given the opportunity to address the shareholders concerns about executive remuneration and explain in the next years' report

[264] Section 300A (1) (a) Corporations Act 2001.
[265] Section 300A (1) (ba) Corporations Act 2001.
[266] Section 300A (1) (c) Corporations Act 2001.
[267] Section 300A (1) (d) Corporations Act 2001.
[268] Section 300A (1) (e) Corporations Act 2001.
[269] Section 300A (1) (e) (viii) Corporations Act .2001.
[270] Section 300A (1) (h) Corporations Act 2001.
[271] Section 202B (1A) Corporations Act 2001.
[272] Section 250R (2) and (3) Corporations Act 2001.
[273] Section 250U Corporations Act 2001.

what it did to respond to the negative vote or why it failed to respond.[274] Should the remuneration report receive a 25 per cent vote or more against its adoption at the subsequent AGM , that is the second consecutive (later) AGM, it receives 'second strike'[275] and thus prompting a spill resolution[276] by shareholders at the same AGM.[277] The purpose of the spill resolution is for the shareholders to decide whether a general meeting, called a spill meeting, will be convened within 90 days from the passed spill resolution with the agenda of resolving that all the persons who were company directors at the AGM cease to hold office immediately before the end of the said spill meeting.[278] However, managing directors or directors who are entitled to remain in office indefinitely without being re-elected are excluded from the directors who would be required to step down.[279] Furthermore, the spill resolution is intended to give the shareholders the opportunity to put to a vote people who will be appointed to the positions that will be vacant at the end of the spill meeting.[280]

4.4.3 ASX listing rules and Corporate Governance Principles and Recommendations

In terms of the ASX listing rules, the rule which directly deals with the regulation of executive remuneration is Rule 10.17, which requires shareholder approval for any increase in the total amount of director's fees, and that an executive's salary or a director's fees must not be tied to the company's operating revenue.[281] Rule 3.1 contains a disclosure obligation essentially requiring listed companies to notify the ASX once they become aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of its securities. Rule 4.10.3 requires each listed company to include a 'statement disclosing the extent to which the entity has followed the best practice recommendation set by the ASX Corporate Governance Council' in its annual report.

[274] Luiz op cit (n15) 273.
[275] Section 250U Corporations Act 2001
[276] For a spill resolution to be approved by shareholders it must pass by 50% or more of the voting rights exercised on the resolution.
[277] Section 250V Corporations Act 2001.
[278] Section 250V (1) (a) and (b) Corporations Act 2001.
[279] Section 250V (1) (ii) Corporations Act 2001.
[280] Section 250V (c) Corporations Act 2001.
[281] ASX Listing Rule 10.17.

Violations of the ASX Listing Rules can result in suspension of the quotation of a company's securities[282] or even removal from the ASX.[283]

The ASX corporate governance principles contain more detailed and relevant requirements related to executive remuneration. The underlying principle with respect to the regulation of executive remuneration under the ASX corporate governance principles is contained under Principle 8 and requires companies to ensure that the level and composition of remuneration is sufficient and reasonable and that the relationship between remuneration and performance is clear.[284] In order to ensure that executives are paid sufficiently and are not rewarded for poor performance, the ASX principles require that there must be an appropriate balance between the executives fixed remuneration and incentive pay. In doing so companies are expected to take into account the entity's obligations at law and labour market conditions, the entity's short and long-term performance objectives, the entity's circumstances, goals and risk appetite.[285]

In order to ensure that there is an efficient and effective mechanism that guarantees transparency, focus and independent judgement on remuneration decisions, boards of listed companies are required to have a remuneration committee.[286] The committee will comprise of at least three members, a majority of whom must be independent directors and must be chaired by an independent director.[287] Should the board opt not to establish a remuneration committee, the board is required to disclose that fact and further disclose the processes it employs for setting the level and composition of remuneration for executives ensuring that such remuneration is appropriate and not excessive.[288] The ASX listing rules make it compulsory for listed companies which are included in the S&P/ASX 300 Index[289] to have a remuneration committee comprised solely of non-executive directors for the entire

[282] ASX Listing Rule 17.3.1.
[283] ASX Listing Rule 17.12.
[284] ASX Corporate Governance Council ASX Corporate Governance Principles and Recommendations 3ed, available at *http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf*, accessed 13 November 2014.
[285] Ibid Recommendation 8.2.
[286] Recommendation 8 (a).
[287] Recommendation 8 (a) (1) and (2).
[288] Recommendation 8 (b).
[289] The S&P/ASX 300 provides investors with broader exposure to the Australian equity market. The index is liquid, float-adjusted and includes up to 300 of Australia's largest securities by float-adjusted market capitalization.

duration of the financial year.[290] Although executive directors can be a part of the remuneration committee they cannot be involved in deciding their own remuneration.[291] The remuneration committee is essentially responsible for reviewing and making recommendations on executive and senior management remuneration, recruitment, retirement, termination and incentive policies, and any incentive schemes.[292] Overall the remuneration committee ensures that the remuneration practices and policies of the company meet the needs of the company and encourage long-term corporate and individual performance.[293]

The remuneration committee is empowered to acquire the services of remuneration consultants however in doing so it must disclose this in the remuneration committees' charter.[294] Additionally, if remuneration consultants are used the listed company has to ensure it complies with s 206K-206M of the Corporations Act 2001 regarding the engagement of remuneration consultants to advice on the remuneration packages to be awarded to key management personnel.[295] The said sections are essentially aimed at regulating the use of remuneration consultants by the board or remuneration committee and ensuring that the consultant's recommendations are free from undue executive influence. The sections require, for example, prior approval from the board or remuneration committee before the consultant's contract is executed[296] and the consultant should also ensure that the recommendation is provided directly to the independent or non-executive directors instead of the executive director.[297]

290 Listings Rule 12.8 and Recommendation 8 (b).
291 Commentary and guidance on recommendation 8.2 of the ASX Principles.
292 SM Luiz 'An Appropriate Regime for the Remuneration of Executives' (2006) 39 XXXIX *CILSA* 57 at 67.
293 Ibid.
294 Commentary and guidance on recommendation 8.2 of the ASX Principles.
295 Ibid.
296 Section 206K (2) (a) and (b) Corporations Act 2001.
297 Section 206L (2) and (3) Corporations Act 2001.

4.4 Comparison with South African Regulation

There are a number of similarities that exist between South Africa's manner of regulating executive pay with that of the Australia and just like the United Kingdom, these similarities tend to relate more to the general corporate governance principles. They can be summed up as follows:

- Both countries require remuneration levels to be fair and responsible by ensuring that it is sufficient enough to attract, retain and motivate individuals of a suitable calibre whilst at the same time taking into consideration the interests of the company and shareholders by linking pay to the company long term strategy and performance.[298] Additionally, executives' pay should be a balance between the fixed and the variable components or performance based remuneration of executives.[299]
- Both countries require the establishment of remuneration committees which must comprise mainly of independent non-executive directors.[300]
- Both countries require companies to disclose the remuneration of executive directors in the annual remuneration report,[301] although Australia's disclosure requirements are much more detailed.
- Failure to comply with either countries statutory requirements will result in a director being held personally liable for any infringement.[302]

Despite the existence of the above similarities there are a number of differences that can be identified between Australia's and South Africa's manner of regulating executive pay. As mentioned earlier the disclosure requirements in Australia are more detailed than those in South Africa. In addition to the standard disclosure requirements, for example disclosures on salaries, benefits and bonuses, Australian public companies are required to disclose in the annual remuneration report a discussion of the company's remuneration

[298] See Principle 8 ASX Corporate Governance Principles and Recommendations and King III Principle 2.25 para 147.

[299] See Recommendation 8.2 ASX Corporate Governance Principles and Recommendations and King III para 157 at 49.

[300] See Recommendation 8 (a) (1) ASX Corporate Governance Principles and Recommendations and King III Principle 2.23 para 131.

[301] See Section 202B (1) and 292 of the Corporations Act 2001 and King III Principle 2.26 para 181 and Section s 30 (4)-(6) Companies Act 2008.

[302] See Section 202B (1A) Corporations Act 2001 and Section 77(3) (d) (i) Companies Act 2008.

policy, the link between the policy and the company's performance, a summary of any performance conditions applicable to remuneration, an explanation of why those conditions were chosen and how they were evaluated as being satisfied.[303] The report must also include information on the company's earnings and shareholder wealth. Although King III does require companies to provide an explanation of the remuneration policy followed throughout the company and how such policy was implemented,[304] South Africa's disclosure requirements are mainly centred around the disclosure of the rudimentary requirements, for example, disclosures on salaries, benefits and bonuses,[305] as well as disclosures on details such as policy on base pay; participation in share incentives schemes; the use of benchmarks; incentive schemes to encourage retention, policies regarding executive employment etc.[306] Additionally, the remuneration policy and an explanation of the link between the policy and the company's performance are legally required to be disclosed in Australia whereas in South Africa they are disclosed on an 'apply or explain' basis.

In terms of the remuneration committee, Australia gives the remuneration committee statutory backing force by providing a definition of the committee and requiring that remuneration consultants be approved by the remuneration committee or the board before entering into the remuneration consultancy contract.[307] However, there is no similar requirement with respect to the South African Companies Act. With respect to the executive director's membership in the remuneration committee, Australia permits executive directors to be a part of the remuneration committee though they cannot be involved in deciding their own remuneration.[308] South African executives may attend by invitation meetings which require their input on the reward and employee relations, but may not vote and they must also not be present when their remuneration is discussed.[309]

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[303] Section 300A (1) Corporations Act 2001.
[304] King III Principle 2.26 para 181 at 52.
[305] Section 30 (4)-(6) Companies Act 2008.
[306] Principle 2.26.1-2.26.10 King III.
[307] Section 206K (2) (a) and (b) Corporations Act 2001.
[308] Commentary and guidance on recommendation 8.2 of the ASX Principles.
[309] Remuneration Committee Forum 'A framework for remuneration Committees (May 2013), available at *http://www.iodsa.co.za/resource/collection/57F28684-0FFA-4C46-9AD9-EBE3A3DFB101/Position_Paper_1_A_framework_for_remuneration_committees.pdf*, accessed 10 September 2014 at 6.

Australia has a number of principles governing the use of remuneration consultants[310] as well as disclosure requirements relating to the use of the remuneration consultants.[311] Though South Africa allows the use external advisers,[312] whose composition must be disclosed in the integrated report,[313] it does not have the same stringent requirements on the use of remuneration consultants like Australia.

Australia's approach to shareholders say on pay is quite different to the South African approach. Whilst South Africa requires a special resolution approved by the shareholders within the previous two years approving the payment of director remuneration[314] as well as a non-binding advisory vote on the remuneration policy before it is implemented.[315] Australia requires an advisory vote on the remuneration report and has also adopted the Two Strike rule. The combination of the advisory vote and the Two Strike rule gives shareholders a meaningful voice because they have the opportunity to voice their concerns and it also compels the board to take note of these concerns or face removal from the board and be re-elected in the event the directors fail to listen to the shareholders for two consecutive years.[316] The same cannot be said for South Africa for two main reasons. Firstly, the advisory vote is not binding therefore even if shareholders disapprove the remuneration policy they are not bound by the recommendations of the shareholders. Secondly, the lack of clarity in the use of the words 'service as directors' in s 66 (8),[317] means that if the section is interpreted narrowly South African shareholders do not have a meaningful voice on executive remuneration.

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[310] Sections 206K-206M Corporations Act 2001.
[311] Section 300A (1) (h) Corporations Act 2001.
[312] King III Paragraph 132 at 46.
[313] Ibid at para 127.
[314] Section 66 (9) Companies Act 2008.
[315] King III Principle 2.27.
[316] Massie op cit (n2) 104.
[317] Companies Act 2008.

4.5 Conclusion

Generally South Africa, the United Kingdom and Australia have a lot in common in terms of their executive remuneration practices particularly with respect to the principles aimed at linking pay to performance, making the remuneration committee more independent as well as some of the disclosure requirements and imposing stiff penalties for defaulting directors. However, it must also be pointed out that over the years the United Kingdom and Australia have taken steps to amend their company legislation and regulations and have introduced more detailed and stringent requirements relating to the disclosure of director's remuneration and shareholder say on pay. With respect to the disclosure requirements, the United Kingdom has gone as far as requiring the disclosure of director remuneration in two separate reports to providing detailed requirements of how particular components of the remuneration should be calculated. Australia has gone beyond the standard disclosure requirements and now requires detailed disclosures such as an explanation of the proportion of the elements of the director's remuneration that are related to performance and those that are not.[318]

In so far as shareholder say on pay in concerned, it can be said that South Africa is still lagging far behind its international counter parts. This is because the United Kingdom and Australian legislation have adopted approaches which either requires a binding or advisory shareholders vote on director's remuneration, whilst the South African Companies Act 2008 does not require the remuneration report to be put to a vote. At best King III recommends the remuneration policy to be put to a non-binding advisory vote which is, however, not binding. Furthermore, the lack of clarity on the meaning of 'service as director' under s 66 (8) makes it difficult for South African shareholders to have a meaningful voice on executive pay.

The following chapter will provide recommendations on how best South Africa can improve its current corporate governance practices relating to executive remuneration.

[318] Section 300A (1) (e) (I) Corporations Act 2001.

CHAPTER 5 CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

The difficulties arising from the agency problem have certainly been recognised by South Africa hence the various instruments that have been put in place to assist in addressing the problem. Whilst the country generally maintains a comprehensive set of corporate governance related laws and regulations aimed at improving and addressing corporate governance issues like excessive executive remuneration, it is however clear from this research that there are still a number of gaps and considerable weaknesses in the country's legislative and regulatory frameworks in so far as regulation of executive pay is concerned.

The main purpose of this last chapter is to propose recommendations towards achieving better regulation of executive remuneration in South Africa. The chapter will do so by suggesting recommendations for improvement based on the key gaps and weaknesses that were identified in chapters three and four. In summary the recommendations will be aimed at achieving better standards of corporate governance in South Africa by focusing on improving the quality of information disclosed on executive pay, ensuring that remuneration committees are more independent and have a more effective say on pay as well as ensuring that shareholders are given a stronger voice when it comes to executive pay levels.

5.1 Summary of Findings and Recommendations

This research sought to evaluate the legal and regulatory mechanisms in South Africa relating to executive remuneration for the purposes of assessing the effectiveness of these mechanisms in ensuring that those in control are accountable to the shareholders and do not remunerate themselves excessively at the expense of the shareholders. Additionally, the research embarked on a comparative analysis with the United Kingdom and Australian legal and regulatory mechanisms with a view to assess South Africa's standing in relation to its international counterparts.

The research revealed that South Africa has hybrid corporate governance framework regulating executive pay which comprises of the King III principles and recommendations, the mandatory obligations under the Companies Act 2008 and the JSE Listings Requirements which are applicable to listed companies. The research further revealed that the regulatory frameworks are essentially centred on three main principles: the appointment of remuneration committees, disclosure of remuneration and approval of remuneration by shareholders. When compared with its international counterparts, South Africa's legal and regulatory frameworks shared a number of similarities with that of the United Kingdom and Australia, however it still lagged behind particularly with respect to its remuneration policies and practices relating to the disclosure of director's remuneration and shareholder say on pay. Given that the Companies Act 2008 seeks to encourage transparency and high standards of corporate governance amongst enterprises in South Africa due to the significant role they play in the social and economic life of South Africans,[319] it is very important that the areas where South Africa still lags behind are addressed.

In view of the above, the following is a brief summary of the key findings from the research followed by the appropriate recommendations:

5.1.1 Remuneration Committee and Consultants

(a) Current Position in South Africa

King III recommends companies to appointment remuneration committees for purposes of setting up and administering the remuneration policy which must be aligned with the company strategy and linked to the executive's contribution to company performance. This principle is supported by the listings requirements which also require the appointment of remuneration committees for listed companies, whose membership and number of meetings held must be disclosed in the annual report. Although this principle and recommendation is very important it is however non-binding except in respect of listed companies.[320] This is problematic because since King III is principle-based it means boards could easily explain away their non-compliance with the principles. The problem is further heightened by the lack of a provision in the Companies Act 2008 requiring the appointment of remuneration committees.

With respect to the use of remuneration consultants, South Africa does not strictly regulate the use of remuneration consultants by remuneration committees. This poses a problem because whilst King III permits the use of remuneration consultants and requires

[319] Section 7 (b) (iii) Companies Act 2008

[320] This is only the case because the JSE listing requirements include compliance with King III but companies that are not listed do not have to comply with King at all.

their composition to be disclosed in the integrated report, this principle is however provided for on 'apply or explain' basis which means that the board can easily explain away why they did not disclose the identity or composition of the remuneration consultants.

(b) Current Position in the United Kingdom and Australia

The United Kingdom and Australia both legally require the appointment of remuneration committees in their respective company law statutes. Both the United Kingdom and Australia require comprehensive disclosure where remuneration consultants are used, for example, the remuneration committee is to disclose whether it used any consultants, the consideration paid to the consultants and how the committee ensured that the recommendations from the consultants was independent and free from bias.

- *Recommendations to Improve the Remuneration Committee and Use of Remuneration Consultants in South Africa*

South Africa should adopt the approach followed both in the United Kingdom and Australia whereby the appointment of the remuneration committee is legally required. By not having such an approach and relying solely on the principles provided in King III companies will use this as an opportunity to explain away why they don't have remuneration committees thus leading to executives deciding their own remuneration. Having a legal provision making the appointment of the remuneration committee mandatory will ensure that the above discussed conflict of interest is avoided.

To further improve the independence of the remuneration committee, it is recommended that it be composed of only independent non-executive directors instead of it being composed of a majority of independent non-executive directors. Executive directors should be strictly prohibited from being members. By requiring only independent non-executive directors to be part of the remuneration committee will ensure that any decisions taken by them with respect to setting out pay are indeed independent and objective. Furthermore, it will minimise any potential influence from the executive directors.

Currently South Africa's regulation and use of remuneration consultants is not comprehensive when compared to the United Kingdom and Australia. To improve this, the following is recommended:

(1) There should either be a clear ‘apply or explain’ principle or binding legal obligation requiring remuneration consultants to be retained by the remuneration committee and for the consultants to provide advice directly to the committee and not the executive directors.[321] This would greatly reduce any conflicts of interest and ensure that the consultant’s advice is indeed independent and free from bias.

(2) In addition, to ensure that the advice provided by the consultants is independent and free from bias there should be a requirement to disclose the identity of the consultants, any relationship that exists between the company and the consultant and lastly disclose any steps taken by the board to ensure that the advice offered by the consultant is in fact independent and free from executive influence.[322]

5.1.2 Disclosure of Executive Remuneration

(a) Current Position in South Africa

King III recommends the disclosure of executive director’s remuneration policy and its explanation in the annual remuneration report. Listed companies are required in the listings requirements to disclose the remuneration and benefits of individual directors in the annual report. The Companies Act 2008 requires the compulsory disclosure of executive remuneration however it does not require the preparation and subsequent disclosure of the remuneration policy and its explanation in the annual financial statements.

(b) Current Position in the United Kingdom and Australia

The United Kingdom and Australia require much more detailed and stringent requirements relating to the disclosure of director’s remuneration when compared with the position in South Africa. The United Kingdom, for example, provides guidelines on how particular components of remuneration should be calculated and disclosed in certain graphical form whilst Australia requires detailed explanations of, for example, the proportion of the elements of the director’s remuneration that are related to performance and those that are not. Furthermore, the United Kingdom has adopted a standard method of reporting certain

[321] Ibid at 114
[322] Ibid

aspects of remuneration by providing guidelines on how remuneration should be calculated, the categories in which it should be broken down and how each category is to be calculated. This is currently not present in South Africa which makes it difficult for shareholders to know how much executives earn particularly with respect to incentive awards. In the United Kingdom and Australia the remuneration policy and the explanation of the link between executive pay and performance is disclosed as a matter of law whereas in South Africa it is rather done on recommendation or an 'apply or explain' basis.

- *Recommendations to Improve Disclosure*

In light of the country's hybrid system of governance, South Africa could introduce a provision in the Companies Act 2008 which would make it legally binding for the remuneration policy and all benefits paid to directors to be disclosed as opposed to having it disclosed on recommendation or an 'apply or explain' basis. In addition, how the remuneration policy is to be implemented and an explanation of the link between pay and performance should be required to be disclosed by law in the Companies Act 2008. Requiring the legal disclosure of the policy and its explanation will ensure the board is held accountable for ensuring that the correct information is disclosed and it will also encourage them to explore various ways of linking pay to performance as they would be compelled to explain the link to the shareholders. This type of disclosure will also be beneficial to the shareholders as they would be given a wider and clearer picture of the packages awarded to executives as well as providing them with an explanation as to why the executives earn those packages.

South Africa should also adopt standard methods of reporting on remuneration similar to those used in the United Kingdom.[323] As mentioned previously the United Kingdom has strict guidelines on how remuneration is to be reported, the categories in which it should be broken down, how each category is to be calculated and how the considerations and interests of the shareholders, unions and employees were taken into account when drafting the remuneration policy. If South Africa could adopt this method of disclosure, South African companies would be more transparent and accountable as they would no longer be able to hide what is being paid to executives. In addition, this standard

[323] Massie op cit (n2) 111

method of reporting would ensure shareholders and other interested parties are fully aware of the earnings of executives particularly with respect to incentive awards.

It is common knowledge that executive and non-executive directors have the same responsibilities in law. In reality however an executive director is a director who has separate responsibilities within the company as an executive and employee. In recognition of this it is important that the Companies Act 2008 makes a clear distinction between the executive and non-executive directors and requires the separate disclosure of remuneration of these two types of directors. By doing so shareholders will be given a clearer picture of who is earning what, how much they are earning and why they are being paid that amount. The separation will also be useful in helping to address the lack of clarity caused by the use of words ‘service as directors’ in s 66(8) as it would be made clear if shareholders have a say over director pay in their capacity as directors only or in any other capacity.

5.1.3 Shareholder Say on Pay

(a) Current Position in South Africa

King III recommends the remuneration policy to be tabled to the shareholders annually for a non-binding advisory vote at the annual general meeting before it is implemented. The Companies Act 2008 makes the payment of executive remuneration subject to the Memorandum of Incorporation and shareholders special resolution approved within the previous two years. The main difficulty that arises with respect to shareholders say on executive pay in the Companies Act 2008 is based on the lack of clarity over the use of words ‘service as directors’ in s 66(8) which when narrowly interpreted results in shareholders having a limited say on the amounts paid to the executives.

(b) Current Position in the United Kingdom and Australia

The United Kingdom and Australia legislation have made their shareholder say on pay vote binding to a certain extent which means that their shareholders have a stronger voice when it comes to executive pay. South African shareholders do not have the same opportunity as their vote is a non-binding advisory vote provided on an ‘apply or explain’ basis in King III.

- *Recommendation to Improve Shareholder Say on Pay*

South Africa can strengthen shareholders say on pay by enacting a provision in the Companies Act 2008 that would make shareholders legally bound to vote on the remuneration policy, its explanation and certain aspects of the remuneration and benefits paid to directors, for example incentive awards, on an annual basis. A mandatory vote would ensure that the board is bound by the policy and remuneration approved by the shareholders and are also held personally liable for contravening the said policy.[324] This would therefore be an improvement from the current position whereby the remuneration policy is subjected to a non-binding advisory vote which is provided for on recommendation or an 'apply or explain' basis in King III. Alternatively, as a way of encouraging investors to take a more active role in approving executive remuneration as well as encouraging board and shareholder engagement, South Africa could adopt the Australian 'two strike' approach. By adopting this approach it would mean that should the remuneration report receive a twenty-five per cent (25%) disapproval at two consecutive shareholders AGMs, directors will lose their positions on the board in a mandatory spill vote by the shareholders. South Africa's adoption of the 'two strike' rule will be beneficial to it as it will motivate boards to listen and actively engage with shareholders after receiving the first strike which in turn will result in beneficial changes to the remuneration policies and practices for purposes of avoiding a second strike.[325] Furthermore, the 'two strike' rule will provide an additional level of accountability for directors and increased transparency to shareholders because the board will be bound to pay attention to the shareholders concerns and not pay themselves without the approval of the shareholders or otherwise they will face re-election.

5.2 Conclusion

In conclusion the reforms undertaken in the United Kingdom and Australia with respect to the regulation of executive remuneration and the nature of their requirements demonstrate that these countries have been able to establish a more articulate and definite manner of regulation compared to South Africa. In particular, the United Kingdom and Australia have been able to legislate many of their remuneration requirements and have given shareholders a much needed voice with respect to the pay of executives. Whilst South Africa has taken a number of steps to address excessive remuneration, most of the principles adopted are provided for in King III which is not legally binding and many companies can choose to

[324] Ibid at 115
[325] Ibid at 116

explain away their non-compliance. By benchmarking from the United Kingdom and Australia, South Africa will be put in a position whereby it is not only in line with its international counterparts but it is also able to address the problems arising from excessive executive remuneration and better promotes the objects of the Companies Act 2008.

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