

**A Case for the Extension of the 'Comply or Explain'
philosophy to a national Code of Corporate Governance in
Zimbabwe: A Comparative Analysis.**

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PLAGIARISM DECLARATION

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Declaration

1. I know that plagiarism is wrong. Plagiarism is to use another's work and pretend that it is one's own.
2. I have used the South African Law Journal convention for citation and referencing. Each contribution to, and quotation in, this dissertation from the work(s) of other people has been attributed, and has been cited and referenced.
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4. The word limit of this dissertation excludes the Abstract, Acknowledgements, Dedication, Footnotes and Introductory background.
3. This dissertation is my own work.
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Date 29/05/09

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The road is tough but I am a victor and not a victim.

To God be the Glory

DEDICATION

To my Mother and Father

Thank you for your love and support in this journey to academic success.

I wish you a long life filled with God's love.

ABSTRACT

After the wave of corporate collapses in the United Kingdom (UK) in the late 1980s and early 1990s, a need for corporate governance reform was realised in that country. There was an introduction of self-regulation as a method of corporate governance. The private sector initiated efforts to improve corporate governance leading to recommendations by the Cadbury, the Greenbury, the Hampel, the Turnbull, the Smith and the Higgs Committees.

The above recommendations formed the substratum of the *Combined Code on Corporate Governance 2006* (Combined Code). South Africa also introduced self-regulation in corporate governance through the *Code of Corporate Practices and Conduct* (King II). The Code took into account recommendations from various corporate governance reports in the UK that formed part of the Combined Code.

In Zimbabwe, The Institute of Directors of Zimbabwe (IODZ) introduced self-regulation in corporate governance by publishing corporate governance manual entitled '*Principles for Corporate Governance in Zimbabwe: Manual of Best Practice*'. The manual is a combination of the Cadbury report (1992) in the UK and the South African's King report (1994). Listed companies have an option to comply with any of the two.

On the contrary in the United States of America (USA) the *Sarbanes Oxley Act 2002* (SOX) was enacted after the disastrous consequences brought by the fall of Enron and World com. USA introduced new legislative provisions and heavy penalties for breaching them. The *Sarbanes Oxley Act* epitomised the 'rules-based approach' to corporate governance as contrasted with the 'principles-based approach' adopted in the UK and South Africa.

Self-regulatory Codes operate under the 'comply or explain philosophy. Compliance with their provisions is not mandatory if followed by an explanation for non-compliance. Legislation though uniform and certain is too rigid for the development and improvement of corporate governance principles. Corporate sins like greed, selfishness and unreasonableness have contributed to the fall of companies in the world. These human characteristics are incapable of being legislated. More so, most companies that had been involved in the corporate scandals had sometimes complied with all the legislative provisions.

This dissertation recommends that the IODZ should make an initiative to start a corporate governance Code that embodies corporate governance principles drafted specifically for Zimbabwean companies. Corporate governance problems in Zimbabwe coupled with the absence of national corporate governance regulation outside the Companies Act makes a self-regulation Code operating under the 'comply or explain' philosophy essential.

Corporate governance Codes and reports in the world should only influence the drafting process and no provision should be copied and pasted without proper regard to the needs of companies in Zimbabwe. The Code will govern public and listed companies with an influence on other companies that fall outside this category.

ABBREVIATIONS

BCCI	Bank of Credit and Commercial International
BEE	Black Economic Empowerment
CEO	Chief Executive Officer
ENG	Eng Capital Investment
FCA	Foreign Currency Accounts
FNBS	First National Building Society
FRC	Financial Reporting Council
FSA	Financial Services Authority
IM	Intermarket Holdings
IOD	Institute of Directors in the UK (IOD)
IODSA	Institute of Directors in South Africa
IODZ	Institute of Directors in Zimbabwe
JSE	JSE Limited
KING II	Code of Corporate Practices and Conduct 2002
LSA	London Stock Exchange
LSE	London Stock Exchange
MPB	Metropolitan Bank
NANGO	National Association of Non Governmental Organizations
RBZ	Reserve Bank of Zimbabwe (The Reserve Bank)
ROSC	World Bank Group 'Report s on the Observance of Standards and Codes'
SOX	Sarbanes Oxley Act 2002
TBC	Trust Banking Corporation

TBF	Troubled Bank Funds
UK	United Kingdom
UMB	United Merchant Bank
USA	United States of America
ZABG	Zimbabwean Allied Banking Group
ZSE	Zimbabwe Stock Exchange

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2 BCLC 351 424 (ChD and CA).

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England

Greenhalgh v Arderne Cinemas Ltd [1951] Ch 286; [1950] 2 All ER 1120 (CA)

In Re Beloved Wilkes's Charity (1851) 3 Mac & G 440 448; 42 ER 330-333.

Salomon v Salomon 1897 A.C 22 (H.L.)

South Africa

C and P v Commissioner of taxes 1960 (4) SA 163 (SR)

Masdrop v Haddow 1959 (3) SA 458 (A) at 471-47

Robinson v Randfontein Estates GM Co Ltd 1921 AD 168 178

Roodpoort United main Reed GM Co Ltd v Dutoit 1928 AD 06 71-72

LEGISLATION AND STATUTES

United Kingdom

United Kingdom Companies Act 2006

United States of America

Securities Exchange Act of 1934

The Sarbanes Oxley Act 2002

South Africa

Corporate Laws Amendment Act (No. 39 of 2002)

Republic of South Africa Companies Act (No. 61. of 1973)

Republic of South Africa Companies Bill 2008 as amended by the portfolio committee on Trade and Industry

Zimbabwe

Zimbabwean Banking Act (chapter 24:03)

Zimbabwean Companies Act (Chapter 24:03)

Zimbabwe Stock Exchange Act (Chapter 24:18)

INTRODUCTORY BACKGROUND

Aims of Dissertation

The writer intended to give the reader a clear picture of corporate governance as a subject relating its importance in Zimbabwe by highlighting corporate governance challenges in that country. This resulted in the proposal for the introduction of a self-regulatory Code operating under the 'comply or explain' philosophy of corporate governance drafted with a focus of addressing the corporate governance problems in Zimbabwe.

The conclusion reached was that a comparison with other countries shows that some stable economies discussed have introduced self-regulation as a corporate governance regulatory measure. This convinced the writer that arguably self-regulation using the 'comply or explain' philosophy could be one of the solutions to the corporate governance challenges in Zimbabwe.

Limitations of Study

It is notable that this dissertation proposed self-regulation as a method of corporate governance in Zimbabwe. Self-regulation using the 'comply or explain' philosophy was the epitome of this dissertation.

Zimbabwe does not have a national corporate governance Code specifically drafted as a Zimbabwean initiative, for Zimbabwean companies and regulating companies using the 'comply or explain' philosophy. The dissertation referred to King II as an example of a corporate governance Code in Africa that provides guidance in the drafting process of a Zimbabwean corporate governance Code. The specific provisions of King II were beyond the scope of this dissertation although the

dissertation referred to its provisions that support the use of self-regulation, as method of corporate governance.

The dissertation also referred to the provisions of the Combined Code in the UK that support the use of self-regulation. Comprehensive discussions of its provisions were beyond the scope of this dissertation. Reference to the SOX's legislative approach helped to compare how other jurisdictions regulate corporate governance. However, the dissertation did not support the American way of corporate governance using the legislation and heavy penalties to instill good corporate governance.

The American way of corporate governance was criticised as restrictive and mandatory by requiring directors to follow rules without exercising their discretion. Note was however taken that when the SOX was enacted it might have been essential as a reactive measure to the corporate governance scandals in the United States of America (USA). Further, the USA is also considering the use of self-regulation through the 'comply or explain' philosophy.

This dissertation suggested the maintenance of legislative regulation in corporate governance regarding corporate governance principles already regulated by way of legislation in Zimbabwe. Regarding principles without legal enforcement, the dissertation suggested the use of self-regulation through the 'comply and explain' philosophy.

Methodology and Research

The first part of the dissertation defined corporate governance, explained its emphasis and stated the advantages that accrue from effective corporate governance. The second part of the dissertation briefly highlighted the corporate governance scandals in Zimbabwe. The Zimbabwean banks exemplified Zimbabwean companies

that suffered because of poor corporate governance practices. The use of banks as examples of corporate governance scandals did not confine the study to a reform in the banking sector but it was because of the limited literature on the operation of companies in Zimbabwe.

The third part of the dissertation made a comparative analysis of corporate governance regulation in various jurisdictions. The idea behind the comparative analysis was to have an insight on the regulation of corporate governance in the leading economies in the world. The jurisdictions discussed provided insight on how Zimbabwe can improve its corporate governance. The regulation of corporate governance in America helped to provide a clear insight on different ways of regulating corporate governance.

In the fourth part of the dissertation, the dissertation discussed self-regulation of companies as a method of corporate governance outlining its advantages major challenges. The discussion endeavored to justify why the UK and the South African method of Corporate governance regulation by way of self regulated Codes of conduct is preferred over the more stringent regulation in America. That part of the dissertation also justified the importance of a corporate governance Code drafted in Zimbabwe, by Zimbabweans and for Zimbabweans as Africans.

A conclusion drawn was that a combination of statutory regulation and self-regulated Codes of conduct would be the ideal method of corporate governance regulation for Zimbabwe. Those principles of corporate governance currently enforced through the traditional method of corporate governance could remain enforced in that way. Regarding, new principles of corporate governance not enforceable through the legislative way; the dissertation suggested the use of self-regulation as a method of regulating corporate governance.

In doing this research published books, scholarly articles, codes on corporate governance, various journals reviews, reports and internet based research have been used.

CHAPTER 1

UNDERSTANDING CORPORATE GOVERNANCE

1.1. Introduction

The need for corporate governance became more important and prevalent after the inception of corporate entities. Once incorporated a company is a separate legal persona separate and distinct from its members, capable of owning real property, entering into contracts, suing and being sued, all in its own name.¹ The court restated the position in *Salomon v Salomon & Co*² where it held that a company from its inception is legally separate from its members. Lord Halsbury L.C stated that:

...short of such proof [i.e. of fraud] it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those that took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are....³

After incorporation, no one can purport to act for or on behalf of the company unless authorized to do so by the company and that once authorized to act for and on its behalf the person acts to the extent of his authorisation⁴ and in furthering the best interest of the company.

¹ Iwai K, 'The nature of the business corporation: Its legal structure and economic functions' (2002) 53 Issue No 3 *The Japanese Economic Review*, at 243 available at papers.ssrn.com [Accessed 7 December 2008].

² *Salomon v Salomon & Co* [1897] A.C 22 (H.L.).

³ *Ibid* at 30.

⁴ Such authority and extent of duty is usually given in a separate contract with the director or in the articles of association though it is accepted that the articles of association do not form a contract between the director and the company.

In *Masdrop v Haddow*⁵ the court held that only those appointed as representatives of the company in accordance to the articles of association could bind the company. Directors have the power to represent the company and to act on its behalf. Shareholders themselves cannot manage or direct the company; the power is mainly with the directors, as they possess the requisite expertise to do so. In managing the company, directors should act not in their interest but in the best interest of the company as a legal entity. Judicial precedence has it that shareholders have no direct interest in the property, business or assets of the company. What they have is their voting and dividend rights. Shareholders change from time to time while the company remains in perpetual succession.⁶ Directors should therefore act in the best interest of the company in exercising their fiduciary duties,⁷

The interests of the company have however been equated to the interest of shareholders. Whilst the corporation owns corporate assets, the shareholders own the corporation hence the need to act in their best interest as the owners of the corporation.⁸ Shareholders own shares which are a bundle of rights from which accrues financial and participatory rights in the corporation.⁹ 'Indeed to hold a corporate share is to own a fraction of the corporation as a thing that is, an asset separate and distinct from the underlying corporate assets. It is the corporation as a "legal thing" that the corporate shareholders own.'¹⁰

Directors should thus manage the company in the interest of its shareholders. 'Corporate law presumes that firms should be managed for shareholders, and not

⁵ *Masdrop v, Haddow* 1959 (3) SA 458 (A) at 471-472.

⁶ *King report on corporate governance for South Africa* (2002) ,at 9.

⁷ *Ibid* at 9.

⁸ Iwai K, 'The nature of the business corporation: Its legal structure and economic functions' (2002) 53 Issue No 3 *The Japanese Economic Review*,at 243-244. Available at papers.ssrn.com [Accessed 7 December 2008].

⁹ *Ibid* at 244.

¹⁰ *Ibid* at 244.

managers, when their interests conflict.’¹¹ Managers should seek to maximize profits for the benefit of shareholders. The interest of shareholders is to see the company realize profits, declare dividends and exist in perpetual succession. On the other hand the interest of managers is personal gain and individual fulfillment. This scenario brings about the ‘agency problem.’¹² Easterbrook F H and Fishel D R ¹³clearly state the position;

The argument is simple. In most substantial corporations-firms with investment instruments that are freely traded, which we call “public corporations” each investor has small stake compared with the size of the venture. The investor is therefore ‘powerless.’ The managers, by contrast, know how the business is running and can conceal from investors information about the firm and their own activities. Armed with private knowledge and able to keep investors in the dark, the managers can divert income to themselves, stealing and mismanaging at the same time. Diversion and sloth may not be obvious, but they exist. Even when they do not, the potential for misconduct remains. Only some form of regulation can protect investors.¹⁴

Due to human imperfection, mainly characterised by self-, interest and self-gain directors have proved to be unable to consider solely the interest of the company and to maximize profit for the firm only for the benefit of shareholders. The wave of collapse of companies in the world and the great emphasis on the need to devise strategies to align the interest of management with that of the shareholders is evidence of the above assertion. Shareholders themselves cannot manage the company. They are also not in charge of their corporation’s managers.¹⁵ Managers

¹¹ Roberta R, *The Genius of American Corporate Law* (1993) at 2.

¹² ‘In modern economies, the management and control of companies is increasingly separated from ownership. The problem comes when management fail to separate management and ownership as well. Managers may seek to maximize their own interest at the expense of shareholders. Further separation may lead to lack of transparency in the use of funds in the company and in the proper balancing of the interest of for instance, shareholders and managers and of controlling and minority shareholders.’ Cited in, ‘What is Corporate Governance’, FCGI (2006) found in www.fcgi.or.id/en/about_gc.shtml [Accessed 11 March 2009].

¹³ Easterbrook F H and Fishel D R *The Economic structure of Corporate Law* (1996) at 1.

¹⁴ Ibid.

¹⁵ Iwai K, ‘The nature of the business corporation: Its legal structure and economic functions’ (2002) 53 Issue No 3 *The Japanese Economic Review*, at 258. Available at papers.ssrn.com [Accessed 12 January 2009].

are the fiduciaries of the corporation and ought to act in the protection of the interest of shareholders.¹⁶

Corporate governance became the only way to align the interest of the fiduciaries (the managers) and the beneficiaries (the shareholders). Corporate governance became one of the key issues of the 1990's because of a number of well-publicized corporate problems and scandals in the late 1980's.¹⁷ Issues ranged from 'questionable earnings to outright fraud, problems involved creative accounting and spectacular business failures, the apparent ease of unscrupulous directors in expropriating other stakeholder funds, the limited role of auditors and the claimed weak link between executive compensation and company performance.'¹⁸

These collapses of companies have heightened public concern with the corporate governance question as to how to devise systems rules and institutions that will induce corporate executives to manage the corporate assets in the interest of the shareholder rather than their own.¹⁹ As noted by the King report

Corporate governance principles were developed, *inter alia*, because investors were worried about excessive concentration of power in the hands of managers with the era of the professional manager. This protection against greed could encourage the sins of sloth and fear with an erosion of enterprise and encouragement of subservience. A balance is needed.²⁰

¹⁶ Ibid at 258.

¹⁷ Mongalo T, 'The emergence of corporate governance as a fundamental research Topic in South Africa' (2003) *South African Law Journal* at 174.

¹⁸ Ibid.

¹⁹ J W Salacuse 'Corporate governance in the new century'(2004) 25 *Issue No 3 The company lawyer* at 71 as stated by A Berle and G Means , *Morden corporation and private property* (1932).

²⁰ *King report on corporate governance for South Africa* (2002) ,at 7.

1. 2. Regulation of Corporate governance

1.2.1. The definition of regulation

Regulation as a general concept has been defined as 'the imposition of rules by a government backed by the use of penalties and the authority of the state, that are intended to change the behavior of individual groups.'²¹

The above definition of regulation is restrictive and focuses on state regulation. Of particular note is that regulation as a concept has evolved and goes beyond regulation by statutes and subsidiary legislation by the government.²² 'Regulatory theorists encourage the adoption of a broad and flexible definition of 'regulation.'²³

[There is an invitation] move away from a preoccupation with a model of regulation by government through the use of statutory rules (meaning primary and secondary legislation), and to consider the use by government of non-statutory rules (where 'non-statutory rules' means standards, policy statements, informal rulings, and 'government' includes statutory authorities, government agencies and other quasi-governmental actors). Going one step further, modern regulatory theory also emphasizes the use by non-government actors of what might be called 'non-rules', such as Codes of conduct or best practice standards.²⁴

²¹ Nielsen E, 'Regulation, Co-regulation, or Self regulation .What is the best approach?' Presentation to Copolco Workshop Prague, Czech Republic (2004) at 1 available at www.iso.org .[Accessed 13 January 2009].

²²Bottomley S, 'Where did the law go? The delegation of Australian corporate regulation'(2003) 15 *Australian Journal of Corporate Law* at 2 available at books.google.ac.za. [Accessed 12 February 2009].

²³ Ibid at 2.

²⁴ Ibid at 2.

Seen from a broader perspective regulation includes 'any technique designed to control, alter or influence behavior.'²⁵ It includes the 'use of voluntary Codes of conduct and best practice standards as prepared by representative bodies such as self regulatory organizations and professional bodies.'²⁶ In the world at large the concept of regulation has developed. An analysis of corporate governance regulation shows that in corporate governance the legislature is no longer the sole corporate governance regulator.²⁷ Self-regulatory Codes on corporate governance like the King II²⁸ and the Combined Code²⁹ now regulate corporate governance using the 'comply or explain' philosophy.

1.2.2. How corporate governance has been regulated

The regulation of corporate governance differs according to jurisdiction. However, an almost universal corporate governance structure involves the legislature as a regulatory body through the enactment of various legislative 'Acts' meant to regulate corporate governance. Further, in common law countries, either English and Roman-Dutch countries, common law has been another major regulatory body that provides for fiduciary duties owed to the company by directors and remedies for shareholders in the event of breach of fiduciary duties or misconduct by directors.

Courts have also played an important role as a regulatory body through reinforcing legislative and common law provisions and restating the common law to suit the changing times through judicial precedents. Doctrines like the 'business

²⁵ Nielsen E, 'Regulation, Co-regulation, or Self regulation .What is the best approach?' Presentation to Copolco Workshop Prague, Czech Republic at 3 (2004) available at www.iso.org . [Accessed 7 December 2008].

²⁶ Ibid at 3.

²⁷ Ibid.

²⁸ *King Report on corporate governance for South Africa* (2002) .

²⁹ *The Combined Code on Corporate Governance* (2006).

judgment rule'³⁰, 'the subjective test'³¹ and the 'the objective test'³² usually align the interest of the shareholders with that of management whilst giving the directors the opportunity to manage the company and exercise their discretion in doing so without much interference from the courts. The effectiveness of corporate governance legislation and regulation depends of course on their competence, integrity, forcefulness and the regulatory agencies in the countries concerned.³³

The Stock Exchange has been another major regulatory body in the field of corporate governance. Examples include the JSE Limited (JSE), the London Stock Exchange (LSE), the Zimbabwe Stock Exchange (ZSE) and the New York Stock Exchange (NYSE). These bodies provide listing requirements of companies, which include more specifically disclosure mechanisms and provisions as to the compositions of boards of directors and audit committees. A strong disclosure mechanism is essential for the exercise of shareholder rights and for monitoring corporate and for imposing discipline on management.³⁴

³⁰ It was early recognised that where directors or trustees acting within their powers, exercise a discretion vested in them, '[t]he duty of supervision on the part of [the] Court will be confined to the honesty, integrity and fairness with which the deliberation has been conducted, and will not be extended to the accuracy of the conclusion arrived at'. This was stated in Truro LC in *In Re Beloved Wilkes's Charity* (1851) 3 Mac & G 440 448; 42 ER 330-333.

³¹ Directors must act, if they act at all, 'bona fide in what they consider---not what the courts consider---to be in the interests of the company'.³¹ This means that the directors must 'proceed upon what, in their honest opinion, is for the benefit of the company as a whole'.³¹

This was said by Lord Evershed MR in *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286; [1950] 2 All ER 1120 (CA).

³² The rule that the directors must act *bona fide* in what they consider and not what the courts consider, is in the interests of the company, must be qualified. It applies only so long as the directors have correctly identified the company's interests as they are defined in law. *per* Robert Walker LJ in *Kaytech International plc, Secretary of State for Trade and Industry v Kaczer* [1999] 2 BCLC 351 424 (ChD and CA). In *Secretary of State for Trade and Industry v Tjolle* [1998] 1 BCLC 333 343-344 Jacobs J said: '[I]t may be difficult to postulate any one decisive test. I think what is involved is very much a question of degree. The court takes into account all the relevant factors. Those factors include at least whether or not there was a holding out by the company of the individual as a director, whether the individual used the title, whether the individual had proper information (e.g. management accounts) on which to base decisions, and whether the individual had to make major decisions and so on. Taking all these factors into account, one asks was this individual part of the corporate structure.'

³³ J W Salacuse 'Corporate governance in the new century'(2004) 25 Issue No 3 *The company lawyer* at 71.

³⁴ *Ibid* at 71.

In recent corporate governance the Stock Exchange listing rules also enforce self-regulatory Codes that operate using the 'comply or explain' philosophy. In the UK the Combined Code is attached to the listing rules. Listed companies are not required to comply with the guidelines in the Combined Code but they are compelled to 'describe how they have integrated the Code into their systems of corporate governance and to explain any deviations from the Code in their annual report.'³⁵ In South Africa the Listing requirements³⁶ of the JSE Limited states that

8.4. The directors should report on the following matters in their annual report:

8.4.7. That the Code of Corporate Practices and Conduct has been adhered to, if not, where there has not been compliance to give reasons.

The above disclosure requirements enforce the 'comply or explain' philosophy, which is the backbone of the self-regulatory Codes.

Corporate governance regulatory frameworks have however not been static and are evolving throughout the years through the realization of the inadequacy of the systems. The collapses of companies reflect that formal systems of corporate governance though effective have not succeeded in completely curbing the 'agency problem.' Mongalo T, states that 'two approaches could be seen as the modern view of corporate governance, coined with ushering in of corporate governance reforms throughout the world.'³⁷ He distinguishes between traditional or conventional

³⁵ Burke K S, 'Regulating Corporate Governance Through the Market. Comparing the Approaches of the United States ,Canada ,and the United Kingdom' (2001-2002) *Hein online*---27 *J. Corporate Law* 341 at 346.

³⁶ *Listing Requirements of The JSE Securities Exchange South Africa.*

³⁷ Mongalo T, 'Self Regulation versus Statutory codification: Should the new regime of corporate governance be accorded statutory backing?'(2004) 67 *THHR* at 266.

corporate governance and the new regime of corporate governance as embodied in Codes of good practice.

1.2.3. Traditional /conventional corporate governance regulation

Corporate governance as provided for in terms of common law and companies legislation, as earlier on discussed, is termed traditional or conventional corporate governance. The regime covers corporate governance such as fiduciary duties of directors, requirements of special resolution, the role of shareholders and company meetings.³⁸ Principles of corporate governance under this regime are legally enforced and shareholders are entitled to sue directors for breach of their fiduciary duties under the derivative action.³⁹ The traditional regime of corporate governance is still important in modern day corporate governance however many companies have collapsed regardless of its regulation. This has led to the introduction of corporate Codes of conducts as a self-regulatory and flexible way of regulating companies.

The major advantage of traditional corporate governance is that it provides for sanctions on failure to comply with legal rules hence guaranteeing compliance with legal rules. Further legal rules are umbrella provisions that govern all companies and regulates of both, private and public companies. However, in spite of the above advantages, the traditional corporate governance regime witnessed many financial scandals notably the fall of World com and Enron in the USA. This heightened the need for corporate governance reform. In corporate governance, the legal regulatory regime still shows signs of failure. The failure, mainly attributed to many reasons, including the shortcomings with the enforcement of corporate governance rules.

³⁸ Ibid at 267.

³⁹ Ibid.

1.2.4. Identified weaknesses of Traditional Corporate Governance regulation: How to strengthen existing legal remedies

Common law and legislation provides for traditional corporate governance principles. Failure to comply with traditional corporate governance principles leads to civil and criminal sanctions. Police investigate criminal cases, the courts prosecute. The police, prosecutors and the court should be effective functionaries for the success of traditional corporate governance regulation. Regarding civil remedies, they ought to be easily enforceable and cheaper for individuals to enforce their rights. The weaknesses in the enforcement of traditional corporate governance principles have mainly contributed to the collapse of companies under the traditional corporate governance regime.

Of particular note is that in traditional corporate governance the force behind compliance is usually the fear of sanction and not the will to comply. The problem comes when the enforcers of the legal rules show signs that they are incapable or incapacitated to do so. The above scenario results in zero or partial compliance by those regulated. 'There is an apparent lack of enforcement of existing remedies for breaches of statutory and common law principles by delinquent directors and officers. The question is why in this regard, the role of the state must be emphasized.'⁴⁰

King II⁴¹, identified problems with the regulator in traditional corporate governance mainly associated with the enforcement mechanism. These include problems with, 'resources and the criminal justice system.'⁴² In substantiating the above points, the King II⁴³ stated that, the criminal justice system is presently under

⁴⁰ *King report on corporate governance for South Africa (2002)*, at 156.

⁴¹ *Ibid.*

⁴² *Ibid* at 156 .

⁴³ *Ibid* at 156

resourced and there is an improper allocation of available resources. Furthermore, the King II maintains that in order to improve the enforceability of the conventional governance principles, the office of the registrar of companies needs adequate resources to regulate compliance with the Companies Act.⁴⁴

The criminal justice system, mainly in third world countries thus lacks adequate resources due to the non-availability of resources or their inappropriate allocation. These resources include, lack of adequate funds to initiate and further investigations, lack of vehicles and skilled personals to undertake investigations. The lack of resources is thus a major challenge as it leads to inadequate or no monitoring of companies. Further proper investigations might prove difficult to undertake due to the costs involved. The availability of rules and sanctions becomes futile in the legal regulatory regime if sanctions lack implementation in the event that rules are not adhered to. In the end people targeted by the rules, lack the motivation to comply and have no fear of sanction for failure to do so.

Another area of concern regarding enforceability as identified by King II is the Police Service. The King II states that '[t]he South African Police Service does not always have enough expertise to investigate commercial cases and that prosecutors are not well trained in the prosecution of commercial cases.'⁴⁵ The lack of commercial investigating skills by the police is not unique to South Africa. It is a prevalent weakness worldwide in the enforcement mechanisms of corporate governance principles. Of particular mention is that in Zimbabwe the police service trains over very short periods often inadequate to make anyone an expert in any field. Further, the police service does not have adequate police personnel trained in the commercial field.

⁴⁴ Ibid at 156.

⁴⁵ Ibid at 156.

The lack of prosecutors trained in the commercial field has been another setback in prosecuting commercial cases. King II, states that the lack of trained personnel in commercial cases has led to a low levels of conviction.⁴⁶ Zimbabwe suffers from the above-mentioned problem. Further, even with trained personals, knowledge alone is not enough if not backed by other resources⁴⁷ that promote its utilization. King II thus states that 'measures to be considered which would help in enhancing the traditional conventional regime include, involving organizations such as Business Against Crime , which undertake programmes aimed at improving the investigation, prosecution and adjudication of commercial crime.'⁴⁸ The above recommendations are not only useful in South Africa but in Zimbabwe as a collapsing economy.

Corruption is another addition to the problems already mentioned the Zimbabwean Police service and the Ministry of Justice. Corruption being a major drawback to any economy leaves cases unnoticed and uninvestigated. It is noted that Zimbabwe does not have organizations like the Business Against Crime. A suggestion of the introduction of such organizations that assist in the investigation and prosecution of commercial cases will help investigate commercial crimes and bring new focus in the police services and the prosecution departments.

The King II also 'recommends enforcing and improving civil remedies by the introduction of class action, contingency fees and the register of delinquent directors.'⁴⁹ The suggested idea is after the realization that 'civil remedies are available to shareholders in that contraventions of the provisions often give rise to a delictual action and even personal liability. The exposure of directors and managers to such civil liabilities is an important regulatory and enforcement tool. Unfortunately, these liabilities rarely get imposed. The main reason appears to be a

⁴⁶ Ibid at 156.

⁴⁷ Resources like funds to initiate and further investigations.

⁴⁸ Ibid at 156.

⁴⁹ Ibid at 156.

lack of access to the law on the part of the victims who are often holders of very small parcels of shares in the relevant company. There is no incentive for these small shareholders to resort to expensive litigation.⁵⁰ There is therefore a need to introduce less expensive ways for minority shareholders to enforce their remedies.

Enforcement problems that characterized traditional corporate governance also led to the introduction of self-regulatory Codes that use the 'comply or explain' philosophy as means of regulating companies.

1.2.5. Self regulation: A new era in corporate governance regulation

Self-regulation for the purposes of this dissertation can be described as 'the system by which an organization or institution deals with its own disciplinary and legal problems often in private rather than being publicly regulated by somebody else'⁵¹. In corporate governance, self-regulation advocates the use of voluntary Codes on corporate governance, which provide regulatory provisions without legal enforcement mechanisms. The Codes operate on the 'comply or explain' philosophy where there are no sanctions provided for non-compliance with the Code when the company discloses the reasons for failure to comply.

The new regime of corporate governance embodied in Codes of good practice is concerned with the enhancement or fortification of rules and principles of company laws found in common law and company legislation for the purpose of accommodating the modern environment within which companies operate.⁵²

⁵⁰ Ibid 156-157.

⁵¹ Dictionary available at www.encyarta.msn.com/dictionary [Accessed 15 February 2009].

⁵² Mongalo T, 'Self Regulation versus Statutory codification: Should the new regime of corporate governance be accorded statutory backing?' (2004) 67 *THHR* at 266.

Self-regulatory Codes also impose stricter checks and balances meant to prevent malpractices involved in corporate decision-making.⁵³

In South Africa, the King Committee on corporate governance in South Africa undertook this regime and it published its recommendations in the *Code of Corporate practices and Conduct*.⁵⁴ In the UK incorporated companies listed on the LSE are subject to the *Combined Code on Corporate Governance*.⁵⁵ The self-regulatory approach taken by the Codes of conduct has proved to be a major development in the field of corporate governance. It is a flexible regime that tries to prevent the rigid approach to corporate governance taken by the traditional method of corporate governance, which had resulted in a 'box-ticking' approach to corporate governance.

Corporate Codes supply standard contract terms for corporate governance. Companies to suit their needs can modify the standard terms. Provisions in corporate Codes run gamut from trivial housekeeping to fundamental fashioning of shareholder manager relations,⁵⁶ unlike statute the provisions of the Codes are almost all embracing to cover even the minute aspects of corporate governance which when left unregulated will result into a big corporate problems.

Corporate Codes operate on a 'comply or explain' philosophy where companies are supposed to comply by their provisions, failure of the companies to comply should be followed by the reasons leading to the non-compliance. The variety in the corporation Codes and in their enabling approach readily

⁵³ Ibid.

⁵⁴ Ibid.

⁵⁵ 'Corporate Governance in the UK' Available at www.itgovernance.co.uk .[Accessed 16 February 2009].

⁵⁶ Roberta R ,*The Genius of American Corporate Law* (2003) at 1.

accommodates the diversity in the organizations capital structure and lines of business among business firms.⁵⁷

Corporate governance Codes are not immune to the 'agency problem'⁵⁸. However, a primary function of the corporate Codes in this regard is to establish corporate governance devices that can mitigate the agency problem by better aligning manager incentives with shareholder interest. The more prominent of such devices are⁵⁹

1. Shareholder elected boards of directors who monitor managers
2. Shareholder voting rights for fundamental corporate changes
3. Fiduciary duties that impose liability on managers and directors who act negligently or with divided loyalty (favoring their own financial interest over that of shareholders).

1.3. The 'comply or explain' philosophy: The foundation of corporate governance regulation through corporate governance self-regulatory Codes

The 'comply or explain' principle states that companies are required to comply with the principle of self-regulatory Codes and in the event that they fail to comply, they must disclose the reasons for non-compliance. 'The essence of the principle is that, compliance with the Code is not mandatory but disclosure relating

⁵⁷ Ibid.

⁵⁸ See footnote 118.

⁵⁹ Roberta R, *The Genius of American Corporate Law* (2003) at 1.

to compliance is.⁶⁰ The argument centers on the fact that companies are different and one set of regulations will not fit all companies.

The 'comply or explain' principle is premised on two considerations firstly, the need for flexibility in the regulation of companies. The argument for the adoption of flexibility in regulating companies is based on the judgment that it is not possible to adopt a "one size fits all approach" in the application of corporate governance Codes.⁶¹ Companies differ in size, structure and organization hence the need for flexibility.⁶²

The second consideration is that market forces have the capability of regulating corporate governance.⁶³ 'The 'comply or explain' principle is based on the assumption that the market will monitor compliance with the Code and will⁶⁴

- (a) Penalize non compliance through lowering share prices, or
- (b) Accept for whatever reason that non compliance is justified in the circumstances [of that particular company].⁶⁵

This view states that since corporate Codes are the views of investors, compliance with them can offer investment opportunities to a company hence the need for reasonable explanations for non-compliance. A note in the financial statement should explain the non-compliance.⁶⁶

⁶⁰ MacNeil I and Li Xiao, ' 'comply or explain' :Market discipline and non compliance with the Combined Code September (2006) 14 *Corporate Governance at 486.*

⁶¹ Ibid at 486.

⁶² Ibid at 486.

⁶³ Ibid at 487.

⁶⁴ Ibid 487.

⁶⁵ Ibid 487.

⁶⁶ See *Listing Requirements Of The JSE Securities Exchange South Africa 8.4.7.*

The 'comply or explain' principle is closely monitored by disclosure obligations as found mainly in the listing rules like the JSE listing rules and the LSE listing rules. The Combined Code in the UK states that '...the Company has either to conform that it complies with the Code's provisions or where it does not to provide an explanation.'⁶⁷ (Footnotes omitted)

In South Africa, the listing rules of the JSE require companies to comply with the requirement of King II and to disclose the extent of their non-compliance.⁶⁸

The 'comply or explain' principle allows directors to view the individual circumstances of their companies before implementing the provisions of corporate governance Codes. Investors are given the opportunity to make informed evaluations of the operation of the company after viewing the extent of compliance and non-compliance with the corporate governance Codes.

The 'comply or explain' principle seems to have worked well in allowing flexibility in the regulation of companies. 'A survey data drawn from the PIRC's Corporate Governance Annual Review in 2004 for FTSE all share companies excluding investment trusts with financial years between 1 July 2003 and 30 June 2004'⁶⁹ shows that no company had a 100% compliance with the Code and at the same time all companies had more than 50% compliance with the Code. The results show that companies do comply with corporate governance Codes but there is still a percentage of non compliance which might as well be an attribute to the flexibility offered by the corporate governance Codes.

⁶⁷ *The Combined Code on Corporate governance* (2006) at 1.

⁶⁸ *Listing Requirements Of The JSE Securities Exchange South Africa* 8.4.7.

⁶⁹ MacNeil I and Li Xiao, ' 'comply or explain' :Market discipline and non compliance with the Combined Code' , *September* (2006) 14 *Corporate Governance*) at 489.

1.4. Corporate governance defined

The term corporate governance has no universal definition. King 11⁷⁰ describes corporate governance as simply the system by which companies are 'directed and controlled'.⁷¹ More specifically, it is concerned with the structures and the processes associated with management, decision making and control in organizations.⁷² Corporate governance places its emphasis on the organs that play a vital role in the decision making of a company and affects all companies whether listed or not. Issues in corporate governance include shareholder rights, transparency and disclosure, responsibilities of the board and equitable treatment.⁷³ Other topical concerns in recent corporate governance include financial and non-financial reporting, the controversy surrounding executive pay the role of remuneration, nomination committees and the significance of self-regulatory nature of corporate governance.⁷⁴

Salacuse J W notes that the above reference to corporate governance though widely accepted is a narrow definition of corporate governance employed by managers, investors, policy makers and lawyers.⁷⁵ 'As applied in practice this narrower definition focuses almost exclusively on internal structure and operation of corporation's decision making process.'⁷⁶ To him, 'economists and social scientists tend to define corporate governance broadly as "the institutions that influence how

⁷⁰ King Report on corporate governance for South Africa (2002) .

⁷¹ Wixley T and Evringham G, *Corporate Governance* (2005) at 1.

⁷² Ibid.

⁷³ Mesnad M ,'Ownership Structures and Corporate Governance Framework in South East Europe', Bucharest, 20-21 September 2001 Session 2.

⁷⁴ Mongalo T, 'The emergence of corporate governance as a fundamental research Topic in South Africa' (2003) 120 Issue 1 *South African Law Journal* at 174.

⁷⁵ Salacuse J W, 'Corporate governance in the new century'(2004) 25 *Company lawyer* at 70.

⁷⁶ Ibid.

business corporations allocate resources and returns” and “the organizations and rules that affect expectations about the exercise of control in the firm”.⁷⁷

As noted the definitions by economists and social scientists ‘focus not only on the formal rules and institutions of corporate governance but also on the informal rules that evolve in the absence of formal rules.’⁷⁸ Moreover Salacuse J W adds that ‘they encompass not only the internal structure of the corporation but also its external environment including capital and labour markets, bankruptcy systems and governmental competition policies.’⁷⁹ The definition of corporate governance is indeed evolving even among the lawyers, managers and investors who Salacuse J W deemed to employ a narrow definition to corporate governance. The focus of corporate governance is moving from solely focusing on the interest of shareholders to the consideration of other stakeholders.

At this point, it is important to justify why this dissertation is discussing the controversy surrounding the corporate governance definition when its main topic is on self-regulation using self-regulatory Codes that operate under the ‘comply or explain’ philosophy. From the beginning even, King II addresses the question of whether corporate governance is inclusive⁸⁰ or exclusive⁸¹. ‘This is a crucial question for, in terms of this study, the issue is whose trust should corporate governance reforms attempt to restore - the shareholders alone or the stakeholders.’⁸² It is understandable that good corporate governance will be measured in the eyes of those who should benefit from the regulation and those who are entitle to demand compliance with corporate governance rules and Codes on the part of directors. This dissertation identifies these individuals as stakeholders and shareholders. It proposes

⁷⁷ Ibid.

⁷⁸ Ibid.

⁷⁹ Ibid.

⁸⁰ A corporate governance structure that considers the interest of shareholders and stakeholders.

⁸¹ corporate governance structure that is solely centered on the advancement of shareholder interest.

⁸² Williams O , ‘Restoring Public Trust In Bussiness.The Crucial Role of Good Corporate Governance’ Corporate Governance Conference 11-12 August 2005 at 5.

corporate governance reform in the context of its definition from an inclusive approach. King II argues that the inclusive approach '...recognizes that stakeholders such as the community in which the company operates, its customers, its employees and its suppliers among others need to be considered when developing the strategy of a company.'⁸³

Realisations are that companies do not exist in a vacuum and they are not self-sufficient. Companies benefit from the society by its provision of labour, moral and family support and they extract raw materials and resources from the environment, which it does not own. Sir Adrian Cadbury , a well rated corporate governance author supports the view by stating that 'Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals...the aim is to align as nearly as possible the interest of individuals, corporations' and society.'⁸⁴

Tricker R I (author of *Corporate governance* Gower 1984) ⁸⁵states that the two elements of corporate governance concern supervising or monitoring management conformance and ensuring accountability of management to shareholders and other stakeholders. The reference to stakeholders is important as it shows the harmony among authors in realizing the evolvement of corporate governance form a shareholder centered approach to the inclusion of stakeholders like employees and suppliers. ⁸⁶

⁸³ King Report on corporate governance for South Africa (2002) page 103.

⁸⁴ Ibid at 5.

⁸⁵ T Wixley and G Everingham ,*Corporate Governance* (2005) at 2.

⁸⁶ Ibid.

1.5. Reasons behind emphasizing good corporate governance

Corporate governance became important after of a series of corporate meltdowns, frauds and other catastrophes that led to the destruction of millions of dollars of shareholder wealth, the loss of thousands of jobs criminal investigations of decisions of executives and record-breaking bankrupt filings.⁸⁷ Indeed the collapse of companies did no only prompt the need for effective corporate governance but was also an effect of poor corporate governance in companies. Good corporate governance has many advantages:

‘The ability of countries to attract foreign capital is affected by their system of corporate governance and the degree to which corporate management is compelled to respect the legal rights of lenders, bond holders and non-controlling shareholders.’⁸⁸ An attractive corporate governance regime will definitely attract foreign investors and lenders. A weak unsupervised and unrevised corporate governance system will eventually result in corporate frauds by management and controlling shareholders and investors will not find it attractive to invest in such countries.

In substantiating the above point ‘Arthur Levitt, the former Chairperson of the US Securities and Exchange commission, said in a speech at Manhattan Conference sponsored by the Federal Reserve:

If a country does not have a reputation for strong corporate governance practices capital will flow elsewhere. If investors are not confident with the level of disclosure, capital will flow elsewhere. If a country opts for lax accounting and reporting standards, capital will flow elsewhere. All enterprises in that country-regardless of how steadfast a particular company’s

⁸⁷ A G Monks and N Minnow , *Corporate governance* (2004) page 1

⁸⁸ Salacuse J W, ‘Corporate governance in the new century’ *The Company Lawyer* (2004) Volume 25 No. 3 at 69

practices maybe-suffer the consequences. Markets must now honour what they perhaps, too often, have failed to recognize. Markets exist by the grace of investors. And it is today's more empowered investors who will determine which companies will stand the test of time and endure the weight of greater competition. It serves us well to remember that no market has a divine right to investors' capital.⁸⁹

Investors are not willing to risk their investments in poorly governed companies as their ultimate goal is not just investment but profit maximization of investments and continuous existence in the market.

If a country does not upgrade its corporate governance regime individual and institutional investors, will refrain from providing capital or will demand a higher risk premium for their capital from enterprises in countries without effective systems of corporate governance than from similar enterprises in countries having strong corporate governance standards.⁹⁰

'A survey by McKinsey and Co., working with Institutional Investors Inc., called Investor Opinion Survey published in June 2000 confirmed that investors are willing to invest more in well governed companies. The survey had the found that,⁹¹

- More than 84% of the more than 200 global institutional investors, together representing more than US\$ 3 trillion in assets, indicated a willingness to pay a premium for the shares of a well-governed company over one considered poorly governed but with a comparable financial record.⁹²

⁸⁹ *King report on corporate governance for South Africa* (2002), at 9

⁹⁰ Salacuse J W, 'Corporate governance in the new century' (2004) 25 *Issue No 3 The Company Lawyer* at 69.

⁹¹ *King report on corporate governance for South Africa* (2002), at 12.

⁹² *Ibid.*

- Three-quarters of these investors indicated that board practices were at least as important as financial performance, when evaluating companies for potential investment.⁹³
- The actual premium these investors would be willing to pay varied from country to country. In the United Kingdom, they would pay 18% more for the shares of a well-governed company than for the shares of a company with similar financial performance but poorer governance practices. In emerging markets or markets perceived to have poor governance practices, this premium escalated to 22% for a well-governed Italian company and to as much as 27% for one in Venezuela or Indonesia.⁹⁴

Firms begin small and to grow they must attract customers and investors by promising and delivering what those people value.⁹⁵

The results of this survey should also be apparent to policy makers and regulators in recognizing that the creation of a good governance climate can make countries, especially in the emerging markets, a magnet for global capital. What was emphasized in this survey is that companies not only need to be well governed but need to be perceived as being well governed in the market.⁹⁶

The most important goal of a firm is the maximization of profits both for the benefit of shareholders and for its existence as a going concern. Effective corporate governance imposes a discipline on the firm managers to maximize returns for the firm. This is important not only for the company but for the economy as it encourages economic growth and hence society indirectly benefits from the existence of a firm. 'With the movement throughout the world towards the expansion of private sectors and the creation of more competitive market economies, effective

⁹³ Ibid.

⁹⁴ Ibid.

⁹⁵ Easterbrook F H and Fishel D R, *The Economic structure of Corporate Law* (1996) at 4.

⁹⁶ *King report on corporate governance for South Africa* (2002) ,at 12.

systems of corporate governance are seen as key variables enabling countries to derive real economic benefits from the fundamental economic changes.⁹⁷

Companies are the providers and producers of goods, which enhance the social well being and economic growth for the benefit of the society. 'According to Worthington the reason why directors are subjected to increasingly vigorous scrutiny is that companies contribute enormously to the economic social well being of our society while their pervasiveness is such that few individuals are left untouched by their activities.'⁹⁸ Well-managed companies yield benefits for all hence the need to focus on the role of directors in managing companies.

The company has evolved tremendously from a small entity owned and managed by a family to a large enterprise with various shareholders located all over the world who are mostly large enterprises and individual minority shareholders who neither have time or interest in the management of the company. The modern day shareholder will merely exit the company and seek for other investment grounds in the event that the company is not yielding returns on investments. Corporate governance simplifies the drafting of contracts between the company and its shareholders.

Without corporate Codes, common law and statutory laws that regulate corporate contracts it was going to be complex for every shareholder and investor to draft individual contractual terms with the company. It was going to be difficult to foresee all the problems that would arise in dealing with the company. The existence of corporate law simplifies this position. Corporate law is a set of terms available off- the- rack so that participants in the corporate venture can save the cost of contracting.⁹⁹

⁹⁷ Salacuse J W, 'Corporate governance in the new century' (2004) 25 Issue No 3 *The Company Lawyer* at 69.

⁹⁸ Mongalo T, 'The emergence of corporate governance as a fundamental research Topic in South Africa' (2003) *South African Law Journal* at 176.

⁹⁹ Easterbrook F H and Fishel D R ,*The Economic structure of Corporate Law* (1996) at 34.

'On this view corporate law supplements but never displaces actual bargains, save in situations of third-party effects or latecomer terms.'¹⁰⁰

The benefits of corporate governance are not only theoretical but have been practically experienced. Ernest and Young listed some of the benefits of good corporate governance as testified by their clients. These include its role to;¹⁰¹

- Improve the communication within the organization.
- Minimize conflict.
- Focus on the main strategy.
- Increase productivity and efficiency.
- Create the sustainability of the benefits.
- Promoting the image.
- Increase Customer Satisfaction.
- Gain the trust from the investor.

1.6. Conclusion

Good corporate governance has profound implication on companies and the economy¹⁰² as seen from the discussions in this chapter. King II¹⁰³ states that 'Simply by developing good governance practices, managers can potentially add

¹⁰⁰ Ibid.

¹⁰¹ 'Building Good Corporate Governance Practices', available at www.ey.com. [Accessed 20 February 2009].

¹⁰² *King Report on corporate governance for South Africa* (2002) at 12

¹⁰³ *King Report on corporate governance for South Africa* (2002)

significant shareholder value.¹⁰⁴ Discussions in the chapter make good corporate governance standards essential in Zimbabwean companies. It is therefore important to have a broader picture of how companies in Zimbabwe have adhered to corporate governance standards in order to justify why this dissertation suggest their enhancement. The next chapter therefore gives an insight into the corporate governance scandals in Zimbabwe in order to substantiate the suggestion that there is a need for corporate governance reform in the form of a self-regulatory Code.

¹⁰⁴ Ibid at 12

CHAPTER 2

CORPORATE GOVERNANCE CHALLENGES IN ZIMBABWE

2.1 Background

Corporate governance is an issue that warrants serious attention in any economy due to its intense benefits as discussed in the last chapter. However, in Zimbabwe it is an issue suffers from lack of adequate literature and development. It has not enjoyed much attention due to the immense focus on political and social issues in the country. What is worth mentioning is that, corporate governance has developed dramatically in the last two decades in the world at large.¹⁰⁵ There has been an introduction of corporate governance Codes first nationally then internationally.¹⁰⁶

The development of self- regulatory Codes has tended to be a response to the lack of specific governmental regulation in particular areas of corporate governance and in some cases a justification for the absence of such regulation.¹⁰⁷ More so, self-regulatory Codes have emerged as a supplement to direct regulation by the government. They have been preferred for the flexibility they offer via regulation by norms rather than mandatory legal rules.¹⁰⁸ Further, observations state that inadequate

¹⁰⁵ Clarke T, *Theories of Corporate Governance: The philosophical foundations of corporate governance* (2004) at ix. Available at www.books.co.za [Accessed 7 February 2008]

¹⁰⁶ Ibid.

¹⁰⁷ Hill J H 'Evolving 'Rules of the game' in Corporate Governance Reform' (2007) 1 Issue No 1 *International Journal Corporate Governance* at 33

¹⁰⁸ Ibid at 33.

enforcement of good governance practices could result in the imposition of onerous government regulation.¹⁰⁹

In response to the corporate governance scandals, common law jurisdictions such as, United Kingdom (UK) , Australia, Canada and South Africa introduced national corporate governance self regulatory Codes¹¹⁰ that operate using the 'comply or explain' philosophy. Examples of such Codes include the *Combined Code on Corporate Governance (2006)* (Combined Code)¹¹¹ in the UK and the *Code of Corporate Practices and Conduct (King II)*¹¹² in South Africa. Zimbabwe does not have a national self-regulatory Code regulating companies but it has also introduced a corporate governance manual named '*Principles for Corporate Governance in Zimbabwe: Manual of Best Practice*'. This study suggests corporate governance reform in Zimbabwe through the adoption of a national self-regulatory Code that operates under the 'comply or explain' philosophy. The suggestion came after the realization that Zimbabwe is not spared from corporate governance scandals and hence the need for corporate governance reform.

Corporate governance regulation in Zimbabwe has been mainly through the provision of rules by the legislature and common law. Compliance with legislative rules is compulsory and there are stipulated penalties for failure to comply. Directors have no opportunity to adopt any other procedure despite the fact that it might be in the best interest of the company.¹¹³ This dissertation therefore suggests the adoption of a more flexible corporate governance regime using self-regulatory Codes operating under the 'comply or explain' philosophy. The philosophy allows directors

¹⁰⁹ Ibid at 33.

¹¹⁰ Examples of such Codes are the Combined Code on Corporate Governance in the United Kingdom and the Code of Corporate Practices and Conduct in South Africa which is mainly known as the King Code and King II in this dissertation.

¹¹¹ *The Combined Code on Corporate Governance*, (2006).

¹¹² *King Report on corporate governance for South Africa* (2002) .

¹¹³ Mervyn K, *The Corporate Citizen : Governance for all entities*(2006) at 13.

to deviate from provisions in self-regulatory Codes as long as they can justify that such deviations are in the best interest of their company.¹¹⁴

This dissertation does not suggest we do away with rule-based regulation but suggest a more flexible approach to corporate governance. '[It is illustrious that] codified governance –based legislation, stock exchange rules and other guidelines – is here to stay. But though compliance is necessary, it is certainly not sufficient .On its own, it is at best meaningless and at worst destructive of value.'¹¹⁵ Mervyn K states that using the legislation based corporate governance regime directors have fallen into the trap of a 'box ticking approach' to corporate governance.¹¹⁶ The lack of capability to exercise independent judgment in the governance of companies on the part of directors is notably another cause for the collapse of companies. Even if the legislature provides the best and updated rules which are complimented by a well structured board it is notably bad corporate governance for a board to comply with those rules 'without...applying its minds as to how the company should be governed.'¹¹⁷

Good corporate governance generally has untold benefits to any economy. Salacuse J W states that the foundations of foreign investor confidence are on the systems of corporate governance in an economy.¹¹⁸ Investors are particular as to the degree 'to which management is obliged to respect the rights of lenders, non -controlling shareholders and bondholders.'¹¹⁹ However, regardless of the value added

¹¹⁴ Ibid at 13.

¹¹⁵ Ibid, as cited by William D, Financial Mail, 'Nice Guy No More' Chairmanship, 14 July 2006 at 21.

¹¹⁶ Ibid.

¹¹⁷ Mervyn K, *The Corporate Citizen: Governance for all entities*(2006) at 12.

¹¹⁸ Salacuse J W , ' Corporate Governance in the New Century' (2004) 25 *The Company Lawyer* at 69.

¹¹⁹ Ibid at 69.

to a company by good corporate governance, corporate collapses have been the major cause behind interest in corporate governance.¹²⁰

2.2. Introduction

Zimbabwe is not an exception to the corporate scandals that affected companies worldwide and led to the quick development of corporate governance in various jurisdictions. Whilst the political situation and the micro and macro economic instability in Zimbabwe has led to the collapse of companies in Zimbabwe, corporate governance issues have contributed immensely to such collapses. In the 21st century, mainly in 2004, Zimbabwe witnessed a massive fall of banks and financial institutions.

In these banks, a lack of sound corporate governance systems contributed to their insolvency. It was argued that, 'corporate scandals and failures witnessed in the banking and financial industry in 2004, revealed serious flaws and lapses in the corporate governance standards for banks and similar financial institutions.'¹²¹ These scandals and failures also revealed that a lack of effective regulation on banks and financial institutions makes them prone to bouts of instability, which ultimately affect the entire financial system.¹²²

A brief history of the corporate governance scandals in Zimbabwe becomes important in understanding the need for corporate governance reform in the form of a

¹²⁰ *King Report on corporate governance for South Africa (2002)*, at 11-12. 'In East Asia in 1997 and 1998, it was demonstrated that macro-economic difficulties could be worsened by systemic failure of corporate governance stemming from ,weak legal and regulatory systems, poor banking regulation and practices, Inconsistent accounting and auditing standards, improperly regulated capital markets; and, ineffective oversight by corporate boards and scant recognition of the rights of minority shareholders.'

¹²¹ Maguranyanga J 'Corporate Governance: Reserve bank of Zimbabwe annual report, (2004) at 3 available at <http://www.rbz.co.zw/annual/2005/pdf/annual4.pdf>. [Accessed on 13 January 2009].

¹²² *Ibid.*

national corporate governance Code. The use of the banking sector is to highlight the need for effective corporate governance in companies since the most glaring examples of corporate governance failures occurred in the sector. In addition, developed literature, though inadequate, documents such failures.

The use of the banking sector does not confine the proposal to the banking sector but stems from the fact that the field has reasonable literature enough to provide a momentary look on the operation of companies in Zimbabwe. Further, the focus of the thesis is on public and listed companies. Most banks are public and listed companies in Zimbabwe. Private companies are however encouraged to use self-regulation through the 'comply or explain' philosophy due to its advantages as will be discussed in the dissertation.

2.3. Corporate Scandals

Many corporate scandals characterised the Zimbabwean economy, leading to a massive economic meltdown. Even to date there are frequent reports of cases of fraud, bribery, corruption and conflict of interest by directors and executives. 'Business ethics remain a challenge in Zimbabwe. [There] is need to promote a culture of professionalism, transparency and accountability.'¹²³

This part of the dissertation will outline cases of financial institutions that have experienced financial distress mainly discovered since year 2003. All the institutions financial institutions locally owned in Zimbabwe.¹²⁴ The dissertation will illustrate that indeed Zimbabwean corporate governance is in dire need for reform. It will also help bring to light the disastrous consequences of poor corporate

¹²³ Choruma A, 'Zimbabwe: Corporate Governance in 2007-Challenges' *Financial Gazette*(Harare) 11 January 2007 available at www.allAfrica.com .[Accessed 17 February 2009].

¹²⁴ Muranda Z, 'Financial distress and corporate governance in Zimbabwean banks', (2006) *6 Issue No. 5 Corporate governance* at 647.

governance in an economy, the advantages of good corporate governance to the economy and the benefits of self-regulation as a method of corporate governance.

2.3.1. Trust Banking Corporation limited (TBC)

TBC began operating as a bank in Zimbabwe in 1996 and started having liquidity problems in 2003.¹²⁵ The founder who assumed the position of the Chief Executive Officer (CEO) and worked together with co-founders headed it. The CEO was domineering and owned 47% shareholding in the holding company. He also acquired 4.64% individual shareholding in the subsidiary company.

Ultimately owning 47% in the holding company gave him a controlling stake in that company and a profound influence on the subsidiary of which he was a shareholder. There was no separation of ownership and control. By assuming the position of CEO it meant that the founder was also a fiduciary to the company as stated in corporate governance law¹²⁶, which position he failed to realize. In conducting the affairs of the company, he had to choose the interest of the company over his own.

Good 'corporate governance dictates that, 'directors may not derive any personal gain or advantage in the course or execution of their office as directors,

¹²⁵ Ibid at 647

¹²⁶ In *Hospital Products Limited v United States Surgical Corporation* (1984) 156 CLR 41 (HC of A). Mason J said: 'The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.'

except such gains as they are lawfully entitled for example, agreed remuneration for their services.¹²⁷ In the case of *Robinson v Randfontein*¹²⁸ the court held that

Where a man stands to another in a position of confidence involving a duty to protect the interest of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his interest conflict with his duty. The principle underlies an extensive field of legal relationship. A guardian to his ward, a solicitor to his client, an agent too his principle affords examples of persons occupying such a position.¹²⁹

Investigations however showed that the directors in the company failed in their fiduciary duty to act in the best interest of the company. Various amounts of monies failed were unaccountable according to information gathered by the Forensic investigation report by BCA Consulting (Pvt) Ltd investigators.¹³⁰ The fact that the directors used the funds of the company is evident on realisation that Gedion Gono¹³¹ stated that, 'as we speak, the same TBC's former owner managers have set up a new financial [institution] in South Africa from where they are carrying on business unhindered.'¹³² Further investigations stated that the directors also transferred company funds to themselves as the TBC's First Rand account statements showed that unexplained funds transferred to Mr. Nyemba and to Mr. Goromonzi.¹³³

The Forensic investigation report by BCA Consulting (Pvt) Ltd further confirmed the bank ended up under curatorship because the directors were not

¹²⁷ Mongalo T, *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 179.

¹²⁸ *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 178.

¹²⁹ *Ibid.*

¹³⁰ Gono G, 'Reflections on: What went wrong at Trust and Royal banks', 5 February 2008 available at <http://www.rbz.co.zw/> at 17 [Accessed 7 February 2008].

¹³¹ The current Reserve bank of Zimbabwe governer .

¹³² *Ibid* at 17.

¹³³ *Ibid* at 17-18.

trustworthy and used shareholder funds for personal gains. Some of the results of the investigations revealed that;¹³⁴

- A Trust bank cheque of ZAR \$961, 180 261.00 was made payable to National Discount House (NDH). The proceeds were distributed by NDH amongst former Trust bank's directors apparently on Mr. Niemba's instructions partly as follows;¹³⁵
 - a) The sum of ZAR\$106,293,987.68 was paid to Luapa Holdings. Mr. Goromonzi is a director of Luapa Holdings (Pvt) Ltd.¹³⁶
 - b) The sum of ZAR \$214,992,809.13 was paid to Wilta (Pvt) Ltd. Mr. Nyemba is a director and shareholder of Wilta (Pvt) Ltd.¹³⁷
- Amounts of ZAR \$84,446,950.94 and ZAR\$800,000,000.00 were paid from Trust bank to Uzben Enterprises and Transtobac companies in which Mr. Nhlupo was a director and shareholder.¹³⁸
- An amount of ZAR \$800,000,000.00 was paid from Trust Bank to Transtobac a company in which Mr. Dhliwayo was a director.¹³⁹

The bank was operating outside the confines of the Banking Act ¹⁴⁰and regulations through engaging in non-banking activities via a wholly owned special

¹³⁴ Ibid at 17-18.

¹³⁵ Ibid at 17-18.

¹³⁶ Ibid at 17-18.

¹³⁷ Ibid at 17-18.

¹³⁸ Ibid at 17-18.

¹³⁹ Ibid at 17-18.

¹⁴⁰ *Banking Act (chapter 24:03)*.

purpose vehicle known as TNB nominees.¹⁴¹ Good corporate governance entails compliance with legislation that regulates the governance of companies. The directors thus engaged in illegality by engaging in non-banking activities. The directors ignored the provisions of the Companies Act¹⁴² and the Banking Act¹⁴³ regulations and these provisions failed to curb greed and selfishness that was a character of these directors.

They breached their duty to act in the best interest of their company by failing to act in accordance with stipulated legislative provisions. In doing so they exposed their company to the risk of prosecution and liquidation which was to the detriment of the shareholders. Of particular note here is that the Reserve Bank of Zimbabwe the chief regulator of banks in Zimbabwe (herein called regulator) failed to supervise the bank adequately. Inadequacies in its poor management could have been unearthed at an early stage if the regulator had taken corporate governance seriously.

Board independence, which is an essential requirement in the governance of a company, was not evident in TBC. The non-executive Chairman who chaired the board had close relations with the CEO. The above scenario contributed to the non supervision of the executive directors by the non- executive directors who should act as independent 'watchdogs' in dealing with the affairs of the company.

'During routine inspection by the Central Bank in January 2004 TBC was found to be in unsafe and unsound condition requiring huge liquidity support for survival. ¹⁴⁴A Corrective Order by the Central Bank was issued and, TBC was forced

¹⁴¹ Gono G, 'Reflections on: What went wrong at Trust and Royal banks', 5 February 2008 available at <http://www.rbz.co.zw/> at 10 [Accessed on 7 February 2009].

¹⁴² *Companies Act* (Chapter 24:03).

¹⁴³ *Banking Act* (Chapter 24:03).

¹⁴⁴ Muranda Z, 'Financial distress and corporate governance in Zimbabwean banks', *Corporate governance*, Volume 6 No. 5 2006 at 647-648.

to restructure its top management ¹⁴⁵ The chairman, T Magaya, the Managing director W Nyemba, the finance director M N Hlupo , the executive- director M C Goromonzi were all ordered to resign. The trust lost between the executive and non-executive directors made it hard for the directors to work together as a team.¹⁴⁶ Forcing the directors to resign evidenced lack of supervision by the regulator as this meant that their misconduct was glaring and had persisted for a long time. 'The Board and its committees were also directed to restructure and strengthen.'¹⁴⁷ TBC then elected a new CEO and executive directors.

The weaknesses of bank were now glaring and ultimately The Reserve Bank of Zimbabwe placed it under curatorship. The Reserve Bank of Zimbabwe then loaned TBC Z\$630 billion as liquidity support to facilitate its revival.¹⁴⁸ TBC failed to repay the loaned money up to January 2004 and it had insider loans¹⁴⁹ that the insiders failed to repay.¹⁵⁰ 'The investigation revealed significant non-performing insider loans granted without formal loan agreements or facility letters, and or proper due diligence as follows: - TMB Nominees (\$23.8billion); Trust Holdings Limited (\$6.8 billion); and other insiders (\$17.6 billion).'¹⁵¹

The bank became insolvent and its curator Mr. Peter Bailey of KPMG confirmed its insolvency. TBC then amalgamated in the Zimbabwean Allied Banking

¹⁴⁵ Ibid.

¹⁴⁶ Gono G, 'Reflections on: What went wrong at Trust and Royal banks', 5 February 2008 available at <http://www.rbz.co.zw/> at 10. [Accessed 7 February 2008].

¹⁴⁷ Muranda Z, 'Financial distress and corporate governance in Zimbabwean banks', (2006) 6 Issue No. 5 *Corporate governance* at 648.

¹⁴⁸ Ibid 648.

¹⁴⁹ These are loans given to directors and executive officers by the company. In most instances in the companies mentioned in this dissertation, they were not repaid.

¹⁵⁰ Muranda Z, 'Financial distress and corporate governance in Zimbabwean banks', (2006) 6 Issue No.5 *Corporate governance* at 648.

¹⁵¹ Gono G, 'Reflections on: What went wrong at Trust and Royal banks', at 12. available at <http://www.rbz.co.zw/> [Accessed 5 February 2008].

Group (ZABG)¹⁵², which is an amalgamation of the troubled banks and operates as a bank in Zimbabwe. The Reserve Bank of Zimbabwe Governor Gedion Gono stated that

In line with the Troubled Banks Resolution Framework, the banks' outstanding, Troubled Bank Funds (TBF) were duly converted to equity. Over and above these, deposits and sundry creditors above \$5 million were also converted to equity. After conversion, existing shareholders interest was written off against accumulated loss and therefore they no longer had interest after conversion of TBF and other liabilities into shares in ZABG.¹⁵³

Depositors and investors painfully parted with their hard-earned money because of poor corporate governance.

2.3.2. Royal Bank

The Royal bank started operating in 2002. Among its major shareholders were Jeffry Mzwimbi and Durajadi Simba who were executive directors. These two individuals were former executives in United Merchant Bank before it collapsed and accusations were that they were responsible for its collapse due to improper management.

The United Merchant bank had collapsed in 1998 and Royal bank started operating in 2002. From their nomination their credibility as 'fit and proper persons' to take managerial post was doubted as they had worked in failed institutions.¹⁵⁴ The Reserve Bank turned down Durajadi's proposed appointment as an executive director at licensing stage due to glaring academic incapability and questionable integrity.¹⁵⁵

¹⁵² Ibid at 13.

¹⁵³ Ibid at 18-19.

¹⁵⁴ Ibid at 20.

¹⁵⁵ Ibid at 20.

However, the registrar in the ministry of finance had the overall decisions and allowed him to take the position of Head of Business Development.¹⁵⁶ Generally corporate governance principles as enunciated by King II '[recommends that] background checks be carried on potential directors to ensure they are fit and proper ([King II] 2002:25).'¹⁵⁷

In the management of Royal Bank Mr. Mzwimbi and other bank officers in the management division were involved in unapproved 'related party transitions'. 'Mr. Mzwimbi spearheaded a cartel of bank management within the institution to selectively award themselves contracts amounting to (\$21.6 billion) for the supply of various goods and services to the companies in which they had interests, or with whom they had relationships.'¹⁵⁸ In doing this, they also failed in performing the duty to act in the best interest of the company. Corporate law clearly states that directors should not benefit from their duty as fiduciaries. The self-dealing rule prohibits a director from acting for the company in a matter, which he has interest. Hence, he may not act on behalf of his company in a contract with himself,¹⁵⁹ or in which he has an interest (or concerning a matter which he owes a duty to another) that conflicts or may possibly conflict with his duty to his company.¹⁶⁰

The Royal bank directors breached their fiduciary duty to act in the best interest of the company by purchasing shares for themselves using shareholder and investors funds.

¹⁵⁶ Ibid at 12.

¹⁵⁷ Williams O F, 'Restoring Public Trust In Business. The Crucial Role Of Good Corporate Governance' Corporate Governance Conference 11-12 August 2005 at 9.

¹⁵⁸ Gono G, 'Reflections on: What went wrong at Trust and Royal banks', available at //www.rbz.co.zw/ at 21 . [Accessed 5 February 2008].

¹⁵⁹ In *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 178 Innes CJ said that: ' [The fiduciary principle] prevents an agent from properly entering into any transaction that would cause his interests and his duty to clash. If employed to buy, he cannot sell his own property; if employed to sell, he cannot buy his own property.

¹⁶⁰ Ibid

[Directors in Royal Bank] abused depositors' funds amounting to \$17.1 billion to purchase shares in First Mutual on behalf of First Mutual senior management and Royal Bank directors. This transaction later exposed the bank to liquidity and reputation risk. First Mutual Limited took Royal Bank to court for ZWD\$60 billion and petitioned for liquidation of the bank.¹⁶¹

Directors in Royal bank were fraudulent and 'the bank was also involved in a legal dispute with Finsreal Asset Management Company which alleged that the directors of Royal bank had passed fictitious entries on their account in the bank's books.'¹⁶²

Insider lending¹⁶³ was also done to the detriment of the company and in abuse of shareholder funds. Among 10 directors, only two were qualified as independent directors, which challenged the supervision of non-executive directors.¹⁶⁴ This made proper corporate governance impossible due to the imbalance between the independent directors and the executive directors. The directors negligently dealt with the affairs of the company by recapitalizing bank funds with depositors' money instead of issuing paid up shares.¹⁶⁵

The institution failed due to poor management among other reasons. There was a curator appointed to manage the affairs of the bank. Some of the misconducts revealed by the Special Investigation Report on Foreign Currency Dealings by Royal bank revealed that:¹⁶⁶

¹⁶¹ 21 Gono G, 'Reflections on: What went wrong at Trust and Royal banks', at 21 available at [//www.rbz.co.zw/](http://www.rbz.co.zw/) [Accessed 5 February 2008]

¹⁶² Ibid at 22 .

¹⁶³ See footnote 56.

¹⁶⁴ Gono G, 'Reflections on: What went wrong at Trust and Royal banks' at 24, available at [//www.rbz.co.zw/](http://www.rbz.co.zw/) [Accessed 5 February 2008 at 24.]

¹⁶⁵ Ibid at 25.

¹⁶⁶ Ibid at 25.

- Messrs Mzwimbi and Simba intentionally disregarded the national laws and regulations governing the foreign currency transactions in Zimbabwe.¹⁶⁷
- Mr. J. Mzwimbi purchased property in 2002 and the purchase price composed of ZAR\$63 million and USD\$100, 000. The foreign currency component was done in violation of Exchange Control regulations.¹⁶⁸
- Royal bank facilitated transfers from people in the Diaspora to relatives and friends in Zimbabwe. There was no foreign currency remitted to Zimbabwe by the bank whilst it created an external obligation payable in Zimbabwe.¹⁶⁹
- The bank also bought foreign currency using parallel market rates from employees and the public.¹⁷⁰

Royal Bank collapsed.

2.3.3. Metropolitan Bank (MPB)

Metropolitan bank started operating in 2000. 'The bank maintained a very small branch network but concentrated on sourcing foreign currency denominated facilities for on lending to businesses in Zimbabwe.'¹⁷¹ It was headed the founder who was also the executive chair and was reportedly without requisite skills in the management of a banking institution. The lack of company executives who possess

¹⁶⁷ Ibid at 25.

¹⁶⁸ Ibid at 25.

¹⁶⁹ Ibid at 25.

¹⁷⁰ Ibid at 26.

¹⁷¹ Muranda Z, 'Financial distress and corporate governance in Zimbabwean banks', (2006) 6 Issue No 5 *Corporate governance*, at 648.

the requisite qualifications to manage a company is a corporate governance concern. Executives should be in a position to manage the company in manner that gives direction to the company. They should be fully aware of the duties they owe to the company in order for them to safeguard the interest of the company and to be held liable in the event of breach of duty.

From the time of inception, the founder was domineering that there was no independence at board level. The bank had neither an established vision nor a proper board of directors.¹⁷² 'Businesses, especially big business and its lenders must show that they understand that they are a crucial part of contemporary society. This is best accomplished by a mission statement that includes an acceptable corporate citizenship, purpose and ethical value.'¹⁷³

The Reserve bank identified problems in the bank in 2004 as 'mainly due to a vacuum in top management as the bank was operating without a substantive CEO and other executives in the key functional areas.'¹⁷⁴ Due to poor management, skills and little emphasis on the importance of corporate governance coupled with improper allocation and delegation of duties the bank was heading for failure. Ultimately, the Reserve Bank issued a Corrective Order to the bank in January 2004.¹⁷⁵ Upon the advice from the Reserve bank, the bank to restructured and appointed a new Board Chairperson.

The Reserve bank ordered the resignation of the founder from his post and the bank appointed a new managing director and an executive director the positions vacant for a long time. New systems and procedures in the area of risk management

¹⁷² Ibid at 648.

¹⁷³ Williams O , 'Restoring Public Trust In Bussiness.The Crucial Role of Good Corporate Governance' Corporate Governance Conference 11-12 August 2005 at 5.

¹⁷⁴ Muranda Z, 'Financial distress and corporate governance in Zimbabwean banks', (2006) 6 Issue No 5 *Corporate governance* , at 648.

¹⁷⁵ Ibid at 648.

had to be set up for the bank.¹⁷⁶ During the climax of the crisis, the bank borrowed ZAR\$19.8 billion from the Central Bank's Troubled Bank Fund the bank repaid the borrowed funds.¹⁷⁷

The Bank is still operating.

2.3.4. Intermarket Holdings (IM)

Intermarket Holdings started operating in the 1990s. At the beginning of financial distress, investigations showed that the founder owned 72% in the holding company through an investment company called Transnational Holdings.¹⁷⁸ This major stake gave him control over the subsidiary company named Intermarket Banking Corporation, which showed liquidity problems in the beginning of 2004.

The Reserve bank of Zimbabwe appointed a curator to manage the bank. Investigations by the RBZ revealed insider loans that were done in the bank with the executive chairman having been loaned ZAR\$ 90 billion using money from depositors.¹⁷⁹ The directors were breaching their duty to act in the best interest of the company by furthering their interest. The executive chairman as a major shareholder literally had all the voting powers and was said to be domineering that he made all the decisions in the company. This evidenced lack of independence at board level.

Investigations by the appointed curator led to a rise in the figure for insider loans to Z\$174 billion.¹⁸⁰ On being implicated for being responsible for the fall of the bank the executive chairman fled from the country. 'Fraud by some IM employees taking advantage of weak management systems exacerbated financial distress in

¹⁷⁶ Ibid at 648.

¹⁷⁷ Ibid at 648.

¹⁷⁸ Ibid at 648.

¹⁷⁹ Ibid at 648.

¹⁸⁰ Ibid at 649.

Intermarket.¹⁸¹ The lack of proper governance principles, credible people on the board and board independence among other things were the causes of liquidity problems in Intermarket. The Reserve bank loaned money to the bank as a survival strategy and it is still operating today.

2.3.5. First National Building Society (FNBS)

Two directors around the 1990s established FNBS and they owned 89% of the shareholding in the company.¹⁸² FNBS grew to be a bank, which managed to open other branches in various places in the country 'their growth was attributed to a more liberal mortgage system that operated in the building society.'¹⁸³ Being the major shareholders in the bank the directors also became the major voice in the bank hence denying other shareholders the right to vote their opinions. The majority shareholding of the directors also deprived the company of independence at board level. Being a director and a major shareholder no director or shareholder managed to go against his views.

In 2003, the founding directors faced accusations of insider lending and squandering depositors' funds on luxuries such as building expensive houses.¹⁸⁴ This led to their arrest but they were later released. The Reserve Bank of Zimbabwe placed FNBS under the management of a curator and later liquidated it on application to the high court. The bank collapsed due to improper corporate governance.

¹⁸¹ Ibid at 649.

¹⁸² Ibid at 649.

¹⁸³ Ibid at 649.

¹⁸⁴ Ibid at 649.

The two founding directors are said to have been so dominant no decision no matter how minor could be passed without their involvement. They dominated both the board and management. Managers outside the directors' circle became scared of making decisions without express authority from the founding directors.¹⁸⁵

There was poor corporate governance in the company, which led to its failure. Depositors and investors lost their funds.

2.3.6 United Merchant Bank (UMB)

'United Merchant Bank was founded in the early 1990s soon after liberalization of the financial services sector.' The founder was a politician and a tobacco merchant who had made his money between the 1960s and the 1980s through selling stationery.¹⁸⁶ His bank showed glaring poor corporate governance practices. Depositor's funds benefited the founder of the company and the directors. 'He constructed what became the world's largest tobacco sales floors. In so doing, he gave himself loans from the bank. He also gave loans to acquaintances without even maintaining adequate books of accounting.'¹⁸⁷

'Onsite examinations carried out by the Reserve bank in 1998 revealed that United Merchant bank was exposed to serious insider lending, extremely poor pre-lending practices and very weak credit administration.'¹⁸⁸ Similar problems were later discovered at Royal Bank where Jeffrey Mzwimbi and Durajadi Simba who were executive at merchant bank occupied executive positions.

¹⁸⁵ Ibid at 649.

¹⁸⁶ Ibid at 650.

¹⁸⁷ Ibid at 650.

¹⁸⁸ Gono G, 'Reflections on: What went wrong at Trust and Royal banks' at 20, available at [//www.rbz.co.zw/](http://www.rbz.co.zw/) [Accessed February 2008].

The directors in United Merchant Bank were literally not in operation and they gave themselves loans, which they never repaid. The bank also possessed fake securities. Clients who were had been given loans never repaid them and the bank had unbalanced accounts. The founder died before revealing all the companies debtors. 'Books of accounting were found to contain very inadequate information. UMB later collapsed in April 1998 due to serious managerial shortcomings and poor corporate governance practices as evidenced by poor risk management practices, fraudulent and unethical banking practices.'¹⁸⁹All the above was evidence of poor corporate governance practices.

The bank collapsed.

2.3.7. ENG Capital Investment (ENG)

ENG was an asset management company, which culminated into a giant investment company.¹⁹⁰ Its founders were two young directors who had just come out of university a few years before which cast doubt on their experience in managing such a big institution.¹⁹¹ The founders of ENG operated as its board of directors and acquired many properties mainly for the director's personal use and satisfaction. 'The two directors virtually operated as the full board. They became quite reputable as deal brokers. Even as the company was starting to show signs of oncoming problems the directors managed to convince highly reputable companies to part with their money.'¹⁹²

¹⁸⁹Muranda Z, 'Financial distress and corporate governance in Zimbabwean banks', (2006) 6 *Issue No 5 Corporate governance* at 650.

¹⁹⁰ Ibid at 650.

¹⁹¹ Ibid at 650.

¹⁹² Ibid at 640.

The directors were very extravagant and loaned money to themselves to buy expensive cars using investor money. Corporate governance was virtually non-existent in the company. In 2004, the company failed to pay investors their money on maturity. The two directors embezzled investor money and failed to account for it. This led to their arrest. One of them managed to escape and is on the run after being released on bail. 'At the time of liquidation it also emerged that the company had become a major shareholder in Century Bank through various investment vehicles under their control. The laxity in the Century board and management was exposed when it also emerged the bank did not know of the share acquisitions that had taken place.'¹⁹³

2.4. The Problem

The above cases show that the lack of proper corporate governance practices can be destructive to the economy. A familiar feature among the failed companies was that, board independence as expected from the roles of non-executive directors was virtually non-existent.¹⁹⁴ The other concern was the problem of board chairmanship. 'Board chairmanship lacking power and leadership leads to inadequate oversight over the board and management. It is a strong source of corporate governance failures. If anything, [most of the banks] did not have a functional board. Lack of board independence inadvertently creates an epicenter for corporate governance failures.'¹⁹⁵

Conflict of interest was also a corporate governance problem whereby management sought to manage the company and at the same time worried about personal gains. They lived luxurious lives through unaccounted and mostly unpaid

¹⁹³ Ibid at 650.

¹⁹⁴ Ibid at 651.

¹⁹⁵ Ibid at 652.

loans (which in terms of banks were depositors' funds). Directors could not exercise fair-minded decisions in dealing with the affairs of the company as most of them were the majority shareholders and were willing to see the company profit even through illegal and illegitimate means.

In all the insolvency problems in the banking sector and other problems that characterized the financial sector, Allan Choruma also identified 10 corporate governance challenges in Zimbabwe namely,¹⁹⁶

- Lack of a culture of transparency and accountability.
- Lack of debate and open dissent at board level.
- CEO tenure of office, which is open, ended.
- Corporate governance is being taken as a compliance matter (tick box) opposed to it being based on voluntary practices.
- Shareholder or investor apathy.
- Poor corporate governance standards in state enterprises and public sector.
- Absence of a home grown Corporate Governance Guidelines.
- Slackness by government and some regulatory authorities on governance issues.
- Lip service on sustainable use of environment (environmental conservation).
- The scourge of corruption and lack of capacity by Anti Corruption Commission to deal with the scourge.

¹⁹⁶ Choruma , A, 'Zimbabwe: Corporate Governance in 2007-Challenges', Financial Gazette(Harare) 11 January 2007 available at *allAfrica.com* . [Accessed on 14 December 2008].

2.5. Emphasizing the need for Corporate Governance reform in Zimbabwe

Generally, the fall of the Zimbabwean financial economy had drastic consequences that affected the economy, the investor and the ordinary citizen. Investors lost their funds, employees lost their jobs and the ordinary citizens lost the money they had banked and the services they enjoyed. In emphasizing the need for good corporate governance, the Reserve Bank Governor of Zimbabwe Dr Gideon Gono had an opportunity to say the following in his address on corporate governance;¹⁹⁷

- ...no amount of natural resource endowment or technological advancement can excel an economy to its efficiency frontiers if there is death of integrity and good corporate governance in its “veins and arteries”.¹⁹⁸
- Good corporate governance and integrity in business are the bedrock and foundation to sustainable economic and social prosperity. A foundation which is never shaken, no matter what breadth, length and height of the socio-economic building it is erected upon it.¹⁹⁹
- Prevalence of lop-sided corporate governance systems, accentuated by greed-driven and rent-seeking inclinations to graft, as well as lack of integrity, is cancerous. This is cancerous, not only because it denies the wider economy to benefit from the trickle-down effects of economic growth, as incomes are effectively utilized and justly distributed among nationals, but also because it impairs future growth and development prospects by the observed tendency

¹⁹⁷ Gono G, ‘Reserve Bank Of Zimbabwe On Corporate: Determining The Future Of State Enterprises And Parastatals’ at 5-8 available at www.rbz.co.zw. [Accessed on 5 December 2009].

¹⁹⁸ Ibid at 5.

¹⁹⁹ Ibid at 5.

of beneficiaries of such ill-practices to siphon resources outside the mainstream economy.²⁰⁰

- A robust economic turnaround program has to therefore, instill a flourishing spirit of good corporate governance and integrity to levels beyond reproach, for it to bear fruit.

He further noted that whilst in fact both private and public companies needed a corporate governance reform and the use of self-regulation as a corporate governance method had started being evident. Such examples included the National Association of Non Governmental Organizations (NANGO), which launched a corporate governance manual called *The Zimbabwe NGO Corporate Governance Manual* applicable to all non-governmental organizations in Zimbabwe.²⁰¹ The banking sector also has guidelines on good corporate governance as enunciated by the Reserve bank namely the *Corporate Governance Guidelines and minimum Internal Audit Standards in Banking Institutions* and the Corporate Governance annual report both issued in 2004.²⁰²

Most importantly the Institute of Directors of Zimbabwe (IODZ) promotes good corporate governance by recommending that companies should comply with the corporate governance principles as laid out in the UK's Cadbury Report (1992) or the South African's King Report(1994).²⁰³ 'The efforts of the IODZ received a major boost with the publication in 2001 of a manual entitled '*Principles for Corporate Governance in Zimbabwe: Manual of Best Practice*'.²⁰⁴ The above is a manual not a

²⁰⁰ Ibid at 5-6.

²⁰¹ Choruma A, 'Zimbabwe: Corporate Governance in 2007-Challenges' Financial Gazette(Harare) 11 January 2007 available at www.allAfrica.com. [Accessed 5 December 2008].

²⁰² Ibid.

²⁰³ Mangena M and Tauringana, 'Working Paper Series Disclosure, Corporate Governance and Foreign Share Ownership on the Zimbabwe Stock Exchange' at 7 November (2006) *Working Paper No 06/43* available at www.brad.ac.uk [Accessed 7 December 2008]

²⁰⁴ Ibid.

Code and differs from the Code proposed by this dissertation as it '... incorporates the Cadbury Report (1992) and King Report (1994) and companies are encouraged to adopt either of the two.'²⁰⁵ This dissertation recommends that the IODZ should make an initiative to start a corporate governance Code that embodies corporate governance principles well drafted specifically for Zimbabwean companies.

It is notable that there is a need for a national corporate governance Code that is not a copy and paste of the provisions in Codes and reports in other countries. It should regulate companies in general using the 'comply or explain' philosophy without focusing on particular companies in the economy. This Code will make it possible to regulate companies in a flexible way that does not make regulation expensive and onerous to companies while at the same time laying standards that will give effective regulation to companies in Zimbabwe.

2.6. Self regulation through the 'comply or explain' philosophy as a viable solution to the corporate governance problems in Zimbabwe

With the disregard of corporate governance standards in Zimbabwe, self-regulation in Zimbabwe through the 'comply or explain' principle is proposed. An issue to note is that, this dissertation does not propose that Zimbabwe should do away with the legal solutions or sanctions for those corporate governance principles in respect of which the statutory and common law framework of enforcement already exists.²⁰⁶

²⁰⁵ Ibid.

²⁰⁶ '...proponents of the free market would argue that a mandatory regime is unnecessary: If enhanced corporate governance practices are beneficial and desired by investors, firm competing for scarce capital will implement them voluntary. On the other hand, investor advocates would argue that a voluntary regime is insufficient, since there is no guarantee that all firms will implement the reforms necessary to provide investors with adequate checks on management and board control. Mandatory rules, on this view, are necessary to protect investors and, in turn, to build confidence in the capital markets.' Cited by Anand Indira N, 'Voluntary v Mandatory Corporate Governance: Towards an optimal regulatory framework.' American Law and Economics Association Annual Meetings (2005) <http://law.bepress.com/alea/15th/bazaar/art> at 4 accessed on 12 January 2009.

The point is that, extending legislative and common law sanctions to corporate governance principles with no framework of enforcement now is futile as companies tend to practice quantitative rather than qualitative corporate governance under the traditional corporate governance regime.²⁰⁷ They do so by either paying total disregard to the mandatory rules or by blindly complying with the rules without applying their minds thereto. 'Even under a mandatory system, compliance is not guaranteed as firms may not be motivated by the fear of penalties to comply.'²⁰⁸ When TBC and Royal Bank in Zimbabwe disregarded provisions in the Banking Act, they went unpunished and investors were not concerned, as the company seemed to perform well whilst the regulator left them inadequately supervised.

Managers also regard compliance with legislative provisions enough corporate governance. They seem not to pay particular regard to the individual needs of their companies. The problem is not entirely their fault, as legislative provisions give no room for flexibility. 'As stated by King in his book *The Corporate Citizen*²⁰⁹ "that rigidity in process dilutes enterprise, and consequently dilutes a director's ultimate responsibility: performance."²¹⁰ So compliance, however neat and tidy it may look, is of no use if the company is not growing and taking the risk – and yes being allowed to make mistakes occasionally.'²¹¹

The 'comply or explain' principle as advocated by self-regulation is a better solution to the 'box ticking approach to corporate governance', which may be occasioned by the legislated approach. Mongalo T states that legislative provisions

²⁰⁷ Mervyn K, *The Corporate Citizen* at 1.

²⁰⁸ Anand Indira N, 'Voluntary v Mandatory Corporate Governance: Towards an optimal regulatory framework.' American Law and Economics Association Annual Meetings at 14 (2005) available at <http://law.bepress.co./alea/15th/bazaar/art> . [Accessed 12 January 2009].

²⁰⁹ Mervyn K, *The Corporate Citizen: Governance for all entities* (2006).

²¹⁰ Ibid, as cited by William D, Financial Mail, 'Nice Guy No More' Chairmanship, 14 July 2006 at 21

²¹¹ William D, Financial Mail, 'Nice Guy No More' Chairmanship, 14 July 2006. at 21

operate on a 'one size fits all approach'.²¹² Companies ought to comply with one set of provisions regardless of their diversity in size and business. It was evident in TBC and Royal Bank that there was outright disregard of the provisions in the Banking Act. This might have been due to the fact that the directors in the company found it too stringent or onerous to comply with some of the legislative provisions in the Banking Act. Self-regulation thus provides flexible regulation of companies through the 'comply or explain' philosophy

A further corporate governance problem noted in Zimbabwean companies was the conflict between the directors' interests and their duties to their companies. Directors are indeed humans and therefore subject to human frailty.²¹³ '[A director] is not a recording machine. He comes to the decision –making table with past prejudices and present needs.'²¹⁴ Self-regulation through the 'comply or explain' philosophy does not remedy human weaknesses but gives the director an opportunity to exercise judgment in the management of a company. Directors have no mandate to comply with the provisions of the Code but they are supposed to explain their non-compliance.

2.7. Conclusion

The corporate governance scandals discussed in this chapter casts doubts on the effectiveness of the regulatory corporate governance structure in Zimbabwe. This dissertation suggests that the introduction of new regime of corporate governance in the form of self-regulatory Code as discussed in the first chapter as one possible solution to curb corporate malpractices discussed in this chapter. The next chapter therefore gives an overview of how leading economies in the world regulate corporate governance. Drawing lessons from other jurisdictions is important to

²¹² Mongalo T, 'Self Regulation versus Statutory codification: Should the new regime of corporate governance be accorded statutory backing?' (2004) 67 *THRHR*, at 274 .

²¹³ Mervyn K , *The Corporate Citizen: Governance for all entities*, (2006) at 14.

²¹⁴ *Ibid* at 14.

establish learning points in an effort to improve the regulation of corporate governance in Zimbabwe.

CHAPTER 3

REGULATION OF CORPORATE GOVERNANCE IN THE UK, USA, SOUTH AFRICA AND ZIMBABWE: A COMPARATIVE ANALYSIS

3.1 Introduction to Corporate Governance in the UK

The regulation of corporate governance in the UK is by the traditional method of corporate governance and the new regime of corporate governance through a self-regulatory Code of Conduct. The traditional method of corporate governance comprises of statute law and the common law whilst the UK Combined Code on Corporate Governance (2006) regulates the new regime of corporate governance. The most significant statute is the Companies Act²¹⁵, which was a consolidation of a number of previous statutes.²¹⁶

Two particular features of the Companies Act are important. The first is that an enormous amount of discretion is left to individual companies as to the detailed management of affairs. In this sense, it may be seen as a minimum standards Act. The second is that it covers both public and private companies.²¹⁷

The listing rules of the LSA also regulate corporate governance by providing provisions that companies should meet before and after they become listed companies as provided by the Stock Exchange.

²¹⁵ *United Kingdom Companies Act 2006.*

²¹⁶ Leader S and Dine J, 'United Kingdom' edited by Pinto R and Visentini G, *The Legal Basis of Corporate Governance in Publicly Held Corporations A Comparative Approach* (1998) at 220.

²¹⁷ *Ibid.*

'The United Kingdom corporate governance is facilitated through a principles-based approach while at the same time supported by a rule of law that is balanced and fair.'²¹⁸

3.1.1. Common law

United Kingdom is a common law country²¹⁹ and English Common law has been a traditional method of regulating corporate governance through common law principles. Common law is the law developed by judges through case law referred to as judicial precedents. Judges follow decisions and reasoning enunciated by other judges through previous decisions through the doctrine of *stare decises*.

With the advent of self-regulation judges are encouraged to take note of the flexibility in corporate governance that is introduced by corporate governance Codes. Nothing prohibits judges to overrule judgments by other judges to suit the changing times. Aspects like fiduciary duties and derivative action for shareholders are issues regulated by common law.

The UK Companies Act²²⁰ has given a statutory backing to some common law doctrines. Examples of these are fiduciary duties, which are now part of the UK Companies Act.²²¹ However, the position maintained is that interpretations of statutory provisions that were once common law rules should be in line with their meaning and interpretation at common law. 'Directors duties were previously found

²¹⁸ Waring K, 'The UK at the heart of European Developments', *International Corporate Governance Network 2007 Yearbook* at 89.

²¹⁹ 'As one would expect from a common law country, the system of corporate governance in the UK is underpinned by a mixture of statute and case law. In the case of "regulated" sectors such as insurance and financial services there is also an elaborate system of "self-regulation".' Leader S and Dine J, 'United Kingdom' edited by Pinto R and Visentini G, *The Legal Basis of Corporate Governance in Publicly Held Corporations A Comparative Approach* (1998) at 220.

²²⁰ *United Kingdom Companies Act 2006*.

²²¹ *Ibid*.

in common law and equitable rules and statutory codification does not in general change the substance of such duties (with the exception of the law on directors' conflict of interest.)²²²

3.1.2. Legal regulatory framework

The UK Companies Act²²³ regulates corporate governance in the UK. The Act has been described as a 'minimum standards' Act²²⁴ as it provides a starting point to corporate governance and leaves considerable regulation to the Combined Code of Corporate Governance.²²⁵ The Act²²⁶ regulates the formation of companies, it defines the relationships of the members of the company with the company law officers and management, and it regulates auditors and states the obligations of disclosure by the company. 'A key objective of the Companies Act²²⁷ is to facilitate better understanding and communication between directors and shareholders in a way which promotes long-term company performance and value creation.'²²⁸ The codification of director's duties achieved the above by clearly stating director's duties so that they are better known and understood.²²⁹

The listing rules of the LSA also regulate companies by requiring all listed companies to comply with the requirements of the UK Combined Code and explain their non-compliance under the 'comply or explain' philosophy of the Code. The

²²² 'United Kingdom' edited by Pinto R and Visentini G, *The Legal Basis of Corporate Governance in Publicly Held Corporations A Comparative Approach* (1998) at 89.

²²³ *United Kingdom Companies Act 2006*.

²²⁴ *Ibid*.

²²⁵ Leader S and Dine J, 'United Kingdom' edited by Pinto R and Visentini G, *The Legal Basis of Corporate Governance in Publicly Held Corporations A Comparative Approach* (1998) at 220.

²²⁶ *United Kingdom Companies Act 2006*.

²²⁷ *Ibid*.

²²⁸ Waring K, 'The UK at the heart of European Developments', *International Corporate Governance Network 2007 Yearbook* at 89.

²²⁹ Waring K, 'The UK at the heart of European Developments', *International Corporate Governance Network 2007 Yearbook* at 89.

Financial Services Authority (FSA) has the responsibility of drafting the listing rules.²³⁰ The Financial Service Market Act 2000 gives a statutory sanction to the listing rules. 'The Financial Services Act puts in place the whole structure of 'self - regulation' for the financial services industry and issues such as the disqualification of directors and insider trading are dealt with by other pieces of legislation.'²³¹

3.1.3. Self- regulation in the UK: The Combined Code on Corporate Governance

Any UK incorporated company listed on the London Stock Exchange is subject to the *Combined Code on Corporate Governance* (Combined Code).²³² The Combined Code is a combination of reports whose aims were to enhance corporate governance regulation especially after the corporate governance scandals in BCCI, Barings Bank and Equitable Life scandals where investors lost investments due to poor management within companies. The Code combines among others the Cadbury report (1992)²³³, the Greenbury report (1995)²³⁴, the Turnbull reports,²³⁵ and the Higgs report (2003).²³⁶

The Combined Code sets out standards of good practice in relation to issues such as board composition and development, remuneration and accountability and

²³⁰ John Armour, 'Enforcement strategies in UK corporate Governance. A roadmap and Empirical assessment' available at www.frg.eur.nl [Accessed 18 February 2009].

²³¹ Leader S and Dine J, 'United Kingdom' edited by Pinto R and Visentini G, *The Legal Basis of Corporate Governance in Publicly Held Corporations A Comparative Approach* (1998) at 221.

²³² 'Corporate governance in the UK' available at www.itgovernance.co.uk [Accessed 3 December 2008].

²³³ *Report of the Committee on The Financial Aspects of Corporate Governance*, 1992, Gee Publishers, London.

²³⁴ *Directors' Remuneration*, Report of a study Group chaired by Sir Richard Greenbury, 1995, Gee Publishers, London.

²³⁵ The Turnbull report on internal control revised and published as the *Turnbull guidance* in 2005.

²³⁶ It reviewed the role and effectiveness of non-executive directors and of the audit committee.

audit and relations with shareholders.²³⁷ The Financial Reporting Council (FRC) is the UK regulator responsible for overseeing the Combined Code.²³⁸ The importance of the FRC regarding the Combined Code emanates from the listing rules as drafted by the FSA. The LSE relinquished its control over the listing process including its authority to administer to the exchange's corporate governance guidelines, to the FSA, a governmental entity. The provisions of the Combined Code are part of the listing rules for listed companies.

The Combined Code is a self-regulatory Code that operates using the 'comply or explain' philosophy. Companies have an option to comply with its provisions and to explain their failure to comply. It does not have any penal provisions for non-compliance. However, companies have a record of compliance with its provisions probably because shareholders expect them to do so and probably to enhance their investment potential by having a record of compliance with corporate governance standards. Of particular note however is the fact that 'this Code is said to be voluntary but non-compliance can be punished by the Stock Exchange (where company is in a regulated sector by the regulator.)'²³⁹ There is a presumption in favour of compliance against companies not by statutory forces that instill compliance but rather by the market forces and shareholder voices that play a major role in the compliance by companies.²⁴⁰

The Combined Code forms part of the listing rules. Companies listed on the LSE have an additional urge to comply with the provisions of the Combined Code as the listing rules require companies to comply with its requirements of the Combined Code and to explain their failure to comply, reasonably and convincingly. Private

²³⁷ 'Combined Code' available at www.frc.org.uk. [Accessed 3 December 2008].

²³⁸ 'Corporate governance in the UK' available at www.itgovernance.co.uk Accessed 3 December 2008.

²³⁹ Leader S and Dine J, 'United Kingdom' edited by Pinto R and Visentini G, *The Legal Basis of Corporate Governance in Publicly Held Corporations A Comparative Approach* (1998) at 221.

²⁴⁰ Riley C, 'The juridification of corporate governance' edited by John de Lacy, *The Reform of United Kingdom Company Law* (2002) at 185.

companies are only encouraged to comply with the Combined Code. Overseas companies listed on the main market are required to disclose the significant ways in which their corporate governance practices differ from those set in the Code.²⁴¹

Recent views on corporate governance are favouring the promotion of 'private ordering' that is; the bargains struck by shareholders, their appointed managers and where appropriate other stakeholders.²⁴² Such view resists the juridification²⁴³ of corporate governance and offers support to the Combined Code.²⁴⁴

The Code, like its predecessors represented a difficult balancing Act. On the other hand there was a perceived need to strengthen corporate governance in response to claimed abuses; on the other hand it was born under a government committed to reduce the regulatory burdens on businesses and extending the discipline of the market forces.²⁴⁵

'Corporate governance needed to be strengthened but not juridified.'²⁴⁶ The Code bears two aspects that evidence its anti-juridification philosophy.²⁴⁷ To begin with, the proposers and drafters of the Code were a non-governmental committee, which was composed primarily of industrialist, financiers and city professionals; in that regard, it was a self-regulatory process as its subjects drafted it.²⁴⁸ Secondly, the

²⁴¹ 'Combined Code' available at www.frc.org.uk .[Accessed 7 December 2008].

²⁴² Riley C, 'The juridification of corporate governance' edited by John de Lacy ,*The Reform of United Kingdom Company Law* (2002) at 179.

²⁴³ Ibid, ' "Garner defines juridification as translations of the German Word Verechtlichung, which denotes the process of transforming social relations and social conflicts into legal conflicts primarily through legislation and judicial decisions.(See BA Garner A Dictionary Of Morden Legal Usage ,Oxford 2nd Edition 1995 at 487)" '.

²⁴⁴ Riley C, 'The juridification of corporate governance' edited by John de Lacy ,*The Reform of United Kingdom Company Law* (2002) at 179.

²⁴⁵ Ibid, at 179.

²⁴⁶ Ibid at 184.

²⁴⁷ Ibid at 184.

²⁴⁸ Ibid at 184.

Code works on voluntary compliance and provides no formal sanctions for compliance.²⁴⁹

The Code also emphasizes the need to apply common sense in applying its provisions and allows companies to view their individual circumstances and to comply to the extent that is in the best interest of their companies and still explain non-compliance to allow for transparency and openness in the management of companies. These provisions are mainly to avoid the 'box-ticking' approach that had been taken to corporate governance which was mainly caused by the urge to comply without putting much reason and sense to it.

The credibility and wide acceptance of the Combined Code in the UK is largely due to the inclusive consultative approach fostered by the FRC when conducting its reviews. The Combined Code is acknowledged as being flexible to change and subsequent amendments are often regarded as necessary to mitigate potential conflicts of unforeseen circumstances. In this sense the Combined Code is an evolving set of recommendations as such is subject to regular review.²⁵⁰

3.2. Introduction to Corporate Governance in the United States of America (USA)

'American corporate law must be understood in the context of the American federal system.'²⁵¹ Federal law is law enacted by the United States congress while individual state legislators enact state law. States enact their own laws on the governance of companies but the laws should be in harmony with the federal laws.

Every state has its own corporate law statute that provides the corporate rules. These statutes do not differ significantly among the states. [They] indicate

²⁴⁹ Ibid.

²⁵⁰ Waring K, 'The UK at the heart of European Developments', *International Corporate Governance Network 2007 Yearbook* at 89.

²⁵¹ Pinto A R, 'The United States' edited by Pinto A R and Visentini G, *The Legal Basis of Corporate Governance in Publicly Held Corporations A Comparative Approach* (1998) at 254.

how to incorporate [the company], deal with financing and legal rules, establish the basic structure of the board of directors, deal with shareholder power and rights and address a variety of other issues.²⁵²

For the purposes of this discussion, corporate governance law in America is in the context of Federal law and not State law. Regarding statutes that govern corporate governance, many states adopt the Model Business Corporations Act. The Act '...was promulgated and approved by the committee on Corporate Laws of the section of Business law of the American Bar Association.'

[It is] designed as a freestanding general corporation statute that can be enacted substantially in its entirety by a state legislature. Thirty states have adopted all or substantially all of the Model Act as their general corporation Statute, and three other jurisdictions have statutes based on the 1969 version of the Act. Many other states have adopted selected provisions of the Model Act.²⁵³

Among the many self-regulatory bodies, common law, statute laws and the listing requirements regulates corporate governance in America. America does not regulate corporate governance by way of a nationally recognized corporate governance Code.

In the UK where the Companies Act²⁵⁴ is a starting point to corporate governance. On the other hand the Sarbanes Oxley Act (SOX)²⁵⁵ which forms part of American Federal laws in America is a comprehensive Act that covers a lot of aspects of corporate governance including some aspects addressed in self regulatory Codes (like the Combined Code in the UK and King II in South Africa). Like most statutes, it provides for sanctions for breach of its corporate governance principles. The American system through the SOX was a response to the corporate governance

²⁵² Ibid.

²⁵³ American Bar Association's Committee on Corporate Laws 'Model Business Corporation Act' Official Text with Official Comment and Statutory Cross-References Revised through December 2007, p ix.

²⁵⁴ *United Kingdom Companies Act 2006*.

²⁵⁵ *Sarbanes Oxley Act 2002*.

scandals that saw the closure of companies in America and the loss of investments by investors due to the poor management in American companies.

3.2.1. Common law

‘Common law has a deep tradition in the United States as in England and American judges have significant discretion in interpreting the law.’²⁵⁶ Common law regulates corporate governance by providing fiduciary duties for directors. Whilst some fiduciary duties are in codified statute, this does not usurp the role of the judiciary in providing common law rules. The court interprets the law when applying the statutory provision to a particular set of facts and makes judgments that will form judicial precedents, which are common law rules.

3.2.2. The Sarbanes Oxley Act (SOX)

Corporate governance structures have traditionally been a private matter between shareholders and managers with some state law restrictions but the SOX has made structures governing the conduct of the corporation a matter of federal law.²⁵⁷ The Securities and Exchange Act²⁵⁸ establishes the Security Exchange Commission, which is a government agency, empowered to enforce and interpret federal securities law.²⁵⁹ The Securities Exchange commission also has the mandate to state rules of compliance with the SOX.²⁶⁰

²⁵⁶ Ibid.

²⁵⁷ Tipgosc M A and Keete T, ‘Corporate governance in America: A comprehensive structure of Corporate Governance in post Enron corporate America’ *CPA Online Journal*.

²⁵⁸ *Securities Exchange Act of 1934*.

²⁵⁹ ‘Corporate Governance in the UK’ available at www.itgovernance.co.uk [Accessed 20 January 2009].

²⁶⁰ Ibid.

The SOX²⁶¹ regulates some issues of corporate governance that are regulated self-regulation both in South Africa and in the United Kingdom. The SOX²⁶² provides for legal sanctions for non-compliance with its provisions. The sanctions are both criminal and civil sanctions. The Act provides for an enlightened public accounting profession practicing with extraordinary dedication and integrity as an important element to satisfy public trust for shareholders as well as stakeholders.²⁶³ To oversee the accounting profession the Act establishes the public account oversight board, which regulates disciplines and oversees accounting firms acting as auditors of companies.²⁶⁴ The Act also provides for independence of auditors, internal audit functions and management accountancy.²⁶⁵

The SOX was a response to the corporate scandals in America that included the fall of Enron and WorldCom in America. The USA took a legislative approach towards corporate governance to curb corporate malpractices. The SOX also requires companies to have a Code of ethics assigned to management and aimed at promoting the importance of corporate morality and ethical standards.²⁶⁶ This provision aims to engage management in corporate governance rather than for them to play a policing role.

The major criticism against SOX is that it requires companies to comply with one-size-fits all requirements while the companies themselves vary tremendously in complexity and in size.²⁶⁷ The next chapter discusses the merits and demerits of both

²⁶¹ *Sarbanes Oxley Act 2002.*

²⁶² *Ibid.*

²⁶³ Tipgosoc M A and Keete T, 'Corporate governance in America: A comprehensive structure of Corporate Governance in post Enron corporate America' *CPA Online Journal.*

²⁶⁴ *Ibid.*

²⁶⁵ *Ibid.*

²⁶⁶ *Ibid.*

²⁶⁷ Campos R C, 'The Regulatory Regime: US Perspective', *International Corporate Governance Network 2007 Yearbook* at 33.

the principle-based approach to corporate governance and the rule-based approach to corporate governance.

3.3. Introduction to Corporate Governance in South Africa

The traditional method of regulation and the self-regulatory approach to corporate governance regulates corporate governance in South Africa. Self-regulation of companies in South Africa operates on the 'comply or explain' philosophy.

3.3.1. Common law

The common law of South Africa bears striking similarity to the Zimbabwean common law as will be discussed under 'Regulation of corporate governance in Zimbabwe' and repetition is not necessary. Both jurisdictions use the Roman Dutch law though English common law has been much influential in the law of commerce both in Zimbabwe and in South Africa. South African courts develop its common law and English court decisions have persuasive value if there is no guidance South African case law.

3.3.2. Legal regulatory framework

The South African Companies Act²⁶⁸ as amended by the Corporate Laws Amendment Act²⁶⁹ governs and regulates companies in South Africa. It provides a starting point to corporate governance. Notably it defines the company, it defines relations between shareholders and directors and managers of the company and it

²⁶⁸ Republic of South Africa Companies Act No. 61. of 1973.

²⁶⁹ Corporate Laws Amendment Act(No. 39 of 2002).

regulates auditors. The Companies Act is being amended and the Companies Bill 2008²⁷⁰ has already been drawn and can become law probably in 2010 (see section 225).

The Companies Bill seeks to remedy the weaknesses of the 1973 Act by updating the provisions of the Companies Act to meet modern trends in corporate governance.²⁷¹ Notably it codifies the common law principles relating to fiduciary duties and outlaws the derivative action in common law by providing for a statutory derivative action. The Bill however states that in interpreting the provisions of the Act which had been traditionally regulated by common law regard is to be had as to their clarity in common law (except that the derivative action in common law has been totally outlawed).²⁷²

The Bill moves away from the providing criminal sanctions for misconducts under the Act. The above is obviously contrary to the American way of corporate governance. 'The intention of the Bill aimed at replacing the current Act was said to achieve the following;'²⁷³

- (a) Encourage entrepreneurship by simplifying the procedures for forming companies.
- (b) Provide innovation by providing for flexibility in the design and organization of companies.

²⁷⁰ Republic of South Africa Companies Bill 2008 as amended by the portfolio committee on trade and industry.

²⁷¹ Mervyn K, 'South Africa's Ambitions: Achieving International Standards of Governance', *International Corporate Governance Network 2007 Yearbook* at 84.

²⁷² Republic of South Africa Companies Bill 2008 as amended by the portfolio committee on trade and industry at 134 Section 165(1) which states that Any right at common law of a person's other than a company to bring or prosecute any legal proceedings on behalf of that company is abolished, and the rights in this section are in substitution for any abolished right.

²⁷³ Mervyn K, 'South Africa's Ambitions: Achieving International Standards of Governance', *International Corporate Governance Network 2007 Yearbook* at 84.

- (c) Promise efficiency of companies in their management.
- (d) Encourage transparency and high standards of corporate governance.
- (e) Make company law compatible and harmonious with the best practice jurisdictions.

3.3.3. Code of Corporate Practices and Conduct (King II)

Corporate governance has been developing in South Africa since the establishment of the King Committee. The King committee was established in 1992 under the auspices of the Institute of Directors in Southern Africa (IODSA).²⁷⁴ Its mandate was to review corporate governance and make recommendations to the corporate world (both public and private).²⁷⁵ The JSE Limited implements some of the recommendations in King II as its listing requirements and thus improving corporate governance standards for listed companies.²⁷⁶

The King Committee issued the first King Report and the *Code of Corporate Practices and Conduct*²⁷⁷ in 1994 and its contents have been much influenced by the reports in Europe that formed various European corporate governance Codes.²⁷⁸ Various committees that included the Cadbury²⁷⁹, the Greenbury²⁸⁰ and Hampel committee²⁸¹ made these reports.²⁸²

²⁷⁴ Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 179.

²⁷⁵ Ibid at 179.

²⁷⁶ Ibid at 179.

²⁷⁷ *King Report on corporate governance for South Africa* (2002) .

²⁷⁸ Mongalo T, *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 179.

²⁷⁹ *Report of the Committee on The Financial Aspects of Corporate Governance*, 1992, Gee Publishers, London.

²⁸⁰ *Directors' Remuneration*, Report of a study Group chaired by Sir Richard Greenbury, 1995, Gee Publishers, London.

²⁸¹ In the form of the *Code for best Practice*.

The King Committee made a review of Corporate Governance and the second King report (King II) was issued on 25 July 2001 which report was finalized on 26 March 2002.²⁸³ King II on Corporate Governance in regard to principles and best practices continues to dominate the governance of companies in South Africa.²⁸⁴ More specifically King II applies to companies listed on the JSE Limited, 'state owned enterprises are governed by the Public Finance Management Act and a protocol on the state owned enterprises together with King II. Local councils have Municipal Management Finance Act. Both these Acts essentially adopt the principles and practices espoused in King II.'²⁸⁵

King II addresses various issues that denote good corporate governance. These are social, ethical environmental and financial issues. The King II addresses the quality of an effective and functioning board and addresses the concerns of various stakeholders. The international community recognizes the King II as a well-drafted self-regulatory Code. It operates using the 'comply or explain' philosophy where companies more specifically listed companies are required to comply with it and to disclose their failure to comply. Companies, not listed on the JSE, are still encouraged to comply with the provisions of King II.

3.4. Introduction to corporate governance in Zimbabwe

The traditional method of corporate governance regulates corporate governance in Zimbabwe. The main sources of corporate governance regulation are the Companies Act²⁸⁶ and the common law. The Zimbabwean stock exchange also

²⁸² Mongalo T, *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 179.

²⁸³ Ibid.

²⁸⁴ Mervyn K, 'South Africa's Ambitions: Achieving International Standards of Governance', *International Corporate Governance Network 2007 Yearbook* at 85.

²⁸⁵ Ibid.

²⁸⁶ *Zimbabwean Companies Act* (Chapter 24:03).

regulates corporate governance by providing for a disclosure mechanism and the Zimbabwean Stock Exchange Act governs it.²⁸⁷

There is no established system of self-regulatory Code in Zimbabwe. The IODZ proposed the adoption of provisions in the Cadbury report in the UK and the King report in South Africa for companies who want to use it. The drafting of the '*Principles for Corporate Governance in Zimbabwe: Manual of Best Practice*' affirmed the proposal. This manual embodies the King report and the Cadbury report and companies are required to comply with either of the two.

Zimbabwe has no specific national Code of Corporate governance but borrows principles from Codes in persuasive jurisdictions like South Africa and the United Kingdom.

3.4.1 Common law

The common law in Zimbabwe is Roman-Dutch law, which has its origins in Roman law, and Germanic law and the law developed in the state of Holland prior to the 18th Century.²⁸⁸ Of particular note is that Roman Dutch common law of commerce is not easily identifiable. Whilst the common law of Zimbabwe and South Africa is Roman-Dutch law, many principles of company's law are English common law principles and the English court decisions have persuasive value in the courts of Zimbabwe and in the South African courts. It is no advantage to trace the common law of corporations in Roman-Dutch law any further because, in all the countries in which the Roman-Dutch law developed introduced legislation based upon the

²⁸⁷ Zimbabwe Stock Exchange Act (Chapter 24:18).

²⁸⁸ Tett and Chadwick, *Zimbabwe Company Law* (1986) at 1.

English Companies Acts at an early stage.²⁸⁹ Many of the rules of English common law of companies apply in South African common law with limited or no modification.

South African courts have quite justifiably adopted the attitude that the principles of English law which are in conflict with our system of law should not be followed on the pretext that they are part of South African companies law. As stated in *Roodpoort United main Reed GM Co Ltd v Dutoit*²⁹⁰. This proposition is likely to be the Zimbabwean position as South African jurisdiction has persuasive value. In *C and P v Commissioner of taxes*,²⁹¹ the court stated that it is justified for the courts in South Africa to use English Common law as the company has its origins in English Law.²⁹² Further, 'Principles adopted in our law for the construction of statutes are the principles of English Law. English law text books and English cases are frequently quoted in arguments and judgments concerned with the construction of a statute.'²⁹³

Common law is a distinctly important source of corporate governance in Zimbabwe. Although the legislature has given us the structure of the corporate being in the modern company Acts the common law fills many gaps not dealt with the parliament, examples include the fiduciary duties of directors and the doctrine of *ultra vires*. Case law also helps interpret provisions of statutes and provide understanding to the nature and character of the corporate personality and the corporate structure in Zimbabwe.

²⁸⁹ Ibid.

²⁹⁰ 1928 AD 06 71-72.

²⁹¹ 1960 (4) SA 163 (SR).

²⁹² Ibid.

²⁹³ Ibid.

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²⁸⁹ Ibid.

²⁹⁰ 1928 AD 06 71-72.

²⁹¹ 1960 (4) SA 163 (SR).

²⁹² Ibid.

²⁹³ Ibid.

3.4.2. Legal regulatory framework

Two 'Acts' substantively govern corporate activity in Zimbabwe, the Companies Act²⁹⁴ 1951 and the Zimbabwe Stock Exchange Act²⁹⁵ 1996.²⁹⁶ The Companies Act²⁹⁷ regulates the pre-incorporation, incorporation, operations and duties of a company and its directors. It also deals with the rights and obligations of directors and shareholders. The Companies Act and regulations govern all public and private companies.²⁹⁸ The Stock Exchange Act²⁹⁹ regulates the ZSE. ZSE is responsible for conducting trades, overseeing the clearing and settlement process, registering brokers, supervising listed companies and brokerage houses, and for market surveillance.³⁰⁰

3.4.3 Self- regulation of Companies in Zimbabwe

Corporate governance is gaining recognition worldwide even in Zimbabwe. Notably however, corporate law in Zimbabwe is not necessarily in line with the modern trends of Corporate Governance. Corporate Governance by way of regulatory Codes of conduct is now widely used as a way of regulating companies both private and public. Of note is the fact that other countries now have specific Codes of conducts, which govern companies like King II in South Africa, and the Combined Code in the UK.

²⁹⁴ *Zimbabwean Companies Act*(Chapter 24:03).

²⁹⁵ *Zimbabwe Stock Exchange Act* (Chapter 24:18).

²⁹⁶ World Bank Group 'Report s on the Observance of Standards and Codes(ROSC)' available at http://www.worldbank.org/ifa/rosc_aa.html accessed 25 January 2009.

²⁹⁷ *Companies Act*(Chapter 24:03).

²⁹⁸ *Ibid.*

²⁹⁹ *Zimbabwe Stock Exchange Act* (Chapter 24:18).

³⁰⁰ *Ibid.*

To date Zimbabwe does not have its own specific national corporate governance Code but it recognises need for self-regulation. According to the World Bank group in its Report on the observance of standards and Codes³⁰¹

The Institute of Directors of Zimbabwe (IODZ) has been active in promoting the principles set out in the Cadbury report of the UK, and King report of South Africa. The IODZ is dedicated to improving the expertise, status and professionalism of managers and directors of Zimbabwean companies through training and education. It also seeks to curb fraud and corruption. IODZ has set up a special purpose committee that prepares and disseminates guidelines on corporate governance. Certain prominent members of the institute, such as Anglo American or Delta Corporation, have also developed their own in-house corporate governance manuals. At this time, the IODZ is intensifying its corporate governance awareness campaign by including parastatal bodies and parliamentarians in its training programs. However, membership is voluntary. Therefore, IODZ cannot monitor compliance of its corporate governance principles by non-member companies.³⁰²

This research proposes the need to have a national corporate governance Code for Zimbabwe to improve the Corporate Governance standards in Zimbabwe. The advantage is that the Code will be specifically suited for the Zimbabwean companies.

3.5. Conclusion

Four jurisdictions have been discussed in this chapter and among them the UK and South Africa have national corporate governance Codes regulating corporate governance. Noteworthy is the fact that these two jurisdictions have thrived economically as compared to their counterparts which is USA and Zimbabwe. Although USA is a leading economy, it is mostly characterised by a lot of financial scandals and economic recessions. This casts doubts on a pure 'rule based' corporate

³⁰¹ World Bank Group 'Report s on the Observance of Standards and Codes(ROSC)' available at http://www.worldbank.org/ifa/rosc_aa.html .[Accessed 25 January 2009].

³⁰²Ibid.

governance regime as the impacts of poor corporate governance regulation spells impacts on the economy as discussed in chapter one. The next chapter will therefore discuss the use of self-regulatory Codes in a more detailed approach by stating its advantages and disadvantages. It will also give suggestions on how Zimbabwe can also implement its national self-regulatory Code that operates under the 'comply or explain philosophy of corporate governance.

CHAPTER 4

**REGULATING CORPORATE GOVERNANCE THROUGH
SELF-REGULATORY CORPORATE GOVERNANCE CODES
AND THE 'COMPLY OR EXPLAIN' PHILOSOPHY. A
PREPARATORY APPROACH FROM KING II**

4.1. Introduction

Of the four jurisdictions discussed in the previous chapter it is noted that (excluding Zimbabwe), South Africa, USA and UK are major players in the world economy and notably have enhanced corporate governance regulation albeit differently. The critical analysis of the regulatory rules and principles of corporate governance in SA, UK and USA is however beyond the scope of this dissertation. It advocates for the use of self- regulation through the 'comply or explain' philosophy as a method of regulating corporate governance. This dissertation does not delve into the content of the rules, regulations and principles of corporate governance in each jurisdiction.

What is notable is that South Africa and the UK both regulate corporate governance using a three tiered system, that is common law, statutory regulation and self -regulation through Codes of conduct that use the 'comply or explain' philosophy. The USA on the other hand like Zimbabwe only uses common law and legislation to regulate corporate governance and does not have national self-regulatory Codes. The absence of self –regulatory Codes in these jurisdiction no doubt deprives their corporate governance structures the benefits that come with the use of self- regulatory Codes as a method of regulating corporate governance.

This dissertation proposes self-regulation using the 'comply or explain' philosophy as used in the UK and in South Africa. This chapter will take South

Africa's approach in implementing self-regulation as a way of bringing change in the corporate governance structure in Zimbabwe. This part of the dissertation will further discuss the unique provisions of King II (as amended) and its self-regulatory nature. It will discuss the advantages and disadvantages of using self-regulation through the 'comply or explain' as a method of corporate governance and its enforcement.

Comments on the Combined Code of the UK will help to highlight the advantages and disadvantages of self-regulation through the 'comply or explain' philosophy as a corporate governance tool. This dissertation considers regulation of corporate governance as inadequate and mentions its inadequacy in passing. Legislative provisions have penalties, which makes the effective. However, there are other corporate governance principles that cannot be legislated. Compliance with legislative provisions can also be expensive especially for smaller companies whilst the need to comply leads to a 'box ticking' approach to corporate governance.

This dissertation proposes the maintenance of traditional corporate governance regulation through common law and legislation. However, due to the proven inadequacies of these systems as seen through the corporate governance scandals worldwide self-regulation through the 'comply or explain' philosophy will bring a balance in the corporate governance structure in Zimbabwe. The 'comply or explain' philosophy has also been proposed for America by the US conference board's Commissioner On Public Trust and Private Enterprises while outlining actions to improve corporate governance auditing and accounting practices.³⁰³

The absence of any force behind compliance with self-regulatory Codes has led to the proposition that there is a need for the government to intervene by providing statutory penalties for non-compliance with self-regulatory Codes. This dissertation however denies such propositions and suggests that stock exchanges and

³⁰³ Mammatt J, 'Development in Corporate governance since King II Report' available at www.ey.com [Accessed 22 ebruary 2009].

market forces provide enough supervision of self-regulatory Codes. Self-regulatory Codes are just but part of a three tiered regulatory structure which includes common law and statutory provisions that are enforced by legal sanctions. This dissertation sees the provision of legal penalties in corporate governance as inadequate in providing effective regulation of companies.

4.2. How a national Self-Regulatory corporate governance Code was initiated in South Africa. A strategy from our neighbour: King II 2002(King II)

The origins of King II are rooted in the Institute Of Directors in the UK (IOD).³⁰⁴ The IOD is an organization whose objective is to support and set standards for the leadership skills of directors across the globe. The institute of directors in the UK is a long-standing organization, which advocates director professionalism³⁰⁵. It has developed affiliates across the globe with the intention to enhance corporate governance principles.³⁰⁶ It is an organization, which is independent from the government. Some of its affiliates are the Institute Of Directors in South Africa, Namibia, Zimbabwe, Hong Kong and The Republic of Ireland.³⁰⁷

Like its mother body in the UK, the Institute of Directors in South Africa (IODSA) 'specifically represents directors, professionals and business leaders in their individual capacities, and is a prestigious membership, providing a unique opportunity for networking and business development in all spheres of

³⁰⁴ Annual convention, 'History, mission and purpose' available at www.iodsa.co.za [Accessed 4 December 2008].

³⁰⁵ 'About the IOD' available at www.iod.com . [Accessed 4 December 2008].

³⁰⁶ Ibid.

³⁰⁷ Ibid.

business.³⁰⁸ The IODSA played an important role in the development of corporate governance in South Africa.

The IODSA provided secretariat support for the King committee to draft the King II.³⁰⁹

The King committee was established in 1992 under the auspices of the IODSA to review corporate governance and make recommendations to the corporate world (both private and public), in particular to the JSE and for it to implement some of the recommendations in its listing requirements and thus improve the standards of corporate governance.³¹⁰

The first publication of the King report (King I) was on 26 November 1994³¹¹ and the King committee started a review on corporate governance and 'extensive consultation took place locally and internationally from the inception of the review in August 2000 until the final release of [King II] in March 2002.'³¹² The second publication of the King report (King II) was on 26 March 2002.³¹³ 'The review procedure was led by the principle convener selected from the King Committee members who were responsible for the codification of the process and much of the structure and content of the final document.'³¹⁴

³⁰⁸ Annual Convention 'Welcome to IOD' 2009 available at www.iodsa.co.za [Accessed 4 December 2008].

³⁰⁹ Malin C A, *Handbook on International Corporate governance* (2006) available at www.books.google.co.uk [Accessed 22 November 2008]

³¹⁰ Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 179

³¹¹ Annual Convention 'King Reports' (2009) available at www.iodsa.co.za [Accessed 13 February 2009].

³¹² Malin C A, *Handbook on International Corporate governance* (2006) available at www.books.google.co.uk [Accessed 12 February 2008]

³¹³ Annual Convention 'King Reports'(2009) available at www.iodsa.co.za Accessed 13 February 2009

³¹⁴ Malin C A, *Handbook on International Corporate governance* (2006) available at www.books.google.co.uk [Accessed 12 February 2009]

Members of the King committee made various contracts with experts and institutions at international level to seek endorsement of the King recommendations in their respective constituencies and to discuss key aspects of corporate governance.

³¹⁵ The development of King II was to elaborate on good corporate governance as defined in law³¹⁶.

A particular emphasis in the King II was on the qualitative aspects of good corporate governance. In other words it was not designed as a regulatory instrument, but as a tool to identify core areas of good practice for boards, directors and companies which extended beyond the existing legal and policy framework to embrace a number of [aspired] principles.³¹⁷

Various reports made in the UK, which were a response to corporate governance failures, influenced the contents of King II. Such reports include the Cadbury report,³¹⁸ the Greenbury report,³¹⁹ and the Hampel report³²⁰ among others. 'These UK initiatives served as a wake up call to the corporate world in South Africa. Indeed the recommendations the recommendations by the Cadbury committee greatly influenced developments in this country in corporate governance'.³²¹ The King II is in line with international corporate governance standards and makes South African corporate governance in harmony with corporate governance in developed countries.

³¹⁵ Malin C A, *Handbook on International Corporate governance (2006)* available at www.books.google.co.uk [Accessed 12 February 2009].

³¹⁶ Ibid.

³¹⁷ Ibid.

³¹⁸ *Report of the Committee on The Financial Aspects of Corporate Governance*, 1992, Gee publishers London.

³¹⁹ *Directors' Remuneration*, Report of a study Group Chaired by Sir Greenbury, 1995, Gee Publishers, London.

³²⁰ *Committee on Corporate Governance*, Final Report, 1998.

³²¹ Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 179.

4.3. How King II regulates corporate governance under the self regulatory regime of corporate governance

Corporate governance as seen through the King II is preferred as a preparatory point in an effort to introduce a self-regulatory corporate governance Code in Zimbabwe. A brief discussion of the regulation of corporate governance by King II will clarify the initiative. It is emphasized that regulation of corporate governance by King II is preferred after the realization that the Code depicts a flexible 'Afrocentric' (this term is defined below) Code whilst at the same time it sets higher standards in corporate governance.

Corporate governance regulatory provisions in South Africa have their origins from the UK model of corporate governance but differ in their provisions. 'This is epitomized by King II's discussion among other things of black Economic Empowerment and related ethical issues which are apparently, not necessarily significant in the UK.'³²² A brief discussion of the unique provisions of the King II is important to justify why among other corporate governance Codes the King II stands as the best introductory point for Zimbabwe.

4.4. The doctrine of *Afrocentricity* as the foundation of the unique self regulatory provisions in King II Report

'*Afrocentricity* is defined as the study of ideas and events from the standpoint of Africans as the key players rather than the victims.'³²³ *Afrocentricity* is about Africans putting Africa at the center of their existence and consciousness.³²⁴ In making decisions ,Africans should consider 'their own continent, their history, their

³²² Ibid at 198.

³²³ Moses G, 'Afrocentricity as a Quest for Cultural Unity. The Afrian studies Metaparadigm', (1996) Available at science.jrank.org/pages/8215/Afrocentricity [Accessed 5 March 2009].

³²⁴ Ibid .

traditions cultures, mythology, creative motif, ethics and value systems exemplifying the African collective will.³²⁵ The idea behind Afrocentricity is that 'persons of African descent must be seen as pro-active subjects within history rather than passive objects of western history.'³²⁶

Afrocentricity is an idea that stressing the need to realize that no matter how neutral an idea might seem, it is influenced by historical and cultural influences of its proposers.³²⁷ *Afrocentricity* thus proposes that 'African intellectuals must consciously and systematically relocate themselves in their cultural and historical matrix which they must draw the criteria by which they evaluate the African experience.'³²⁸ It is worth noting that '*Afrocentricity*' is not centered on demeaning other races or making Africans the superior race.³²⁹ Its argument is that policies in Africa should reflect the African experience.³³⁰

The doctrine of *Afrocentricity* undeniably has political connotations. However it is important to note that especially used for academic purposes this doctrine has nothing to do with races and cultures but expresses an, 'ardent belief in the possibility of diverse populations living in the same earth without giving up their fundamental traditions except where the traditions invade other people's privacy.'³³¹ The reference to the doctrine of *Afrocentricity* in this dissertation is from a mature concept that will help Zimbabweans and Africans to be in touch with their realities and draft laws and Code provisions that cater for their peculiar situations and needs.

³²⁵ Khoza R J, 'Global Perspectives: Leadership – a View from Africa' , *International Corporate Governance Network 2007 Yearbook* at 8.

³²⁶ Moses G, 'Afrocentricity as a Quest for Cultural Unity. The African studies Metaparadigm', (1996) *science.jrank.org/pages/8215/Afrocentricity* . [Accessed 5 March 2009].

³²⁷ Ibid.

³²⁸ *International Corporate Governance Network 2007 Yearbook*.

³²⁹ Molefi Kete Asante available at *World Ages Schives.com* .[Accessed 17 February 2009].

³³⁰ Ibid.

³³¹ Ibid .

Afrocentricity does not oppose the capitalist environment in which most African companies operate and it does not attempt to impose socialism in Africa. 'The *Afrocentricity* of Asante and other leading thinkers stress an avoidance of conflict with the capitalist system and possess solutions which remain in the context of existing capitalism.'³³² *Afrocentrists* have therefore refrained from interrogating capitalism.³³³ 'This *Afrocentricity* implicitly accepts bourgeois theories of knowledge and cultural construction even while arguing for a new epistemological and antological paradigm.'³³⁴

In drafting a corporate governance Code for Zimbabwe recommendations are put forward as to the need to draft an *Afrocentric* corporate governance Code. Such an approach will take into account the need to use corporate governance as a means to make good some of the problems faced in Zimbabwe and in Africa generally.

4.5. King II an example of an *Afrocentric* Self Regulatory Corporate Governance Code that uses the 'comply or explain' philosophy

King II will exemplify a corporate governance Code in an African country that has moved from a European centered approach to corporate governance to the inclusion of provisions peculiar to the African scenario. King II is a self-regulatory Code that regulates corporate governance using the 'comply or explain' philosophy.

³³² Darder A, *Culture and difference: critical perspectives on the bicultural experience in the United States (1995)* available at www.google.co.za at 98 .[Accessed on 16 April 2009]

³³³ Williams. J.C. 'In defense of materialism: a critique of Afrocentric ontology' (2005) 47 Issue No 1 *SAGE Journals Online, Race & Class*

³³⁴ Darder A, *Culture and difference critical perspectives on the bicultural experience in the United States (1995)* available at www.google.co.za at 26 .[Accessed on 16 April 2009].

4.5.1. The doctrine of 'Ubuntu'

King II in South Africa is an example of a Code that has taken into account the realities faced by South Africa as a nation. 'King II is mindful of the need to create a uniquely South African business culture different from that embraced by American and British businesses.'³³⁵ King II recognizes the African value system, which emphasizes the collective over the individual good. Naidoo R states that it emphasizes the need for 'mutual dependence and co-existence, which is premised on the doctrine of 'ubuntu'.³³⁶

In the Zimbabwean culture this doctrine can be termed 'hunhu'. The doctrine recognizes the need to respect each other and to take into account one another's interest in making decisions. Naidoo R states that the doctrine has its base on inclusive systems of 'consultation for consensus over dissension and a mentally inherent trust and belief in the fairness of the human being'³³⁷, which is a human characteristic inherent in the African culture.

4.5.2. Stakeholder approach to corporate governance

King II also recognizes the need 'to bring on board those people who might previously have felt excluded or alienated by the Eurocentric character of corporate governance in South Africa, regarding it as an attempt to impose inappropriate European value systems on Africa.'³³⁸ In order to pre-empt racial conflicts centered on the imbalance of resource allocation and privileges, it is important to take a stakeholder centered approach to corporate governance in Zimbabwe. This suggestion comes after the realization that silence on those issues weakens corporate

³³⁵ Naidoo R, *Corporate Governance*, at 13 available at books.google.co.za.

³³⁶ Ibid at 13.

³³⁷ Ibid.

³³⁸ Ibid.

governance by creating unnecessary conflicts at the workplace and gives politicians an opportunity to use racial and gender imbalances in companies as a way of furthering their own interest.

In its operation, the King II emphasized the need of the company to cater for previously disadvantaged groups like blacks and women, preferring a stakeholder model approach to corporate governance as opposed to a shareholder model approach.³³⁹ The stakeholder approach to corporate governance in Zimbabwe should be taken after the realization that even in Zimbabwe the shareholder approach to corporate governance only benefits few white minority who were previously the owners of most reputable companies in Zimbabwe. An effective drafter of a self-regulatory corporate governance Code in Zimbabwe should have, 'a pro active mind in order to foresee stakeholder issues peculiar to Africa namely, poverty, diseases, underdevelopment and ignorance.'³⁴⁰

In advocating for an Inclusive approach to corporate governance the King II emphasises the need to distinguish between accountability and responsibility.³⁴¹ It states that one is liable to render an account when one is accountable and one is liable to be called to account when one is responsible.³⁴² Managers are accountable at common law and by statute and they are responsible to stakeholders. The stakeholder concept of corporate governance does not make managers accountable to stakeholders because making them accountable to stakeholders would make them accountable to no one.³⁴³

³³⁹ *King report on corporate governance for South Africa (2002)* .

³⁴⁰Shonhiwa S, 'The Effective Cross-Cultural Monase :A guide for business leaders in Africa' available at www.struiknew.co.za .[Accessed on 17 February 2009] .

³⁴¹ *King report on corporate governance for South Africa (2002)* at 5

³⁴² Ibid.

³⁴³ Ibid.

4.5.3. Black Economic Empowerment (BEE)

Racial imbalance is still evident in Africa due to its prior colonial experience. King II addresses the need to bring a balance between the previously disadvantaged black majority and the previously advantaged white minority. BEE is a corporate governance measure aimed at eradicating conflicts at the work place by bringing a racial balance and giving black South Africans an opportunity to enjoy from the privileges they rightfully own. 'It is aimed at redressing the unacceptably unequal distribution of wealth...At the heart of black economic empowerment should be initiatives that will advance blacks economically on a large scale, rather than the enrichment of a few.'³⁴⁴

The doctrine expects each company to employ a certain percentage of black South Africans with experience in the relevant field and to have a stipulated amount of shares that black persons should own. Policies like BEE remain important corporate governance principles in the African context, more specifically in Zimbabwe, because if left unaddressed, they are a threat to corporate governance generally by promoting the existence of endless conflicts within corporations.

4.6. Corruption as an issue to be addressed in the Zimbabwean Self Regulatory Corporate Governance Code

Corruption is a worldwide problem. There is a world fight against corruption due to its grave effects to the economy and that its extent differ from country to country Angel Gurría³⁴⁵ stated that,

³⁴⁴ King report on corporate governance for South Africa (2002) at 125

³⁴⁵ Gurría A, 'The OECD fights Corruption' at 3 available at www.oecd.org. [Accessed on 16 April 2009].

The impact of corruption goes far beyond the specific misbehaviour of the actors involved. Its repercussions sweep across entire populations. A one million euro bribe can rapidly amount to a one hundred million euro loss in a poor country – through de-railed development plans and incoherent investment decisions. Unfinished roads, crumbling schools and crippled health systems are but a few serious examples which illustrate the seriousness of this phenomenon.³⁴⁶

There has been an establishment of rigorous laws against corruption internationally to alleviate the impacts of corruption. What is noteworthy is that besides the legal approach to corruption it is at its peak in Zimbabwe and in other parts of the world. Too much inaction that makes legislative provisions remain statements made on paper hamper the legislative approaches to corporate governance.³⁴⁷ Further weak criminal legislation and ineffective law enforcement are other reasons for the failure of the legislative approach.³⁴⁸ Corporate Codes of conduct have therefore emerged as another way of combating corruption due to the need of a multidisciplinary approach to the problem.

The flexibility offered by Corporate governance Codes comes as an advantage to businesses in their effort to regulate corruption. Due to the diversity of companies, the definition of corruption can differ depending on the culture and operation of the business. Notably there is a lot of diversity in defining bribery.³⁴⁹ 'This diversity is a feature of the language used in describing parties to bribery and in defining activities which are prohibited (e.g. promising bribes v actually giving them, gifts and entertainment and solicitation.)'³⁵⁰ Unlike legislative provisions Corporate Codes of Conduct cater for that diversity and are not designed to cater for the individual needs of companies. Moss I further supports the use of corporate codes in regulating corruption by stating that

³⁴⁶ Ibid

³⁴⁷ Ibid at 4

³⁴⁸ Ibid at 6

³⁴⁹ Gordon K and Miyake M, 'Business approaches to Combating Bribery:A Study of Codes of Conduct' at 91 *December 2001 34 Issue 3-4 Journal of Business Ethics*.

³⁵⁰ Ibid

A code of conduct helps staff to identify the boundaries between desirable and undesirable behavior. Codes of conduct are important tools in organisational development. They are part of a range of organisational tools and strategies that together help build and sustain organisational integrity and strengthen agency resistance to corruption.³⁵¹

Corruption 'is operationally defined as the misuse of entrusted power for private gain'³⁵². Traditionally, it is viewed as a practice by public officials, but a broader perspective of corruption has been adopted.³⁵³ It involves two sides, 'public officers are liable to receiving corrupt payments and the private sector is liable for providing those payments.'³⁵⁴ To explain it more simply corruption in the public sector could not have been at the stage where it is now without the private sector providing the incentives. It has narrowly been confined to bribery and issues like hiring relatives (nepotism), awarding contracts to supporters (cronyism), and abusing privileged information by dealing in corporate securities (insider trading) have always been classified differently.³⁵⁵ However, all the above though not necessarily regarded as corrupt activities could still fall into the definition of corruption as they involve the use of power for private gain.

Establishing the direct link between corruption and corporate governance is an important task. Corruption has more to do with governance systems that create incentives for misbehavior than individual behavior.³⁵⁶ Corporate governance comes as a major tool in combating corruption and destroys all the incentives for misbehaviors. It creates, 'a system where illegal flow of capital from the private

³⁵¹ Moss I. 'Code of Conduct the next stage' at 7 available at www.icac.nsw.gov.au. [Accessed 16 April 2009].

³⁵² 'Transparency International : The global coalition against corruption' available at www.transparency.org accessed 17 February 2009.

³⁵³ 'Corporate Governance An Antidote to Corruption' found www.cipr.org . [Accessed 17 February 2009].

³⁵⁴ Ibid.

³⁵⁵ Ibid.

³⁵⁶ 'Hills Program on Governance' available at www.csis.org .[Accessed 18 February 2009].

sector to the pockets of the government is impossible.³⁵⁷ It provides rules, regulations and moral standards that entail responsible corporate behavior. Enhancing corporate governance by introducing a self regulatory Code that incorporate expected ethical behavior will also come as an important measure against corruption as corruption , 'is bound to become an unacceptable ethical behavior.'³⁵⁸

'Combating corruption requires ensuring that effective accountable governance structures are in place.'³⁵⁹ Hammering on corporate governance will thus eradicate corruption by reinforcing values of the rule of law, transparency and fairness. It is likely to improve domestic investment and stop capital flights.³⁶⁰

4.7. The self regulatory nature of King II

The self-regulatory nature of King II is evident in various ways as stated below.

The drafter of King II that is the King Committee is not a government-affiliated committee. It was not a proposal by the government but was an initiative of the Institute Of Directors in Southern Africa.³⁶¹ The King II is therefore not a legislative document. Its chief enforcer is the JSE which is a self regulated body and

³⁵⁷ 'Corporate Governance An Antidote to Corruption' found www.cipr.org. [Accessed 17 February 2009].

³⁵⁸ Ibid.

³⁵⁹ 'Hills Program on Governance' at 3 available at www.csis.org. [Accessed 18 February 2009].

³⁶⁰ 'Corporate Governance An Antidote to Corruption' found www.cipr.org . [Accessed 17 February 2009]

³⁶¹ Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 230.

is independent of government interference.³⁶² The JSE is a regulatory agency to the Securities Services Act³⁶³.

It makes provisions in the King II a part of its listing rules and listed companies are required to comply with them. Non-compliance with the King II is not penalized unless a company fails to disclose the reasons leading to the non-compliance. 'Quasi-self-regulatory stock exchanges such as [JSE] are the proper regulators of corporate governance largely because of the combination of self regulation and governmental oversight inherent in frameworks.'³⁶⁴The quasi-self regulatory organizations possess attributes that are critical in the rapidly changing field of corporate governance, namely, flexibility and industry expertise.³⁶⁵ The shift of a burden of monitoring listed companies to private entities reduces governmental oversight costs.³⁶⁶ On the other hand, they have some supervision from the Government, which diminishes the faults inherent in self-regulatory organizations that include bias, inadequate enforcement of self-regulatory organization's rules.³⁶⁷

Finally, King II operates under the 'comply or explain' philosophy. The King II expects companies to comply with its provisions from companies but event of failure to comply; they are supposed to explain their non-compliance. The philosophy was due to the need for flexibility in regulating companies after the realization that using the legislative route as the only primary method of regulating

³⁶² Ibid 230.

³⁶³ Securities Services Act [No. 36 of 2004].

³⁶⁴ Burke S K , 'Regulating Corporate Governance Through the Market : Comparing of the Approaches of the United States ,Canada and the United Kingdom', (2001-2002) *HeinOnline—27 J Corporate Law* 341 , at 346.

³⁶⁵ Ibid .

³⁶⁶ Ibid.

³⁶⁷ Ibid .

companies led to the 'box ticking' approach to corporate governance.³⁶⁸ Further, there are other principles of corporate governance that cannot be legislated.³⁶⁹

4.8. Advantages of self regulation through the 'comply or explain' philosophy

Self-regulatory Codes operating under the 'comply or explain' principle have a number of advantages as will be stated:

Self-regulatory Codes cover important aspects of corporate governance that prove difficult to reduce to legally enforceable rules.³⁷⁰ In explaining the quality of persons who qualify as non-executive directors the Code mentions aspects of character which are not readily ascertainable and cannot be reduced to a legal requirement as they manifest themselves over time. This requirements like 'director...independent in character and judgment' found in the Combined Code might 'require a qualitative judgment which shareholders and financial commentators have shown themselves ready and able to make, but it would be difficult if not impossible to frame a legal regulation which could have the same effect.'³⁷¹

The 'comply or explain' philosophy advocated by self-regulatory Codes also comes as an advantage as legal requirements can be onerous making compliance hard or impossible. Companies should comply with King II but can explain their

³⁶⁸ Ibid 230

³⁶⁹ In the UK the Hampel report says that companies must give reasons for their non-compliance with it and clause 8.4.7 of the Code provides that 'directors must, in their communication with stakeholders, report whether the code of corporate practices and conduct has been adhered to or not, if not in what respects there has been adherence'.

³⁷⁰ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 28 available at <http://books.google.co.za> [Accessed 18 February 2009].

³⁷¹ Ibid at 28.

non-compliance. It is notable for example that a fixed board structure provided for by the legislature could pose budget problems for small companies as it might prove too expensive to have both executive and non executive directors and they might be no need to have such a board structure.

On the other hand, self-regulatory Codes that operate under the 'comply or explain' philosophy give management the opportunities to view the individual circumstances of their company before blindly complying with the requirements. The King II states that, before companies implement the provisions of the Code, '...they should give due consideration to the application of the Code in so far as the principles are applicable.'³⁷²The Combined Code states that,

While it is expected that listed companies will comply with the Code's provisions most of the time, it is recognized that departure from the provisions of the Code may be justified in particular circumstances. Every company must review each provision carefully and give considered explanation if it departs from the Code provisions.³⁷³

Codes of conduct are more effective in achieving their purpose of regulating corporate governance.³⁷⁴ In the board structure of companies, the Code clearly refers to a division of responsibilities, which enables shareholders or others to enquire as to the operation of the company.

If it was a legal requirement that companies should have a chairman and a chief executive, the intent of the law could be by passed by appointing a cipher in one or other posts. The letter of the law would have been followed but its purpose frustrated. No follow up by investors would be possible,

³⁷² King report on corporate governance for South Africa (2002) ,at 20.

³⁷³ The Combined Code On Corporate Governance ,(2006) at 1.

³⁷⁴ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 28 available at ,<http://books.google.co.za> [Accessed 18 February 2009].

because the response would be that the board concerned had met its legal requirement.³⁷⁵

Self-regulation is a flexible method of regulating corporate governance. 'A drawback of the statutory approach to corporate governance is that standards prescribed by legislation will generally be the same for all companies [thus] a 'one size fits all approach.'³⁷⁶ This approach poses problems as companies differ in sizes, type of businesses, personalities and skills of directors.³⁷⁷ Small companies have generally had difficulties in structuring their boards in accordance with compulsory legislative provisions and it might prove unnecessarily expensive for small companies to have non-executive directors. The Combined Code states that, 'smaller companies, in particular those new to listing, may judge that some of the provisions are disproportionate or less relevant in their case.'³⁷⁸

Further setting up all committees in the Code and having a proper balance between non-executive and executive directors might also prove to be not only expensive but also impossible for smaller listed companies.³⁷⁹ More so, legislation as drafted by the government does not accommodate the individual needs of companies and the government will not be flexible enough to enact laws that will cater for their diversity. Directors are also encouraged to pay regard to the size and complexity of the company and the nature of the risks and challenges it faces before complying with the requirements of the Code.³⁸⁰ Further, they are encouraged to use common sense in directing companies as this promotes partnership and trust based on mutual understanding.³⁸¹

³⁷⁵ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 28 available at <http://books.google.co.za> [Accessed 18 February 2009].

³⁷⁶ Mongalo T, *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 232.

³⁷⁷ *Ibid* at 232.

³⁷⁸ *The Combined Code On Corporate Governance*, (2006) at 2.

³⁷⁹ *Ibid* at 232, The difficulty is acknowledged in the Cadbury Report in Paragraph 3:15 and the Hampel Report paragraph 1:10.

³⁸⁰ *The Combined Code On Corporate Governance*, (2006) at 2.

³⁸¹ *Ibid* at 2.

Shareholders have the right to challenge explanations by directors if they are unconvincing but this should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches.³⁸² Institutional shareholders and their agents should be careful to respond to the statement from companies in a manner that supports the 'comply or explain' principle.³⁸³ The Combined Code further states that its provisions do not operate in opposition of the shareholders right to information.³⁸⁴

The other advantage of self-regulatory Codes is that they propose higher standards of corporate governance, drawn because of the emergence of specific governance concerns that needed response. 'Codes were therefore, primarily a response to issues facing boards, rather than being imposed on companies in order to raise governance standards in some general sense.'³⁸⁵ Those who proposed corporate governance Codes proposed not only the highest standards in corporate governance but also standards meant to address the corporate governance concerns as evidence by the corporate scandals worldwide. The Hampel report³⁸⁶ stated that, 'both the Cadbury³⁸⁷ and the Greenbury reports³⁸⁸ were responses to things perceived to have gone wrong , that is corporate failures in the first case and unjustified compensation packages in the privatized utilities in the second. Understandably, both concentrated largely on the prevention of abuse.'³⁸⁹

³⁸² Ibid at 2.

³⁸³ Ibid at 2.

³⁸⁴ Ibid at 2.

³⁸⁵ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 30 available at <http://books.google.co.za> [Accessed 18 February 2009].

³⁸⁶ In the form of the *Code for best Practice*.

³⁸⁷ *Report of the Committee on The Financial Aspects of Corporate Governance*, 1992, Gee Publishers, London.

³⁸⁸ *Directors' Remuneration*, Report of a study Group chaired by Sir Richard Greenbury, 1995, Gee Publishers, London.

³⁸⁹ Dewing I P and Russel P O , 'Establishing a permanent body for Corporate Governance' at 357 available at www.sciencedirect.com . [Accessed 22 February 2009].

Legislation on the other hand is usually a result of much deliberation and consultation, which brings compromise resulting in settlement on lower standards mainly for the sake of progress. Statutory standards that enacted will therefore function as the 'lowest common denominator'. As stated by Mongalo T,

The lowest common denominator aspect is apparent where companies or laws are enacted tend to treat the relevant rules as an exhaustive statement of all obligations that exist in relation to the relevant topic. Thus, the standards would be weaker than they are at present if the legislative route were adopted. Compliance might also take place according to the latter rather than the spirit of the relevant requirements.³⁹⁰

Self -regulatory Codes also have some practicality in their applications and predictably good results. Cadbury A states that,

All the recommendations in the 1992 (recommendations from various reports in Europe) Code of best practice were derived from the government systems of companies which were recognized as having been consistently successful. The standards which were set by the Codes were those which were already in a place in respected companies and the aims of all these Codes could be described as that of spreading best practice and enabling boards to learn from each other's experience. In addition, boards were being asked to satisfy their shareholders over their systems of governance and not to report to some external regulatory authority.³⁹¹

Legislative law review is also a long process, laws remain unrevised, and without amendment which is another major drawback in traditional corporate governance. Parliamentarians always have many agendas and corporate issues are not their high priority. Further parliamentarians might not have a clear picture of issues concerning corporate governance due to lack of expertise in that field.

³⁹⁰ Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 232.

³⁹¹ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 30 available at <http://books.google.co.za> [Accessed 18 February 2009].

'Some of the advantages of self regulation, as stated by the International Capital Markets group (1992) in their Standards of Self Regulation of the Securities Markets include the following,'³⁹²

- In self regulation it is possible to impose ethical standards which go beyond those which can be imposed by statutory regulation
- Self-regulators are directly accountable to their members. Self-regulatory systems have a built in motivation to regulate for effectiveness and the least interference.
- Self-regulation operates in an environment where there is a willingness to accept regulations from within for the common good of the group.
- Self-regulators, being 'part' of the group understands the issues more intimately and are therefore more sensitive to the needs of the regulated and the whole group.
- The regulated have an opportunity to participate at all levels of the self-regulatory process thereby making it easier to appreciate and accept new regulations.
- Self-regulation has a built in system of checks and balances in that the regulated see it as their duty to expose non-compliance.

³⁹² Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 232-233.

- Self-regulators have the ability, being the players, to comprehend complex regulatory problems at an early stage and to develop corresponding solutions to these issues before they reach a stage where they can disrupt the group operations.
- Self-regulatory codes have at their disposal a reservoir of resources, which are available at no cost sometimes, and within easy reach.
- Self-regulation is more comprehensive yet much cheaper than official regulation to operate and implement.
- As a result of self regulation, governmental resources, including funds and personnel, are freed to be used where most effective. This optimizes use of scarce resources.
- Self-regulation, as the name implies does make sense because groups, individuals, communities, professions etc owe it to themselves to behave and conduct themselves responsibly with the least external coercion. It therefore follows that if they can responsibly regulate themselves; there will be the least interference from outside.

Codes of corporate governance remain a good corporate governance mechanism. However, their application should be in a flexible manner so that they will not be burdensome for companies. Boards and management only need to exercise judgment in applying them. The individual needs of companies should be given cognizance of in interpreting corporate governance Codes. Boards and management should realize that compliance is not compulsory as long as they can justify their non-compliance.

Codes on corporate governance were not framed as rigid rules and if they are treated as such they can become impositions. However, it is not the so much the Codes themselves, which are at fault, but the manner in which boards have pressed to apply them. The need for flexibility and for a proper appreciation of the circumstances of individual companies has at times been lost sight of in the quest for rules and certainty, rather than the exercise of judgments.³⁹³

4.9. Disadvantages of self- regulatory Codes that operate under the 'comply or explain' philosophy

The major disadvantage of self- regulatory Codes as reiterated by many scholars is the lack of a driving force behind compliance with the Codes. "One of the problematic features of the Code is that companies do not have to comply with any elements of it; they need only disclose non compliance (emphasis in original)."³⁹⁴ Compliance with the Code is thus voluntary and 'if a Code is so to speak, purely voluntary and has no teeth, the risk is that it will be followed by the well-intentioned and ignored by the less conscious, those above all whose Codes are drawn up to influence.'³⁹⁵ Further, questions arise firstly, whether they can be meaningful regulation when companies have an option not to comply and secondly whether those regulatory bodies to which non-compliance should be explained are in fact doing their job.

The other disadvantage is that these self -regulatory Codes still lack certainty over their amendment since their provisions were a direct response to corporate governance concerns. In the event of South Africa it is questionable whether it is the JSE or the King committee that is responsible for the amendment of King II. 'Concerns were also expressed over the tension between the role of non-

³⁹³ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 31 available at <http://books.google.co.za>.

³⁹⁴ Ian P Dewing and Peter O Russel 'Establishing a permanent body for Corporate Governance' at 358 *www.sciencedirect.com* as quoted from Power (1997 page 55) accessed 20 February 2009.

³⁹⁵ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 29 available at <http://books.google.co.za> [Accessed 18 February 2009].

governmental regulators and their responsibilities for administering a widening range of rules and the need to look at the independence and monitoring of those regulators.³⁹⁶

4.10. Can we rely on Self-regulation through the 'comply or explain' philosophy?

It has been questionable whether self-regulation through the 'comply or explain' principle is necessarily reliable as an effective corporate governance mechanism. The major concern has been on its 'comply or explain' philosophy, which makes compliance voluntary whilst non-compliance only needs an explanation. It is also questioned whether the legislative approach to corporate governance like the SOX is a better approach to corporate governance regulation.

Notably, self-regulatory Codes were introduced after it became evident that legislation could never be the only way to regulate corporate governance. Corporate scandals evidenced the failures of legislative regulation. However, the two regulatory mechanisms regulate corporate governance from two different approaches; the legislative way imposes a force behind compliance whilst self-regulation gives room to individual judgment. Clearly and undeniably, both of these regulatory mechanisms have untraded advantages. Lord Hoffman³⁹⁷ thus provides explanation on corporate governance needs self-regulation to complete the governance structure.

Lord Hoffman identified three levels of control in corporate governance and stated the function of each layer.³⁹⁸ The first level exist the bedrock of duties owed

³⁹⁶ Kirkbride J and Letza S, 'Establishing the boundaries of regulation in corporate governance: Is the UK moving towards a process of collaboration?' (2003) 108 ,Issue 4 *Business and Society Review* pages 463-485 available at www3.interscience.wiley.com , [Accessed 18 February 2008].

³⁹⁷ Ibid .

³⁹⁸ Ibid.

by directors at common law and equity. The second layer imposes a number of specific statutory duties intended to reinforce the duties at common law. The final layer specifies duties under self-regulatory Codes, which Lord Hoffman perceives as intended to reinforce common law duties in areas not thought suitable for legislation.³⁹⁹

Like the statutory layer, the self-regulatory layer even tries to reinforce the common law duties of care and skill. For example, the provisions in the Combined Code, which requires a board to meet regularly, receive adequate information on which to make decisions and stating that directors appointed for the first time to the board of a listed company should receive some training for the job.⁴⁰⁰

Lord Hoffman suggests this final layer emanates from the deficiencies of the preceding layers and that self-regulatory duties have become more prominent in recent years.⁴⁰¹ Hoffman proposition clearly sheds more light into corporate governance regulation. King II states that indeed some of the principles proposed by self-regulatory Codes were a restatement of principles that already existed in traditional corporate governance, meaning that since some of the principles in traditional corporate governance were legally enforceable some principles in self-regulatory Codes are legally enforceable under traditional corporate governance.⁴⁰² However, Self-regulatory Codes also have completely new principles, which do not have legal remedies and are incapable of being legislated.

Statutory regulation and self-regulation thus play different roles in the regulation of companies as seen through the advantages brought by self-regulation. The issue centers on their balance and the governance aspects to which they are appropriate. Lord Hoffmann states that three layers, that are common law, statute and

³⁹⁹ Ibid.

⁴⁰⁰ Ibid at 463-485 also stated by Eisternhardt, 'Agency theory: An Assessment and review (1989) 1 *Academy Management Review* 57-74.

⁴⁰¹ Ibid at 463-485.

⁴⁰² *King report on corporate governance for South Africa* (2002), at 155.

self-regulatory Codes will achieve the best in the management of companies.⁴⁰³ Self-regulatory Codes remain essential for the management of corporate governance issues that cannot be enforced through legislation and common law.

The conclusion from Hoffman's analysis is that the law has to strike a balance between encouraging virtue and thereby not inhibiting good management and enterprise. The latter is achieved through the three layers of regulation and control. Legal principles have developed, or should be developed which encourage agents (i.e. directors) to be loyal in their management of a company, to show proper skill and care and to reduce the need to watch over them at all times. It is the three-tiered approach that seeks to achieve this.⁴⁰⁴

4.11. How to have the best from self regulation through the 'comply or explain' philosophy: Enforcement devices

Statutory or any form of legal backing is not recommended for self regulatory Codes as this is not in line with the spirit of self regulation which is to make the regulation of companies as flexible as possible. King II supports the above point and states that further legislation is not desirable regarding those principles, which are not suitable for legal enforcement.⁴⁰⁵ There are proposed ways of enforcing corporate governance particularly the principle of disclosure, the Stock exchange, shareholder activism and the media.

⁴⁰³ Ibid at 463-485.

⁴⁰⁴ Kirkbride J and Letza S, 'Establishing the boundaries of regulation in corporate governance: Is the UK moving towards a process of collaboration?' (2003) 108 Issue 4 *Business and Society Review* pages 463-485 available at www3.interscience.wiley.com [Accessed 18 February 2008].

⁴⁰⁵ Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 226 .

4.11.1. The principle of disclosure

This dissertation proposes the principle of disclosure as a self-regulatory enforcement mechanism. Disclosure is exposure hence because of the element to 'expose' it has the advantage of 'curbing malpractices and excessive rewards.'⁴⁰⁶ Disclosure is important as it exposes any form of misconduct, and non-performance hence giving the victims the opportunity to take appropriate remedial action. Cadbury A states that the disclosure obligation of companies as enunciated by the London Stock exchange is responsible for the success of the Combined Code.⁴⁰⁷ Justifying, unjustified non-compliance is not easy hence; the only option left is to comply.

Disclosure is also important as it gives shareholders the opportunity to make an informed judgment as to the management of the company. 'The consequences of disclosure, however, were that it gave shareholders an informed opinion as the basis for judging whether a company's governance structure was acceptable, or in need of strengthening in some way. Equally, it provided them with the information they required in order to enter into a constructive dialogue with the company concerned. Thus compliance with the disclosure requirement of the London Stock Exchange enabled the Code to achieve its aims without having to be enforced by further sanctions.'⁴⁰⁸

The power of the Code is [therefore] more specifically in its ability to open an informed debate between management and shareholders.⁴⁰⁹ Mongalo T states that,

⁴⁰⁶ Ibid at 228, see *King Report on corporate governance for South Africa* (2002) Section 6 Chapter 4 at 147.

⁴⁰⁷ Cadbury A, *Corporate governance and chairmanship a personal view* (2002) at 29. available at <http://books.google.co.za> .[Accessed 15 March 2009]

⁴⁰⁸ Ibid at 29.

⁴⁰⁹ Ibid at 29.

[King II] maintains that disclosure has important advantages including providing a shrinking effect in that it will dissuade malpractices or executive rewards. It equates disclosure to sunlight and maintains that sunlight is justly commended as the best disinfectant, electric light as the best policemen.⁴¹⁰

The Stock exchange like the JSE and the LSE become important as watchdogs who when companies do not comply with Self regulatory Codes become mandated to make sure they disclose the reasons. The Stock exchange should also provide effective penalties for companies that fail to disclose and delisting should be one of the penalties.

4.11.2. The media

The media also has an important role in regulating self- regulation. Journalism should have well trained financial journalist who have the capability to keep an eye on corporate governance issues and have the capability to bring pressure on companies to comply with appropriate corporate governance principles. The media should expose companies, which are complying with corporate governance issues and those that do not comply. That gives companies an additional urge to comply and to justify their non-compliance.

4.11.3. Shareholder Activism

Shareholder activism is also another way of enforcing self- regulation. Indeed in self -regulation shareholders should act as watchdogs' in order to protect their interest. Through the exercise of their votes shareholders should probe reasons for non- compliance at the same time giving managers the room to manage the company (as they are the ones mandated to do so). Shareholders should have the ability able to

⁴¹⁰ Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 226 see *King Report on corporate governance for South Africa* (2002) , Section 6 Chapter 4 at 147.

vote out directors who do not keep an eye on the affairs of the company and shareholders should be capable of voting for a takeover.

King II emphasizes the importance of shareholder activism.⁴¹¹ 'In this regard, King II proposes that measures should be undertaken to avoid shareholder apathy, shown more especially by institutional shareholders who constitute the majority of shareholders.'⁴¹² King II suggest that shareholders should be compelled to attend meetings by subjecting them to censure more specifically those who possess say 5 percent voting rights and choose not to attend meetings.⁴¹³ Minority shareholders should also be educated of their rights and the way to exercise them.

Shareholder activism through the exercise of votes is also important, as it is another way shareholders initiate change through the market for corporate control. Voting on mergers and takeovers by shareholders will give self-regulation an opportunity to succeed. Managers will seek to do the best for the company in fear that their complacence will force shareholders to change their management. For self-regulation to have a chance to succeed, shareholders must have voting rights. However, the market for corporate control still functions since shareholders vote on mergers and acquisitions. With shareholders vote restricted permanently or via takeover defenses, shareholders lose their ability to initiate change through the market for corporate control as well as through conventional monitoring mechanism.

⁴¹¹ Ibid see *King Report on corporate governance for South Africa* (2002) Section 6 Chapter 6 at 149 – 151.

⁴¹² Mongalo T. *Corporate Law and Corporate Governance, A Global Picture of Business Undertakings in South Africa* (2003) at 229.

⁴¹³ Ibid at 229.

4.12 Conclusion

This chapter substantiated the need for a corporate governance reform in Zimbabwe as discussed by the previous chapters by giving a practical look into the contents and the drafting process of a Zimbabwean corporate governance Code. It further provided a broader picture of self-regulation by discussing its merits and demerits. Its conclusion was that corporate governance regulation through a self-regulatory Code operating under the 'comply and explain' philosophy of corporate governance is worth a try in Zimbabwe not only for its benefit to the economy but also as a means to cater for the peculiar needs of companies in Zimbabwe. The next chapter will therefore give an overall conclusion to the whole dissertation discussion.

CHAPTER 5

RECOMMENDATIONS AND CONCLUSIONS

5.1. Introduction

Companies in Zimbabwe – mainly those discussed in this dissertation – clearly depict the gravity of the corporate governance problems faced by the country and the need for reformation.⁴¹⁴

This dissertation discussed various corporate governance scandals, and identified various corporate governance problems. These included the lack of independence at board level, fraud on the part of directors, outright disregard of legislation that regulates corporate governance, lack of expertise by board members and poor management skills on the part of directors. Conflict of interest on the part of directors was glaringly the most evident concern.⁴¹⁵

In running the affairs of a company, executives never apply the same diligence as the owner of the company might.⁴¹⁶ 'The divergence of management's objectives from those of owners is a well-established phenomenon in the literature. Addressing this innate conflict of interest is the core task of any effective corporate

⁴¹⁴Corporate insolvency, loss of jobs and loss of investor confidence mainly in TBC, Royal Bank and ENG clearly show how poor corporate governance can be detrimental to the economy

⁴¹⁵'A closely related issue is the problem of self-dealing: asset-diverting behavior on the part of insiders to the detriment of outsiders, typically minority shareholders.' Odenius J, 'Germany's Corporate Governance Reforms: Has the System Become Flexible Enough?' WP/08/179 at 9.

⁴¹⁶'Berle and Means ascertained the underlying problem of corporate governance as the separation of ownership from control.' ⁴¹⁶Haverkamp L, 'Corporate Governance: Codification or Self regulation- Is SOX a viable solution for New Zealand' University of Canterbury law School, Master's Thesis cited from Berle A and Means G, *The Modern Corporation and Private property* 1932.

governance system.’⁴¹⁷ Surprisingly on an independent observation, when the owners of the company are to be given an opportunity to manage their companies they are still faced with conflict of interest. The above assertion is justified by the fact that directors in Zimbabwean companies included owners of the banks who misappropriate shareholder funds.⁴¹⁸

Corporate governance states that in dealing with the company, directors are supposed to consider the interest of the company. ‘The American Law Institute says that “the objective of the corporation is the conduct of business activities with the view to enhancing corporate profit and shareholder gain”.’⁴¹⁹ Company law views the interests of the company as the interests of shareholders. The above proposition is true as justified by researchers but it might not be exhaustive in the Zimbabwean scenario or in the world subject to evidence.

Major shareholders in banks discussed were not only directors but also owners of most of the companies discussed. They did not act in accordance with the interests of the companies and their selfish interests are inequitable to the interests of the companies. As regards directors who were not owners or shareholders of the companies, they also failed to identify the interest of the company.

This dissertation therefore recommended the introduction of self-regulation as a way of enhancing corporate governance regulation.

⁴¹⁷ Odenius J, ‘Germany’s Corporate Governance Reforms: Has the System Become Flexible Enough?’ WP/08/179 at 9 .

⁴¹⁸ They furthered their own personal interest at the expense of the interest of their companies.

⁴¹⁹ Monks A R and Minnow A G, *Promoting Flexibility In The Application Of Traditional Corporate Governance* at 21 available at www.books.google.com .[Accessed 10 March 2009].

5.2. Enhancing corporate governance regulation in Zimbabwe

To supplement existing corporate governance regulation this dissertation recommended the introduction of self-regulation through a self-regulatory Code that uses the 'comply or explain' philosophy. The commencement of the drafting process will be after consultation with various stakeholders in Zimbabwe and in consultation with various corporate governance experts in the world. It will not duplicate and insert any particular provisions in any Code of corporate governance but will pay particular regard to recent corporate governance regulatory provisions internationally. This intends to bring the Code in line with international corporate governance standards. The Code will also pay particular regard to the needs of Zimbabwe as an African country.

Drafters⁴²⁰ of the Code should also consider it important for Africa to move away from a European centered model of corporate governance and to draw towards an *Afrocentric* model as discussed in the dissertation. In doing so it should be noted as discussed that *Afrocentricity* does not counter capitalistic views and hence it has nothing to do with demeaning European centered views but advocates an approach that suits the needs of the people in which companies in Africa operate⁴²¹. An approach that refrains from countering capitalism is ideal as most companies in Africa have an origin in Europe, which advocates for capitalistic views.

A Further realization is that existing rules in traditional corporate governance⁴²² need reinforcement and enforcement. This is possible by amending the Companies Act as will be briefly discussed below. This dissertation proposed Self-

⁴²⁰ This part of the dissertation recommends the IODZ as the drafter and the ZSE as the chief player in implementing a corporate governance Code for Zimbabwe. Their suggested roles are discussed below.

⁴²¹ Darder A, Culture and difference: critical perspectives on the bicultural experience in the United States (1995) at 98 available at www.google.co.za [Accessed on 16 April 2009]

⁴²² Traditional corporate governance was discussed earlier in the dissertation.

regulation regarding the regulation of aspects not regulated by the rule-based approach. Reasons for suggesting the introduction of self-regulation in Zimbabwe whilst at the same time maintaining the rule-based approach to corporate governance are briefly echoed below as they have been discussed earlier in the dissertation.

5.3. Reasons why Zimbabwe should maintain the rule-based approach to corporate governance and a brief discussion of the major weak point in traditional corporate governance

Traditionally, mandatory rules, backed by legislative penal provisions, enforced through the courts of law, have regulated corporate governance. 'The major advantage of [traditional] corporate governance is that it allows the state to establish minimum standards to which market participants must adhere.'⁴²³ Participants in the market have a compulsion to comply with legislative provisions, failure of which makes them liable, thereby protecting the investor. On the contrary, voluntary provisions do not guarantee compliance.⁴²⁴ The society thus benefits from the provision of mandatory rules. More so heavy penalties guarantee compliance.

Mandatory rules also protect the investor by providing standard rules, which the uninformed investor measures the company.⁴²⁵ 'The laws thus constitute a standard form and investors need only learn the terms of reference of one system.'⁴²⁶ Further, the state is there to monitor and enforce the rules. Hence, as Barker R notes

..., the UK emphasis on a voluntary corporate governance code – although representing a lighter regulatory touch than systems based entirely on "hard

⁴²³ Anand I A, 'Voluntary vs. Mandatory Corporate Governance: Towards an optimal regulatory framework' ,American Law and Economics Association Annual Meetings, Year 2005 ,Paper 44 at 8.

⁴²⁴ Ibid at 8.

⁴²⁵ Ibid at 11.

⁴²⁶ Ibid at 11.

law” – is nonetheless underpinned by a certain amount of carefully-targeted law and regulation. This polices the extreme borders of corporate governance behaviour, and provides an incentive for boards and shareholders to engage with one another in a constructive dialogue on non-statutory aspects of corporate governance.⁴²⁷

The weaknesses of the traditional corporate governance revolve around the ‘tick box approach’⁴²⁸ to corporate governance.⁴²⁹ Inadequate enforcement of corporate governance rules in Zimbabwe worsens the problem. The drawbacks have been mainly due to inadequate resources by the criminal justice system.⁴³⁰ As Barker argues, the weakness that surrounds the traditional corporate governance regime is that it-

reflects the view that not all aspects of corporate governance behaviour should (or can) be defined by the inflexible requirements of formal legislation. Furthermore, it also acknowledges that there is a strong commonality of interest between companies and shareholders that should be encouraged by giving shareholders a central role in the enforcement of corporate governance standards.”⁴³¹

A realistic advantage of such self-regulatory provisions is that they allow flexibility in the regulation of companies. On the contrary, regulators do not allow deviations from statutory rules. Using self-regulation ‘... shareholders can be more pragmatic.

⁴²⁷ Barker R ‘The UK Model of Corporate Governance: An Assessment from the Midst of a Financial Crisis’ at 4 (2008) available at http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_publication_The_UK_Model_of_Corporate_Governance.pdf . [Accessed 12 March 2009].

⁴²⁸ The approach has been discussed earlier and by it because directors are expected to act in accordance with legislative provisions; they do so without paying attention to the needs of the company.

⁴²⁹ Ibid

⁴³⁰ As highlighted by King II and discussed earlier in this dissertation These resources include the lack of funds to initiate investigations, vehicles to further the investigations, and police and prosecutors who are experts in commercial matters on.

⁴³¹ Barker R ‘The UK Model of Corporate Governance: An Assessment from the Midst of a Financial Crisis’ at 4 (2008) available at [.http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_publication_The_UK_Model_of_Corporate_Governance.pdf](http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_publication_The_UK_Model_of_Corporate_Governance.pdf) . [Accessed 12 March 2009].

They can permit deviations from defined codes of conduct if they are persuaded that they are justifiable in specific instances.⁴³²

Of particular note is that most financial scandals are associated with the United States that uses a rule-based approach to corporate governance.⁴³³ This dissertation therefore suggests the introduction of self-regulation as a method of corporate governance as a way to ensure a balance between statutory regulation and self-regulation in Zimbabwe.

5.4. Good reasons for a self regulatory Code that operates through the 'comply or explain' philosophy

Self-regulatory codes compliment traditional regulation. They offer unique advantages to the corporate governance structure. They are '...flexible individually tailored, easy to apply and possess needs for internal pressures for compliance.'⁴³⁴ 'Self regulation permits regulation where traditional legislation fails to meet requirements of conflict prevention, agency, flexibility and internalization.'⁴³⁵ The enforcement of self-regulatory Codes is through the 'comply or explain' principle. Braker R states that,

The ...'comply or explain' principle is finding increasing favour amongst policy makers around the world, based on its ability to promote high standards of governance without stifling the wealth creation process. In

⁴³² Ibid at 4.

⁴³³ 'The Sarbanes-Oxley Act – with all of its statutory requirements for rigorous internal controls – has not prevented the collapse of many of the leading names of US banking and finance. This suggests that a highly regulated approach to corporate governance is not a sure fire means of avoiding economic instability.' Ibid at 9

⁴³⁴ Seales F Jnr and Spencer M, *Corporate Codes of Conduct* , at 166 available at www.books.google.co.za accessed 17 March 2009.

⁴³⁵ Lundband N and Kiefer A , 'The Economic Efficiency of Self Regulation, Two Case Studies', at 1 Annual Conference ,April 5th – 6th 2002 University of Ansterdam available at www.bilela.ac.uk .[Accessed 19 March 2009].

particular, it is seen as being less costly and more flexible than the main alternative approach: the legislatively based corporate governance model of the United States.⁴³⁶

Firstly, through the 'comply or explain' principle, corporate Codes regulate corporate ethics.⁴³⁷ Directors have human weaknesses that the law is incapable of governing but needs Codes that emphasise moral behavior. Secondly, because of the internal regulation proposed by self-regulatory Codes they are capable of detecting misconduct in its early stages.⁴³⁸ Codes also give directors an opportunity to deal with a problem before the state discovers it.⁴³⁹ In doing so, they avoid prosecutions and reputational injuries to the company.⁴⁴⁰ Thirdly corporate governance Codes prevent criminal liability. Because they are an 'effective program to prevent and detect violations of the law they prevent prosecution hence criminal liabilities to the company.'⁴⁴¹

⁴³⁶ Barker R 'The UK Model of Corporate Governance: An Assessment from the Midst of a Financial Crisis' at 1 (2008) available at http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_publication_The_UK_Model_of_Corporate_Governance.pdf. [Accessed 12 March 2009].

⁴³⁷ Seales F Jnr and Spencer M, *Corporate Codes of Conduct*, at 166 available at www.books.google.co.za. [Accessed 17 March 2009].

⁴³⁸ Ibid at 166.

⁴³⁹ Ibid at 166.

⁴⁴⁰ 'A Code could turn what would otherwise have been a three year fraud scheme into a three week fraud scheme.' Ibid at 166

⁴⁴¹ Ibid at 166

5.5. How Zimbabwe can implement the suggested Zimbabwean corporate governance Code

5.5.1. The role of the Institute Of Directors in Zimbabwe

The IODZ like the IODSA is an affiliate organization to IOD in the UK, as discussed earlier in the dissertation.⁴⁴² In furthering good corporate governance, the IODSA provided secretariat support to the King Committee to draft the King II, which is a self-regulatory Code in South Africa.⁴⁴³ Likewise, The IODZ also advocates for the advancement of corporate governance practices in Zimbabwe. This is evident because after realizing the world emphasis on corporate governance, the IODZ recommends compliance with Cadbury report or, the South African's King report.⁴⁴⁴ The IODZ enhanced its efforts in 2001 by the publishing a corporate governance manual entitled '*Principles for Corporate Governance in Zimbabwe: Manual of Best Practice*'.⁴⁴⁵

This dissertation recommends that the IODZ should make an initiative to start a corporate governance Code that embodies corporate governance principles that well drafted specifically for Zimbabwean companies. The principles from the King II (the most recent version at the time of drafting) as a corporate governance Code regulating corporate governance in an African setup will help with the insight to start the drafting process. The Combined Code in the UK exemplifies corporate governance outside Africa and its provisions will have persuasive value.

⁴⁴² The aim of the IOD is to 'support, represent and set standards for directors.' About the IOD' available at www.iod.com.

⁴⁴³ Malin C A, *Handbook on International Corporate governance (2006)* available at www.books.google.co.uk [Accessed 22 November 2008].

⁴⁴⁴ Mangena M and Tauringana, 'Working Paper Series Disclosure, Corporate Governance and Foreign Share Ownership on the Zimbabwe Stock Exchange' Working Paper No 06/43 November 2006.

⁴⁴⁵ Ibid. The above is a manual and differs from the Code proposed by this dissertation and it '... incorporates the Cadbury report (1992) and King report (1994) and companies are encouraged to adopt either of the two.' Ibid.

The provisions of the two Codes together with other Codes as will be recommended by other scholars will be used to kick start the drafting process. Provisions in these Codes only influence the drafting process and provide insight as to the principles of corporate governance governed by self-regulation. Consultations with shareholder, stakeholders and company managements will be necessary in order to gain knowledge as to the corporate governance problems they might want the Code to address.

The above will ensure a corporate governance Code that embodies corporate governance principles that are in line with not only international standards but also addresses the peculiar corporate governance concerns in Zimbabwe. A committee like the King Committee will be essential to undertake the drafting process and to consult all the interested parties in the drafting of the Code.

5.5.2. The Role of the Zimbabwean Stock Exchange

The Listing Rules among other things provide require disclosure of information to the market. The LSA, JSE, NYSE all have disclosure provisions for listed companies. Of particular relevance to this dissertation is that provisions of corporate governance Codes form part of the information disclosed in self-regulatory jurisdictions like the UK and South Africa. As stated by Barker R, in the UK, the LSE rules

‘... include the formal requirement to provide a corporate governance statement in the annual report, explaining how the company has applied the Combined Code. In the case of companies incorporated abroad – but listed in the UK – the firm must disclose how its domestic governance practices differ from those set out in the Code.’⁴⁴⁶

⁴⁴⁶ Barker R ‘The UK Model of Corporate Governance: An Assessment from the Midst of a Financial Crisis’ (2008) at 4 available at http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_publication_The_UK_Model_of_Corporate_Governance.pdf [Accessed 12 March 2009]

The ZSE should thus make the Code proposed by this dissertation part of its listing rules. The preamble to the Combined Code offers the following advice:

While it is expected that listed companies will comply with the Code's provisions most of the time, it is recognized that departure from the provisions of the Code may be justified in particular circumstances. Every company must review each provision carefully and give a considered explanation if it departs from the Code provisions.⁴⁴⁷

The listing rules thus promote the flexibility of self-regulatory Codes as compliance with the Code is not a compulsory listing rule but an explanation follows the non-compliance. 'It is also important that shareholders devote adequate time to evaluating the reasons for non-compliance with the [Corporate Governance Codes]. Non-compliance should not necessarily be treated as synonymous with poor governance.'⁴⁴⁸

5.6. Further Recommendations: Amending the Companies Act in Zimbabwe

5.6.1. Legislating fiduciary duties

Since this dissertation suggests the maintenance of traditional corporate governance and recommends the enhancement of its rules so that they can be in line with international corporate governance standards. Notably, traditional corporate

⁴⁴⁷ *The Combined Code on Corporate Governance* (2006) Preamble

⁴⁴⁸ Barker R 'The UK Model of Corporate Governance: An Assessment from the Midst of a Financial Crisis' (2008) available at http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_publication_The_UK_Model_of_Corporate_Governance.pdf accessed 12 March 2009

governance is moving towards the legislation of fiduciary duties⁴⁴⁹ as done in the UK, USA and in South Africa.

Fiduciary duties include the duty of care and skill, the duty to avoid conflict of interest, the duty to exercise independent and unfettered discretion and the duty not to usurp corporate opportunities. Legislating fiduciary duties will mean an imposition of responsibilities on directors, which is a move, aimed at curbing the misuse of authority.⁴⁵⁰ 'The responsibilities imposed by law generally may not be waived by contract as they are designed to prevent abuse of power by the fiduciary.'⁴⁵¹

5.6.2. Introducing flexibility in the application of traditional corporate governance principles

With the constant evolution of corporate governance principles, rule-based corporate governance has proven to be as rigid and inflexible. On the contrary, corporate governance Codes operating under the 'comply or explain' principle provides a flexible corporate governance regime. It is however notable those voluntary provisions face the possibility of non-compliance hence the need to maintain a balance between a rule-based approach to corporate governance and the voluntary corporate governance regime.

⁴⁴⁹ In *Hospital Products Limited v United States Surgical Corporation* (1984) 156 CLR 41 (HC of A). Mason J said: 'The critical feature of these relationships is that the fiduciary undertakes or agrees to act for or on behalf of or in the interests of another person in the exercise of a power or discretion which will affect the interests of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power or discretion to the detriment of that other person who is accordingly vulnerable to abuse by the fiduciary of his position.'

⁴⁵⁰ Young B S, 'The Ethics of Corporate Governance. The North American perspective.' Corporate governance : North America at 35 available at www.meralsight.com accessed 17 March 2009

⁴⁵¹ Ibid at 36

With regard to the corporate governance principles regulated by the rule-based approach to corporate governance, this dissertation suggests flexibility in their application. This suggestion stems from the realization that companies remain diverse in many respects and legislative provisions may not suite particular needs of a company.

This dissertation thus recommends the introduction of flexibility in traditional corporate governance by drawing lessons from the Companies Bill⁴⁵² in South Africa. The Bill gives the Companies Ombud the power to exempt companies from compliance with certain provisions in certain circumstances.⁴⁵³ 'In other words an agreement, transaction or arrangement which advances good corporate governance, for example, may be exempted from compliance with an unalterable provision of the proposed legislation upon the order of the regulatory authority, the Companies Ombud.'⁴⁵⁴

⁴⁵² *Republic of South Africa Companies Bill 2008* as amended by the portfolio committee on trade and industry.

⁴⁵³ Section 6(2), provides that: "A person may apply to the Companies Ombud for an administrative order exempting an agreement, transaction, arrangement, resolution or provision of a company's Memorandum of Incorporation or rules from any prohibition or requirement established by or in terms of an unalterable provision of this Act, other than a provision that falls within the jurisdiction of the [Takeover Regulation] Panel.

(3) The Companies Ombud may make an administrative order contemplated in subsection (2) if it is satisfied that—

(a) the agreement, transaction, arrangement, resolution or provision serves a reasonable purpose other than to defeat or reduce the effect of that prohibition or requirement; and

(b) it is reasonable and justifiable to grant the exemption, having regard to the purposes of this Act and all relevant factors, including—

(i) the purpose and policy served by the relevant prohibition or requirement; and

(ii) the extent to which the agreement, transaction, arrangement, resolution or provision infringes or would infringe the relevant prohibition or requirement."

⁴⁵⁴ Mongalo T, 'The unusual and welcome legislative flexibility of the Companies Bill, 61 of 2008' at 3.

5.7. Conclusion

The amendment of the Zimbabwean corporate governance regime is essential in order to bring back investor, shareholder and stakeholder confidence. Developing corporate governance rules and principles is therefore a giant step towards the alleviation of economic problems in Zimbabwe, which have contributed in impoverishing the country.

This dissertation recommended the strengthening of the corporate governance regime by introducing a Zimbabwean corporate governance Code that operates under the 'comply or explain' philosophy. The Code drawn should consider Zimbabwe's particular needs in relation to corporate governance. Enhancing corporate governance rules by amending the Zimbabwean Companies Act in light of other developments worldwide is also a separate recommendation in this dissertation.

The above recommendations are in an effort to enhance the corporate governance regime in Zimbabwe on recognizing the benefits that accrue therefore as discussed.

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