



**University of Cape Town
School for Advanced Legal Studies – Faculty of Law**

**Department of Commercial Law
Master of Laws-Commercial Law**

**CORPORATE GOVERNANCE REGULATORY FRAMEWORK IN
ZAMBIA: RECOMMENDATIONS FOR IMPROVEMENT**

**WALUBITA LUWABELWA
LWBWAL001**

Supervisor: Doctor Tobias Wiese

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ABSTRACT

Formulating an effective regulatory framework for a country is a tasking exercise even to the finest policy maker. It calls for an appreciation of the intricate social, cultural and economic nuances of a country so as not to divorce the legal and institutional framework from the people the framework is meant to serve.

This dissertation considers the legal and institutional framework of corporate governance in Zambia. It argues in favour of a contextualised study of corporate governance in Zambia due to the country's high poverty levels, favourable geographical location for trade, and unfavourable capital structures of public listed companies, among other reasons.

Several weaknesses in the current corporate governance framework are identified. These include the weak institutional capacity of private regulatory bodies, lack of a proper legal framework of self regulatory organisations, and the large number of small and medium enterprises, mining companies and state owned enterprises that fall outside the purview of corporate governance regulation.

More importantly, the dissertation undertakes a comparative analysis of selected corporate governance themes in South Africa, United States of America and the United Kingdom. Based on this comparative analysis, it makes recommendations for improvement of corporate governance in Zambia. It suggests a balanced mix of a prescriptive and enabling approach to corporate governance regulation in Zambia. In particular, it recommends that the *Zambian Companies Act* should be amended to provide for key corporate governance aspects. The dissertation however cautions against over regulation beyond what is necessary for Zambia's needs, and frowns upon adopting a 'one-size-fits-all' approach to corporate governance in Zambia.

DEDICATION

To my late parents Godwin Tabacha Luwabelwa and Inonge Luwabelwa.

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LIST OF ABBREVIATIONS

ALI	Principles of Corporate Governance and Structure: Restatement and Recommendation
CEO	Chief Executive Officer
CFO	Chief Financial Officer
COMESA	Common Market for Eastern and Southern Africa
CSR	Corporate Social Responsibility
DGCL	Delaware General Corporation Law
EDGAR	Electronic Data Gathering Analysis and Retrieval system
EIS	Environmental Impact Statement
IMF	International Monetary Fund
IODZ	Institute of Directors of Zambia
LUSE	Lusaka Stock Exchange
MBCA	Model Business Corporation Act
SADC	Southern African Development Community
SEC	Securities and Exchange Commission
SME	Small and Medium Enterprise
SOE	State Owned Enterprise
SOX	Sarbanes Oxley Act
SRO	Self Regulatory Organisation
UK	United Kingdom
USA	United States of America
ZFE	Zambia Federation of Employers
ZICA	Zambia Institute of Chartered Accountants

CHAPTER 1-GENERAL BACKGROUND

*'There is always a link between good governance and compliance with law. Good governance is not something that exists separately from the law and it is entirely inappropriate to unhinge governance from the law.'*¹

Companies today have become an integral part of commerce and industry. The frequency with which we deal with companies has increased so much and as a consequence, people will usually view them as entities that make profit from selling products and services.²

The genesis of registration of incorporated forms of companies can be traced to England in 1844. The thinking at that time was that companies would publicly offer shares³ and more importantly, that the companies would have a separation between the shareholders and the persons who would have control of the company.⁴

The modern separation in legal personality of the corporate entity and its incorporators hails from the landmark case of *Salomon v Salomon & Co Ltd*.⁵ This case established the principle that 'a company is at law a different person from the subscribers to the memorandum,'⁶ and that 'the company is not in law the agent or trustee of the subscribers.'⁷ One of the consequences of *Salomon v Salomon*⁸ is that the modern corporation has seen not only a separation in legal personality of the corporate entity and the members of such corporate entity, but also a separation between shareholders and the persons who manage the company affairs.

This separation between owners and managers of a company, coupled with the fact that management's ownership interest often represents little more than a token shareholding, has exponentially increased the potential for conflict among the

¹ King Committee on Corporate Governance *King Code of Governance for South Africa* (2009) at 6. Available at <http://www.library.up.ac.za/law/docs/king111report.pdf> [Accessed 22 February 2011].

² Derek French et al *Company Law* 26ed (2009) at 3. See also www.oup.com/uk/orc/bin/9780199290277/mayson_chap01.pdf [Accessed 20 January 2011].

³ French (note 2) at 59.

⁴ *Ibid.*

⁵ 1897 AC 22. Available at http://en.wikipedia.org/wiki/Salomon_v_A_Salomon_%26_Co_Ltd [Accessed 14 January 2011].

⁶ *Ibid.*

⁷ *Ibid.*

⁸ *Ibid.*

various corporate stakeholders. Corporate governance intervenes to try and manage this separation of ownership from control.⁹

Corporate governance has today received more attention globally but it is still a subject of debate as to the exact constituent elements of corporate governance, and how far corporate governance reaches into other facets of the law.¹⁰ Despite these uncertainties, it is widely agreed that corporate governance has received growing attention due to large costly corporate crashes such as the Maxwell publishing empire, Enron and Worldcom.¹¹

Zambia has also experienced spectacular failures in the last two decades particularly in the sectors of banking, commerce, and industry. The classic example is the Meridian BIAO Bank that was dogged from its early days by a liquidity problem believed to have been caused by funds being transferred from more profitable banks to aide less profitable banks.¹² A close examination of the underlying factors causing the collapse of most Zambian companies suggests a deficiency in adhering to good corporate governance standards.¹³

The growth of corporate governance in developed economies has mainly been attributed to an attempt at capping agency costs resulting from the differences between what shareholders desire from a company and what managers would wish to achieve. This is often times referred to as the principal and agent conflict. For emerging economies however, conflicts between the minority shareholders and the controlling shareholders are thought to be a major cause of increased attention towards matters of corporate governance. These are also known as principal and principal conflicts.

It has been argued that principal and principal conflicts are caused by certain factors such as business group structures, and extensive family ownership and

⁹ Ramani Naidoo *Corporate governance : an essential guide for South African companies* 2ed (2009) at 32.

¹⁰ Naidoo (note 9) at 4.

¹¹ The collapse of Enron and Worldcom in 2002 resulted in the enactment of the Sarbanes Oxley Act, while the collapse of Maxwell publishing empire catalyzed the publication of the Cadbury Report on Corporate governance in the UK in 1992. See Ramani Naidoo (note 9) at 2.

¹² Information available at <http://www.thefreelibrary.com/Meridien+collapse+-+the+inside+story.-a017085716> [Accessed 26 January 2011].

¹³ The Institute of Directors of Zambia, *Manual on corporate governance : a guide for companies and organisations on best practices in corporate governance* (2004) at 1 & 2.

control.¹⁴ Thus the corporate governance interventions in developing economies that experience principal and principal conflicts inevitably vary from those in developed economies that experience mainly principal and agent conflicts.¹⁵

What then is corporate governance?

1. Defining Corporate Governance

Corporate governance, being a recently developing area, does not lend itself to a single definition. Perhaps its simplest definition is ‘the system by which companies are directed and controlled.’¹⁶ It involves not only ‘what the board of a company does’¹⁷ but also ‘how it sets the values of the company.’¹⁸

Corporate governance can be understood as:

...a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance provides the structure through which company objectives are set, the means by which those objectives are attained and performance is monitored....¹⁹

It regulates how corporate power is used to ensure that the objectives of the company of creating sustainable shareholder value are achieved.²⁰

Another definition of the term goes thus:

...the system by which the power of a corporation is exercised in the stewardship of the corporation’s total portfolio of assets and resources with the objective of maintaining and increasing shareholder value, with the satisfaction of other stakeholders in the context of the organisation’s mission....²¹

Although corporate governance does not lend itself to a single definition, certain essential components of the term can be deduced from the various definitions. Therefore, corporate governance relates to a process of management control aimed at achieving corporate efficiency and profit by effecting responsible corporate

¹⁴ Michael N Young et al ‘Corporate governance in emerging economies : a review of the principal–principal perspective’ *Journal of Management Studies* 45:1 January 2008 0022-2380 at 196. Available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-6486.2007.00752.x/full> [Accessed 3 August 2010].

¹⁵ Ibid.

¹⁶ Young (note 14) at Paragraph 2.5 Available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-6486.2007.00752.x/full> [Accessed 3 August 2010].

¹⁷ Young (note 14) at Paragraph 2.5.

¹⁸ Young (note 14) at Paragraph 2.5.

¹⁹ The OECD Principles of Corporate Governance 2004 at 11. Available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [Accessed 17 January 2011].

²⁰ Naidoo (note 9) at 3.

²¹ The Institute of Directors of Zambia, *Manual on corporate governance : a guide for companies and organisations on best practices in corporate governance* (2004) at 3.

behaviour, and considering the effect of corporate behaviour on various corporate stakeholders.²²

Apart from formulating a standard definition of corporate governance, there also exists strong differences of opinion about the benefits of corporate governance, and whether these benefits justify the costs of compliance with corporate governance regulation and best practice. It has even been argued that corporate governance is of greater importance for larger public companies with dispersed shareholding than in other organisations such as private companies, state owned corporations, and not for profit organisations.²³

Suffice to say, it is widely recognised that corporate governance at corporate level aides in achieving sustained long-term economic success.²⁴ Corporate governance enhances corporate responsibility and increases the likelihood of foreigners to invest in a countries local economy.²⁵ Corporate governance helps prevent corruption and other unethical business practices, and encourages market discipline and transparency.²⁶ Further, companies with a reputation for being good corporate citizens are able to attract better calibre employees.²⁷

Du Plessis²⁸ suggests four macroeconomic benefits of good corporate governance. First, it helps in stabilising the macroeconomy. Second, it increases the ability of government to implement development policies aimed at reducing poverty using scarce resources. Third, it enables the management of public enterprises in an accountable manner. Fourth, good corporate governance enables the spreading of information to stakeholders, and helps 'broaden and deepen local capital markets.'²⁹

At continental level, good corporate governance is an important precondition for a nation's development. The state of Africa's economy, including its legal and

²² Jean Jacques du Plessis et al *Principles of contemporary corporate governance* (2005) at 7. Also available at http://assets.cambridge.org/97805216/17833/excerpt/9780521617833_excerpt.pdf [Accessed 21 February 2011].

²³ Brian Coyle *The ICSA study text in corporate governance 6ed* (2009) at 5, 30-31.

²⁴ G. J. Rossouw 'Business ethics and corporate governance in Africa' *Business Society* 2005 44: 94 at 99. DOI: 10.1177/0007650305274851. Available at <http://bas.sagepub.com/content/44/1/94>. [Accessed 18 October 2010].

²⁵ Rossouw (note 24).

²⁶ Rossouw (note 24).

²⁷ Naidoo (note 9) at 10.

²⁸ Du Plessis (note 22) at 1.

²⁹ Ibid.

institutional framework, reveal an urgent need for good corporate governance to help African countries like Zambia improve their economic and corporate governance mechanisms.³⁰

2. The research question and scope

The research question that this dissertation addresses is whether the legislative and institutional corporate governance regulatory framework in Zambia is suitable to enhance economic development in Zambia. In addressing this question, the dissertation evaluates whether importing a foreign corporate governance framework, rather than adopting one that is unique to a country's social and economic climate, is beneficial for corporate governance reform. The dissertation thus seeks to make recommendations to enable Zambia improve its corporate governance regulatory framework to meet international corporate governance standards.

The dissertation draws from three jurisdictions that are considered leaders in corporate governance reform. These are South Africa, the United States of America (USA), and the United Kingdom (UK). South Africa has been selected because of its King Reports on Corporate Governance that have made the country an admirable African nation that is at the forefront of international corporate governance best practice. The USA is significant to this dissertation as it is a developed country that has implemented a mandatory corporate governance approach. This serves as a good spring board for a comparative study. Finally, the UK has been included because the legal system in Zambia is modelled on the British legal system, and to this day Zambia recognises aspects of the British jurisprudence as part of its legal system.

The scope of this dissertation is limited to the main legislative and institutional sources of corporate governance in the four jurisdictions highlighted above. From Zambia, the dissertation looks at the corporate governance provisions in the *Zambian Companies Act of 1994* and the *Lusaka Stock Exchange Corporate Governance Code for Listed and Quoted Companies of 2005* respectively. The dissertation also assesses the effectiveness of the relevant regulatory institutions in monitoring the adherence of companies to these provisions.

From South Africa, the dissertation focuses on the *Companies Act Number 71 of 2008* with very brief mention of the *Companies Act Number 61 of 1973*, and

³⁰ *Manual on corporate governance* (note 13) at 1.

the King Report and Code of Governance for South Africa 2009. From the USA, state and federal laws like the Sarbanes-Oxley Act 2002, and the American Law Institute Principles of Corporate Governance and Structure: Restatement and Recommendation (ALI) are considered. The UK Companies Act 2006 and the UK Corporate Governance Code (formerly the Combined Code) are also analysed.

This dissertation looks at the general principles of corporate governance, but concentrates on thematic areas considered to be most pertinent for improved corporate governance in Zambia. These are management of a company, composition of the board, separation of chairperson and chief executive officer, board committees, and codifying directors common law duties. The dissertation also focuses on the rights of shareholders and other stakeholders, the company secretary and other officers of the company, audit committees, and disclosure and transparency.

3. Significance of the dissertation

This dissertation assesses the effectiveness of the corporate governance regulatory framework in Zambia by making a comparative study with South Africa, the USA and the UK. The approach of evaluating selected corporate governance themes in Zambia against these three jurisdictions is important because the organizational activities relating to enhanced corporate governance will not be exactly the same in every country and in every economy. Further, differences in how entrenched the culture of good corporate governance is in developed countries can vary substantially from those in developing economies.³¹

At the end of this dissertation, the dissertation aims to:

- outline the current legal and institutional corporate governance framework in Zambia;
- evaluate the suitability of the legal and institutional corporate governance framework in Zambia for national economic development by comparing selected corporate governance themes with South Africa, the USA, and UK; and

³¹ Michael N Young et al 'Corporate Governance in emerging economies : a review of the principal-principal perspective' *Journal of management studies* 45:1 January 2008 0022-2380 at 198. Available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-6486.2007.00752.x/full> [Accessed 3 August 2010].

- determine whether a ‘one-size-fits-all’ approach is best suited for Zambia, culminating in recommendations for improvement.

Implementation of the recommendations of this dissertation will harmonise Zambian corporate governance with international best practice. It will lead to reduction in investment costs and increase the legal and institutional certainty for overseas companies, investors and local companies that trade beyond the borders of Zambia.³²

4. Overview of chapters

Chapter one has given a conceptual framework of the dissertation. It has traced the background to the concept of corporate governance and briefly discussed some definitions of corporate governance. Chapter one has stated the research question and carved out the limitations of the dissertation to ten corporate governance themes. A justification for taking a comparative approach has also been given.

Chapter two begins by contextualizing the discussion of the corporate governance legislative and institutional framework within the Zambian setting. It proposes certain reasons justifying the need for studying corporate governance in Zambia. The chapter then outlines the legal provisions relating to the corporate governance thematic areas from statute, case law, listing rules, and codes of best practice. Chapter two also briefly discusses the question as to whether self regulated organisations are the proper corporate governance watchdogs in a country. It then proceeds to briefly outline the roles performed by various regulatory institutions. These are the Institute of Directors of Zambia, the Lusaka Stock Exchange, the Bank of Zambia, the Securities and Exchange Commission and the Zambia Institute of Chartered Accountants.

In chapter three, the dissertation evaluates the ten corporate governance themes discussed in chapter two using the jurisprudence from South Africa, the USA and the UK.

Chapter four then synthesizes the discussions in chapters two and three. The chapter evaluates the suitability of the Zambian corporate governance framework under each corporate governance theme. The dissertation critically evaluates the

³² Justine Tumuheki ‘Towards good corporate governance: an analysis of corporate governance reforms in Uganda’ University of Cape Town Masters Research Thesis (2007) at 24.

suitability of the legal provisions relating to the corporate governance themes in Zambia, and where necessary, proposes that Zambia adopts the position obtaining in South Africa, USA or the UK. The chapter proceeds to critically analyse the work of the regulatory institutions.

Chapter four concludes that a 'one-size-fits-all' approach is unsuited for Zambia, and that international corporate governance principles must undergo an adaptation process to suit in to Zambia's peculiar social and economic environment. The dissertation recommends that Zambian companies will need to prioritise the corporate governance thematic areas, and move away from a mere 'box-ticking' approach to one that promotes a culture of good corporate governance.

CHAPTER 2-THE ZAMBIAN CORPORATE GOVERNANCE REGULATORY FRAMEWORK

The Zambian corporate governance matrix consists governance codes, standards, case law, regulations and practice notes. Before delving into the specifics of the Zambian corporate governance regulatory framework, an outline of the country profile of Zambia is important to contextualise the argument for improved corporate governance within the country.

2.1 Country Profile

Zambia is located in Southern Africa. It is a landlocked country with a capital city called Lusaka. Zambia has eight neighbouring countries, namely Botswana, Zimbabwe, Mozambique, Tanzania, the Democratic Republic of the Congo, Angola, Malawi, and Namibia. From 1891 to 1923, Zambia was a colony of the British South Africa Company after which the United Kingdom took over the administration of the colony. On 24 October 1964, the country gained independence as a member of the Commonwealth of Nations.³³

Demographically, Zambia's population stands at 13 272 553 people.³⁴ Year on year inflation rate stands at 9.9 per cent and commercial bank interest rates average 29.6 per cent.³⁵ Most rural Zambians have turned to subsistence farming due to high levels of unemployment found in urban towns and cities. The country faces severe development challenges reflected in its slow rate of economic growth that cannot support the rapid population growth.

It is thus unquestionable that the challenge of reducing poverty in Zambia is not an option but is an imperative, and one key accelerator of economic growth is the corporate sector.

³³ Information available at <http://en.wikipedia.org/wiki/Zambia> [Accessed 27 November 2010].

³⁴ Ibid.

³⁵ Statistics are as of 2009. Information available at http://www.zamstats.gov.zm/media/vol_92_2010_the_monthly_november1.pdf [Accessed 27 November 2010].

2.2 Why corporate governance reform in Zambia

Apart from the need for accelerated economic development, Zambia exhibits peculiar features that are not uncommon to other African developing economies. These features necessitate the implementation of good corporate governance for economic development.

First, the business sector in Zambia is fraught with many challenges. These include inadequate road and railway networks, high telecommunications costs, inflation and tax rates, inadequate access to credit facilities, insufficient skilled labour, and difficulties in breaking into foreign market standards due to lack of appropriate certification facilities.³⁶ In order for companies to survive and sustain profits in such a difficult Zambian business environment, they will need to foster good corporate governance.

Second, mining has been an important sector in Zambia for over 70 years.³⁷ However, mining companies have been associated with poor salaries, unsatisfactory occupational and health safety standards, expensive health facilities, poor sanitation and lack of recreational facilities.³⁸ Corporate governance policy towards this sector will need to be carefully crafted so as to achieve compliance from mining firms while attracting further investments.

Third, Zambia is located in a strategic geographical location. The geographic proximity of regional markets makes neighbouring countries attractive export destinations for products from small and medium Zambian enterprises and smallholder farmers. Improved corporate governance has the potential of increasing economic activity from both local and foreign investors thus making Zambia an attractive central business hub within regional markets such as the Common Market for Eastern and Southern Africa (COMESA), and the Southern African Development Community (SADC).

Fourth, given the fact that the majority of State Owned Enterprises (SOEs), Small and Medium Enterprises (SMEs), and mining companies are not listed, there is

³⁶ International Monetary Fund, *Fifth National Development Plan* (August 2007) at 142.

³⁷ International Monetary Fund (note 36) at 62.

³⁸ John Lungu 'Corporate governance and the extractive industry in Zambia' presentation to the workshop on economic and corporate governance and accountability in Southern Africa, 7 – 9 December 2005, Lusaka, Zambia at 15. Available at <http://www.uneca.org/> [Accessed 26 November 2010].

still a huge pool of corporations that do not fall under the direct ambit of corporate governance reforms. The share of the economy of listed companies in Zambia is small, approximately US\$ 6 300 000.³⁹ SOEs in particular are a special constituent of the Zambian corporate regime, and their emergence can be traced to the desire for economic empowerment of the local populace.⁴⁰ Corporate governance practitioners will need to be cognisant of these unique corporate constituents and devise ways of making them accountable.⁴¹

Fifth, Zambia experiences a major challenge of capital market ownership. Most shareholders are dispersed and do not have much knowledge about how to engage with management of companies. Consequently, local investors have no effective vote in these companies⁴² and minority shareholder protection is very minimal due to the overwhelming power of foreign majority shareholders. This necessitates a study of corporate governance especially as regards minority rights protection.

The dissertation now outlines the constituent elements of the Zambian corporate governance framework.

2.3 The Companies Act

The main source of Zambian company law is the Companies Act.⁴³ The Act expressly vests management of a company in the board of directors subject to exceptions provided in the Act and the articles of association.⁴⁴ Section 215 (1) of the Act states:

³⁹ Information available at <http://www.luse.co.zm/>, LUSE 2010 Year Statistics. [Accessed 30 January 2011].

⁴⁰ After independence, the government of the day embarked on socialist approaches to development that saw the nationalization of companies and the formation of 280 SOEs. Most SOEs in Zambia have today been privatised. See Janet Simwanza and Ramanie Samaratunge 'Public sector reforms in Africa: a comparison of Zambia and Botswana' Paper to be presented at the International Research Society for Public Management (IRSPM XIII), 6-8 April, 2010, Berne, Switzerland. Information available at http://www.irspm2010.com/workshops/papers/21_publicsectorreforms.pdf [Accessed 28 January 2011].

⁴¹ For a more in depth study of corporate governance in parastatals, see Mwaka Judith Chulu *Corporate Governance in Public Companies* (2009) Unpublished PhD Dissertation University of Exeter, Exeter.

⁴² Mumba Kapumpa 'Corporate governance: the role and status of capital and financial markets in Southern Africa' a presentation to the workshop on economic and corporate governance and accountability in Southern Africa, 7 – 9 December 2005, Lusaka, Zambia at 18 Available at <http://www.uneca.org/> [Accessed 26 November 2010].

⁴³ Chapter 388, Laws of Zambia, 1995.

⁴⁴ See s 215 (1) of the Companies Act (note 43).

Subject to this Act, the business of a company shall be managed by the directors, who may pay all expenses incurred in promoting and forming the company, and may exercise all such powers of the company as are not, by this Act or the articles, required to be exercised by the company by resolution....⁴⁵

The Act provides for a chairman of the board of directors who is selected by members of the board, and he presides as chairman at every general meeting.⁴⁶

In order to allow for efficiency in the management of companies, the Companies Act allows directors to delegate plenary powers to board committees provided there is no contrary provision in a company's articles of association.⁴⁷ All the members of the board committees must be directors.⁴⁸

The board of a company will often appoint people responsible for running its daily affairs. In this regard, the Act provides for a managing director who acts in a dual capacity of employee and director of the company. The import of the statutory power of the board to appoint a managing director is that it can confer upon him plenary powers of the board, which can be withdrawn or varied by the directors at any time.⁴⁹ The Act however does not elaborate the managing director's functions.

A company secretary is important in facilitating good corporate governance. The Companies Act requires every company to appoint a company secretary.⁵⁰ The secretary may be a body corporate and a company may have two or more persons acting jointly as secretary.⁵¹ The Act does not elaborate the duties of the company secretary and does not require the directors to consider the level of experience or knowledge in company secretarial work of the person appointed as company secretary.

A central theme in corporate governance is the proper discharge of duties by directors. The duties of directors are not statutorily codified, which is a glaring deficiency in the Act. Thus one has to turn to common law. The Companies Act however does not expressly disallow or replace the common law.

⁴⁵ Companies Act (note 43) s 215 (1).

⁴⁶ Companies Act (note 43) s 44.

⁴⁷ Companies Act (note 43) subsec 217 (6).

⁴⁸ Compare with s 72 (2) (a) of the South African Companies Act Number 71 2008 that allows for a committee to include non-director members who may not vote on matters the committee decides.

⁴⁹ See Companies Act (note 43) s 66.

⁵⁰ Companies Act (note 43) s 205. Theoretically, the articles of association can stipulate another mode of appointing subsequent company secretaries other than by the directors.

⁵¹ Companies Act (note 43) subsec 205 (5)(6). It is an offence for a company to carry on business for more than 2 months without a company secretary.

As regards shareholder activism, the Act allows shareholders to engage directors to hold them accountable. The Act recognises a member's right to capital, dividends, vote, receive information and appoint proxies.⁵² The Act also provides for shareholder remedial measures, namely minority protection on take-over bids,⁵³ a remedy against oppression and the right to apply to wind up a company's affairs.⁵⁴ A liquidator, creditor or company member can also take out court proceedings to impose personal liability on any person for the debts of the company without any limitation.⁵⁵

Unfortunately, the statutory remedy of a derivative action is ominously missing from the Act. Consequently, a member would need to establish a right to sue under the exceptions to the rule in *Foss v Harbottle*⁵⁶ in order to succeed in such an application. The principle established by this case is that the majority of the members in a company have the power to bind the minority, and that the courts will refuse to interfere in the running of the company while the majority is acting lawfully. The other principle formulated by the court is the proper plaintiff principle that provides that the proper plaintiff to institute legal action where a company has suffered a wrong is the company itself.

The Supreme Court of Zambia had occasion to uphold the proper plaintiff principle in the case of *Avalon Motors Limited (in Receivership) v Bernard Leigh Gadsden Motor City Limited*⁵⁷ when it observed thus:

...where the directors wish to litigate the validity of the security under which the appointment [of Receiver] has taken place or in any other case where the vital interests of the company are at risk...but the Receiver neglects or declines to act, the directors should be entitled to *use the name of the company* to litigate....[emphasis mine]⁵⁸

⁵² Companies Act (note 43) s 2.

⁵³ The transferee has a duty to purchase the minority shareholder's shares. See Companies Act (note 43) s 238.

⁵⁴ Oppression is defined as 'oppressive or unfairly prejudicial to, unfairly discriminatory against a member or members of a company or contrary to the interests of the members as a whole.' See Companies Act (note 43) s 239.

⁵⁵ Companies Act (note 43) ss 383 and 384.

⁵⁶ (1843) 67 ER 189.

⁵⁷ (1998) S.J. 26 (S.C.). Available at <http://www.saflii.org/zm/cases/ZMSC/1998/6.pdf> [Accessed 25 February 2011].

⁵⁸ Ibid.

Every company in Zambia should appoint an auditor.⁵⁹ The Act however does not stipulate for an audit committee. The auditor has a tenure of one year and the first auditor is appointed by the directors or the members in a general meeting.⁶⁰

Disclosure and transparency of a company's affairs is ensured under the Act by making a company and each officer liable for failure to file annual returns with the Registrar.⁶¹ The Registrar may also publish the names of companies that have not filed annual returns in the Government Gazette or in any newspaper.⁶²

2.4 Other Legislation

Corporate governance legislation is not unique unto itself because it is influenced by other spheres of the law.⁶³ These legal domains deal with securities regulation, company law, accounting, labour law, and environmental law among others.⁶⁴ The legal domains that affect corporate governance practices in Zambia are no exception.

Apart from the Companies Act, certain companies in Zambia are incorporated under particular statutes from which they derive their powers.⁶⁵ For small enterprises, these are regulated by the Zambia Development Agency Act.⁶⁶ Public limited companies are also regulated by the Securities Act.⁶⁷ This Act regulates the entire Zambian securities market to ensure adequate investor protection, and support the operation of a free, orderly, fair and secure securities market.⁶⁸

As regards employee stakeholders, the principle labour relations statutes in Zambia are the Employment Act,⁶⁹ Industrial and Labour Relations Act⁷⁰ and the Minimum Wages and Conditions of Employment Act.⁷¹

⁵⁹ For statutory companies or private companies receiving public funds, they are audited by the Auditor General pursuant to the Public Audit Act, Chapter 378 of the Laws of Zambia, 1995 s 3.

⁶⁰ See Companies Act (note 43) s 171.

⁶¹ Ibid s 189.

⁶² Ibid s 184 (4).

⁶³ OECD Principles of Corporate Governance (note 19) at 31.

⁶⁴ Ibid.

⁶⁵ A classic example is the Zambia National Broadcasting Corporation established under the Zambia National Broadcasting Corporation Act Chapter 154, Laws of Zambia, 1995.

⁶⁶ 11 of 2006.

⁶⁷ Chapter 354, Laws of Zambia, 1995.

⁶⁸ Securities Act (Note 67) ss 18, 19 and 20. All financial intermediaries conducting securities business or providing investment advisory services in Zambia must be licensed unless exempted by law. Information also available at

http://www.luse.co.zm/index.php?option=com_content&task=view&id=13&Itemid=31 [Accessed 22 February 2011].

⁶⁹ Chapter 268, Laws of Zambia, 1995.

Zambia has quite a comprehensive regulatory environmental framework that enables the Environmental Council of Zambia, among other things, to request for information on the management methods of natural resources from any individual or organisation anywhere in Zambia.⁷²

Mwenda⁷³ posits that the Banking and Financial Services Act⁷⁴ is the legislative cornerstone for regulating financial institutions, particularly banks. Financial institutions are also regulated by the Bank of Zambia Act,⁷⁵ the Financial Institutions (Validation of Acts) Act⁷⁶ and the Prohibition and Prevention of Money Laundering Act.⁷⁷

2.5 Legal Precedent

The Zambian jurisprudence on the duties of directors and the separate legal personality of a company are found mainly in the English common law and doctrines of equity. Inevitably, Zambian case law still relies heavily on English case law. A classic illustration is the Supreme Court of Zambia case of *Siulanda and 36 Others v Foodcorp Products Limited*⁷⁸ that reiterated that

....the Court below quite correctly directed itself on the law which has long recognized the separateness of the corporate entity from those behind it, owning it and directing its affairs. The celebrated case of *Salomon v Salomon*⁷⁹ on the point is still good law....⁸⁰

That notwithstanding, the Zambian government has undertaken to clarify the role of the common law within the Zambian legal system. The proposed draft constitution is more explicit as to what constitutes Zambian common law. It defines common law to include the common law of England, doctrines of equity, the law as

⁷⁰ Chapter 269, Laws of Zambia, 1995.

⁷¹ Chapter 276, Laws of Zambia, 1995.

⁷² See the Environmental Protection and Pollution Control Act 12 of 1990 s 6.

⁷³ Mwenda however argues that despite the establishment of an effective regulatory framework for banking and financial services supervision, this framework should have been in place even before capital markets were liberalised. See Kenneth K Mwenda *Legal Aspects of Banking Regulation : Common Law Perspectives from Zambia* (2010) at 66.

⁷⁴ Chapter 387, Laws of Zambia, 1995.

⁷⁵ Chapter 360, Laws of Zambia, 1995.

⁷⁶ Chapter 420, Laws of Zambia, 1995.

⁷⁷ Act 14 of 2001.

⁷⁸ (SCZ Judgment No. 9 of 2002) [2002] ZMSC 28 (24 April 2002) Available at <http://www.saflii.org/zm/cases/ZMSC/2002/28.html> [Accessed 23 February 2011].

⁷⁹ 1897 AC 22. Available at http://en.wikipedia.org/wiki/Salomon_v_A_Salomon_%26_Co_Ltd [Accessed 14 January 2011].

⁸⁰ See (note 78).

determined by the superior court of judicature, and Zambian customary law.⁸¹ It is yet unclear how this definition of common law will influence the jurisprudence on the duties of directors once the new constitution is enacted. Thus, any statutory reform to statutes such as the Zambian Companies Act will need to bear in mind the provisions of the new constitution.

2.6 Regulations, Codes of Best Practice and Accounting Standards

The OECD Principles of Corporate Governance caution that while voluntary codes improve corporate governance arrangements, they have the potential of not giving clear guidance to shareholders and stakeholders about their status and implementation.⁸² This is where regulatory authorities and professional bodies in Zambia play the key role of promulgating and monitoring adherence to codes of best practice.

For companies in the financial sector, the Bank of Zambia as the central bank has issued the Banking and Financial Services Risk Management Guidelines 2008, the Banking and Financial Services (Corporate Governance) Guidelines 2006 and the Banking and Financial Services Risk Guidelines. The central bank also makes regulations pertaining to risk management, anti-money laundering, commercial bank circulars and prudential guidelines on how to apply international reporting standards to financial information.⁸³

Accounting practices in the country are regulated by the Zambia Institute of Chartered Accountants. The Institute has adopted, among others, three international accounting standards as barometers for the accountancy profession in the country. These are 'the International Financial Reporting Standards, the International Standards in Auditing, and the International Accounting Standards.'⁸⁴

The institute has also adopted the International Code of Ethics for Professional Accountants.⁸⁵ This code regulates matters pertaining to integrity,

⁸¹ Sub articles 16 (1) (2), the Constitution of Zambia Bill 2010. Available at <http://www.parliament.gov.zm/> [Accessed 22 September 2010].

⁸² OECD Principles of Corporate Governance (note 19) at 30.

⁸³ Information on the regulations issued by the Bank of Zambia is available at <http://www.boz.zm/> [Accessed on 18 September 2010].

⁸⁴ International Monetary Fund (note 36) at iv.

⁸⁵ Ibid.

proficiency, degree of professional due care, confidentiality and general professional behaviour. The code also regulates professional accountants in public practice.⁸⁶

2.7 Listing Rules and Governance Codes

The Lusaka Stock Exchange (LUSE) is currently the only stock exchange in Zambia. The exchange has four sets of rules regulating the market. First, the Rules of the Exchange stipulate membership requirements, conduct of members as well as disciplinary matters. Second, the Trading Rules regulate the manner in which all trades and market transactions are to be conducted and third, the Clearing and Settlement Procedural Rules outline the process of clearing and settlement of market transactions on the LUSE.⁸⁷

The fourth set are the Listing Rules that provide the criteria of listing securities on the exchange, as well as prescribe the conduct of listed companies once listed. The Listing Rules aim at giving guidelines for protection of investors and set standards of disclosure of price sensitive information by listed companies.⁸⁸

The LUSE has issued a governance code known as the Lusaka Stock Exchange Corporate Governance Code for Listed and Quoted Companies⁸⁹ (the 'LUSE Code'). The LUSE Code forms the bedrock of corporate governance for quoted or listed companies in Zambia on a 'comply or explain' basis.

The LUSE Code provides that boards of public and quoted companies should be mainly made up of non executive directors to provide an appropriate balance in decision making. The board is required to establish a minimum of two board committees, being the audit⁹⁰ and remuneration committees. The board should determine the committee's terms of reference, review its performance annually and ensure active non executive participation.⁹¹ The board committees are free to take

⁸⁶ International Federation of Accountants, International Ethics Standards Board for Accountants, *Code of Ethics for Professional Accountants* (Revised July 2006). See at 3-4 for a concise summary of its contents.

⁸⁷ Information is available at http://www.luse.co.zm/index.php?option=com_content&task=view&id=15&Itemid=33 [Accessed 22 November 2010].

⁸⁸ Ibid.

⁸⁹ The Luse Code came into effect on 1 January 2005 and has been endorsed by the Institute of Directors of Zambia.

⁹⁰ The Lusaka Stock Exchange (Luse) *Corporate Governance Code for Listed and Quoted Companies* (2005) Part C Principle 9 at 7. The chairperson of the audit committee should be someone other than the chairperson of the board.

⁹¹ LUSE Code (note 90) Principle 1 at 6.

advice from independent professionals who are not part of the board of directors. Board committees should also make full disclosure to the board, except where the committees have been mandated otherwise.⁹²

As regards the chairperson and chief executive officer, the LUSE Code provides that they should be performed by separate persons. It however allows the same person to perform both roles if the board has an independent director as deputy chairperson, and if there is a complement of independent directors sufficiently involved in the annual evaluation of the chairperson's performance.⁹³

The company secretary of a public company is responsible for guiding the members of the board on how they can discharge their responsibilities towards the organisation.⁹⁴ Interestingly, the LUSE Code advocates for the board to evaluate annually the performance of the company secretary by using a 'fit and proper test'⁹⁵ in the same way that is recommended for new director appointments.⁹⁶

There is a synergy between the LUSE Code and the requirements of the Zambian Institute of Chartered Accountants in that the financial statements of a company (or group of companies) should comply in all respects with Zambian accounting standards. External auditors of a public company should be appointed on the audit committee's recommendation⁹⁷ and should maintain an arm's length from the organisation at all times. Further, the annual report should contain details of all services that are non audit in nature that are provided by external auditors.⁹⁸

The LUSE Code is also abreast with the international trend of sustainability reporting. It is categorical in requiring boards to integrate financial and human capital development into the business practice, particularly in areas of demographics, gender, people with disabilities, and corporate training initiatives. A board should have a policy for environmental management and should support charitable or educational appeals from both its immediate business environment and nationally.⁹⁹

⁹² LUSE Code (note 90) Principles 6 and 7 at 6.

⁹³ LUSE Code (note 90) at 3.

⁹⁴ Ibid.

⁹⁵ This is defined as '...ascertaining the suitability of a person in relation to a director or company secretarial position in a listed or quoted company and includes a reference to qualifications and experience.'

⁹⁶ LUSE Code (note 90) Principles 45-47 at 6.

⁹⁷ LUSE Code (note 90) Part E Principles 7 and 1 at 7.

⁹⁸ LUSE Code (note 90) Part E Principles 3-5 at 7.

⁹⁹ LUSE Code (note 90) Part H Principles 1- 2, 4,5-6 at 10.

It is surprising though that the Luse Code does not expressly require a company to produce an integrated sustainability report.¹⁰⁰

Having considered the legal regulatory framework, it is important to consider how this legal framework is put in practice by the various corporate governance regulatory institutions.

2.8 Institutional framework in Zambia

It is a moot point whether self regulatory organisations (SROs), such as stock exchanges, should be responsible for regulating corporate governance in a country. Burke¹⁰¹ argues in favour of SROs in that they are flexible and have the expertise appropriate to easily adapt to development trends in corporate governance. Further, exchanges are better able to shift the costs of monitoring corporate compliance to listing rules and governance codes. Although government regulators are experts in policy formulation, they have the disadvantage of not having the industry experience of SROs of knowing the ramifications of a new piece of legislation, and may thus take a reactive rather than proactive approach to solving problems.¹⁰²

In contrast, one down side to a complete SRO system is that is open to bias and inadequate enforcement. It has been argued that a SRO may shy away from punishing deviant issuers if that has the potential of creating a negative public image of the institution. An exchange may also fear delisting a delinquent member because it may reduce market liquidity and transaction fees.¹⁰³

Still other schools of thought have argued in favour of a quasi SRO system that incorporates government institutions that monitor the work of private voluntary organisations.¹⁰⁴ Zambia's corporate governance model reflects this quasi SRO system in which government institutions, like the Securities and Exchange Commission and the Lusaka Stock Exchange, work hand in hand with voluntary

¹⁰⁰ See LUSE Code (note 90) Principles 2 and 3 on 'Disclosure and stakeholder communication' that merely require the board to have formal procedures for communicating with its main stakeholders and institutional investors.

¹⁰¹ Kerry Shannon Burke 'Regulating corporate governance through the market: comparing the approaches of the United States, Canada and the United King' (2002) 27 3 *The Journal of Corporation Law* 341 at 349.

¹⁰² Burke (note 101) at 349.

¹⁰³ Burke (note 101) at 351.

¹⁰⁴ See the arguments for the need to establish a regional stock exchange and promote multiple listings and cross-border trade securities in Kenneth K Mwenda 'Legal aspects of corporate finance : the case for an emerging stock market' University of Warwick PhD research thesis (2000).

organisations like the Institute of Directors Zambia. A closer look at each institution in turn will outline the synergies in the mandate of these various organisations.

2.8.1 The Institute of Directors of Zambia

From the onset, one must note that the Institute of Directors of Zambia (IODZ) does not have a corporate governance code such as the King Code of Governance for South Africa. However, the IODZ did in November 2000 publish the first Manual on Corporate Governance in Zambia that was later reviewed in 2004. This manual applies to all companies on a voluntary basis.¹⁰⁵ The IODZ has also come up with a corporate governance code on SMEs that is yet to be adopted by the LUSE.

Victoria C Silutongwe, Executive Director of the Institute of Directors of Zambia, explains that the IODZ is a leadership forum that helps its members develop through education, information and communication, so as to have a positive influence on the larger business environment.¹⁰⁶

In particular, the objectives of the institute are five fold. First, it aims to promote excellence in corporate governance. Second, it represents interests of directors and facilitates their professional development in support of the economic well being of the country and third, it inculcates the highest standard of ethics amongst directors. Fourth, the institute provides an effective voice for company directors in public affairs to achieve the twin tasks of preserving basic commercial freedoms and preventing the abuse of such freedoms. In particular, it focuses on the social, legislative, and economic roles of directors in public affairs.

Fifth, the institute enhances the standard and effectiveness of directors through information and education on their moral, legal, financial and other rights and obligations towards stakeholders. Stakeholders includes 'management, the community as a whole, employees, shareholders, and companies.'¹⁰⁷

A similarity exists between the admission criteria of the IODZ and the Companies Act.¹⁰⁸ A person may not be admitted as a member of the institute if they

¹⁰⁵ No data was readily available as to how many Zambian companies had adopted the manual. This was revealed in an interview conducted on 6 January 2010 with the Executive Director of the Institute of Directors of Zambia, Victoria C Silutongwe, at the Institute of Directors of Zambia offices in Lusaka, Zambia.

¹⁰⁶ Ibid.

¹⁰⁷ See *Manual on corporate governance* (note 13) at 2. The Institute of Directors of Zambia was launched on 7 April 2000 and commenced its operations in June 2000.

¹⁰⁸ See Companies Act (note 43) s 207.

are disqualified to be appointed as a director under the Companies Act. The board of directors of the IODZ enjoys an additional discretion to refuse to admit anyone who does not pass the ‘fit and proper person’ test.

Since its inception, the IODZ has focussed its energies on raising the standards of corporate governance in the boardroom through a sustained programme of director training. The aim of these programmes is to sensitize directors of their responsibilities to stakeholders, and how the role of directors adds value to the company beyond mere legal compliance.¹⁰⁹

The Institute has also been working with the Bank of Zambia under the government’s Financial Sector Development Plan to train directors of banks, and to train directors in state owned enterprises like ZESCO Limited.¹¹⁰

A positive development that has been made by the institute is the creation of the category of membership called Honorary Member. By this, the board may invite any individual to be an Honorary Member of the institute who, in the opinion of the board, has so distinguished himself by virtue of his contributions in building high corporate governance standards in Zambia, and whose achievements would inspire the other members of the institute.¹¹¹

2.8.2 The Lusaka Stock Exchange

The LUSE is a self regulated mutual organization owned by nine broker shareholders, six of whom are actively trading members.¹¹² The exchange was established to:

- empower Zambians through the wider ownership of shares;
- provide a source for cheaper longer term capital;
- encourage investments; and
- facilitate the divestiture of government interest in parastatal companies.

The exchange also provides an efficient, orderly, and transparent market that allows marketable instruments and shares to be traded on the secondary market.¹¹³

¹⁰⁹ *Manual on corporate governance* (note 13) at 1 & 2.

¹¹⁰ This was revealed in an interview conducted on 6 January 2010 with the Executive Director of the Institute of Directors of Zambia, Victoria C Silutongwe, at the Institute of Directors of Zambia offices in Lusaka, Zambia.

¹¹¹ Institute of Directors of Zambia, *Brief on the Institute of Directors of Zambia* (2010) at 3.

¹¹² *Ibid.*

¹¹³ Kaonda Stephen Mulenga ‘Roles and functions of the Lusaka Stock Exchange’ Presentation to the Basic Stock Brokers and Investment Advisors Course, Lusaka (18 March 2010).

Since it started operations on 21 February 1994, the LUSE has 20 companies listed and also some government bonds traded on its primary and secondary markets.

The LUSE has rules by which it operates. Of particular importance are the listing rules that enumerate the criteria for listing securities on the exchange, and that prescribe the conduct of listed companies once listed. The listing rules also oblige listed companies to meet disclosure requirements through the publications of price sensitive information.¹¹⁴ Price sensitive information is disseminated to public investors on the exchange and in the event that this obligation is breached, the exchange has powers to suspend a member or a company from conducting business on the exchange.

Priscilla C. Sampa, the Legal Counsel and Company Secretary of the Luse, revealed in an interview¹¹⁵ that an important feature of the exchange is that it adheres to the requirements of the Securities and Exchange Commission. This is to the effect that an exchange must observe the rules of the Compensation Fund established pursuant to the Securities Act. This Fund aims to create investor confidence by providing compensation to people for monetary losses suffered due to the wrong acts of a licensed dealer or investor.¹¹⁶

2.8.3 The Bank of Zambia

Mwenda in *Legal Aspects of Banking Regulation Common Law Perspectives from Zambia*¹¹⁷ critically investigates the efficacy of the legal framework for banking supervision under Zambia's Banking and Financial Services Act 1994. He also evaluates the efficacy of the legal framework for central bank independence under the Bank of Zambia Act 1996. He argues that under Zambian law, the Bank of Zambia does not enjoy central bank independence because the legal framework permits the State executive arm to meddle into the affairs of the Bank of Zambia.

Perhaps the most important function of the central bank from a corporate governance perspective is in two respects. First, it promulgates subsidiary legislation

¹¹⁴ Anthony M. Simpasa 'The roles and functions of the Bank of Zambia' presentation to the Basic Stock Brokers and Investment Advisors Course, Lusaka (17 March 2010).

¹¹⁵ This interview was conducted on 17 December 2010 at the Lusaka Stock Exchange offices in Lusaka, Zambia.

¹¹⁶ Kaonda (Note 113).

¹¹⁷ Mwenda (note 73) at 65. For an in depth econometric study of bank governance in East and Southern African countries, see Austin Mwape *Bank Governance and Regulation in East and Southern African Countries* (2006) Unpublished PhD Dissertation, University of London, London.

pertaining to corporate governance pursuant to the Bank of Zambia Act.¹¹⁸ Second, it safeguards depositors' funds by preventing imprudent activities on the part of financial institutions. It executes this function through interactions with financial market players such as commercial banks and non bank financial institutions.¹¹⁹

The Bank of Zambia is also the central bank of Zambia. It formulates and implements monetary policy, regulates financial systems, acts as a fiscal agent of the government, manages foreign exchange reserves and formulates money exchange rate policy.¹²⁰ It also issues currency, facilitates the development of an efficient payments and settlement system, is a banker to both the Government and other banks, and advises the Government on monetary and economic policies.¹²¹

Despite the arguments by Mwenda, the central bank has made a positive policy step recently by undertaking a Financial Sector Development Plan from 2004 to 2009. This is aimed at correcting a number of regulatory and legal weaknesses in the financial sector.¹²² This plan is currently being implemented and its full benefits are yet to be felt.

2.8.4 The Securities and Exchange Commission

It was highlighted earlier that one down side to a complete SRO system is that it is open to bias and inadequate enforcement. The Securities and Exchange Commission (SEC) mitigates these concerns and ensures that rules of achieving compliance by companies are clear, and that there are channels to voice concerns from interested parties on an exchange.¹²³

The SEC has three core mandates. It:

- protects investors;
- ensures that markets are fair, efficient, and transparent; and
- reduces systemic risk in the securities market.¹²⁴

¹¹⁸ Chapter 360, Laws of Zambia, 1995.

¹¹⁹ Anthony M Simpasa 'The Roles and Functions of the Bank of Zambia' Presentation to the Basic Stock Brokers and Investment Advisors Course, Lusaka (17 March 2010).

¹²⁰ Simpasa (note 114). See also the Bank of Zambia website at <http://www.boz.zm/> [Accessed on 18 September 2010].

¹²¹ Ibid.

¹²² Information available at http://www.boz.zm [Accessed on 18 September 2010].

¹²³ Burke (note 101) at 349.

¹²⁴ Information available at <http://www.sec.gov.zm/> [Accessed 26 September 2010].

Another important corporate governance role of the commission is to protect minority shareholders during takeovers and mergers of public companies. The Securities (Takeover and Mergers) Rules 1993 and the Securities Act respectively empower the SEC to oblige an offeror to make a mandatory offer to buy remaining shares held by minority shareholders at a value determined by an independent committee.¹²⁵

Liweleya¹²⁶ adds that the SEC regulates collective investment schemes, pension funds and insurance schemes. These are now an important constituent in corporate governance because they act as institutional investors. The SEC also enjoys powers to deregister a pension or insurance scheme for not complying with the Pension Scheme Regulation Act.¹²⁷

2.8.5 The Zambia Institute of Chartered Accountants

The Accountants Act establishes the Zambia Institute of Chartered Accountants (ZICA).¹²⁸ The institute has the twin tasks of maintaining accountancy standards among its members, and dealing with reports of professional misconduct. Thus section 29 of the Accountants Act provides that a member of ZICA is guilty of professional misconduct if that member is guilty of any of the acts that are outlined in the schedule to the Act. The Disciplinary Committee of the institute in this regard plays an important task of ensuring high levels of ethical behaviour among the members of the institute.

It is important to pose at this point and consider the specific corporate governance themes from an international perspective. This dissertation focuses on South Africa, the USA and the UK.

¹²⁵ See Clauses 5-9, s II, 3rd schedule, Securities (Takeovers and Mergers) Rules, 1993.

¹²⁶ Liweleya, Michael 'The role and functions of the Securities and Exchange Commission' Presentation to the Basic Stock Brokers and Investment Advisers Course, Lusaka (16 March 2010)

¹²⁷ See Chapter 255, Laws of Zambia, 1995 s 33.

¹²⁸ Chapter 390, Laws of Zambia, 1995.

CHAPTER 3-COMPARATIVE ANALYSIS OF CORPORATE GOVERNANCE THEMES : SOUTH AFRICA, THE UNITED STATES OF AMERICA AND THE UNITED KINGDOM

Chapter three gives a comparative analysis of the corporate governance themes discussed in chapter two from the jurisdictions of South Africa, the USA and the UK.

3.1 Overview of corporate governance regulation in South Africa

The 2004 blueprint for corporate law reform promised South Africans a liberalised, simple and flexible corporate regime in which corporate formation would be maximised, formality and administrative burdens minimised and the categorisation and regulation of companies would be rationalised. This promise has been advanced by the Companies Act of 2008.¹²⁹

3.1.1 The Companies Act

The Companies Act¹³⁰ vests the management of a company in the board of directors just like the Zambian Companies Act. Olson¹³¹ posits that board structure under the Act seems to lean towards a unitary board. Thus, the Act requires a minimum of three directors for state owned companies while for non-public or personal liability companies, the minimum is one director.¹³²

The Act does not expressly distinguish between executive directors and directors that are non-executive, and the Act expressly allows for a board to have *ex officio* members. A distinction can be drawn in this regard with the Zambian

¹²⁹ Philip Knight was the principal drafter of the Companies Act 2008. For a discussion on the dangers of maximising flexibility, see Philip Knight 'Keep it simple and set it free: the new ethos of corporate formation' in Tshepo Mongalo *Modern company law for a competitive South African economy* (2010) at 3.

¹³⁰ 71 of 2008. The Draft Companies Amendment Bill 2010 was passed on 19 July 2010 to correct several anomalies in the Act. Available at http://www.dti.gov.za/ccrd/Final_Companies_Amendment_Bill.pdf [Accessed 24 February 2011].

¹³¹ John F Olson 'South Africa moves to a global model of corporate governance but with important national variations' in Tshepo Mongalo *Modern company law for a competitive South African economy* (2010) 219 at 227.

¹³² Companies Act (note 130) subsec s. 66(2). Compare with the Zambian Companies Act, Chapter 388, Laws of Zambia, 1995 s 204 that requires all companies to have at least two directors.

Companies Act that provides for a managing director who acts in a dual capacity of employee and director of a company.¹³³

In addition, the Act allows a board to delegate powers to any number of additional committees.¹³⁴ The importance of board committees cannot be overemphasized, with some commentators approximating the number of hours that the members of a board of a listed company meet annually at about 36 hours.¹³⁵ A committee may include members that are not directors, who may not vote on matters the committee decides.¹³⁶ Further, the Minister of Trade and Industry has powers to require a company to constitute a social and ethics committee if the Minister determines that it is beneficial to the public interest. This is having considered the company's 'annual turnover, size and nature of workforce, and the nature and extent of its activities.'¹³⁷

Naidoo¹³⁸ suggests that the governance role of company secretary has been underestimated. She adds that even though appointment of company secretaries is not mandatory for private companies, it is a role which requires specific functional expertise in light of recent developments that enable a company secretary to be held liable for governance misdeeds like directors.

The company secretary, among other functions, must advise directors on their duties, powers, and relevant laws relating to such powers, including any violations of the memorandum or companies law.¹³⁹ On the other hand, every company in Zambia must appoint a company secretary.¹⁴⁰ Chapter two had also pointed out that the Zambian Companies Act does not elaborate the functions of the company secretary, nor does it require directors to consider the person's knowledge and levels of company secretarial experience.

¹³³ Companies Act (note 130) s 66.

¹³⁴ Companies Act (note 43) subsec 72 (4).

¹³⁵ Tom Wixley & Geoff Everingham *Corporate Governance* (2010) at 70.

¹³⁶ Companies Act (note 130) subsec 72 (2) (a).

¹³⁷ Companies Act (note 130) subsec 72 (4). This is a development from the Companies Act 61 of 1973 that did not expressly provide for committees and explicit board structures.

¹³⁸ Naidoo (note 9) at 202 and 203.

¹³⁹ Companies Act (note 130) s 88.

¹⁴⁰ Companies Act (note 130) s 205.

The Minister of Trade and Industry has published the Companies Draft Regulations of 2010 that define ‘prescribed officer’¹⁴¹ of a company. This is a much wider classification than the statutory definition of prescribed officer under the *Zambian Companies Act*.¹⁴² It includes a person who has:

- general executive authority over the company;¹⁴³
- general responsibility for the financial management of the company;¹⁴⁴
- management of the legal affairs of the company;¹⁴⁵
- general managerial authority over the operations of the company;¹⁴⁶ or
- some direct or indirect control over the general management of the business of the company.¹⁴⁷

Some authors have argued that an audit committee is the principle governance watchdog in most companies, and that it was the first governance committee to be widely accepted by the business community in South Africa.¹⁴⁸ In South Africa, audit committees have become widely used since the King Report in 1994.¹⁴⁹ There are several variances to note in terms of auditor requirements between the South African and *Zambian Companies Acts*. In South Africa, the Act requires an audit committee and a substantial audit function for the board of state owned and public companies while in Zambia, every company must appoint an auditor but not necessarily an audit committee.¹⁵⁰ The South African Companies Act limits the tenure of an auditor to five consecutive financial years¹⁵¹ while the *Zambian Companies Act* has no express limit.

¹⁴¹ Department of Trade and Industry Companies Draft Regulations 2010 reg 45. Available at http://www.iodsa.co.za/downloads/documents/Summary_%20Companies%20Regulations%202010.pdf [Accessed 6 November 2010].

¹⁴² Although the *Zambian Companies Act* (note 43) s 2 uses the term ‘include’, it defines ‘officer’ narrowly to mean ‘a local director of a foreign company, a receiver of any part of the undertaking of the company, and a liquidator appointed by the members in a voluntary winding-up.’

¹⁴³ See *Companies Draft Regulations 2010* (note 141).

¹⁴⁴ *Ibid.*

¹⁴⁵ *Ibid.*

¹⁴⁶ *Ibid.*

¹⁴⁷ *Ibid.*

¹⁴⁸ Wixley (note 135) at 98.

¹⁴⁹ Wixley (note 135) at 98.

¹⁵⁰ A casual reading of section 172 of the *Zambian Companies Act* (note 43) may lead one to conclude that the appointment of an auditor is optional because of the term ‘may’. A closer reading of the sections, however, reveals that it is mandatory and that the use of the term ‘may’ merely gives a private company an option of appointing a registered auditor.

¹⁵¹ *Companies Act* (note 130) subsec 92 (1).

Moving to shareholder rights, the South African Companies Act gives greater shareholder rights than the Companies Act in Zambia in several respects. The Act provides for shareholder participation at annual general meetings even where shareholders have not given advance notice of the matters they wish to be discussed at the annual general meeting.¹⁵² Also, shareholders who hold voting rights of a minimum of ten per cent in a company may call a special meeting.¹⁵³ Further, section 61 (5) of the Act makes interesting reading as it empowers management or a shareholder to apply to court which can consequently stop an otherwise validly called meeting.¹⁵⁴

In addition, a shareholder may be availed certain rights to information from the company under other pieces of legislation apart from the Companies Act. The court held in *Davis v Clutchco (Pty) Ltd*¹⁵⁵ that the fact that a shareholder had no right to information does not remove the right of the shareholder under the Promotion of Access to Information Act¹⁵⁶ to see the company records. This constitutional protection of access to information from juristic persons is not evident in the Zambian corporate regime. A further variance is that in South Africa, a minimum of two shareholders can put forward a resolution on an issue on which they enjoy voting rights,¹⁵⁷ and a shareholder or director may challenge the form of a resolution by a court action if it is not clear or properly explained.¹⁵⁸

A special note needs to be made about the derivative action in South Africa. Unlike the derivative action in Zambia that is rooted in English common law, the South African Companies Act does away with the derivative action under the common law.¹⁵⁹ The South African Companies Act goes further to allow a wider

¹⁵² Companies Act (note 130) subsec 61 (8).

¹⁵³ Companies Act (note 130) subsec 61 (3) (b).

¹⁵⁴ The Act allows a shareholder to apply to a court for an order setting aside the meeting on the ground that the demand is frivolous or vexatious, or that the matter has already been considered. See Companies Act (note 130) s 61 (5).

¹⁵⁵ 2004 (1) SA 75 (C).

¹⁵⁶ 2 of 2000. This Act was passed pursuant to the provisions of the Constitution of the Republic of South Africa, Act 108 of 1996, subsec 32 (2).

¹⁵⁷ See Companies Act (note 130) subsec 65 (3) and (4) for the possible grounds to defeat such a shareholder resolution.

¹⁵⁸ The defect can be cured by a court. See Companies Act (note 130) subsec 65 (5).

¹⁵⁹ Companies Act (note 130) s 165. It is important to note that section 266 of the Companies Act 61 of 1973 did not revoke the common law, and the section only availed the statutory derivative action to members. It was restricted to actions against a director or past director to recover damages a company suffered because of wrongful acts, breach of faith and trust. See, however, Companies Act (note 130) subsec 5 (2) for possible application of the common law.

group of persons to initiate a derivative action on behalf of the company. This includes a:

- shareholder or one who is entitled to be registered as a shareholder;¹⁶⁰
- director;¹⁶¹
- prescribed officer;¹⁶²
- registered trade union that represents employees of the company or another representative of employees of the company;¹⁶³ or
- person granted leave of the court to do so if the court is satisfied that it is necessary and expedient to do so to protect a legal right of that person.¹⁶⁴

Coetzee¹⁶⁵ succinctly distinguishes the derivative action from a shareholder's right to take out a personal action. In a derivative action, the company is entitled to any damages that are awarded as a result of the derivative action and a notice must be served on the company. In a personal action, any damages awarded accrue to the shareholder personally and the member need not serve a notice on the company. A shareholder can also take out a personal action where the member's rights under the articles of association and memorandum have been infringed.¹⁶⁶

In addition, a member is allowed to commence a personal action against a company where any act of the company is 'unfairly prejudicial, unjust or inequitable.'¹⁶⁷ In *Hulett & Others v Hulett*,¹⁶⁸ the court went further to recognise a shareholder actions base on equitable considerations where the company was a 'quasi partnership', that is where it had personal characteristics resting on 'trust and confidence.'

In contrast with the USA, the UK or Zambia, the Act allows shareholders, directors, officers or trade union representatives of company employees to take out a court action restraining the company from doing anything that is not consistent with

¹⁶⁰ Companies Act (note 130) subsec 165 (2).

¹⁶¹ Companies Act (note 130) subsec 165 (2).

¹⁶² Companies Act (note 130) subsec 165 (2).

¹⁶³ Companies Act (note 130) subsec 165 (2).

¹⁶⁴ Companies Act (note 130) subsec 165 (2).

¹⁶⁵ For a full discussion on this distinction, see Lindi Coetzee 'A comparative analysis of the derivative litigation proceedings under the Companies Act 61 of 1973 and the Companies Act 71 of 2008' in Tshepo Mongalo *Modern company law for a competitive South African economy* (2010) 290 at 293.

¹⁶⁶ For the instances when a member can take out such action, also see section 65 (2) of Companies Act 61 of 1973.

¹⁶⁷ Companies Act 61 of 1973 subsec 252 (2).

¹⁶⁸ 1992 (4) SA 291 (A).

the Act.¹⁶⁹ Further, where trade unions intend to initiate a business rescue process, they can request for the financial statements of the company and must also be notified if the board provides financial assistance to any director.¹⁷⁰

Notwithstanding the codification of director's duties in section 76 of the Act, the South African Companies Act does not explicitly say that the statutory code replaces the common law.¹⁷¹ The common law duties of directors include the duty to:

- exercise care and skill,¹⁷²
 - act in the best interests of the company,¹⁷³
 - exercise powers for their proper purpose,¹⁷⁴
 - bring an independent mind to bear on what is in the best interests of the company,¹⁷⁵
 - not use corporate property, information or opportunities for personal profit;¹⁷⁶
- and
- avoid conflicts of interest.¹⁷⁷

Section 75 (5) reinforces the duty to avoid conflicts of interest by requiring disclosure of interests by directors. As regards the duty of care and skill, the Act in section 424(1) provides that where a company carries on business recklessly, such a director can incur personal liability for some or all of the company's debts. The Act also proscribes a company from drafting its memorandum of incorporation with the aim of relieving a director from the duties set out in sections 75,76 or 77,¹⁷⁸ or from misconduct or wilful breach of trust.¹⁷⁹

3.1.2 Listing Requirements and the King Reports

The Johannesburg Stock Exchange Listings Requirements (Listing Requirements) stipulate how new applications are to be made, and regulate corporate actions and

¹⁶⁹ Companies Act (note 130) subsec 20 (4).

¹⁷⁰ Companies Act (note 130) subsec 31 (3) and s 71.

¹⁷¹ See for instance Companies Act (note 130) subsec 5 (2).

¹⁷² See the English case of *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

¹⁷³ *Re Smith and Fawcett Ltd* [1942] Ch 304 (CA).

¹⁷⁴ *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* 1985 3 All ER 52 (CA).

¹⁷⁵ See the case of *PPWAWA National Provident Fund v Chemical Energy, Printing, Wood and Allied Workers' Union* 2008 (2) SA 345 (W).

¹⁷⁶ See *Symington v Pretoria-Oos Privaat Hospitaal Bedryfs (Pty) Ltd* 2005 (5) SA 550 (SCA).

¹⁷⁷ See *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 177.

¹⁷⁸ Companies Act (note 130) subsec 78(2) (a).

¹⁷⁹ Companies Act (note 130) subsec 78(2) (b).

continuing obligations of issuers and issuers of specialist securities.¹⁸⁰ The Listings Requirements apply to first time issuers, presently listed companies, and all other securities that applicants may wish to list and those presently listed. They also apply to directors of applicant issuers and to sponsors.¹⁸¹

Wixley¹⁸² observes that the JSE Securities Exchange South Africa (JSE) has been supportive of the King Recommendations and required compliance with a variety of aspects of King II since September 2003. The Listing Requirements now incorporate the Third Report on Corporate Governance in South Africa (King III). An applicant issuer must also state how far it has adhered to the King Code, and the reasons for noncompliance where the applicant issuer has not complied.¹⁸³

King III comprises a Code of principles on an 'apply or explain' basis and a Report that amplifies the principles in the Code. King III also includes recommendations on governance best practice.¹⁸⁴ The Code reflects a hybrid model of governance in which practices are mandatory where they are already legislated for under the Companies Act, and those that are not are requirements of good practice. As such, King III can apply to all entities despite their form of incorporation.¹⁸⁵

Unlike the Luse Code and contrary to the approach of the previous King Reports, King III has delegated the practical implementation guidelines to the Practice Notes that are to be issued by the Institute of Directors in Southern Africa. This was aimed at making sure King III remains current and relevant.¹⁸⁶

King III recommends that the board must be made up of mostly independent non-executive directors with a minimum of two executive directors.¹⁸⁷ It has been argued that although this provision aims to reduce the possibility of conflicts of interest and promote objectivity, King III appeared to have presumed that the detailed reasons why boards need to be independent were accepted and

¹⁸⁰ JSE Limited Listings Requirements, Service Issue 13, February 17 2010 at 17. Available at <http://www.jse.co.za/How-To-List-A-Company/Main-Board/Listing-requirements/JSE-listing-requirements.aspx> [Accessed 24 November 2010].

¹⁸¹ Ibid.

¹⁸² The Listing Rules were amended as from 1 April 2010. See Wixley (note 135) at 11.

¹⁸³ JSE Limited Listings Requirements (note 176) Rule 7.F.5.

¹⁸⁴ Naidoo (note 9) at 34.

¹⁸⁵ King Code (note 1) at 15.

¹⁸⁶ Naidoo (note 9) at 34.

¹⁸⁷ That is the Chief Executive Officer and Chief Financial Officer. See King Code (note 1) Principle 2.18.

understood.¹⁸⁸

King III deviates from the South African Companies Act and the Zambian Companies Act when it urges a board chairperson to consider how many outside chairs that person holds.¹⁸⁹ Like the Luse Code, King III recommends that a chairperson must be an independent non-executive director and where one person serves as both chairperson and CEO, there must be an independent non-executive director as deputy chairperson, or else the board must comprise a strong non-executive director element.¹⁹⁰

As to aspects of duties of directors, Wixley has argued that King III, together with a companies board charter, will be relevant in future in judging the performance of directors. Because King III does not set them out in one place, he categorises directors duties under four headings: competence, commitment, fiduciary responsibilities and oversight.¹⁹¹

The King Code further recommends that the board appoints and removes the company secretary.¹⁹² The company secretary must have an arms-length relationship with the board¹⁹³ and help the nominations committee appoint directors, induct directors and assist formulate training programmes for directors.¹⁹⁴ As with the Companies Act, the company secretary must guide the members of the board on their duties as regards good governance,¹⁹⁵ and ensure that the charters of the board and the committees are kept up to date.¹⁹⁶ Surprisingly, the King Code creates room for the company secretary to participate in evaluating each director, the board committees and indeed the entire board.¹⁹⁷ The Luse Code in a similar vein advocates for the board to annually evaluate how well the company secretary has

¹⁸⁸ For a fuller discussion, see Wixley (note 135) at 25.

¹⁸⁹ Ibid Principle 2.16.8.

¹⁹⁰ Ibid Principle 2.16.

¹⁹¹ See Wixley (note 135) at 46. He adds that the Guidelines issued subsequent to the King Report will also aide board members understand how they might fulfil their roles.

¹⁹² King Code (note 1) Principle 2.21.1.

¹⁹³ Ibid Principle 2.21.3.

¹⁹⁴ Ibid Principle 2.21.6.

¹⁹⁵ Ibid Principle 2.21.7.

¹⁹⁶ Ibid Principle 2.21.8.

¹⁹⁷ Ibid Principle 2.21.13.

performed using a ‘fit and proper test’¹⁹⁸ in the same manner as is recommended for new director appointments.¹⁹⁹

Both the LUSE Code and King Code provide for an audit committee, and recommend that the responsibility of determining the terms of reference of the audit committee is the board’s. Both codes contain provisions relating to external auditors, auditor independence and provisions of non-audit services.²⁰⁰ One important function of the audit committee under King III is to assist the board determine, assess, monitor, assure, disclose, and respond to risk.²⁰¹

Further, the King Report recognises that sustainability has come to the fore in the 21st century and forms the bedrock of business opportunity and risk.²⁰² It recommends that the board play a key role in identifying the company stakeholders and engage with them on a continual basis.²⁰³ Companies are now required to publish an integrated report focussing on financial, governance, strategy and sustainability issues.²⁰⁴

3.2 Overview of Corporate Governance Regulation in the USA

Although there is an array of laws and standards that affect the management of America’s business, corporate governance largely reflects a federalist organisation. States mainly regulate the relationship between a corporation’s management and shareholders through both legislation and judicial construction. In the USA, state statutes have not said much in the past about corporate governance, but have more recently focussed on enhancing the role of management in governance. The common law however has made significant strides in interpreting the board’s fiduciary obligations.²⁰⁵

¹⁹⁸ This is defined as ‘...ascertaining the suitability of a person in relation to a director or company secretarial position in a listed or quoted company, and includes a reference to qualifications and experience.’

¹⁹⁹ LUSE Code (note 90) Principles 45-47 at 6.

²⁰⁰ Ibid Principle 1 and Part E Principles 1, 3-5, and 7.

²⁰¹ King Code (note 1) Principle 4.

²⁰² King Code (note 1) at 9.

²⁰³ Ibid Principle 8.

²⁰⁴ Ibid Principle 9. See also Part H, LUSE Code (note 90).

²⁰⁵ Carol B Swanson ‘Corporate governance: sliding seamlessly into the twenty-first century’ (1995-1996) 21 *The Journal of Corporation Law* 417 at 433.

3.2.1 The Sarbanes Oxley Act 2002

Chapter one had highlighted the failures of Enron and other large companies in the early years of the new millennium. One reaction of corporate America to corporate failures was to legislate to prevent future market surprises, principally by enacting the Sarbanes Oxley Act of 2002 (SOX).

Corporate governance practitioner Naidoo²⁰⁶ has noted that many commentators have criticised the SOX as a legislative overreaction, citing agency costs, conflicts of interest, and persistent fundamental failures in corporate decisions even after passing the Act. In addition, the SOX has been accused of not only failing to stop the corporate scandals that became known during the credit crisis in companies such as AIG and Bear Sterns,²⁰⁷ but also for giving investors a false confidence that they could rely on the law rather than prudence.²⁰⁸

That notwithstanding, the objectives of the Act are five-fold. The Act aims to:

‘...restore confidence in the accounting profession, improve the “tone at the top”, improve disclosure and financial reporting, improve the performance of gate keepers, and enhance enforcement tools.’²⁰⁹

As with the South African Companies Act, the SOX prohibits an accountancy firm from being responsible for the bulk of non-auditing services of their client firms²¹⁰ to maintain auditor independence.²¹¹ The Act makes auditor rotation mandatory in that an audit partner responsible for a file of a client should not deal with the same client for more than five consecutive years.²¹² It is of interest that the Act provides for leeway to assess how the requirement to rotate auditors will affect companies.²¹³

Another feature of the Act is found in section 3 (b) (1). This section treats a violation of any provision of the Act, rules or regulation of the Commission or the

²⁰⁶ Naidoo (note 9) at 267.

²⁰⁷ Jill E Fisch ‘The overstated promise of corporate governance’ review of Jonathan Macey ‘Corporate governance: promises kept, promises broken’ (2010) 92 *The University of Chicago Law Review* 925.

²⁰⁸ Naidoo (note 9) at 267.

²⁰⁹ Information available at <http://www.terry.uga.edu> [Accessed 8 February 2011].

²¹⁰ SOX Act s 201. See also the Securities Exchange Act of 1934 s 10A (g).

²¹¹ Sharon Hannes ‘Compensating for executive compensation: the case for gatekeeper incentive pay’ (2010) *California Law Review* 98 2 at 403. Section 15 USC 78j-l(m) of the Securities Exchange Act requires every listed company to have an audit committee composed entirely of independent directors.

²¹² SOX Act s 203.

²¹³ SOX Act s 207.

Board as a violation of the Securities Exchange Act of 1934.²¹⁴ Further punitive measures can be enforced against any person who prepares or issues an audit report of an issuer²¹⁵ that is not a registered public account firm.²¹⁶

The SOX imposes strict requirements for audit committee members by requiring public listed companies to disclose whether a financial expert serves on its audit committee. The audit committee of the boards of public companies must only have independent board members, that is, those that do not manage the company or receive any consulting fees or other compensation from the company. The Act also ensures the independence of auditors by proscribing auditors from performing services for the corporations that they audit that are not related to auditing.²¹⁷

Further, section 304 of the Act introduces 'claw back provisions'.²¹⁸ These are designed to recover profits that are earned as a result of fraud or accounting errors.²¹⁹ Hannes²²⁰ has criticised this provision in that it is reactive rather proactive and therefore has a limited deterrent effect.

Another unique provision not found in other jurisdictions like Zambia is section 101 that establishes a Public Company Accounting oversight board, with extensive powers that are somewhat similar to those enjoyed by the Securities and Exchange Commission in the USA.

The SOX also requires Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) of listed firms to certify that the periodic reports of their firms fairly represent their financial condition and results of operations.²²¹ This is meant to serve as an internal control check of the truthfulness of both the financial report and the executive's certification of the financial reports.²²²

A peculiar feature of the Act is that it has extra territorial jurisdiction. The SOX does not distinguish between USA issuers and non USA issuers.²²³ An issuer is thus simply a company that issues securities on the USA markets²²⁴ and

²¹⁴ SOX Act subsec 3 (b) (1).

²¹⁵ SOX Act s. 102.

²¹⁶ Ibid.

²¹⁷ SOX subsec 201 (a).

²¹⁸ Hannes (Note 211) at 403.

²¹⁹ Ibid.

²²⁰ Ibid at 404.

²²¹ SOX Act s. 302.

²²² Ibid.

²²³ SOX Act s 106.

²²⁴ SOX Act s 2.

consequently, a non USA issuer of securities that are traded in the USA falls under the provisions of the SOX.

3.2.2 State Corporation Laws

State corporation laws in the USA generally favour a unitary board with liberal delegation of board functions to committees. This position is similar to the *Zambian Companies Act* and *South African Companies Act* respectively. A unique feature of the USA model however is that it has more detailed prescriptions of the roles of board committees.²²⁵

As regards shareholder activism, Fisch²²⁶ observes that corporate law generally prohibits shareholders from using litigation to challenge operational or strategic decisions, unless they can demonstrate a conflict of interest, absence of an informed decision making process or the lack of good faith by the board. This reflects the *Zambian model*, but it deviates from the *South African model* of enhanced shareholder rights.

Two notable corporation statutes are the *Delaware General Corporation Law (DGCL)* and the *Model Business Corporation Act (MBCA)*.

As to the role of chairperson and CEO, a significant feature in the USA is that the same person may perform the role of chairperson and chief executive officer.²²⁷

Officers of the company are appointed by the company under the *DGCL*, with duties that are specified in the by-laws or by the board. One of the officers must serve as company secretary but unlike the *Zambian* or *South African* position, the *Act* bestows only ministerial responsibilities with no governance related duties.²²⁸

The derivative action in the USA generally suffers the same common law limitations as in *Zambia*.²²⁹ In the case of *Re Bank of New York Derivative Litigation*,²³⁰ the court held that the contemporaneous ownership requirement:

²²⁵ Olson (note 131) at 228.

²²⁶ Fisch (note 207) at 937.

²²⁷ Ibid.

²²⁸ *DGCL* s 142.

²²⁹ However, federal law backs the USA derivative action. See Federal Rule of Civil Procedure 23.1. Information available at http://findarticles.com/p/articles/mi_qa3736/is_200501/ai_n13637494/ [Accessed 23 November 2010].

‘...is not satisfied if the shareholder has not owned stock in the corporation throughout the course of the activities that constitute the primary basis of the complaint....’²³¹

Additionally, the plaintiff must either make a demand that the board of directors initiate the suit or demonstrate why such a demand would be futile.²³² The rationale of the court was that this:

...prevents shareholders from using the derivative suit to forum shop, prevents shareholders from using the derivative suit to litigate “purchased grievances”, and allows both courts and litigants to reach equitable results in shareholder derivative suits....²³³

As regards stakeholder participation in the USA, Olson²³⁴ notes that there are virtually no statutory rights granted to stakeholders other than shareholders. Some states do provide for discretionary consideration of the interests of non-shareholder stakeholders, but give such stakeholders no rights of direct participation in corporate governance.²³⁵ This is reflective of the Zambian model.

To encourage shareholder activism, shareholders can also initiate lawsuits on a contingency fee whereby their legal fees are paid upon recovery of damages from the company. This is helpful in mitigating free riding by other shareholders and the problem of coordinating dispersed shareholders.²³⁶

3.2.3 Securities and Exchange Commission

The Securities and Exchange Commission (SEC) plays several key roles. It licenses and regulates corporate issuers of securities on stock exchanges, stock exchanges,

²³⁰ No. 99/604465, Supreme Court of the State of New York, New York County. For a fuller discussion of this case, see Terence L. Robinson Jr ‘A new interpretation of the contemporaneous ownership requirement in shareholder derivative suits: *In Re Bank of New York Derivative Litigation* and the elimination of the continuing word doctrine’ 2005 *Brigham Young University Law Review* 229 at 231 Available at <http://www.lawreview.byu.edu/archives/2005/1/5ROB-FIN.pdf> [Accessed 23 February 2011].

²³¹ *Ibid.*

²³² Fisch (note 207) at 936.

²³³ Information available at http://findarticles.com/p/articles/mi_qa3736/is_200501/ai_n13637494/ [Accessed 23 November 2010].

²³⁴ Olson (note 131) at 223.

²³⁵ See for instance the Pennsylvania Business Corporation Law, 15 Pa ConsStat at 1715.

²³⁶ Burke (note 101) at 364.

and brokers and dealers responsible for conducting the trading of securities. It does this within the purview of securities legislation.²³⁷

The SEC plays the important role of obliging public companies to submit various periodic reports (such as quarterly and annual reports). The SEC must also receive a narrative account from a company outlining the 'operations of the previous year, and future goals and approaches to new projects.'²³⁸

Transparency and disclosure is achieved through an online database called EDGAR (the Electronic Data Gathering Analysis and Retrieval system) that gives investors information that has been filed with the agency.²³⁹ The commission enjoys enforcement authority to institute both civil and criminal actions for abrogation of the securities law.²⁴⁰

3.2.4 ALI Principles of Corporate Governance

The American Law Institute embarked on a project to come up with the basic corporate governance principles that apply in the USA. In restating the law, the aim was to produce general propositions to assist company managers and directors know about their duties, and that would serve as a basis for court adjudication of such duties.²⁴¹ The culmination of this work was the formulation of the Principles of Corporate Governance and Structure: Restatement and Recommendation (ALI).

Topics covered under the ALI include:

- the objective and conduct of the business corporation;²⁴²
- the structure of the corporation;²⁴³

²³⁷ That is the Investment Company Act of 1940, the Securities Act of 1933, the Trust Indenture Act of 1939, the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Credit Rating Agency Reform Act of 2006 and the Sarbanes-Oxley Act of 2002. Information available at http://en.wikipedia.org/wiki/U.S._Securities_and_Exchange_Commission [Accessed 23 November 2010].

²³⁸ Reminiscent of the SOX reaction to corporate collapses in the USA, the Shareholders Bill of Rights 2009 was passed as a federal response to strengthening the Securities Exchange Act of 1934.

²³⁹ See (note 237).

²⁴⁰ See (note 237).

²⁴¹ Available at http://www.ali.org/ali_old/stu_corp_gov.htm [Accessed 25 November 2010].

²⁴² Information available at http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=88 [Accessed 23 November 2010].

²⁴³ Information available at http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=88 [Accessed 23 November 2010].

- the duty of care;²⁴⁴
- the duty of fair dealing;²⁴⁵
- the role of directors and shareholders in transactions in control and tender offers;²⁴⁶ and
- corporate remedies.²⁴⁷

Unlike the Luse Code, the ALI concisely spells out the five primary functions of a board. These include the oversight of company business, review and approval of the company financial and major corporate plans, selection of audit and accounting practices, senior executives,²⁴⁸ and performance of other functions as prescribed by law or other standards of the corporation.²⁴⁹

Board structure under the ALI separates governance from management, which is similar to that of King III. ALI provides a tiered corporate structure comprising principal senior executives and other officers, and employees who receive their managerial powers from the board, or from the principal senior executives.²⁵⁰

The ALI retains the position of shareholder primacy but recommends that it must be done with considerations of the ethical obligations of the company in mind, including considerations of responsible conduct of business. In addition, corporations must give sufficient resources to humanitarian and philanthropic purposes, public welfare, and education.²⁵¹

²⁴⁴ Information available at http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=88 [Accessed 23 November 2010].

²⁴⁵ Information available at http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=88 [Accessed 23 November 2010].

²⁴⁶ Information available at http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=88 [Accessed 23 November 2010].

²⁴⁷ Information available at http://www.ali.org/index.cfm?fuseaction=publications.ppage&node_id=88 [Accessed 23 November 2010].

²⁴⁸ That is selection, regular evaluation, fixing compensation and replacement.

²⁴⁹ ALI (note 241) Principle 3.02 (a).

²⁵⁰ ALI (note 241) Principle 3.01.

²⁵¹ ALI (note 241) Principle 2.01 (a).

3.3 Overview of Corporate Governance Regulation in the United Kingdom

According to the UK Department of Trade and Industry, companies in the United Kingdom operate within a particular corporate legal framework.²⁵² What follows is an overview of corporate governance provisions in the UK.

3.3.1 Companies Act

Unlike the Zambian Companies Act, the UK Companies Act 2006 does not expressly vest the management of the company in the board of directors. This is delegated to the articles of association of private companies that are limited by shares. The same draft model articles of the Act spell out the functions of directors.²⁵³

As regards board structure, the UK Companies Act does not provide expressly for the organisation of the board. As with the Zambian Companies Act, the UK Companies Act provides for a non-mandatory model of articles of incorporation which suggests certain organisational details of board structure.²⁵⁴

Bourne²⁵⁵ argues that one of the most significant changes brought by the UK Companies Act is the statutory code of duties that a director owes to a company. Unlike the position in Zambia, the UK does more than merely codify the existing common law position on directors' duties; it leaves the development and interpretation of the legislative formulations of the duties to the normal rules of statutory interpretation in common law systems.²⁵⁶ That notwithstanding, the following duties of directors have been codified:

- duty to declare interest in a proposed transaction or arrangement;²⁵⁷
- duty to exercise reasonable care, skill and diligence;²⁵⁸
- duty to promote the success of the company;²⁵⁹
- duty to exercise independent judgment;²⁶⁰

²⁵² Department of Trade and Industry, Companies Act 2006 Explanatory Notes, Note 3. Available at http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpgaen_20060046_enpdf [Accessed 24 November 2010].

²⁵³ Ibid Note 280.

²⁵⁴ Olson (note 131) at 229.

²⁵⁵ Nicholas Bourne *Bourne on Company Law* (2011) at 167.

²⁵⁶ Bryan Horrigan *Corporate social responsibility in the 21st century. debates, models and practices across government, law and business* (2008) at 247. See also UK Companies Act 2006 s 170.

²⁵⁷ UK Companies Act 2006 s 177.

²⁵⁸ UK Companies Act 2006 s 174.

²⁵⁹ UK Companies Act 2006 s 172.

- duty to act within the directors powers,²⁶¹
- duty to avoid conflict of interest,²⁶² and
- duty not to accept benefits from third parties.²⁶³

As a way of fostering transparency, the UK Companies Act has a unique provision by which companies (or their subsidiaries) must have records of the contract of employment of directors.²⁶⁴

A further unique feature of the Act is the statutory duty of directors to act in a manner that will ‘most likely promote the success of the company as a whole.’²⁶⁵

Section 172 directs that in doing so, the director must consider among other things:

...the interest of the company’s employees, the need to foster the company’s business relationships with suppliers, customers and others, the impact of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company....²⁶⁶

Another unique feature of the Act is that it provides in Section 417 that directors must include in their report aspects of business review. Thus all companies, save for small companies, should explain to their members how they have undertaken the task of promoting the success of the company under section 172 of the Act, or simply make a statement that they have nothing to report on in this regard. The *Zambian Companies Act* does not have such a requirement.

The provisions relating to company secretary under the Act are similar to the *South African Companies Act*. The Act requires a public company to appoint a secretary and stipulates certain qualifications and duties of the secretary.²⁶⁷ Unlike the *Zambian Companies Act*, private companies are not obliged to have a company secretary.²⁶⁸

Chapter two had briefly outlined the rule in *Foss v Harbottle*²⁶⁹ The UK Companies Act does not replace the rule in *Foss v Harbottle* but outlines a more

²⁶⁰ UK Companies Act 2006 s 173.

²⁶¹ UK Companies Act 2006 s 171.

²⁶² UK Companies Act 2006 s 175.

²⁶³ UK Companies Act 2006 s 176.

²⁶⁴ UK Companies Act 2006 s 228.

²⁶⁵ UK Companies Act 2006 s 172. This section conserves the rule in *Percival v Wright (1902) 2 Ch 421* that placed a duty on directors to the providers of capital.

²⁶⁶ *Ibid.*

²⁶⁷ UK Companies Act (note 257) ss 271-73.

²⁶⁸ UK Companies Act (note 257) s 270.

²⁶⁹ (1843) 67 ER 189.

flexible and modern approach to derivative actions.²⁷⁰ Under the UK Companies Act, an alleged breach of any of the general duties of directors outlined in chapter two of part ten of the Act (including the duty to exercise reasonable care, skill and diligence) is a ground for a derivative claim. A derivative action may be brought against a director or in exceptional circumstances, even against third parties.

Additionally, unlike in Zambia, the ambit of actions for which a derivative action can be instituted has been increased to include even wrongs committed against the company before the person instituting the claim became a member of the company.²⁷¹ Further, a minimum of 50 shareholders (or those that represent at least 5 per cent of the issued share capital) can institute an action on the company's behalf for any liability under section 369²⁷² of the UK Companies Act.

3.3.2 Listing rules and governance codes in the UK

The Listing Rules are a key source of corporate governance standards in the United Kingdom. In particular, a company that has a 'Premium Listing of equity shares'²⁷³ needs show how it has adhered to the UK Corporate Governance Code²⁷⁴ (UK Code).

It was highlighted in chapter two that the LUSE Code recommends a majority of non executive directors to provide an appropriate balance in decision making. Similarly, the UK Code recommends a unitary board comprising non-executive directors that can help bring a fresh level of expertise to the company board. The UK Code also demarcates the role of governance and management.²⁷⁵

Like the LUSE Code, the UK Code prohibits the same person from carrying out the twin roles of chairperson and CEO. In the case where the roles of CEO and chairman are combined, the UK Code recommends that the major shareholders should be consulted and availed the reasons of such an appointment.²⁷⁶ Interestingly,

²⁷⁰ Companies Act 2006 explanatory notes (Note 262) Note 491.

²⁷¹ UK Companies Act (note 257) s 260.

²⁷² This relates to liability of directors for unauthorised expenditures or donations.

²⁷³ See Listing Rule 9.8. Information available at

<http://fsahandbook.info/FSA/html/handbook/LR/9/8> [Accessed 24 November 2010].

²⁷⁴ Formerly called the Combined Code.

²⁷⁵ The UK corporate governance code (note 17) s A.

²⁷⁶ UK corporate governance code (note 274) Principle A.3.1-A 3.3.

the UK Code is more stringent on the independence of the chairperson by requiring 'an independent senior non-executive director.'²⁷⁷

The UK Code recommends the creation of board committees and stipulates their duties. It recommends that a board must have a compensation , audit, and nomination committee.

In addition, the company secretary has wide responsibilities under the UK Code similar to the South African Companies Act. The company secretary is key in providing information among the board members, and also between management at senior level and the non-executive directors. The company secretary must also assist in inducting and professionally developing directors, and through the chairperson, advise the board on all governance matters.²⁷⁸

The next chapter evaluates the Zambian position on the corporate governance themes using the jurisprudence obtaining in the three jurisdictions. This will be done by picking out under each theme what is considered most suitable; that is whether the current legal position in Zambia should remain, or whether Zambia should adopt the model of South Africa, the USA or the UK. The chapter concludes by giving recommendations for improved corporate governance in the specific corporate governance thematic areas.

²⁷⁷ UK corporate governance code (note 274) Principle A3.2- A3.1.

²⁷⁸ UK corporate governance code (note 274) Principle B.5.

CHAPTER 4-FINDING THE RIGHT CORPORATE GOVERNANCE REGULATORY BALANCE

There is no ‘one-size-fits-all’ corporate governance regulatory model. In determining what the best corporate governance regulatory model for a country should be, the critical inquiry is not whether a particular approach to law is perfect, but whether it is superior to the next best alternative.²⁷⁹

4.1 Legislative Framework

The starting point in this process is identifying what legislative improvements will best address the individual corporate governance priorities of companies. Below are what I have highlighted as essential elements for corporate governance reform in Zambia.

4.1.1 Management of the company

Wixley²⁸⁰ observes that one of the key determinants of the degree to which a board of a company is effective is its board composition, and how well its members understand their responsibility. The Zambian Companies Act therefore does well to expressly clothe the board of directors with the authority to manage the affairs of the company, and in this regard the Act does not need any express statutory amendment. This is reflective of the South African Companies Act.

The LUSE Code, however, is not express enough as to the board’s functions, and does not help matters by delegating the role of stipulating the functions of the board to individual companies. The LUSE Code must succinctly spell out the functions of the board as is done in the American Law Institute Principles of Corporate Governance and Structure: Restatement and Recommendation. This works out well in informing inexperienced board members in board matters. It also serves as a reminder to the board not to lose focus of its function, particularly in small family owned private companies in which the majority shareholder is often also the chairperson or managing director.

²⁷⁹ Jonathan R Macey ‘Corporate law and corporate governance : a contractual perspective’ (1992-1993) 18 3 *The Journal of Corporation Law* 185 at 194.

²⁸⁰ Wixley (note 135) at 24.

4.1.2 Composition of the board

It was pointed out in chapter two that a huge pool of SOEs and SMEs fall outside the direct ambit of corporate governance regulation. In Zambia, most companies are non listed SMEs²⁸¹ that account for 85 per cent of the total employment.²⁸² SMEs 'are characterized by concentrated ownership and control, poor institutional protection of minority shareholders'²⁸³ that has been attributed to the fact that most companies fail to make the transition from small family owned companies to larger professionally managed corporations.

The Zambian Companies Act would thus be more flexible towards SMEs if it followed the South African Companies Act model that provides for different minimum numbers of directors for different types of companies; for instance one director for non-public or personal liability companies. As most Zambian SMEs do not have separation of ownership and control, the tiered approach of allowing incorporation of companies with a single director in Zambia would encourage good corporate governance in SMEs.

Further, although under the Zambian Companies Act it is not mandatory for a company to appoint a managing director, the fact that the statute has provisions relating to the managing director has the potential of negating flexibility in a company's board structure. The statutory provisions relating to managing director should be removed from the Companies Act and instead companies should be allowed to determine their own board structure. The South African Companies Act serves as a good blueprint for company law reform in Zambia in this respect by not expressly providing for separate structures for executive and non executive directors. This will aid in achieving a liberalised, simple, and flexible company law regime that will encourage local and foreign investment.

For unlisted SME's and large public companies however, the requirement for a large number of independent non-executive directors may not be feasible in a

²⁸¹ G. J. Rossouw 'Business ethics and corporate governance in Africa' *Business Society* 2005 44: 94 at 95. DOI: 10.1177/0007650305274851. Available at <http://bas.sagepub.com/content/44/1/94> [Accessed 18 October 2010].

²⁸² See the article entitled 'Preference Act coming' in *Times of Zambia*, Volume 14 Number 938, 21 December 2010 at 7.

²⁸³ Michael N Young et al 'Corporate Governance in emerging economies : a review of the principal-principal perspective' *Journal of Management Studies* 45:1 January 2008 0022-2380 at 197. Available at <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-6486.2007.00752.x/full> [Accessed 3 August 2010].

developing country like Zambia that does not have a large pool of experienced directors. This requirement may result in, as is already happening, directors yielding to the temptation of taking on more positions on boards than they can effectively handle. This is a minus for good corporate governance as it increases the chances of a director breaching a director's fiduciary duties to one of the companies. The same reasons invalidate the King III recommendation that a board member be removable by the board without shareholder approval and that chairperson's of a board must consider the number of outside chairs held.

4.1.3 Separation of chairperson and CEO

Chapter three had highlighted that the UK Corporate Governance Code demarcates the role of chairperson and CEO which is adequately covered for in the LUSE Code. For public listed companies, this is appropriate because no person must exercise powers without an apt degree of accountability.

Further, in public listed companies, shareholders must have a greater say in board selection through mechanisms such as the requirement of prior consultation with major shareholders if a person is to be both chairperson and CEO. This is an effective measure to curb shareholder apathy in the affairs of public and listed companies, and would also deter concentration of the functions of governance and management in one person.

On the other hand, in private companies that are fairly small and family owned, the role of chairperson and CEO is often combined. Wixley²⁸⁴ lends weight to this assertion when he writes that few private companies appoint non-executive directors due in part to a reluctance to incur additional costs, and also a shortage of skilled individuals to act in that capacity. As such, the recommendation for the separation of the roles of chairperson and CEO may not be of much practical importance in small private companies. It is hoped that this requirement for separation of chairperson and CEO will not manifest in the SME Code of Corporate Governance once it comes into effect.

²⁸⁴ Wixley (note 135) at 241.

4.1.4 Board committees

Wixley had suggested in chapter three the importance of board committees by arguing that the board of directors of a typical listed company meets together for less than 36 hours a year.²⁸⁵ Committees are advantageous because they ensure diversity of opinions on the board, make full use of board members' expertise, time and commitment, and are cardinal where it is apparent that issues are too complex to be handled by an entire board.²⁸⁶

Thus, the Zambian Companies Act will need reform in three specific areas along the lines of the South African Companies Act. The first is a statutory requirement of a social ethics committee, the second is the appointment of *ex officio* members to the board, and third is the statutory requirement of an audit committee.

Social and ethics committees are especially critical in the mining sector for several reasons. Mining companies are often culprits of environmental pollution and are slow to actively engage in developing their immediate communities. Also, most mining companies are not listed on the Luse and are therefore not under the direct supervision of the Luse or the Securities and Exchange Commission regulations.

The Zambian Companies Act should be tailored along the South African Companies Act and South African Companies Draft Regulations to give the Zambian Minister of Commerce Trade and Industry the power to oblige particular mining companies to establish a social and ethics committee. Such a committee must fulfil stipulated objectives under the companies regulations. This will act as a catalyst to small companies to follow suite, although caution must be had that this ministerial power is not used to punish erring companies to gain political mileage.

In addition, the inclusion of *ex officio* members on a company's board would be a welcome addition to the Zambian Companies Act. This however would be more applicable for public listed companies in Zambia whose operations are more complex and require greater expertise than for smaller, family owned private companies.

²⁸⁵ Wixley (note 135) at 70.

²⁸⁶ Information available at <http://managementhelp.org/boards/brdcmtte.htm> [Accessed 11 December 2010].

4.1.5 Codifying directors common law duties

It was outlined in chapter two that the *Zambian Companies Act* does not codify the duties of directors but that the law is based primarily on English common law. It was also noted by Bourne²⁸⁷ that the UK *Companies Act* effectively contains an inexhaustive codification of director's common law duties, and leaves room for the development and interpretation of the statutory codification of these duties to the courts.

Zambia would do well to amend its *Companies Act* to reflect the UK model. This will demystify the duties of directors by correcting any misunderstandings in the law on what duties directors are expected to perform. It will make the law more accessible as it will be contained in statute rather than case law, and will help address the key question: 'in whose interests should companies be run?' Moreover, this is in line with the modern outlook of business regarding wider stakeholder responsibility and removes a great degree of confusion in this area of the law without hampering judicial activism.²⁸⁸

4.1.6 Rights of stakeholders

The *Zambian Companies Act* does not expressly recognise stakeholder participation. As was noted in chapter two, however, the governance process of the company extends to other areas of the law. Recognition of non-shareholder constituents can be found in other pieces of legislation relating to commerce, labour, occupational health and safety, insolvency or under contract. The recognition of non-shareholder stakeholders is also found in the *Luse Code*. The *Luse Code* however needs to go further by expressly obliging public and listed companies to produce integrated sustainability reports rather than just financial reports.

The UK *Companies Act* tries to provide for stakeholder protection under section 172. It is not yet clear how the courts will interpret this section, the criteria to be used by boards in prioritising the considerations in the section and the extent of the extra liability it will place on directors. In this regard, I suggest that Zambia need

²⁸⁷ Nicholas Bourne *Bourne on Company Law* (2011) at 167.

²⁸⁸ See also the arguments by the Department of Trade and Industry *Companies Act 2006 Explanatory Notes* at 46. Available at http://www.imolin.org/doc/amlid/UK_Companies_Act_2006.pdf [Accessed 23 November 2010].

not follow the UK statutory model but retain the current comply or explain approach under the Luse Code subject to the suggestions made in the preceding paragraph.

I share the sentiments of Wixley who suggests that managing stakeholders must be a balancing act. He warns that stakeholders may be self seeking, unduly interfere with running of the company, and that relationships can be seriously damaged if it is felt that some stakeholders are privy to information that is being denied to others.²⁸⁹

Further, sustainability reporting adds to the cost of reporting because it widens the ambit of information that reports of companies should contain, and requires the need for implementing comparable reporting standards across firms.²⁹⁰ In addition, strategic sectors such as the mining industry that rely heavily on foreign investment and that employ large numbers of workers would suffer. This is because foreign investors are likely to be scared off by the increased protection afforded to stakeholders like employees and trade unions beyond the present labour law regime.

4.1.7 Shareholders rights and engagement

In retrospect, chapter two had highlighted the justification for a study of corporate governance in Zambia by arguing that it would help ameliorate the challenges of capital market ownership. Shareholders in most public companies in Zambia are dispersed, not very knowledgeable about the company in which they invest in and are generally apathetic towards actively engaging in corporate matters. This is partly due to impracticalities in a company being able to send information and notices to every shareholder, causing shareholders not to have the chance to propose business for consideration at the annual general meeting. The Zambian Companies Act should therefore adopt the South African Companies Act provisions that allow shareholders to propose matters they would want to be dealt with at an annual general meeting, even without advance notice.

One other important shareholder activism tool is the derivative action. In this regard, the UK Companies Act settles for an appropriate balance between the Zambian model that follows English common law and the South African legislative approach. A statutory amendment to the Zambian companies will consequently

²⁸⁹ Wixley (note 135) at 164.

²⁹⁰ Tumuheki (note 32) at 47.

impact on judicial decisions such as *Avalon Motors Limited (in Receivership) v Bernard Leigh Gadsden Motor City Limited*.²⁹¹

Adopting the UK statutory position will be beneficial in five other respects.

First, legislation is by its very nature inflexible and Zambia is not so strong in legislative reform as seen from the fact that the *Zambian Companies Act* has not undergone legislative overhaul since 1994. Second, the UK *Companies Act* retains the rule in *Foss v Harbottle* while clarifying the difficulties in the common law of ascertaining if a shareholder can take out a derivative action. Third, widening the spectrum of persons who can take out a derivative action to include directors, prescribed officers and trade unions like in the South African model could potentially cripple smaller *Zambian* companies due to high litigation costs, and could expose large companies to the risk of market exposure.

Fourth, the UK model makes a breach of the codified duties of directors a ground for a derivative action, and allows such an action to be brought against a director or third party. Fifth, the UK model has to an extent mitigated the pernicious effect of the contemporaneous ownership rule outlined in the United States case of *In Re Bank of New York Derivative Litigation*²⁹² by allowing a derivative claim to be brought for wrongs committed prior to becoming a member of a company.

4.1.8 The company secretary and other officers of the company

The position of the South African *Companies Act* as regards the company secretary is suitable for the *Zambian* corporate environment. I suggest this based on the three main reasons outlined below.

First, it relieves private companies from the obligation of appointing a company secretary. The *Zambian Companies Act* is currently pernicious in that a every company is fined a daily penalty if the company neglects to appoint a company secretary for a period of two months.²⁹³ Second, the South African *Companies Act*

²⁹¹ (1998) S.J. 26 (S.C.). Available at <http://www.saflii.org/zm/cases/ZMSC/1998/6.pdf> [Accessed 25 February 2011].

²⁹² No. 99/604465, Supreme Court of the State of New York, New York County. For a fuller discussion of this case, see Terence L. Robinson Jr 'A new interpretation of the contemporaneous ownership requirement in shareholder derivative suits: *In Re Bank of New York Derivative Litigation* and the elimination of the continuing word doctrine' 2005 *Brigham Young University Law Review* 229 at 231 Available at <http://www.lawreview.byu.edu/archives/2005/1/5ROB-FIN.pdf> [Accessed 23 February 2011].

²⁹³ Tumuheki (note 32) at 45.

has expanded the duties of the company secretary as a key officer of public and state-owned companies, to enhance adherence to corporate governance. Third, the South African Companies Act introduces some modicum level of competence on the part of the company secretary by requiring a board to consider the knowledge or experience in relevant laws of the company secretary.

As regards other officers of the company, the South African Companies Act delegates the definition of prescribed officer to regulations to circumvent the difficulty of making quick legislative amendments to the statute. This is a welcome amendment to the Zambian Companies Act. However, the Zambian Minister of Commerce Trade and Industry would want to be wary of making the definition of 'prescribed officer' too wide as was observed by Wixley²⁹⁴ about the significant legal implications of this far reaching definition.²⁹⁵

4.1.9 Audit committees

To begin with, Zambia's equity market liquidity may not be ready for prescriptive regulation of auditor functions, such as the Sarbanes Oxley Act in the USA. Hannes²⁹⁶ observes that costs of compliance to the SOX are believed to have caused indirect costs of 'business disruption,'²⁹⁷ increased the number of 'firms going private,'²⁹⁸ and lessened the number of mergers and acquisitions 'due to fear of compliance problems in newly acquired divisions.'²⁹⁹

Beyond merely allowing directors to delegate plenary powers to committees,³⁰⁰ the Zambian Companies Act must be more express to require every state-owned and public company to have an audit committee, like in South Africa. A statutory provision in the Zambian Companies Act along the lines of section 94 of the South African Companies Act could be very beneficial for improved corporate governance in Zambia.

²⁹⁴ Wixley (note 135) at 35.

²⁹⁵ Subsec. 172 (9) of the Zambian Companies Act defines 'officer' to include '....an officer of a related body corporate, and a person who within the last twelve months has been an officer or promoter of the company or of a related company, unless exempted by the Registrar....'

²⁹⁶ Hannes (Note 211) at 413.

²⁹⁷ Ibid.

²⁹⁸ Ibid.

²⁹⁹ Ibid.

³⁰⁰ Zambian Companies Act (note 43) subsec 217 (6).

This is because Section 94:

- does not require all companies to have audit committees but applies to public, state-owned and other companies that volunteer to have audit committees;
- sets out grounds of disqualification for appointment to an audit committee;
- allows the Minister of Trade and Industry to prescribe minimum qualification requirements for members to ensure that there are right levels of knowledge and skills of the audit committee members; and
- sets out the duties of the audit committee.

One sector that has the potential of negatively affecting the economy if risk governance and management is not properly handled is the banking sector because banks have a sensitive role to play in the economy as financial intermediaries. As was observed by Mwenda,³⁰¹ the Banking and Financial Services (Corporate Governance) Guidelines 2006³⁰² provide that at a minimum, each board should ensure that it has an audit committee, risk management committee, and the loans review committee.

The weakness of the legal set up just outlined above is that most public companies and SOEs in Zambia are not in the banking industry and are thus not legally obliged to establish audit committees. Moreover, even the public companies on the Lusaka Stock Exchange are encouraged to establish audit committee's on an 'apply or explain' basis. It is imperative therefore that the Zambian Companies Act adopts Section 94 of the South African Companies Act so that even public companies, SOEs and other companies are forced to establish audit committees.³⁰³

That notwithstanding, the South African proscription for an auditor to serve for more than five consecutive financial years is inappropriate for Zambia. This is mainly because of the cost factor of auditor rotation and the small size of the auditing market that is not yet large enough to cater for rotation of auditors. It has also been observed that long auditor tenure has advantages such as familiarity with the business and increased willingness to make client specific investments.³⁰⁴ Moreover, even the USA, the SOX gives leeway to assess how the requirement to rotate auditors will affect companies.

³⁰¹ Mwenda (Note 73) at 247.

³⁰² See Principle IV.

³⁰³ Public Audit Act, Chapter 378 of the Laws of Zambia, 1995 s 3.

³⁰⁴ Hannes (Note 211) at 424.

4.1.10 Disclosure and transparency

Burke³⁰⁵ has described the culture of UK as one that is polite, secretive, and conflict adverse. Zambia as a country seems to have adopted its colonial master's disposition.³⁰⁶ Burke rightfully points out that this cultural disposition is the cause of the low effectiveness of shareholder activism, reluctance of management from revealing information that is averse to the company's profits, and the choice by institutional investors to opt for private conversations with management.

On the other hand, corporate legislation in the UK reveals developments in breaking away from the culture of secrecy. Section 228 of the UK Companies Act mandates companies to keep written copies of the terms of engagement of directors. This is an important provision particularly for small private companies as it encourages disclosure of director compensation to minority shareholders. Zambia would do well to include this provision in its Companies Act.

A related aspect of transparency is the UK business review element of the directors report that is beneficial in assisting members judge how well directors have performed in promoting the success of the company. The UK Companies Act is flexible enough to exempt small companies from this requirement and does not make it mandatory for quoted companies to report on the non-financial aspects³⁰⁷ of the company. This would also be a meaningful inclusion in the Zambian Companies Act as it would assist the general public make informed choices on stock purchases. It also is not too burdensome in terms of costs of disclosure for companies. It further allows companies to maintain their competitive advantage by simply stating that they do not have anything to report relating to the non-financial aspects of the company.

³⁰⁵ Burke (note 101) at 373.

³⁰⁶ *Ibid.*

³⁰⁷ That is the environment, employees, community matters or essential contractual arrangements.

4.2 Institutional and regulatory reforms in Zambia so far

*There are many obstacles in Africa that frustrate the quest for good corporate governance. Prominent on the list of obstacles are the lack of effective regulatory and institutional frameworks that can ensure the enforcement of the standards of good corporate governance....*³⁰⁸

It has already been pointed out in chapter two that Zambia has adopted a quasi Self Regulatory Organisation (SRO) system. This is a regulatory system in which government institutions like the Securities and Exchange Commission and the LUSE work hand in hand with voluntary organisations like the Institute of Directors of Zambia (IODZ). This quasi SRO system is best suited for Zambia to regulate secondary markets and mitigate the possible bias of SROs.³⁰⁹ In an interview,³¹⁰ the Legal Counsel and Company Secretary of the Luse, Priscilla C. Sampa, revealed that it may be difficult for a pure SRO system to enforce its corporate governance rules because compliance of members to the corporate governance codes of the exchange is voluntary. Non compliance of members is exacerbated by the lack of a proper legal regime under which the LUSE operates.

For private companies, particularly mining companies that are not listed or quoted on the LUSE, combined efforts by both the government and other private institutions like the IODZ are needed to instil improved corporate governance. The IODZ has scored a few successes such as the development of the Small and Medium Enterprises Code of Corporate Governance in 2007 that awaits amendment of the Securities Act³¹¹ before its adoption by the LUSE.

Further, IODZ has held a presentation to 150 Members of Parliament on good governance principles and implementation.³¹² Although the IODZ is in the process of increasing corporate governance advocacy through broadcasting radio programmes

³⁰⁸ G. J. Rossouw 'Business ethics and corporate governance in Africa' *Business Society* 2005 44: 94 at 95-96. DOI: 10.1177/0007650305274851. Available at <http://bas.sagepub.com/content/44/1/94> [Accessed 18 October 2010].

³⁰⁹ Burke (note 101) at 351.

³¹⁰ This interview was conducted on 17 December 2010 at the Lusaka Stock Exchange offices in Lusaka, Zambia.

³¹¹ Chapter 354, *Laws of Zambia*, 1995.

³¹² Centre for International Private Enterprise 'Corporate governance for emerging markets' at 11. Available at http://www.cipe.org/programs/corp_gov/pdf/CGToolkit0808.pdf [Accessed 17 January 2011].

on the national Zambia National Broadcasting Corporation,³¹³ it will need to do more work in marketing its manual on corporate governance, especially to mining companies.

The IODZ is not without its own shortcomings. As highlighted by its Executive Director, Mrs C Silutongwe,³¹⁴ the institute currently only has three members of staff. Its committees operate on a voluntary basis and there is no remuneration for work done in these committees. As such, the existence of the institute is not known by a good number of company directors. Further, the finances of the institute are quite dire because the IODZ survives on monies realised from training programmes.

On account of the sensitivity of the banking sector, laws and regulations in this sector must be formulated so that they are capable of being enforced without showing favouritism to any market player. This will help institutions like the Bank of Zambia achieve their goal of safeguarding depositors' funds by preventing imprudent activities on the part of financial institutions. Further, it has been suggested that the Bank of Zambia can increase good corporate governance by imposing some sanctions on culpable banks and financial institutions for engaging in unsafe and unsound practice.³¹⁵

Additionally, the growth of institutional shareholders like collective investment schemes, pension funds and insurance schemes places a greater burden on the SEC. For instance, in its 2008 annual report, the Communications Authority reported an interest of ZMK 6 079 166³¹⁶ gained from investments in treasury bills. The SEC will be key in regulating disclosure of how the institutional investors exercise their ownership rights, elect board members, place proposals on the agenda of company meetings and engage in direct discussions with the target companies to foster improved corporate governance.³¹⁷ A failure by institutional shareholders to

³¹³ Revealed in an interview with the Executive Director of the Institute of Directors of Zambia, Victoria C Silutongwe, conducted on 6 January 2011 at the Institute of Directors of Zambia offices in Lusaka, Zambia.

³¹⁴ Ibid.

³¹⁵ Mwenda (note 73) at 229.

³¹⁶ Approximately US \$ 1 350 926. See Communications Authority 2008 annual report.

³¹⁷ Caution should be taken however that such co-ordination does not lead to inefficiencies or manipulation of the capital markets.

exercise their ownership rights could result in a loss to investors of their investment funds.³¹⁸

Private institutions like the IODZ have correctly focussed on trying to solve some of the corporate governance challenges unique to statutory bodies. The main shareholders of statutory bodies are members of the public whose taxes have been invested in these organisations and it is imperative that tax payer's money is properly used.

It is also important to note that institutional responses to corporate governance cannot be far removed from political and governmental policy towards private sector development. In a speech to the Ministerial Round Table of the World Investment Forum in China³¹⁹ recently, the Minister of Commerce Trade and Industry Mr Felix Mutati observed that the Citizens Economic Empowerment Act was passed into law in 2007 to encourage foreign investors to reserve a certain percentage of shares or positions to the locals in order to access certain preference such as public tenders.³²⁰

4.3 Conclusion and Recommendations

The pace at which a country develops economically is partly determined by its legal and institutional set up. I have highlighted ten key variables that if implemented, will improve corporate governance of companies in Zambia and contribute to its economic development.

The ten key variables are the management structure of a company, composition of the board, separation of chairperson and CEO, and codification of the common law duties of directors. I have also highlighted the aspects of shareholder activism, the company secretary and other officers of the company, audit committees, disclosure and transparency.

Zambia has made some strides in modernising its corporate governance regulatory framework, especially in public companies trading on the LUSE. The LUSE Code is abreast with international corporate governance trends in the area of board composition, risk governance, sustainability reporting and auditor

³¹⁸ Annotations to the OECD Principles of Corporate Governance (note 19) at 29.

³¹⁹ Ministry of Commerce Trade and Industry, Department of Industry, 6-9 September 2010, Xiamen at 1. Excerpts of the speech are available at <http://www.oecd.org/dataoecd/32/37/45562632.pdfv> [Accessed 26 November 2010].

³²⁰ Ibid.

independence. Notwithstanding, the aim of policy reform in Zambia should be to integrate the provisions of the various standards and codes with legislation. In this regard, legislators are encouraged to review the regulations introduced by institutions such as the Institute of Directors of Zambia, Bank of Zambia, LUSE and the Zambia Institute of Chartered Accountants with the aim of incorporating these recommendations into the Companies Act.

As a country, Zambia must be wary of sanctioning the development of governance codes beyond what is practical, realistic, and necessary for good governance.³²¹ One advantage of adopting an enabling approach to a mandatory approach is that enabling rules are flexible enough to allow corporations to adopt the elements of corporate governance that they think best suits their needs. This inevitably allows for greater risk taking, innovation and is less costly for board decision making. It is foolhardy to expect national parliament to have the skills and time to keep abreast with the fast paced corporate governance developments.

However, certain corporate governance aspects will best be improved upon by adopting a mandatory approach. These corporate governance aspects include single director companies, social ethics committees, appointment of *ex officio* members to the board and shareholder resolutions. I have also proposed that the derivative action, the company secretary, disclosure of service contracts of directors and the business review element must be provided for in the *Zambian Companies Act*.

Beyond reforms in legislation and best practice standards, external factors that have hindered significant corporate governance reform in Zambia will also need to be addressed. These include change in corporate culture, reorientation of the business community from corruption as accepted ways of doing business,³²² development of the stock exchange, and improvement of audit and accounting standards by the Zambia Institute of Chartered Accountants.³²³

I propose that a shift in corporate culture can be catalysed by professional bodies, tertiary educational institutions and regulatory authorities making concerted

³²¹ Naidoo (note 9) at 267.

³²² Social aspects such as traditional values, cultural attitudes and behaviours have had a negative impact on the fight against corruption in Zambia. See the National Anti Corruption Policy 2009 at 15.

³²³ Holly J. Gregory 'The globalization of corporate governance' at 2 Available at <http://www.nacdonline.org> [Accessed 26 November 2010].

efforts in regulating and advocating for good corporate governance. Teaching of corporate governance courses must also be introduced at higher institutions of learning such as universities. Professional associations like the IODZ can play a role by extending their membership to students to help shape students into responsible business managers.

Some authors have noted that in the public sector, governance is driven primarily by legislation and regulations. This framework is liable to be less effective because of a lack of coordination among numerous government ministries.³²⁴ There is need to set up a central unit that can monitor and coordinate the boards of parastatals to ensure that they adhere to good corporate governance.³²⁵

In chapter two, the point was made that the majority of SOEs, SMEs, and mining companies are not listed, leaving a huge pool of corporations outside the direct ambit of corporate governance reforms. It was also noted in chapter two that corporate governance is influenced by other areas of the law such as labour law, company law, and environmental law. Thus, reforms in these other spheres of the law will help improve corporate governance especially in SOEs, SMEs, and mining companies. To further cater for areas of deficiency discussed in this dissertation in SMEs, SOEs and mining companies, amendments to the Companies Act will need to be made in tandem with other statutes like the Zambia Development Agency Act³²⁶ and statutes under which some SOEs are incorporated.

In addition, for SMEs, SOEs and mining companies, the focus of corporate governance must be on training and capacity building, ascertaining local economic value, access to information and increased reporting. Other key corporate governance areas in these sectors are reputation, risk governance, engagement of management and adherence to labour standards and conditions.³²⁷ The IODZ will play a critical role in meeting these objectives in SOEs once it implements its plans to hold training

³²⁴ Wixley (note 135) at 226.

³²⁵ Information available at <http://www.times.co.zm/news/viewnews.cgi?category=7&id=1226901794> [Accessed 28 January 2011].

³²⁶ 11 of 2006.

³²⁷ Recommendations from the workshop on economic and corporate governance and accountability in Southern Africa, 7 – 9 December 2005, Lusaka, Zambia at 32. Available at http://www.uneca.org/eca_programmes/srdc/sa/publications/corporate_governance.pdf [Accessed 17 January 2011].

programmes with permanent secretaries and heads of departments of cabinet ministries.³²⁸

Furthermore, the proposal by the current Executive Director of the IODZ to have compulsory registration of company directors with the IODZ is a welcome idea. This would be advantageous in that the IODZ would act as a professional regulatory body of directors and will have enough oversight of the corporate governance standards of its members.³²⁹

As to institutional shareowners, their apathy in engaging actively with the board of the target companies can be overcome by encouraging the formation of bodies representing these institutions, as has been done in other jurisdictions. One notable example from which Zambia can take a leaf is the National Association of Pension Funds in the UK. In addition, pension funds should be made to formulate a Statement of Investment Principles and Policies, or such equivalent document, and trace out the extent to which corporate governance issues have been considered in making investment decisions.³³⁰

Companies that are currently making strides in promoting good corporate governance should be rewarded as an incentive to other companies to follow suit. In 2009, the Zambia Federation of Employers (ZFE) introduced an award giving ceremony for organisations demonstrating sound policies in occupational health and safety, environment, corporate social responsibility and staff development. Although this a positive development, more companies can be reached by creating categories specific to SOEs and SMEs to foster good corporate governance in these companies.³³¹

All in all, the success of corporate governance reform in Zambia goes beyond regulatory reforms and will depend on the knowledge, experience, and skills of those managing companies. The board, management and even employees of companies should all be convinced of the importance of good corporate governance and the benefits that flow from it. Companies will need to prioritise objectives by

³²⁸ Revealed in an interview with the Executive Director of the Institute of Directors of Zambia, Victoria C Silutongwe, conducted on 6 January 2011 at the Institute of Directors of Zambia offices in Lusaka, Zambia.

³²⁹ Ibid.

³³⁰ Adapted from recommendation 22 of King Code (note 1).

³³¹ Kansanshi Mining PLC came first in the Environment and Corporate Social Responsibility categories respectively. See article by Godfrey Phillip Msiska entitled 'Kansanshi Mining PLC- Employer of the year 2010' in *Zambian Traveller* Issue 64 January / February 2011 at 10.

progressively focussing first on mandatory areas of compliance followed by other areas of good corporate governance practice ranked according to the company's own needs, resources and philosophy. Company objectives must have flexible time limits for the attainment of each objective.³³² In the end, companies will move from mere piecemeal implementation of selected governance themes to a more holistic approach that focuses on the thematic areas discussed in this dissertation.

³³² Naidoo (note 9) at 272.

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