

**Keynote Address by Tshediso Matona, Director-General: Trade and Industry, Conference on South African Company Law for the 21<sup>st</sup> Century, Pretoria, 19 March 2007**

Ladies and gentlemen, I am indeed delighted to be here. I must, however, apologise for the Minister's and Deputy Minister's absence. The Minister happens to be on official business in the United States of America, while the Deputy Minister was required to deal with a high-level Russian delegation.

Given the theme of the conference, South African Company Law for the 21<sup>st</sup> Century, I would like to talk about the importance of company law to our economy and why it needs to modernize. Let me start with the events of recent weeks in corporate South Africa.

**Fidentia**

Director accountability in South Africa has been badly shaken by events at Fidentia. The actions of a small number of individuals have had immense repercussions on the whole business community. We know only too well the effects of scandals like these. We previously had our fair share in the late 90s – Saambou, Masterbond, etc.

Events at Fidentia happened at an opportune time for us to be able to identify some weaknesses in our corporate governance regime. Government recognises that the provision of loans to directors and subsequent writing off of such loans by companies has serious repercussions for the investing public, particularly for widows and orphans as the events at Fidentia have demonstrated. It poses the question whether such loans should be permitted by law, as is currently the case in our company law and in the proposed Bill, or whether a general prohibition should be built in. Financial assistance to directors for purposes unrelated to the

company do not benefit the company in any direct way. A careful assessment of this issue is therefore necessary. We are happy that action is being taken and as we reform our company law we need to ensure that such actions are effectively regulated.

On a related note, financial reporting and accountability has also presented enormous challenges in the past. In the previous year, Parliament has passed some of the most significant statutes in an endeavour to improve accounting and auditing standards. The Corporate Laws Amendment Act and the Auditing Professions Act are notable in this regard. These enactments are significant in improving the regulatory framework for auditing and accounting standards.

And our system is the stronger for it. Which is not to mean that we can relax. I do not believe that we can be complacent. What is noteworthy is that South Africa is not immune to what is happening in other economies, developing or developed. In the global economy, this is simply not a practical or realistic view to take. Stock markets all around the world are affected by what goes on in other economies.

Consequently, we must take action on the global stage to restore confidence. In particular, we must press ahead with developing a full set of rigorous and effective international standards and, in particular, ensuring that the incentives built into remuneration packages encourage responsible behaviour, particularly in the aftermath of events at Fidentia. We need to decide what balance between a 'rules-based approach', as contained in our current statutes, and a 'principles-based approach', as contained in the Codes of Best Corporate Practice, must be struck to improve corporate behaviour.

But our approach must involve a mixture of action on both the international and domestic stage. This is crucial in the global economy - where all our economies

are inter-dependent. Globalisation and the pace of technological change presents challenges for policy makers across the world.

### **The importance of Company Law and the imperative to modernise**

In 1911, Nicholas Murray Butler, the president of Columbia University, claimed that the limited liability company outweighed even electricity as "the greatest single discovery of modern times". If an invention is measured by endurance, then after a hundred and sixty years, the limited liability company is certainly not doing badly.

As observed by John Monks: "Company Law provides the legal basis for one of the most important institutions organising our economy".

Company law is central to our economy and our prosperity - for wealth creation and social renewal. It can promote enterprise - or it can hold it back. Company law can do so in a number of ways. Firstly, the requirements of the law to register and maintain a company can be such that it is too costly to operate in the formal economy, and individuals may choose to operate as unregistered entities without the advantages of limited liability. Thus, it can create incentives for greater informal sector activity. Secondly, the corporate finance provisions, if outdated, can disadvantage our companies with respect to their global competitors and constrain their ability to raise capital and compete effectively. Furthermore, ineffective corporate rescue provisions, which may result in creditors receiving lower recoveries, can create disincentives for equity investors, limiting sources of capital for South African businesses.

A facilitating and enabling framework for all 1.7 million South African corporations (i.e. companies and close corporations) Company Law is a key indicator of our

national competitiveness - weighed up by potential investors.

That notwithstanding, our company law was largely created in the nineteenth century. But what was a source of competitive advantage to us then, is now a source of competitive disadvantage. The law has got out of date - and become encrusted with all sorts of amendments and case law.

When a Discussion Document for the Reform of Company Law was first published on 23 June 2004, it was correctly observed that the 1973 Companies Act is outdated, highly formalistic, has unnecessarily burdensome information requirements, is creditor-oriented and is overly criminal.

So there is a need to tidy up the law. But we also need to reflect on the huge change we have seen in our economy since the last review.

To quote from the Discussion Document:

“The domestic and global environment for enterprises has changed markedly since the 1970s. Corporate structures and financial instruments have undergone significant developments. Many old concepts have been abandoned or modified and new concepts have been developed. We now live in a world of greater globalisation, increased electronic communication, greater sensitivity to social and ethical concerns, fast changing markets, greater competition for capital, goods and services. South Africa cannot afford to be left behind. There is a growing recognition by companies and governments that there is a need for higher standards of corporate governance and ethics and greater interdependence between enterprises and the societies in which they operate. A number of corporate failures in South Africa and other jurisdictions have revealed serious defects in the prevailing standard of corporate governance and the administration of the law and have resulted in investors suffering extensive losses. The introduction, in 1999, of the Public Finance Management Act, (PFMA)<sup>i</sup> also emphasizes the importance of good corporate governance for

public entities and new company law will have to take into account the implications for public enterprises, where appropriate.”

Furthermore, “socio-political and economic change in South Africa has underscored the need for social responsiveness, transparency and accountability of enterprises. The mobility of international capital has highlighted the need for domestic laws to be investor friendly and competitive with international trends. The rise in international trade and foreign investment since 1994 has made necessary the harmonisation and modernisation of company law, as well as the need to make specific provision for foreign companies to operate in South Africa. This is further underscored by South Africa’s reintegration into the region and the role that the country and domestic companies play in the economic development of Southern Africa and Africa in general. Finally, the growth of the small business sector has created a need for simpler and more accessible laws.”

The United Kingdom’s 1862 Companies Act, from which the 1973 Act originated, was developed for joint-stock companies to raise capital for large projects, such as building railways - but today 99% of all firms registered at the Companies and Intellectual Property Registration Office (CIPRO) are privately owned or closely held corporations. This has very significant implications for the very foundations of company law and has been a key issue that informed the development of new company law.

The upshot is that the urgency for modernizing our company law cannot be gainsaid.

### **“A Balancing Exercise”**

In any reform process, competing objectives must be balanced. Company law is no different and this most recent reform has also sought to achieve such a balance. In developing company law for the 21<sup>st</sup> century, it is important to create flexibility and simplicity particularly for closely held companies. But it is also

imperative to enhance corporate governance and financial reporting, especially for public interest companies.

Aided by the advent of information communication and technology (ICT) and the rapid development thereof, corporate formation in the twenty first century should be hassle free and encourage corporate formation in the formal economy – i.e. Company Law should assist in bridging the gap between the first and second economies existing in South Africa.

While the government acknowledges that measures should be taken to increase the contribution of small and medium – sized enterprises to the country's GDP, cognisance is taken of the important role and the contribution that public interest companies make to the country's GDP and development. As such, company law in the twenty first century should also seek to enhance corporate accountability and financial reporting for public interest companies. This is not the responsibility of South Africa alone, but measures need to be taken at a global level as well. We all know too well what the effects of lax corporate governance and corporate accountability can be in a more Globalised environment. We have seen the ramifications of events at Worldcom, Enron, Polly Peck, Parmalat, Leisurennet, Saambou, to name but a few.

On the corporate governance front, clarity and enhanced accountability is of utmost importance, particularly given the recent events at Fidentia. Related important measures to improve corporate governance were taken in South Africa at the end of the last century. Classic examples of these measures included the two King Reports and Codes in 1994 and 1999; the Public Finance Management and Municipal Finance Managements Acts; the amendments to the Banks Act, and, more recently, the Corporate Laws Amendment Act, 2006. Company Law reform in the area of corporate governance should be preceded by the acknowledgement of the fact that at the moment, directors' duties are set out in 250 years of case law. And, not surprisingly, the message isn't getting through. A

1999 survey of IoD members in the UK found considerable confusion amongst directors - half of those surveyed incorrectly thought they had an explicit duty to take into account the interests of creditors and customers when considering actions on behalf of their company. Some thought they had no duty to shareholders! Three quarters thought that directors' duties were difficult to understand because of the variety of legal sources involved. That is, among other reasons, why we need to make directors duties clearer.

Another important area of corporate accountability is the improvement of financial reporting standards. Important measures have already been undertaken in this regard. Firstly, the IFRS have already been adopted for public companies in South Africa and through the Corporate Laws Amendment Act of 2006, attempt has been made to provide legal backing for financial reporting standards, The institutional framework proposed in both the Corporate Laws Amendment Act and the Companies Bill in this regard will go a long way in ensuring improved financial reporting standards, particularly for public interest companies.

## **Conclusion**

To sum up, this is the most fundamental reform of company law for over 30 years. We are rewriting the settlement between business and society for the modern economy.

Importantly, the Bill has taken the best out of best practice jurisdictions, thus living up to the objective of making company law compatible and harmonious with best practice jurisdictions internationally. Importantly, the process is about responsible government creating the right market framework for successful and responsible business. It's about the relationship we need between the state and the market in the modern economy.

This law reform is aimed at creating an environment where responsible business can flourish. With the aim of prosperity for all.

And I look forward to working with you in the future as we take this important work forward.

Thank you.

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<sup>i</sup> Act 1 of 1999.