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1. INTRODUCTION

It is widely acknowledged that South Africa’s Constitution\(^1\) is ambitious in its aims. In recognition of the devastating social and economic effects of our past, the Constitution is in many ways a transformative document which intends to propel our society into a future based on dignity, equality and freedom\(^2\). These are political and social ideals, but they cannot be viewed isolated from economics. There is no dignity in poverty. No substantive equality when roughly 60% of the wealth of a country is held by an elite 10%\(^3\). Similarly, free speech and the right to vote once every four years are meaningless when a critical skills shortage\(^4\) denies the majority of participating autonomously in commerce. It is necessary to begin this paper by highlighting the transformative nature and vision of the supreme law because the political and economic orthodoxy will tend to be knee-jerk in their resistance to transformative legislative intervention that creates duties on the private sphere.

Government’s role in company law cannot merely be regulatory. Globalization and the modern economy mean that corporations wield incredible power to shape the countries that they operate in\(^5\). Large Multi-nationals have a disproportionate degree of political and social power\(^6\). Traditionally, CSR was viewed conservatively, through the prism of the shareholder primacy model advocated by Adolf Berle\(^7\) and endorsed by eminent economists such as Milton Friedman\(^8\). The focus fell on limiting negative externalities such as environmental damage and protecting the rights of workers, but only in so far as enhancing shareholder value. More recently, in recognition of the value inherent in intangibles such as trust, ethics, worker satisfaction and a good social reputation, CSR has been embraced as an actual means of creating shareholder value\(^9\). This

\(^1\) Constitution of the Republic of South Africa, 1996
\(^2\) Ibid at Chapter 1(a)
\(^9\) Supra note 6 at 572 .
model is known as the enlightened shareholder model and reflects, by and large, the prevailing approach to CSR and CSI in South Africa and abroad.

In the light of our constitution’s aforementioned aims and ethos combined with the current social and economic problems that continue to dog South Africa’s young democracy, the question arises as to whether the enlightened shareholder model is the correct approach to ensuring that firms practice effective CSI, particularly of the kind that addresses South Africa’s root problems as a developing nation.

This paper argues for legislation that makes Corporate Social Investment (CSI) spending mandatory for certain public and state owned companies. More specifically, the argument is made for spending of the kind that addresses South Africa’s most fundamental social and economic problems. South Africa currently follows an enlightened shareholder approach characterized by soft law and guidelines and this trend has been continued by the new Companies Act. After revealing the inadequacy of this approach, and laying the foundations for proposed legislative reform, the paper proceeds to formulate a legislative framework that will achieve CSI’s objectives as tailored towards South Africa’s developing economy.

2. DEFINING CORPORATE SOCIAL RESPONSIBILITY AND INVESTMENT

The term CSR has historically been used very broadly to refer to company activities such as transparent governance, fair labour practices, green initiatives and social investment in community in line with the company’s operations. Corporate governance is adequately addressed in South Africa by King III, while fair labour practices and environmental issues are adequately addressed by labour law and environmental law respectively. Corporate Social Investment is seen as a sub-category of CSR and it is in achieving this aspect of CSR characterized by the social and economic upliftment of the immediate community that this paper’s argument for peremptory legislation lies.

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10 Ibid at 582
11 King Committee on Governance, Draft Code of Governance, Principles for South Africa – 2009.
13 See the extensive list of Environmental legislation listed at: http://www.capetown.gov.za/EN/ENVIRONMENTALRESOURCEMANAGEMENT/PUBLICATIONS/Pages/EnvironmentalLegislation.aspx
2.1 Instances In South African Law

2.1.1 Broad-Based Black Economic Empowerment Act (BEE ACT)\textsuperscript{14}:

The BEE Act aims to redress the inequalities of the past not only by increasing Black ownership, but also by facilitating social and economic redress for all historically disadvantaged groups through, \textit{inter alia}, skills development and sound human resource practices.\textsuperscript{15} Although the Act falls short of making compliance mandatory, it was recognised that its effectiveness in facilitating its stated aims would rest on an incentive scheme that made compliance attractive. The Codes of Good Practice on Black Economic Empowerment\textsuperscript{16} contains such a scheme. It includes a list of indicators of good practices together with a weight assigned to each one. Based on these indicators a company is given a BEE status. This BEE accreditation is not merely superfluous; it is tied to tangible economic benefits. For instance, when contracting with the state, the more compliant firm stands a better chance of securing the contract. It is also a determining factor in the issuing of licenses, concessions and similar authorizations.\textsuperscript{17} Thus to a certain degree the BEE Act represents a welcome move towards a broader stakeholder approach, although the scope of the Act is narrow. It is important to note that the BEE Act was born out of an appreciation of our unique social, political and economic situation and is representative of a precedent for a move towards a more general compulsory CSR and CSI framework.

2.1.2 Revised South African Mining Charter:

Similarly, the latest South African Mining Charter\textsuperscript{18} represents a step in the right direction. In recognising the key role of the mining sector in the economy, the charter places a degree of responsibility on companies to uplift the communities that their operations affect and also to invest in the development of skills and education for its employees. Thus, in S2.5 of the revised charter it is required of mining companies to spend a percentage of its annual payroll, over and above the skills levy, in essential skills development along demographic lines. This amount should also go towards African based research and development to

\begin{itemize}
\item \textsuperscript{14} 53 of 2003.
\item \textsuperscript{15} Henk Kloppers & Willemien du Plessis, ‘Corporate Social Responsibility, Legislative Reforms and Mining in South Africa’ (2008) \textit{J. Energy Nat. Resources L.} 97.
\item \textsuperscript{16} General Notice 112 in GG 29617 of 9 February 2007.
\item \textsuperscript{17} Supra note 14 at 99.
\item \textsuperscript{18} Department of Mineral Resources of Republic of South Africa \textit{Amendment of the broad based socio-economic empowerment charter for the South African mining and minerals industry} September 2010 Available at http://www.pmg.org.za/files/docs/100908policy.pdf.
\end{itemize}
improve technology and efficiency in areas such as exploration, mining and processing as well as environmental sustainability. In terms of community development, the charter places an onus on companies to undertake an assessment with regards to the community’s social and labour needs and to develop a sound plan to address these needs\(^{19}\). The charter also sets targets for improving housing and living conditions\(^{20}\) and finally places great emphasis on sustainable development measures\(^{21}\). It is important to note that despite the fact the charter is delegated legislation and that it represents a consensual agreement between stakeholders in the mining industry, it nevertheless contains a degree of coerciveness. Item 3 of the revised charter states that non-compliance with the charter and the Mineral and Petroleum Resource Development Act\(^{22}\) (MPRDA) will constitute a breach of the MPRDA and will hold the company liable subject to s47 of the Act. This could result in the suspension or cancellation of the company’s prospecting or mining license.

### 2.1.3 Triple bottom line reporting:

King III requires all listed public companies to report on its impact on all stakeholders using a triple bottom line approach. Thus, companies must account not only for their financial performance, but also on their performance in terms of their impact on the environment, employees and broader social issues. The report recommends that companies extend their focus away from narrow immediate shareholder interests to a view geared towards sustainability. A good definition of the sustainable corporation is: “...one that creates profit for its shareholders while protecting the environment and improving the lives of those with whom it interacts”. Arguably, King III forces companies to be accountable for its social impact; however, the level of accountability falls short of creating legally enforceable obligations upon firms to engage in CSI.

The aforementioned instances in South African law of legislation compelling firms to engage in a degree of CSI, while laudable, are unsatisfactory in addressing the needs of the economy as a whole. They are merely instances of soft law, their scope is too narrow and they address only certain issues or operate merely on a single industry. Thus, the majority of companies are under no legal compulsion to engage in CSI.

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\(^{19}\) Ibid at Item 2.6.

\(^{20}\) Ibid at Item 2.7.

\(^{21}\) Ibid at Item 2.8.

\(^{22}\) 49 of 2008.
2. SOUTH AFRICA’S CURRENT APPROACH

South Africa’s CSR framework before the adoption of the new Company’s Act reflected an enlightened shareholder approach. Under this model, the maximization of value for shareholders is of primary concern. The justification for CSR is as follows: it begins with the premise that every company’s primary motive is to enhance shareholder value. The second premise is a little more controversial although both theoretical and empirical evidence has rendered it decidedly less so\textsuperscript{23}. It is now widely accepted that a good social reputation is a powerful deliverer of shareholder value. Thus, it is in fact in the company’s interest to enhance and foster its social reputation and therein lies the rationale behind a company’s investment in CSR\textsuperscript{24}. Acceptance of this argument entails that there is no need to compel firms to engage in CSR activities as it is incidental to maximizing shareholder value.

2.1 Shortcomings of the Current Approach

The first question that must be asked goes to what kind of CSR activities this model encourages. The answer is that it encourages activities aimed at maintaining and building the company’s reputation\textsuperscript{25} with a view to enhancing its ability to profitably engage with its immediate stakeholders. The sheer range of possible CSR initiatives that the company could partake in to achieve these ends means that the chances that the spending is geared towards the most necessary of social and economic goals are slim indeed without legislation that funnels funds appropriately. This point is given further weight if one looks at the case of CSR in China. Although the Chinese Company Act has gone a step further than most jurisdictions by requiring companies to ‘undertake social responsibility’ in the course of business\textsuperscript{26}, what constitutes social responsibility has not been adequately specified. Accusations of mere window dressing have proliferated with opponents citing numerous examples of companies touting their CSR programs, while engaging in unethical and abusive practices behind closed doors.

\textsuperscript{23} Rick Sarre ‘Responding to Corporate Collapses: Is There a Role for Corporate Social Responsibility?’ (2010) \textit{7 Deakin Law Review} at 10

\textsuperscript{24} David Vogel, \textit{The Market for Virtue} (2005) 3.


These practices are examples of what has been termed ‘insincere CSR’ and lends credence to the contention that the market driven model results in CSR being used as a marketing tool and no more. Examples in China range from search engine companies engaging in censorship to the state owned China National Petroleum Organisation’s indirect involvement in the Darfur genocide. In the United States, firms like Enron and Washington Mutual were widely praised for their CSR pursuits, while inwardly they practiced a particular brand of unethical mismanagement. From the companies’ perspective, the lack of a defined sphere of responsibility could expose them to unfair media and social criticism if expectations are not appropriately narrowed. In conclusion, while CSR activities are inadequately specified it leaves scope for firms to engage in activities that, while laudable, do not go to our root problems as a developing nation. Furthermore, as long as it is tied to enhancing the company’s reputation, the incentive exists for abuse to cover up the potentially darker side of one’s enterprise.

On a second ground, the syllogism underlying the argument for the enlightened shareholder approach to CSR is premised on an idea of rationality. The assumption is that, in keeping with rationality, a firm will recognise the value of CSR and then implement it. The problem with this is that we find that the market is characterized by bounded rationality. Bounded rationality refers to the fact that in real life agents do not always act according to economists’ view of rationality as premised upon narrow self interest. This could occur for a myriad of reasons, the most common being an asymmetry of information. We cannot rely on market forces to correct for what is essentially a market failure. The best solution presents itself in the form of legislative intervention that will compel all companies to allocate sufficient spending to appropriate CSR projects.

Finally, I wish to examine a useful way of analysing the effectiveness of CSR regulations first presented by Thomas McInerney, writing for the International Development Law Organization. We think of companies as falling into one of four categories. Category A companies are both aware of the need for CSR

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28 Supra note 24 at 66
29 Ibid.
32 Supra note 23 at 175.
33 Supra note 23.
initiatives and are intent on carrying them out. Category B companies possess the desire to carry out CSR initiatives, but are unaware of the standards required or are uncertain as to the best way to contribute meaningfully. Category C companies are aware of regulations and of the ideal CSR programs to engage in, but are unwilling to implement them, while category D companies are both unaware and unwilling to engage in CSR. It is easy to see that for a CSR framework to make an impact it must at the very least provide a useful and clear guide as to what constitutes CSR. In South Africa’s case, it would be those activities that contribute to the alleviation of our particular social and economic problems. However, if functioning merely as a guide, this would only be of value with regards to category B companies. What is needed to mobilize all public companies is legislation that both defines what constitutes CSR and makes it mandatory.

2.2 The New Companies Act

Unfortunately, South Africa’s new Companies Act\textsuperscript{34} falls far short of providing sufficiently clear guidance. In addition, its peremptory effect is limited. Section 72 of the Act read with s43 of the latest regulations\textsuperscript{35} provides for the following. The Act provides the minister with the authority to require, by regulation, a company or a certain class of companies to form a social and ethics committee. Regulation 43 thus provides that there is now an obligation to form a social and ethics committee incumbent upon all state owned companies, listed public companies as well as any other company scoring a public interest score above 500 in either of the previous two years.\textsuperscript{36} A firm’s public interest score is calculated taking into account the number of employees employed, the company’s degree of unsecured debt as well as turnover and the amount of persons, known to the company as having either a direct or indirect interest in the company’s issued securities.\textsuperscript{37} It is hoped that this last category is given a broad interpretation so that the immediate community impacted by the company’s activities be taken into account in calculating the company’s public interest score. Ostensibly, with regards to social and ethics committees, the Act creates obligations upon state owned and listed public companies as well as those companies that by their nature exert a synonymous influence on broader stakeholders.

\textsuperscript{34} Companies Act 71 of 2008.

\textsuperscript{35} Department of Trade and industry of Republic of South Africa Companies Regulations pursuant to the Companies Act 2008, 20 April 2011.

\textsuperscript{36} Ibid s72(4).

\textsuperscript{37} Regulation 26(2).
Companies obliged under the Act to form committees may nevertheless apply to the Companies Tribunal for exemption. The grounds are limited to three bases. Firstly, if the company is a subsidiary and its principle has a committee that will perform its duties on their behalf. Secondly, if the company already has a similar committee created in terms of other legislation that already performs similar functions. Finally, there is also discretion to provide an exemption on the basis that the committee would not be reasonably necessary for the public’s interest given the nature and scope of the company. With regards the final basis, it would seem that the tribunal is required to seek to balance the interests of the public with the interests of the individual company.

It should be noted, however, that it is difficult to envisage the situation where it would not be in the public’s interest to require a qualifying company to have a social and ethics committee given that these are precisely the companies that leave the greatest footprint upon the public.

The Social and Ethics Committee created by the Act has a role confined to consultations and reports. It is, in effect, relatively toothless in respect of actually driving CSR. Arguably, the committee can drive change by creating a forum for complaints as well as greater awareness of a company’s social responsibilities; however, with no powers beyond making recommendations, CSR generally and thus CSI remains unsatisfactorily enforced. The Committee is required to consult with a social and ethics advisory panel consisting of employees, members of the community and representatives of certain professional bodies. Again, the advisory panel has no power beyond making recommendations.

The Act requires that the committee compile and deliver a report to the annual general meeting with regards to how the company has performed in terms of social and economic development and good corporate citizenship which entails fair labour practices, good environmental practices as well as upliftment of the immediate community. Unfortunately, by including an extensive list of what constitutes good corporate citizenship it seems that no direction has been provided as to what specifically a company needs to be doing. By including everything, it leaves the decision in the hands of the companies themselves, in effect providing no guidance at all.

In addition to not specifying how money should be spent, the Act also creates no obligations with regard to the amount of spending at all. This is all unsurprising.
as the Act clearly does not seek to provide a peremptory CSR framework. In summary, the Act makes very little impact and seems to reflect continued support for the enlightened shareholder approach.

3. PROPOSED NEW PROVISIONS

It is proposed that the new Companies Act requires the addition of CSI provisions that will serve to ensure effective CSI implementation in the future. The new provision will have to have several key features. Firstly, a very strict definition of what qualifies as CSI will have to be formulated. The definition needs to confine activities to those that directly assist in alleviating our most pressing social and economic problems. Secondly, it must be made incumbent upon every state owned, publicly listed company as well as any other company scoring a certain public interest score to engage in CSI initiatives by spending at least a certain specified percentage of their income or average income. Finally, in order to carry force, the Act must provide sanctions for non-compliance. These three aspects will be unpacked in more detail in the following passages.

3.1 What Qualifies as CSR Spending?

A strictly defined set of qualifying criteria must be specified. To this end, legislation must be formulated in such a way so as to limit what qualifies as CSR spending to that that goes towards remedying our root economic and social problems. It is suggested that the development of skills and education are foremost causes to engage in, as well as HIV-AIDS and poverty relief. These are tentative suggestions and it is envisaged that further investigation by drafters will yield those issues that are paramount. Thereafter, the Act can make provision for further regulations to be passed for specific industries and in specific provinces depending on the prevailing circumstances.

3.2 Who and How Much?

The Act must identify which class of companies are required to engage in this mandatory spending. In line with the regulation 43, it is suggested that these should be state owned companies, publicly listed companies and any other company which scored a public interest score over 500 in either of the previous two years. The common theme is that these are the companies that wield the greatest public influence and are best placed to address the problems in their immediate sphere of influence.

The amount of mandatory spending should be based on either net profit or average net profit over a number of years. This ties spending to a company’s ability to spend. An appropriate percentage will be one based on extensive analysis that is beyond the scope of this paper. Nevertheless, an indication could be gleaned from the BEE Code, which requires companies to spend 1% of net profit before tax on social upliftment projects. Research has shown that despite the recent recession, companies have overall managed to even exceed this figure\textsuperscript{42}. This amount need not be uniform, but could vary within a reasonable range depending on the industry and geography under consideration.

3.3 Government Regulation – Sanctions for Non-compliance

Firstly, it must be stressed that the State itself must spearhead regulation and particularly the enforcement of CSR regulations\textsuperscript{43}. The argument has been advanced that developing countries lack the expertise, co-ordination and finance needed to adequately police large companies. In response to this, one need only look to the work done by the Competition Commission in rooting out cartels, price fixing, market sharing and anti-competitive behaviour. The threat alone of action provided by a comprehensive and active competition law framework has had a strong positive effect on companies’ adherence to competition laws.\textsuperscript{44} The orthodox view that values processes only in terms of their achieved ends needs to be discarded if one considers the benefits that accrue from undergoing the process itself. In terms of peremptory CSR legislation of the kind this paper proposes, it is acknowledged that, particularly at first, policing and enforcement may encounter difficulties, nevertheless, an important benefit of the process itself is that it results in a stronger state, capable of curtailing non-compliance more effectively in the future.\textsuperscript{45} If the process is left to private audit authorities, the gap between the market and the State’s ability to regulate it widens considerable as time goes by.

Emphasis must be placed on the mandatory nature of the obligation. The language of the statute must leave no doubt and strong sanctions will aid this. A range of remedies are available to authorities in order to ensure compliance and address non-compliance. The most obvious sanction entails a fine greater than or equal to what the company would have had to invest in mandatory CSR

\textsuperscript{42} Mail & Guardian online, CSI grows up (2010) Available at: http://mg.co.za/article/2010-04-16-csi-grows-up Last accessed 12 September 2011.
\textsuperscript{43} Supra note 25 at 188.
\textsuperscript{44} Competition Commission Annual Report 2009/2010.
\textsuperscript{45} Supra note 23 at 193.
spending in the offending period. This money would go into a fund to be spent appropriately or could be accompanied by an order to spend the fine on a designated cause. In addition, the revocation of trading licenses and certain permits can act as a deterrent and finally, the company can be directed to undergo a training course to educate their directors and employees with regard to good corporate citizenship. These measures could be supplemented by a CSR scorecard similar to that used to measure BEE compliance.

4. OBJECTIONS TO MANDATORY CORPORATE SOCIAL RESPONSIBILITY

The major objection to making CSI spending mandatory, particularly in a developing country, comes from those that believe that company law should strive to encourage business by being as unobtrusive as possible. The argument is that peremptory legislation with regard to CSI of the type that this paper proposes, will discourage foreign investment and increase the cost of doing business. To this argument there are two responses. The first entails a legislative solution. The Act could create a tax incentive for qualifying CSR spending thus mitigating the cost of business problem. Given that the tax concession is for spending that would otherwise have been spent by the treasury, the burden does not fall on government. The second response goes to the short-sightedness of the objection. South Africa’s systematic problems are among the primary deterrents for foreign investment. Spreading the burden of alleviating these ills will, in the long run, strengthen our economy and make South Africa a more desirable place to invest in.

The next set of objections relates to the argument that it is inappropriate for companies to have regard to any interests other than those of its shareholders. In the first instance, it is argued that since the shareholders provide the capital for the company, they own the company and are thus entitled to be given exclusive consideration. The flaws in this argument are that upon incorporation the company is a full juristic person incapable of being ‘owned’. In addition, stakeholders such as employees, creditors and the immediate community can also lay claim to a degree of ‘ownership’ since they

46 Supra note 25 at 188.
47 This argument extends all the way back to Adam Smith’s ‘Invisible Hand’.
50 Ibid.
provide the company with its useful assets\textsuperscript{51}. It has also been argued that stakeholders can protect themselves from mismanagement whereas shareholders cannot. Thus, companies need to narrowly focus on shareholder interests\textsuperscript{52}. In response, while it is true that some stakeholders can protect themselves through contract or acquiring security, this is not the case for all stakeholders such as the broader community. In addition, shareholders can diversify their share holdings to decrease their exposure to risk. They are also free to sell their shares\textsuperscript{53}. The argument thus holds very little weight. Finally, in response to all the objections raised, the business case for CSR clearly establishes that a consideration of broader stakeholder interests is in fact in the interest of the shareholders\textsuperscript{54}.

5. **CONCLUSION**

In conclusion, this paper has argued for very specific legislative reform, the adoption of which could be a huge step towards building a stronger economy while alleviating some of our most fundamental problems. If adopted, our experience would serve as a blueprint for other developing nations and could revolutionize the way companies view their position as corporate citizens. At the very least, there are strong arguments for a move away from the traditional enlightened shareholder model towards an approach that recognises the need for stronger regulation and legislation to ensure the widespread procurement of CSI that goes towards addressing South Africa’s root social and economic problems.

\textsuperscript{51} Ibid.
\textsuperscript{52} Ibid.
\textsuperscript{53} Ibid.
\textsuperscript{54} Supra note 23.
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