

WEIGHING THE COST OF “BEE FRONTING” ON BEST PRACTICES OF CORPORATE GOVERNANCE IN SOUTH AFRICA

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1. Introduction

It is undebatable that the concept of corporate social responsibility has been subsumed as an integral aspect of corporate governance in South Africa and globally.¹ Corporate social responsibility is accentuated as no longer an option to be debated by the country’s business fraternity as it is a moral, political and economic imperative.² This assertion is informed mainly by the political history of South Africa. Pursuant to the dismantling of Apartheid in South Africa, the government prioritised addressing the socio-economic ramifications of the country’s turbulent past, one of them being the “bottlenecked” participation of the black population in the national economy. A major policy thrust consistent with this national agenda is the Black Economic Empowerment³ policy, which initially focused on increasing equity ownership and executive representation of black South Africans⁴ in major companies.⁵ As a result of implementation glitches dominated mainly by the inability of the BEE policy to broadly distribute wealth to a spectrum of the black society, BEE was reformulated into the “Broad Based Black Economic Empowerment”⁶ programme. The latter spread the economic empowerment of black South Africans across seven dimensions, namely; management

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¹ Corporate social responsibility has been receiving similar attention as other global priorities such as sustainable development, climate change, investment, free trade and international security. See G8 Summit 2007 *Growth and Responsibility in the World Economy G8 Summit Declaration* 4 – 8.

² Own emphasis. Nkomo “Teaching Business Ethically in the New South Africa” *Management Quarterly* 2003 128 129, Arya & Bassi “Corporate Social Responsibility and Broad-Based Black Economic Empowerment Legislation in South Africa: Codes of Good Practice” 2009 *Business & Society* 674 690.

³ Hereafter, BEE.

⁴ In terms of the black economic empowerment programme, the term “black people” was used generically to refer to persons of African, Coloured, Chinese and Indian origin.

⁵ For a detailed discussion on the ascertainment of the level of black ownership in companies for the purpose of meeting the BEE policy expectations, see Marais & Coetzee “The Determination of Black Ownership in Companies for the Purpose of Black Economic Empowerment (Part 1)” 2006 *Obiter* 111; Marais & Coetzee “The Determination of Black Ownership in Companies for the Purpose of Black Economic Empowerment (Part 2)” 2006 *Obiter* 502.

⁶ Hereafter, B-BBEE.

representation, employment equity, skills development, preferential procurement, enterprise development and corporate social investment.⁷

In 2003, the Broad-Based Black Economic Empowerment Act⁸ was promulgated to provide legal backing to the underlying aim of the B-BBEE programme.⁹ A key feature of the legislation is its empowerment of the Minister of Trade and Industry to steer the implementation of B-BBEE by issuing Codes on Good Practice of Black Economic Empowerment.¹⁰ Among other aspects, the Codes on Good Practice of Black Economic Empowerment include indicators to measure compliance with the B-BBEE Act. The generic scorecard is a prominent establishment of the Codes on Good Practice of Black Economic Empowerment.¹¹ It provides a means by which the company's compliance with the Broad-Based Black Economic Empowerment Act is measured through the accumulation of points upon the implementation of reforms that recognise the economic empowerment dimensions envisaged by the legislation.

The implementation of the Broad-Based Black Economic Empowerment Act has not been an easy process. Some business entities are accused of contravening the legislation by deliberately misrepresenting facts about the extent of their compliance with the empowerment obligations outlined in the B-BBEE scorecard.¹² The practice of "fronting" as it has come to be known is one of the loopholes by which the obligations conferred by the B-BBEE Act have been circumvented.¹³ Due to its complexity and multi-faceted

⁷ See the Department of Trade and Industry *South Africa's Economic Transformation: A Strategy for Broad-Based Economic Empowerment*.

⁸ Act 53 of 2003, hereafter, the "B-BBEE Act".

⁹ Section 2 of the Act which provides for the empowerment of black South Africans through management representation, employment equity, skills development, preferential procurement, enterprise development and corporate social investment.

¹⁰ The first set of the Codes of Good Practice on Black Economic Empowerment were passed in 2007. They are divided consistently with the economic dimensions addressed by the Broad Based Black Economic Empowerment Act as follows: Code 000: Framework for Measuring BBBEE, Code 100: Measurement of the Ownership Element of BBBEE, Code 200: Measurement of the Management Control Element of BBBEE, Code 300: Measurement of the Employment Equity Element of BBBEE, Code 400: Measurement of the Skill Development Element of BBBEE, Code 500: Measurement of the Preferential Procurement Element of BBBEE, Code 600: Measurement of the Enterprise Development Element of Broad Based Black Economic Empowerment, Code 700: Measurement of the Socio-Economic Element of BBBEE and The Code of Good Practice on BBBEE for Qualifying Small Enterprises is contained in Code 800 (Statements 800-807).

¹¹ See Code 000: Framework for Measuring BBBEE in the Codes of Good Practice on Black Economic Empowerment.

¹² Rose , Hofstatter & wa Africa "Toll company in trouble over BEE fronting" <http://www.timeslive.co.za/local/2011/12/18/toll-company-in-trouble-over-bee-fronting> (last accessed 04-07-2013) ; Sibanyoni M "Kelly Group accused of Tender Fronting" <http://www.fin24.com/Companies/ICT/Kelly-Group-accused-of-tender-fronting-20120311> (last accessed 04-07-2013).

¹³ See Sapa "Proposed BEE legislation could criminalise fronting"

manifestations, the mapping out of strategies to curb fronting practices has been an equally cumbersome process. In 2009, the Department of Trade and Industry released the *Guidelines on Complex Structures and Transactions and Fronting*¹⁴ as an initial official step to control fronting.¹⁵ This process was followed by the criminalisation of the practice in the Broad-Based Black Economic Empowerment Amendment Act¹⁶ which came into effect in 2015.

This article investigates the practice of fronting, particularly its effects on best practices of corporate governance in South Africa. The investigation comes against the backdrop that South African companies are perceived as being among the best governed in the world’s emerging economies.¹⁷ Central to this discussion is the view of the practice of fronting as an assault on principles of good corporate governance which hinges on an unfettered exercise of the fiduciary responsibilities of directors, stakeholder governance and ethical leadership. The article comprises of five major headings, namely; a brief overview of corporate social responsibility in South Africa which is the rationale behind the Broad-based Black Empowerment Act, the definition of fronting by the *DTI Guidelines*, a consideration of the effect of fronting on best practices of corporate governance in South Africa, an evaluation of the legal framework provided by the recently-promulgated Broad-Based Black Economic Empowerment Amendment Act to combat fronting and the conclusion. I acknowledge that the concepts of corporate governance and fronting have received wide but often separate academic attention from South Africa scholars respectively. Nonetheless, this article draws a novel connection between the two concepts by considering how fronting impacts the foundational principles of best corporate governance in South Africa.

<http://www.moneyweb.co.za/moneyweb-south-africa/proposed-bee-legislation-could-criminalise-fronting> (last accessed 04-07-2013). The article states that the Director General of the Department of Trade and Industry Portfolio Committee reported to Parliament in January 2013 that there are low levels of compliance with the black economic empowerment policy by large sectors of the economy such as agriculture, manufacturing and retail due to the prevalence of fronting activities. See also Deloitte & Touché *A New Challenge for South African Companies* 2012.

¹⁴ Hereafter, *DTI Guidelines*.

¹⁵ The guidelines were released in line with the mandate conferred to the Minister of Trade and Industry by section 9 of the B-BBEE Act to issue of the Codes on Good Practice of Black Economic Empowerment.

¹⁶ Act 46 of 2013. Apart from criminalising fronting, the legislation also paved way for the introduction of new B-BBEE weightings on the generic scorecard.

¹⁷ *King Report on Corporate for South Africa* 2009, Introduction and Background par 3. Hereafter, *King II*.

2. Corporate Social Responsibility in South Africa: The Influence of the Broad-Based Black Economic Empowerment Act of 2003

Corporate social responsibility is a subject of voluminous scholarly debate. Its roots can be traced back to the stakeholder theory which is anchored in the idea that a company exists to serve the interests of different stakeholders that are influenced by its operation, for example, its employees, customers, the environment and others.¹⁸ The theory stands in direct contrast to the shareholder supremacy theory which views the primary reason for the existence of a company as being to maximise profits for its shareholders who are in its context, its owners. Within the milieu of the stakeholder theory, there are different motivations for the obligations of the business towards the society which is the environment within which it operates and also an important stakeholder.

Corporate social responsibility denotes that in an effort to protect public interest, a company does more than the law requires.¹⁹ It is noted that the pressing needs of society, such as poverty and health demands, can compel businesses to act in “a socially responsible manner”.²⁰ Furthermore, from a moral perspective, society expects that private citizens which include businesses have an obligation to act in responsibly.²¹ The views on what constitutes “responsible corporate behaviour” are also antithetic. According to Hodes, [a] company is said to be socially responsible when directors manage it in such a way that the company” voluntarily expends its resources to do something not required by law and without immediate

¹⁸ For further discussion on the stakeholder theory, see Freeman, Wicks & Parmar “The Stakeholder Theory and the Corporate Objective Revisited” 2004 *Organisational Science* 364; Laplume, Sonpar & Litz “Stakeholder Theory: Reviewing a Theory that moves us” 2008 *Journal of Management* 1152; Donaldson & Preston “The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications” 2005 *Academy of Management Review* 65.

¹⁹ Hinkley “Do No Harm: A Corporate Hippocratic Oath” 2007 *The Australian Financial Review* 63.

²⁰ From this submission, a link is drawn between corporate social responsibility and the achievement of broader international developmental goals such as poverty eradication with business being regarded as an important force in the fulfilment of these goals. See Frynas “Corporate Social Responsibility and International Development: A Critical Analysis” 2008 *Corporate Governance* 274.

²¹ Carroll “The Four Faces of Corporate Citizenship” 1998 *Bus. & Soc’y Rev.* 1 2-5; Avi-Yonah “Corporate Social Responsibility and Strategic Tax Behavior” 2006 *U. of Mich. L. & Econ.* 1-28; Schwartz & Carroll “Corporate Social Responsibility: A Three Domain Approach” 2003 *Bus. Ethics Q.* 503; Elhauge “Sacrificing Corporate Profits in the Public Interest” 2005 *New York University Law Review* 733 758. Whilst acknowledging the ability of the society to influence legal compliance by companies, the author argues that the structure of modern companies which is characterized by the control of the company by shareholders creates impediments to the compliance enforcement on the basis of social and moral sanctions due to the following reasons: (i) some shareholders feel social and moral sanctions less than others (ii) the corporate structure insulates shareholders from social and moral sanctions as they are not in contact with those who impose them. Moreover, they are usually unaware of operational decisions and legal regulations; and (iii) shareholders in public companies have collective action problems that prevent them from becoming informed or acting based on social and moral sanctions even if they do care about them. Against this background, the author asserts that sole proprietorships are most likely to be influenced by social sanctions than public companies.

economic benefits”.²² Parkinson, whose view on corporate social responsibility is often referred to by numerous scholars, defines it as a reflection of the company’s sensitivity to the impact of the company on third parties, which he refers to as “profit-sacrificing social responsibility”.²³

Bringing the corporate social responsibility debate to South Africa, Mongalo²⁴ cites the collapse of the “shibboleths of apartheid” as having instigated the country’s business entities to embrace the stakeholder theory as they realised that they did not operate in a vacuum.²⁵ Although the policy of Apartheid had been dismantled, its lingering effects, particularly the economic isolation of black South Africans, was among the imminent challenges that demanded urgent attention. South Africa’s new government had to embark on broad strategies that included utilisation of corporate social responsibility as a vehicle to bring about economic equality and social transformation. The Black Economic Empowerment Programme was among the first policies to be mooted to address the country’s economic disparities along the corporate social responsibility dimension.²⁶ The *raison d’etre* of the BEE policy was to uplift the economic welfare of black South Africans through them acquiring considerable equity ownership and attaining executive representation in major companies. The policy culminated in its underlying objectives being accorded legislative backing in 2003 with the promulgation of the Broad-Based Black Economic Empowerment Act, which encourages the concept of corporate social responsibility in South Africa.

South African legislation is regarded as not placing an obligation on companies to fulfill their corporate social responsibility *per se*. However, corporate social responsibility language is used to bring about measures to achieve some of the corporate social responsibility

²² Hodes “The Social Responsibility of a Company” 1983 *South African Law Journal* 100 468.

²³ Parkinson *Corporate Power and Responsibility: Issues in the Theory of Company Law* (1993) 261; See also Elhauge 2005 *New York University Law Review* 756 for a discussion on what is termed “the fiduciary duty to engage in profit-sacrificing legal compliance”.

²⁴ Mongalo *Corporate Law and Corporate Governance: A Global Picture of Business Undertakings in South Africa* (2003) 198.

²⁵ See Kloppers & du Plessis “Corporate Social Responsibility, Legislative Reforms and Mining in South Africa” 2008 *J. Energy Nat. Resources L* 91-93 who argue in the contrary that corporate social responsibility received attention in South Africa following the lifting of economic sanctions against the country in 1991 which was before the total demise of Apartheid. The authors further state that corporate social responsibility during the time was either voluntary or as a result of pressure by importing companies. Notable philanthropic activities such as the initiation of the Urban Foundation by mining companies after the 1976 uprising in Soweto and the launch of the Sullivan Code in 1977 to encourage the respect for human rights by US companies operating in South Africa during Apartheid also raise the question whether the serious consideration of corporate social responsibility in South Africa started after Apartheid.

²⁶ Other important post-apartheid economic policies include the Growth Empowerment and Redistribution and the Rural Development Programme.

objectives.²⁷ It is further submitted that the historical legacy of Apartheid provides a special role for the state²⁸ in regulating corporate behaviour. Given the monumental task of redressing decades of social and racial imbalances in South Africa, corporate social responsibility efforts in this context cannot be purely voluntary and must include government regulations to motivate and enforce corporate social initiatives.²⁹ This explains the compulsive nature of the of the B-BBEE Act which ensures that companies directly or indirectly consider the broader South African community within its political and socio-economic context.³⁰ On a direct level, the B-BBEE strategy of a company will ensure an increase in black participation in terms of ownership, management, expertise and control of the company.³¹ On an indirect level, preferential procurement, involvement in enterprise development and socio-economic upliftment projects will ensure that the community at large reaps the benefits of socially responsible corporate conduct.³²

The strength of the B-BBEE Act in embedding the social responsibility of businesses in South Africa cannot be overlooked. The legislation binds the public sector, which mainly consists of governmental departments, public entities or state-owned enterprises and organs of State. Similarly, private companies are also bound by legislation when they require licences, concessions or authorisation, bids to provide goods and services to government, wish to acquire state-owned enterprises, or try to enter into public-private partnerships.³³ The corporate social responsibility implications of the B-BBEE Act are further cemented by punitive measures suggested in the B-BBEE Amendment Act for firms which seek to circumvent or not comply with the objectives of broad-based black economic empowerment programme.³⁴

²⁷ Kloppers & du Plessis 2008 *J. Energy Nat. Resources L* 91-93. Other important pieces of legislation that cohere with the corporate social responsibility agenda include the Employment Equity Act 55 of 1998, the Skills Development Act 97 of 1998 and the Mineral and Petroleum Resources Development Act 28 of 2002.

²⁸ Hamann, Agbazue, Kapelus & Hein "Universalizing Corporate Social Responsibility? South African challenges to the International Organization for Standardization's new Social Responsibility Standard." 2005 *Business and Society Review* 1.

²⁹ Arya & Bassi 2009 *Business & Society* 689.

³⁰ Esser & Dekker "The Dynamics of Corporate Governance in South Africa: Broad Based Black Economic Empowerment and the Enhancement of Good Corporate Governance Principles 2008 *Journal of International Commercial Law and Technology* 157 165.

³¹ *Ibid.*

³² Esser & Dekker 2008 *Journal of International Commercial Law and Technology* 165.

³³ Matthew *Is BEE a South African growth catalyst? (Or could it be...)* Draft produced for the South African Government as part of the International Growth Panel Initiative 2007.

³⁴ See Memorandum on the Objects of the Broad Based Black Economic Empowerment Act 2013 par 3.1.

3. Defining “BEE Fronting”

The *Guidelines on Complex Structures and Transactions, and Fronting* released by the Department of Trade and Industry in 2009 are an important source to refer to in defining fronting. Section B of the document defines fronting as “as deliberate or attempted circumvention of the B-BBEE Act or the Codes”.³⁵ Fronting commonly involves reliance on data or claims of compliance based on misrepresentations of facts, whether made by the party claiming compliance or by any other person.³⁶ Three³⁷ practices are singled out by the *DTI Guidelines* as constituting fronting namely:

- (a) Window-dressing. This includes cases in which black people are appointed or introduced to an enterprise on the basis of tokenism and may be discouraged or inhibited from substantially participating in the core activities of an enterprise; and discouraged or prohibited from substantially participating in the stated areas and/or levels of their participation;³⁸
- (b) Benefit Diversion. This includes initiatives implemented where the economic benefits received as a result of the B-BBEE Status of an enterprise do not flow to black people in the ratio as specified in the relevant legal documentation; and
- (c) Opportunistic Intermediaries. This includes enterprises that have concluded agreements with other enterprises with a view to leveraging the opportunistic intermediary's favourable B-BBEE status in circumstances where the agreement involves significant limitations or restrictions upon the identity of the opportunistic intermediary's suppliers, service providers, clients or customers; the maintenance of their business operations in a context reasonably considered improbable having regard to resources; and terms and conditions that are not negotiated at arms-length on a fair and reasonable basis.³⁹

Apart from its provision of the definition of fronting which is hinged on the above-mentioned trends, the *DTI Guidelines* also list different indicators that provide a basis to allege or suspect that a particular company could be involved in fronting.⁴⁰ Verification agencies,⁴¹

³⁵ *DTI Guidelines* 6.

³⁶ *Ibid.*

³⁷ This does not however mean that fronting only manifests in these three ways. For a discussion on other forms of fronting, see Business Unity South Africa *A Guide on Recognising and Preventing Fronting* 2005 par 6.1 to 6.8. Also section 1 (e) of the Broad Based Black Empowerment Amendment Act, 2013.

³⁸ This is considered to be the most common form of fronting. See Deloitte *A New Challenge for South African Companies* 2012 2.

³⁹ *DTI Guidelines* 6.

⁴⁰ *DTI Guidelines* 7-8.

procurements officers⁴² or other corporate decision makers are encouraged in terms of the *DTI Guidelines* to report any detection of fronting to the Department of Trade and Industry. The proposed Broad Based Black Economic Empowerment Amendment Act also contains stern provisions on the role of verification agencies in reporting fronting as it holds them accountable in instances where an entity is guilty of fronting but managed to obtain a B-BBEE verification certificate from a verification agency.⁴³ It follows that due care and vigorous review will be expected from verification agencies in assessing an organisation's compliance with the B-BBEE Act.

4. Assessing the Damage of Fronting to the “Health of Corporate Governance” in South Africa

Having given a background on fronting, it is expedient now to consider how the practice affects key elements of corporate governance. As a point of departure, the concept of corporate governance has to be defined. Corporate governance has been broadly described in vast academic literature. The most common definition often used is given by the Cadbury Committee in the United Kingdom in its report on the financial aspects of corporate governance released in 1992, which explained the concept as “a system by which companies are directed and controlled”.⁴⁴ Although there is a variation of views on what the key principles of corporate governance entail; concepts such as shareholder protection, stakeholder protection, corporate disclosure, the responsibilities of the board of directors, corporate disclosure and ethical leadership are often mentioned, although unsystematically in numerous academic discussions that focus on the tenets of good corporate governance.⁴⁵

⁴¹ Verification agencies are accredited representatives who provide an independent service of assessing the extent to which a company complies with the provisions of the B-BBEE Act. Considering that some BEE codes may have direct and indirect fronting risk indicators that need to be independently scrutinised or verified, these agencies are essential for the proper implementation and control of the B-BBEE processes.

⁴² Procurement officers ensure that procurement within organisations is done in compliance with the B-BBEE Act targets.

⁴³ Section 130 (2) to 130 (6).

⁴⁴ Committee of Financial Aspects of Corporate Governance *Report of the Committee on the Financial Aspects of Corporate Governance* 1992 para 2.5. See Rossouw, van der Watt & Malan “Corporate Governance in South Africa” 2002 *Journal of Business Ethics* 289, the authors state that this definition has become “fashionable” since its original publication in the Cadbury Committee report.

⁴⁵ See for example, Du Plessis, Harvogan & Bagaric *Principles of Contemporary Corporate Governance* 2nd ed (2011) 10. The authors state that the most important components of corporate governance are that it is a system of regulating and overseeing corporate conduct, takes into consideration the interest of internal stakeholders and other parties who can be affected by the corporation's conduct, aims at ensuring responsible behaviour by corporations and has the ultimate goal of achieving the maximum level of efficiency and profitability for a corporation.

This article will consider the effects of fronting on corporate governance being guided by the principles stated above. It should however be explicitly understood that although the discussion may sporadically refer to the legal liability of directors for non-observance of some of the cited corporate governance principles, that is not its underlying object as this subject falls beyond the scope of the article. Reference to cases of director liability will only serve to substantiate arguments on the wrongfulness of the practice of fronting particularly when its effects on the principles of good corporate governance are considered.

4.1 Fronting *vis-à-vis* the Fiduciary Responsibilities of Directors

The board of directors is recognised as “the focal point of corporate governance” in South Africa.⁴⁶ Like other jurisdictions, South African company law recognises fiduciary duties which directors owe to the company as a result of their relationship with it. South African law⁴⁷ in that respect has been heavily influenced by English common law which identifies the duty to act in good faith and in the best interests of the company as the overarching fiduciary duty from which other duties of directors flow from.⁴⁸ The duty to act in good faith and in the best interest of the company has also been partially codified in the Companies Act.⁴⁹ This duty shall receive further attention below considering its affinity with the thesis of this paper.

The crux of the directors’ duty to act in good faith and in the best interests of the company is that directors are considered to be trustees of the assets of the company which is under their control.⁵⁰ Owing to this special relationship with the company, directors are bound to exercise the power conferred upon them in good faith to the best interests of the company. A director’s duty is thus to act in what he or she honestly considers to be in the best interests of the company.⁵¹

⁴⁶ King III Chapter 2, Principle 2.1.

⁴⁷ See *Fisheries Development Corporation of SA Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd* 1980 (4) SA 156 (W) 165; *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd (FBC Fidelity Bank Ltd (Under Curatorship), Intervening)* 2001 (2) SA 727 (C) para 37 738.

⁴⁸ Cassim *et al Contemporary Company Law* 2nd ed (2011) 475.

⁴⁹ 71 of 2008, hereafter the Companies Act, 2008. Section 76 (3) (a) and (b) of the Act mandates directors to “exercise their powers and perform their functions in good faith and for a proper purpose and also in the best interests of the company.”

⁵⁰ *Selangor United Rubber Estates Ltd v Cradock and Others* (No 3) [1968] 1 WLR 1555 1575, [1968] 2 All ER 1073.

⁵¹ See Cassim *et al Contemporary Company Law* (2011) 476 citing *Re Smith & Fawcett Ltd* [1942] Ch 304 which asserted that the duty of good faith considers what the director not the court regards to be in the best interests of the company. See also *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9 AT 23. A subjective test is employed to ascertain the director’s state of mind, that is whether there reasonable ground for the belief that the director was acting in the best interests of the company. See *Teck Corp Ltd v Millar* (1972) 33 DLR (3d) 288 (BCSC); *Greenhalgh v Ardene Cinemas* [1950] 2 All ER 1120.

Does the practice of fronting contravene the underlying object of the director's duty to act in good faith and in the best interests of the company? This article answers the above question in the affirmative as shall be substantiated later. I certainly acknowledge that BEE fronting does not on face value appear to be harmful to the interests of company considering the economic benefit which companies may derive from the practice. In opportunistic intermediary transactions for example, enterprises conclude agreements with other actors in their industry with the view of leveraging their B-BBEE status to suit the B-BBEE requirements of an identified economic opportunity. Having stated the above, the follow-up questions that arise is: Can a director be allowed to engage in illegal practices such as BEE fronting as long as he can prove that he is acting in good faith and to the best interests of the company?

In providing an all-encompassing answer that further addresses both questions posed above, due attention has to be given to the provision of section 76 (3) (a) of the Companies Act, 2008. A vital aspect of the legislative provision is how it connects the director's duty of good faith with his duty to exercise his powers for a "proper purpose".⁵² The result is that it does not suffice for a director to exercise his power for the benefit of the company but he is also expected to exercise such power for a "proper purpose". "Proper purpose" has always been taken to mean that directors must exercise their powers for the purpose for which the power was given to them and not for a collateral or ulterior motive.⁵³ This rule is far reaching in that if directors act for a collateral or improper purpose they can still breach this duty irrespective of the fact that they have acted in a manner that benefits the company.⁵⁴ Section 76 (3) (a) presents the duties of good faith and proper purpose as separate and distinct, and yet cumulative, with the result that even if the directors have subjectively honestly acted in the interests of the company, they could yet be objectively be in breach of their duty to exercise their powers for a proper purpose.⁵⁵ Against this background, a director who sanctions fronting activities by the company even to its benefit has to be held liable for breach of the duty to exercise his power for a proper or legitimate purpose. Furthermore, the

⁵² Section 76 (3) (a) of the Companies Act , 2008.

⁵³ Cassim *et al Contemporary Company Law* (2011) 476.

⁵⁴ *Hogg v Cramphorn* [1967] Ch 254. See also Ramnath & Nmechille "Interpreting Directors' Fiduciary Duty to Act in the Company's Best Interests Through the Prism of the Bill of Rights: Taking Other Stakeholders into Consideration" 2013 *Speculum Juris* 98 for discussion on the application of the director's duty of good faith in the context of the company's social responsibility.

⁵⁵ *Ibid.*

illegality of fronting makes it difficult for such a director to seek refuge under the Business Judgment Rule which was introduced in the Companies Act, 2008 to spare directors of personal liability in the absence of willful misconduct or willful breach of trust.⁵⁶

4.2 Fronting *vis-à-vis* the Interests of a Company’s Stakeholders

Both the BEE policy and its legislative pronouncement in the B-BBEE Act embody the full acceptance of stakeholder consideration as a fundamental aspect of corporate governance in South Africa. The first King Report on Corporate Governance in South Africa⁵⁷ captures the essence of stakeholders in corporate governance in a global context by stating that:

“ [C]onsequently the concept of corporate governance has grown. Other interested parties or stakeholders have become part of corporate governance in the different systems of corporate governance prevail in different countries. The different stakeholders include shareholders, employees, bankers, suppliers, consumers, environmentalists, the community or country in which it operates and the State.”⁵⁸

Concomitantly, *King II* encourages stakeholder recognition under the auspices of the inclusive approach to good governance, which requires that the purpose and values of the company be communicated to all stakeholders. The inclusive approach to good governance is intimately connected to the “triple bottom line approach” which is also a pertinent feature of *King II*.⁵⁹ The later requires the governance of companies to be cognisant of economic, environmental concerns and social concerns.⁶⁰ Corporate governance has therefore become a vehicle to achieve societal transformation which also encompasses addressing the remnants of Apartheid such as the limited availability of economic opportunities to black people.⁶¹ Similarly, the *King III Report on Corporate Governance*⁶² and the Companies Act, 2008 advance the triple bottom line approach. In the Companies Act, 2008 the “enlightened shareholder value model” recognised by the legislation is the heartbeat of stakeholder governance. In terms of the enlightened stakeholder value model, companies can pursue the

⁵⁶ See section 76 (4) of the Companies, 2008.

⁵⁷ Hereafter, *King I*.

⁵⁸ See *King I*, chapter 1 par 3.

⁵⁹ *King II* par 17.1; Introduction, Executive Summary of *King II*, par 5.1.

⁶⁰ See *King II* par 17.1. Also Mongalo “The Emergence of Corporate Governance as a Fundamental Research Topic in South Africa” 2003 *South African Law Journal* 120 173, 177; Esser “Protection of Stakeholder Interests in Terms of the South African King III Report on Corporate Governance: An Improvement on King II” 2009 *South African Mercantile Law Journal* 188; Elkington *Cannibals with Forks: The Triple Bottom Line of 21 Century Business* (1999, reprinted ed. 2002) 2.

⁶¹ For further reading, see Esser & Dekker 2008 *Journal of International Commercial Law and Technology* 161; Rossouw *Business Ethics: A South African Perspective* (1994) 32.

⁶² Hereafter, *King III*. Para 12 95.

best interests of their shareholders but with a long term consideration of various stakeholder interests such as their social environment.⁶³ Section 7 of the Act epitomises the model by its affirmation of the significant role which companies can play in socio-economic development.

The effect of fronting on stakeholder governance in corporate governance has to be studied. My argument is that the practice goes against the spirit of stakeholder recognition in South African corporate governance. When companies engage in the practice of fronting, it is a blatant denial of economic opportunities to the broader population of previously disadvantaged racial groups who are important stakeholders the B-BBEE Act seeks to empower. Furthermore, the company also escapes the social obligation to act as a vehicle for socio-economic development which is a philosophy that features both in the Companies Act, 2008 and the King Reports on Corporate Governance as highlighted earlier.

4.3 Fronting *vis-à-vis* Ethical Corporate Leadership

As pointed out earlier,⁶⁴ the stakeholder theory places an obligation on business entities to look beyond the sole object of making profit but to also consider the social implications of their activities. This has resulted in the adoption of ethical and moral considerations seeping through corporate governance. Ethics are understood as the means by which individuals come to construe, decipher, act upon themselves in relation to the true and false, the permitted and forbidden, the desirable and the undesirable.⁶⁵ In the context of business, ethics have been defined as terms of personal values and virtues that should be applied to business practices, societal or religious values that should be applied to business practices and decision-making that will ensure that business activities are beneficial to individuals and society alike within the framework of a competitive market-driven economy.⁶⁶ Business ethics are considered as a means to inculcate within the company's employee population, a sense of how to do

⁶³ For further discussions on the enlightened shareholder value model, see Stein & Everingham *The New Companies Act Unlocked* (2011) 8 - 10; Esser *The Recognition of Various Stakeholder Interests in Company Management* (LLD thesis, University of South Africa, 2008) 32; Cassim *et al Contemporary Company Law* (2011) 449.

⁶⁴ See paragraph 2 above.

⁶⁵ Rose "Governing the Enterprising Self" in Heelas and Morris *The Values of the Enterprise Culture: The Moral Debate* (1992) 144.

⁶⁶ Rossouw "Business Ethics in South Africa" 1997 *Journal of Business Ethics* 16 1539 1540. The author alleges that these definitions featured in a survey of business ethics in South Africa involving interviews with prominent academics at business schools and other academic departments involved in the teaching of business ethics, as well as with business leaders who take a special interest in business ethics.

business responsibly.⁶⁷ Ethical behaviour is marked by unselfish attributes that balance what is good for an organisation with what is also good for the stakeholders which includes the society.⁶⁸

South Africa has witnessed the adoption of ethics as a vital aspect of its corporate governance. There has been a notable thrust to ensure that corporate governance reflects the value system of the society in which it operates. *King III* defines responsible corporate citizenship as an ethical relationship of responsibility between the company and the society in which it operates.⁶⁹ Consequently, the board is obliged to provide effective leadership based on an ethical foundation by considering the impact of the company and its business on internal and external stakeholders as well as the economy, society and the environment.⁷⁰ It is the duty of the board to ensure that the company is, and is seen to be a responsible corporate citizen and the company's ethics are managed effectively.⁷¹ *King III* also encourages the board to develop a code of ethics which embodies the four virtues of good governance namely, fairness, accountability, responsibility and transparency.⁷² Apart from the provisions of *King III*, the Companies Act entrenches ethical corporate leadership through section 72 which mandates state-owned, listed and other companies with a public interest a score of more than 500 points to establish a social and ethics committee.⁷³ The committee serves as the ethical conscience⁷⁴ of the company as it operates within the parameters of the triple bottom line approach.

⁶⁷ See Hurst “Corporate Ethics, Governance and Social Responsibility: Comparing European Business Practices to those in the United States” http://www.scu.edu/ethics/publications/submitted/hurst/comparative_study.pdf 6. (last accessed 28-05-2012).

⁶⁸ See Khomba & Vermaak “Business Ethics and Corporate Governance: An African Socio-Cultural Framework” 2012 *African Journal of Business Management* 3510.

⁶⁹ *King III* 15.

⁷⁰ *King III* Principles 1.1 to 1.3. Also Esser & Havenga *et al Corporate Governance Annual Review* (2012) 27.

⁷¹ *King III* par 1.1 – 1.3. See emphasis in *South African Broadcasting Corporation Ltd v Mpofu* [2009] 4 All SA 169 (GSJ).

⁷² *King III* *ibid*.

⁷³ Section 50 of the Companies Act, 2008 Regulations sets out the rules related to the compilation of the committee and in addition sets out the regulations related to the advisory panel and its composition.

⁷⁴ The Ethics and Social Committee carries out the following functions: monitoring the company's activities, having regard to any relevant legislation, other legal requirements or prevailing codes of best practice related to; guiding the company's social and economic development including issues related to employment equity, broad-based black economic empowerment, EOED recommendations and the United Nations Global Compact principles; good corporate citizenship, including the company's promotion of equality, prevention of unfair discrimination and reduction of corruption; and monitors the company's contribution to development of the communities in which its activities are predominantly conducted.

Fronting has been bluntly described as “a cynical manipulation of regulatory requirements that amounts to defrauding the government, and defeats the aims of BEE”.⁷⁵ Belshaw and Goldberg also lament the creation of “unsustainable token empowerment entities” as a consequence of fronting.⁷⁶ The fraudulent nature of the practice certainly antagonises it with the ethical fabric of corporate governance. An ethical compass enables the board to ensure that the company does not harm its stakeholders. Considering that that fronting deprives society of economic empowerment which is the underlying purpose of the B-BBEE Act, it follows that the practice epitomises intentional harmful corporate conduct that demeans ethical corporate leadership as the latter treasures society as an important stakeholder. This argument is supported by the perception that by implementing the B-BBEE programme, a company fulfills an ethical economic obligation necessitated by South Africa’s socio-political history.⁷⁷ Lastly, fronting torpedoes values of fairness, accountability,⁷⁸ responsibility and transparency which inform good governance in the context of ethical leadership.

The ethical foundation of corporate governance in South Africa is also influenced by the values of *Ubuntu* which denote an African humanism emphasising empathy, understanding, reciprocity, harmony and cooperation. The principles of *Ubuntu* permeate various forms of governance and policy making in South Africa which also include the regulation of corporate behaviour.⁷⁹ In the gamut of corporate governance, it has been stressed that through *Ubuntu*, corporate structures are not overthrown but there is consensus on what is fair and right and to see attuned leadership in action.⁸⁰ When considered in view of this assertion, fronting also flouts values such as empathy and communalism that underlie the social contract on which

⁷⁵ See “Sigau guns for BEE wolves” <http://www.themercury.co.za/index.php?fSEctionId=282&fArticleId=2814616> (last accessed 13-12-2013).

⁷⁶ Balshaw & Goldberg *Cracking Broad-based Black Economic Empowerment: Scores and Scorecard Unpacked* 1st ed (2005).

⁷⁷ Motloung “Helping you and the economy grow” 2007 *EconoBEE Newsletter* 2; Nkomo *Management Quarterly* 2003 128, 129 on corporate social responsibility as a moral imperative in South Africa; Ngwenya *Successes and Failures of BBBEE – A Critical Assessment* (Mini MBA thesis, Stellenbosch University, 2007).

⁷⁸ Fombad ‘Accountability Challenges in Public-Private Partnerships from a South African Perspective’ 2013 *African Journal of Business Ethics* 16. The author discusses fronting as a form of corruption that compromises accountability in public-private partnerships in South Africa.

⁷⁹ See the *King II* 18 – 19. Also Khomba, Bakuwa & Kangaude-Ulaya “Shaping Business Ethics and Corporate Governance: An Inclusive African Ubuntu Philosophy” 2013 *Global Journal of Management and Business Research Administration and Management* 31; Khomba and Vermaak 2012 *African Journal of Business Management* 3510; Padayachee “Corporate governance in South Africa: from Old Boys Club to ‘Ubuntu’?” 2013 *Transformation: Critical Perspectives on Southern Africa* 260.

⁸⁰ See quotation of Reuel Khoza in “King pushes for Ubuntu-fused governance” <http://www.ujuh.co.za/king-pushes-for-ubuntu-infused-corporate-governance/> (last accessed 19-12-2013). See also Kayuni & Tambulasi “Ubuntu and Corporate Social Responsibility: the Case of selected Malawian organisations” 2012 *African Journal of Economic and Management Studies* 66- 67 for discussion on the nexus between *ubuntu* and corporate social responsibility in a corporate governance context.

the concept of *Ubuntu* is premised. The values of *Ubuntu* remain cardinal to effective corporate leadership in South Africa.⁸¹

5. A Commentary on the Legal Framework to Combat Fronting under the B-BBEE Amendment Act

This segment of the article commends the provisions of the B-BBEE Amendment Act providing a legislative framework to combat fronting. Whilst accepting the legal framework as a positive feature of the Act, its positive contribution to corporate governance is hinged on it being robustly supported by efforts from other important actors such as directors and shareholders. This shall be considered later in the discussion.

A significant feature of the Broad-Based Black Economic Empowerment Act is its criminalisation of fronting. Section 13O (1) of the Act criminalises fronting alongside other forms of dishonesty related to it. The latter practices include misrepresentation or attempted misrepresentation of the broad-based black economic empowerment status of an enterprise or entity, the provision of false information or misrepresented information to a B-BBEE verification professional in order to secure a particular broad-based black economic empowerment status or any benefit associated with the compliance with legislation and the provision of false information or misrepresentation of information relevant to assessing the broad-based black economic empowerment status of an enterprise to any organ of state or public entity. In terms of section 13O (2) criminal liability is also extended to a B-BBEE verification professional or any procurement officer or other official of an organ of state or public entity who becomes aware of the commission of, or any attempt to commit, any offence referred to in subsection (1) and fails to report it to an appropriate law enforcement agency. The provisions of section 13O (1) prohibiting fronting have to be read in conjunction with section 1 (e) of the Act which gives a non-exhaustive list of transactions that amount to fronting. The legislation empowers the Broad Based Black Economic Empowerment Commission to investigate cases of fronting on its own accord or following a complaint.⁸² The Commission is permitted by the legislation to institute legal proceedings in court to

⁸¹ See *South African Broadcasting Corporation Ltd and Another v Mpofu* (A5021/08) [2009] ZAGPJHC 25; [2009] 4 All SA 169 (GSJ).

⁸² Section 13J (1).

restrain any breach of the Act, including any fronting practice, or to obtain appropriate remedial relief.⁸³

Section 13O (3) provides heavy sanctions for persons or business entities found guilty of contravening subsection (1) or (2) of the legislation. In the case of a contravention of subsection (1), the offender shall be liable for a fine or be susceptible to imprisonment for a period not exceeding 10 years or to both a fine and such imprisonment or, if the convicted person is not a natural person, to a fine not exceeding 10 per cent of its annual turnover. Where a contravention of subsection (2) exists, the offender shall be liable for a fine or susceptible to imprisonment for a period not exceeding 12 months or to both a fine and such imprisonment. In terms of section (5), a court in which any person is convicted of an offence in terms of subsection (3) is compulsorily mandated to report the conviction to the B-BBEE Verification Professional Regulator, if that person is a B-BBEE verification professional to the Employer Council and to that person's employer. In terms of section 13P, any person convicted of an offence, which includes fronting, may not contract or transact any business with any organ of state or public entity. Such a person will be entered into the register of tender defaulters, which the National Treasury may maintain for that purpose. Where the convicted person is not a natural person, the court may in its discretion restrict the restrictive order permitted by the legislation only to members, directors or shareholders who contravened the Act.

There are commendable features of the legislation which are indicative of a decisive stance to confront fronting as a practice that goes against the underlying purpose of the broad-based black economic empowerment programme. Firstly the criminalisation of fronting backed by punitive sanctions restrains individuals or business entities from participation in the practice. The liability of B-BBEE verification agents, procurement officers or other officials of an organ of state or public entity for failure to report to the Commission or attempt to commit offences that include fronting is also an effective deterrent as such persons are strategically positioned to detect any contravention of the legislation earlier than other parties. Secondly, the provision of a non-exhaustive list of fronting transactions or arrangements in section 1 (e) affords an opportunity for the investigative process to assess each case on its merits therefore casting the net wide in order to harness various and complex fronting activities.

⁸³ Section 13J (4).

It has been argued in the article that fronting breaches the unfettered exercise of the directors’ duty of good faith and for a proper purpose, stakeholder governance and ethical corporate leadership which are all aspects interwoven in the function of company boards. Against this background, it is important for the board of directors of companies to consider fronting as a real corporate risk and therefore in conjunction with their management teams develop a risk management system to abate it.⁸⁴ Apart from the risk management team, the ethical concerns of fronting also invoke the active role of the Ethical Committee of the company if it has such an establishment as provided by section 72 of the Companies Act, 2008. Considering that the Ethical Committee gives the company ethical direction, it is critical that it ensures that the board of directors does not engage in fronting. Moreover, the committee has to pioneer far-reaching initiatives like the embedding of anti-fronting clauses in the company’s Code of Ethics and also the conduct of educational campaigns within the company. The latter will ensure that employees who are also stakeholders of the company are equipped to report any suspected fronting activities if detected.

Lastly, shareholders also have a critical role to play as they can invoke remedies provided in terms of company law to discourage director misconduct which includes the sanctioning of fronting transactions. Section 69 (8) (b) (iv) (aa) of the Companies Act, 2008 for example provides for the disqualification of a director who is convicted of an offence that includes fraud, misrepresentation or dishonesty upon the application of shareholders to court. Similarly, section 77 (3) (c) makes provision for the personal liability of a director if he or she is a party to any transaction to achieve a fraudulent purpose. Both provisions provide effective means by which shareholders can ensure that directors do not breach the law.

6. Conclusive Remarks

This paper has established that the broad-based black economic empowerment programme is a key legal instrument in promoting corporate social responsibility in South Africa. The promulgation of the B-BBEE Act in 2003 marked an important dimension for the concept of corporate social responsibility in South Africa as it was given legislative backing. The legislation remains a critical legal instrument to address the economic inequality in South Africa emanating from the country’s political history. Whilst the importance of the legislation

⁸⁴ Business Unity South Africa *A Guide on Recognising and Preventing Fronting* 2005 par 7.4. Also *King III* advocates for mitigation of ethical risks by the board of directors, see Principle 1.3: 37 – 39.

in enforcing corporate social responsibility is an uncontestable fact, its implementation remains challenged by the practice of fronting which has become a doorway by which some business entities in South Africa have wriggled away from the social responsibility conferred upon them by it.

The effects of fronting have to be considered in view of its gravity on the practice of best standards of corporate governance in South Africa. South Africa's reputable standards of corporate governance are susceptible to damage owing to the negative effects of fronting particularly on the country's fundamental pillars of corporate governance, namely the exercise of the fiduciary duties of directors, stakeholder governance and ethical corporate leadership. The amendment of the B-BBEE Act to criminalise fronting is welcomed as a decisive legislative step to respond to fronting as a challenge that confronts corporate governance. Finally, whilst embracing the legal framework to combat fronting, its success in achieving the underlying objective can be expedited by an all-inclusive approach whereby important actors in corporate governance namely directors, stakeholders and shareholders assume different responsibilities and act collectively to discourage the practice.