

**A Legal Analysis of the Application of Corporate Governance Principles in  
the Aviation Sector.**

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**Mini-dissertation submitted in fulfillment of the requirements for the degree of  
Masters in Development and Management Law**

In the

**Faculty of Management and Law**

**School of Law**

At the

**University of Limpopo**

**Supervisor**

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**2017**

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## **ABSTRACT**

The introduction of the King reports on corporate governance in South Africa introduced good corporate governance principles to be applied by companies and entities; public, private and state-owned companies. The purpose of King I, II, III and draft King IV on corporate governance is to provide and promote a good transitional process in companies in order for them to showcase the principles of accountability, sustainability and transparency; which are the fundamental aspects of which every company has to adhere to in order for it to be a good corporate citizen of the state. Ethics as mostly dealt with in draft King IV being the founding principles of good corporate governance. The trends across the domains show a lack of good corporate governance between the shareholder, board and management with displacement of the controlling and managing abilities between the parties. Despite continued upheavals, repeated disappointment and financial shortcomings the government continues to bail state-owned airlines from a state of insolvency. This study aims to analyze the application of the corporate governance principles in the aviation sector looking closely into state-owned airlines.





## **Declaration**

I, **Adv. Unarine Sandra Tshikovhi** declare that the mini-dissertation hereby submitted to the University of Limpopo for the degree of Masters of Laws (LLM) in Development and Management Law has not previously been submitted by me for a degree at this or any other University, that it is my own work in design and execution, and that all material contained herein has been duly acknowledged.

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**Tshikovhi US (Adv.)**

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**Date**

## **Dedication**

I dedicate this study to my only daughter Denzhe Masana Unarine Tshikovhi, who I have neglected through the time of my study. You are my light, sunshine and the source of my joy and you will forever keep the days of my life shining always.

## **Acknowledgementsi**

I would like to express my greatest appreciation and gratitude to my supervisor Adv. Lufuno Tokyo Nevondwe, you have been a tremendous mentor to me. I would like to thank you for providing and inciting the passion to study, research support and guidance in my work. To Prof Kolawole Odeku, thank you for the useful contributions, your faith in my abilities and your positive warm encouragement.

I would like to send my greatest salute and appreciation to my parents, words cannot describe how blessed I am to still have you both in my life. To my Father, Vhangani Richard Tshikovhi, thank you for being an inspiration and setting a good example in my life; to my mother Esther Tshikovhi your love, support and continuous encouraging words pushed me thus far and for that I salute and thank you.

In addition I am grateful to my two sisters Lusani Sharon and Mikovhe Rilwele Tshikovhi who introduced and opened my mind to a world and passion of academic growth and hard work. Thank you for helping me realizes the great potential I have and for inspiring me to do my best and work hard in order to succeed.

To my youngest sister Zwavhudi and only brother Rofhiwa thank you for being the best and for allowing me to realize that nothing is impossible; your endless prayers, words of encouragement and support has inspired me.

To me niece, Zwonaka thank you for your enduring love and to my only daughter Denzhe, you will always light up my life.

## **List of Abbreviations**

B-BBEE	Black Broad Based Economic Empowerment
CEO	Chief Executive Officer
DPE	Department of Public Enterprises
EAA	East African Corporation
GDP	Gross Domestic Product
IODSA	Institute of Directors in Southern Africa
JSE	Johannesburg Stock Exchange
LTTS	Long Term Turnaround Strategy
OECD	Organization for Economic Cooperation Development
PFMA	Public Finance Management Act, 1 of 1999
PWC	Price Water Coopers
SAA	South African Airways
SAAC	South African Aviation Corps
SAAF	South African Air Force
SABC	South African Broadcasting Corporation

SACAA	South African Civil Aviation Authority
SAICA	South African Institute of Chartered Accountants
SAPF	South African Power Flying Association
SOC	State Owned Companies
SOE	State Owned Entities

## **Table of Statutes**

1. Companies Act 61 of 1973.
2. Air Traffic Navigation Services Company Act 45 of 1993.
3. The Constitution of South Africa Act, 108 of 1996.
4. South African Civil Aviation Authority Act, 40 of 1998.
5. Public Finance Management Act, 1 of 1999.
6. Prevention and Combating of Corrupt Activities Act, 12 of 2004.
7. Broad-Based Black Economic Empowerment Act, 53 of 2005.
8. South African Airways Act, 5 of 2007.
9. South African Express Act, 34 of 2007.
10. Companies Act, 71 of 2008.
11. Civil Aviation Act, 13 of 2009.

## **Table of Cases**

1. *Extrasure Travel Insurance Ltd v Scattergood* (2003)1 BCLR 598(CHD).
2. *South African Broadcasting Authority Ltd V Mpofu* (2009) SA All 169 (GSJ).
3. *Dikoko v Mokhatla* 2006 (6) SA 235.
4. *South African Broadcasting Corporation (SABC) and Others v The Democratic Alliance and Others* [2015] ZA SCA 156

## CHAPTER ONE: INTRODUCTION

### 1.1. Historical Background to the Study.

South Africa was not left out of the aviation<sup>1</sup> sector that was occurring worldwide, after the flight by the Wright brothers 108 years ago, a civil engineer known as John Weston began the construction of his own aero plane in 1907 at Brandfort in the Free State.<sup>2</sup> He although lacked an engine with sufficient power so he dismantled the aircraft and shipped it to France.<sup>3</sup> While in France he fitted a Gnome rotary engine of 50hp and flew the aircraft successfully in 1910.<sup>4</sup> However on the 20<sup>th</sup> October 1908, the first aircraft was imported to South Africa and it was a Ralph S. Mansel glider that was built by Voisin Frères of Billancourt in France.<sup>5</sup> Since then it was the start of the John Weston Aviation Company in South Africa which did much in popularizing flights in the country by touring the main centres and offering flights to the public.<sup>6</sup> This changed the way people and objects were transported as on the 27 December 1911, the first airmail was carried by a Bok Driver in his Bleriot monoplane.<sup>7</sup> The government then decided in 1912 to start flying training for military purposes and it published invitations in a Government Gazette dated 13 May 1913 for citizens to join the South African Aviation Corps (SAAC) as officers-aviators.<sup>8</sup>

The Union Government did not have any training facilities so it negotiated with Cecil Compton Paterson to have military pilots trained at his flying school.<sup>9</sup> In July 1913, the Paterson Aviation Syndicate was registered and on 10 September 1913, General J C

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<sup>1</sup> Definition as per the International Civil Aviation Organization working paper, presented in Montreal on the 16 September 2009 defined as “All civil aviation operations other than scheduled air services and non-scheduled air transport operations for remuneration or hire.

<sup>2</sup> “John Weston” The grandfather of Aviation in South Africa”, South African Journal of Military Studies, Vol 3, No 6 (1973).

<sup>3</sup> <http://www.sahistory.org.za> on First Aeroplane flight Kimberley breaks non-stop-flight-record dated Sunday, 18<sup>th</sup> June 1911 (assessed on 13 March 2015).

<sup>4</sup> Ibid \*(note 3 ) above.

<sup>5</sup> <http://planespotter.iteg.co.za> on History of Aviation in South Africa (assessed on 13 March 2015).

<sup>6</sup> Ibid (note 2) above.

<sup>7</sup> Ibid (note 4) above.

<sup>8</sup> <http://www.sapfa.org.za> on History of Aviation in South Africa (assessed 13 March 2015).

<sup>9</sup> “They Mounted up as Eagles (A brief tribute to the South African Air Force), Military History Journal Vol 5 (6) December 1982.

Smuts signed a Memorandum of Agreement with Paterson whereby ten pupils were to be trained as pilots.<sup>10</sup> The pilot testing would be supervised by the Aeronautical Society of South Africa as prescribed by and on behalf of the Federation *Aeronautique Internationale*. After the pupils had left in early 1914, the Flying School at Alexandersfontein was abandoned due to the commencement of World War I and Paterson's returned to England.<sup>11</sup> In December 1915, 26 South African Squadron (Sqdn) was formed and at the end of hostilities in 1918, 26 Squadron was eventually recalled to England and disbanded in 1918.<sup>12</sup> The British Government offered aircraft to each of their Dominions to allow them to start their own Air Forces. South Africa received a total of 113 aircraft and these aircrafts were used to form the South African Air Force at a new base close to Pretoria on the farm Zwartkops.<sup>13</sup>

In June 1920, the South African Air Force (SAAF) was born.<sup>14</sup> The periods before and after the establishment of the Union of South Africa were characterized by the adoption of vast airlines and legislations governing the aviation sector although the South African Civil Aviation scene was not a happy and good one as it was hamstrung by government officials who did not understand the situation and funding was a challenge.<sup>15</sup>

The controlling body at the time was the Department of Post and Telegraphs whilst the Civil Air Board was merely an advisory board with no executive powers; Sir Pierre Van Ryneveld as director of Air Services at the time had little say over the Aviation policy.<sup>16</sup>

During the outbreak of the World War II, it resulted in South Africa being divided into two wings; a defence wing controlled by the Department of Defence and a commercial wing controlled by Administration.<sup>17</sup> In 1929, the father of civil aviation in South Africa, Major

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<sup>10</sup> <http://www.kimberley.org.za> on [Kimberleys-history-15-october](#) (assessed on 02 April 2015).

<sup>11</sup> Ibid (note 3) above.

<sup>12</sup> <http://www.moth.org.za/wp-> on [VCNewsletterSeptember2012](#) (assessed 04 April 2015).

<sup>13</sup> Ibid (note 10) above.

<sup>14</sup> Ibid (note 2) above.

<sup>15</sup> <http://www.sapfa.co.za> on the [1910-to-1920-early-flying-in-south-africa](#) (assessed 02 April 2015).

<sup>16</sup> Ibid (note 2) above.

<sup>17</sup> (4) Notwithstanding subsection (3), Part 1 of Chapter 11 and the Civil Aviation Regulations, 1997, apply to— (a) an aircraft belonging to the South African National Defence Force and South African Police Service; and (b) an aircraft in use exclusively by the South African National Defence Force and South

Allister Miller founded Union Airways<sup>18</sup> in Port Elizabeth after being awarded a government contract to fly airmail between Cape Town and the entire major centers in South Africa.<sup>19</sup> The company was registered in 24 July 1929 and began operations on 26 August 1929 with five De-Havillan DH 60 Gipsy Moth bi-planes.<sup>20</sup>

The popular airline known as South Africa Airways (SAA) was formed on 1 February 1934 following the acquisition of the Union Airways by the South African Government.<sup>21</sup> Forty staff members, along with one De Havilland DH.60 Gypsy Moth, one De Havilland 80a Puss Moth, three Junkers F. 13s and a leased Junkers F13 and Junkers A50 were among the acquired. Upon the acquisition, the government changed the airline's name to the South African Airways and was under the control of the South African Railways and Harbors administration which is currently Transnet.<sup>22</sup>

The aviation sector in South Africa is currently regulated by the South African Civil Aviation Authority (SACAA)<sup>23</sup> and provides for the establishment of a Civil Authority; for the transfer of certain functions of the State to the Authority; and for matters connected therewith.<sup>24</sup> Amongst the years South Africa has experienced the adoption of different airlines apart from SAA which are SA Express, SA Air link, Kulula, FlySafair and Comair Travel.

In 2006, SAA therefore split from Transnet, its parent company, to operate as an independent airline<sup>25</sup> and its main objective is to engage in passenger airline and cargo transport services, air charter services and other related services.<sup>26</sup> It currently owns

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African Police Service, where such aircraft are in flight through controlled airspace or in use at non-military aerodromes and heliports.

<sup>18</sup> Union Airways was the first South African commercial airline.

<sup>19</sup> <http://www.unionairways.org.za> (assessed 11 March 2015).

<sup>20</sup> <http://www.saamuseum.co.za/saa-history.html>(assessed (23 March 2015).

<sup>22</sup> It was formed as a limited company on 1 April 1990. A majority of the company's stock is owned by the Department of Public Enterprises, or DPE, of the South African government. The company was formed by restructuring into business units the operations of South African Railways and Harbours and other existing operations and products.

<sup>23</sup> Act 40 of 1998.

<sup>24</sup> As per the preamble of the South African Civil Aviation Authority Act.

<sup>25</sup> Op cit page 1 (note 6).

<sup>26</sup> Section 6(1) of Act no 5 of 2007.

Mango, a low-cost domestic airline which was founded in 2006<sup>27</sup>. SAA also has established links and has shares in South African Airlink and South African Express.<sup>28</sup> It was also therefore converted into a public company under the companies Act<sup>29</sup> with share capital and listed as a major public entity in terms of schedule 2 of the Public Finance Management Act,<sup>30</sup> the State thus became a shareholder and member of SAA.<sup>31</sup>

The airline has matured and developed over the years with it launching its first Cadet Pilot programme in 1997 to provide previously disadvantaged individuals an opportunity to become pilots and unveiling a new corporate identity where its aircrafts reflected the colors of the national flag; it also signed a R1.4 billion deal, giving SA's group holding company a 20% stake to SWISSAIR.<sup>32</sup>

In 2002, SAA then bought 49% share in Air Tanzania Limited<sup>33</sup> however regardless of its progressive developments the airline has seen a frequent change in its Chief Executive Officers over the last 4 years<sup>34</sup> and is currently being directed by a new recently appointed acting CEO, Mr. Musa Zwane.<sup>35</sup>

Another state-owned airline, South African Express Airways SOC Ltd emerged (hereafter SA Express), having been established and commenced operations in 24 April 1994,<sup>36</sup> although it has incorporated strategic alliance with SAA it is however independently operational.<sup>37</sup> In December 2007, the South African Express Act<sup>38</sup> was passed which provided for the transfer of SA Express shares and interests from

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<sup>27</sup> South African Airways website at <http://www.flysaa.com>

<sup>28</sup> <https://www.flysaa.com>.

<sup>29</sup> Act 71 of 2008.

<sup>30</sup> Act 1 of 1999.

<sup>31</sup> Public Enterprises in South Africa has been established since the early 20<sup>th</sup> century and they have undergone various phases and stages of transformation and restructuring.

<sup>32</sup> Ibid (note 5) above.

<sup>33</sup> South African Airways Annual Report 2005 p 52.

<sup>34</sup> SAA has had 7 Chief Executive and Acting Chief Executive Officers in the past four years.

<sup>35</sup> Ibid (note 28) above.

<sup>36</sup> <http://www.flyexpress.aero>.

<sup>37</sup> <http://www.southafrica.to/transport/Airlines/SA-Express/SA-Express-nes.php> (assessed 16 March 2015).

<sup>38</sup> Act 34 of 2007.

Transnet to the South African state and for the conversion of the airline into a public company with share capital.<sup>39</sup> The airline is regionally servicing neighboring countries such as Zambia, Zimbabwe and Namibia.

The South African airline industry has undergone a major change and it is probably the biggest change in its 70 year existence;<sup>40</sup> since the deregulation of the domestic airline industry in the early 90's. At this stage it was estimated that SAA had more than 95% of the domestic airline market.<sup>41</sup>

## **1.2. Statement of the Research Problem**

Just 14 years ago the South African aviation sector was celebrating SAA as a powerhouse and pride of the country, with being awarded vast awards amongst others are the Best Airline of Africa in 1990 and the Best cargo Airline to Africa in 2001.<sup>42</sup> Since then the entity has seen the rapid fall of the highly competitive airline with poor accountability and governance challenges as well as frequent change in leadership in both its Board of Directors and Chief Executive Officers, either resigning or charged with financial misconduct and mismanagement.

The state-owned entities<sup>43</sup> (SOE) in the aviation industry, SAA and SA Express were transferred from Transnet to be public companies; and for many preceding years, these companies have reported major financial losses amounting to millions and billions of rands and government as shareholder continues to hemorrhage obscene amounts of public money to always bail them out of a state of insolvency in their repeated financial losses and; Should the SOE's be insulated from failure and the taxpayers continue to suffer as taxes are diverted in order to bail out and salvage the poor performing SOE's.

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<sup>39</sup> Preamble of South African Express Act.

<sup>40</sup> <https://www.moneyweb.co.za/archive/privatise-saa-to-stop-needlessly-squandering-scarc> article on Moneyweb by Terry Markman published on the 4<sup>th</sup> August 2007.

<sup>41</sup> T Markman "Air Transport and the challenges for 2010, Southern African Transport Conference" Pretoria 9 – 12 July 2007.

<sup>42</sup> B Lubbe "Tourism Management in South Africa", Pearson Education South Africa, p 137.

<sup>43</sup> Defined by Price Water Coopers as an enterprise in terms of the Act as a company and either listed as a public entity in Schedule 2 or 3 of the Public Finance Management Act 1999.

Corporate governance is a system or process wherein companies are directed and controlled,<sup>44</sup> it is all about companies and entities being good corporate citizens and all that it entails.<sup>45</sup> The third challenge the aviation sector is faced with is lack of effective corporate governance systems in place in order to effectively ensure sustainability, accountability and transparency of the entities hence the repeated reporting of financial losses and frequent change in leadership. This particular challenges facing SOE's in South Africa are relevant to a consideration of the legislative and regulatory framework and are challenges that are acknowledged as potential barriers to the effective and efficient regulation of the SOE's.<sup>46</sup>

Another major challenge facing the South African aviation sector is the lack of demographic and gender imbalance in pilot corps<sup>47</sup>, for many years the South African Aviation industry has been struck by whites with both less blacks and women in the sector, currently 85% of SAA pilots are white of which 7, 6% are white females and 15% of SAA pilots are Blacks, Colored's and Indians.<sup>48</sup> This position still remains regardless of the airlines transformation strategy in place to change, transform and bridge the gender gap regardless of the current legislations in place to amend and change the sector to involve everyone.

### **1.3. Literature Review.**

According to the South Africa's Protocols on Corporate Governance in the Public sector,<sup>49</sup> corporate governance embodies processes and systems by which enterprises are directed, controlled and held to account. Corporate governance in South Africa was institutionalized by the publication of the King Report on Corporate Governance in

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<sup>44</sup>Prof Karin Barac, "Corporate governance in the public sector" Department of Applied Accountancy, University of South Africa p 1.

<sup>45</sup> Jackson & Stent, Auditing notes for South African students (2012) 8.

<sup>46</sup> Bronstein V & Olivier M "An Evaluation of the Regulation Framework Governing State Owned Enterprises (SOE's) in the Republic of South Africa" University of Witwatersrand.

<sup>47</sup><http://www.flysaa.com> on cadet pilot programme.

<sup>48</sup> J Malala, Viewpoint: Does race matter in South Africa, BBC News 29 August 2012 available at <http://www.bbc.com/news/world-africa>.

<sup>49</sup> Department of Public Enterprise, 2002.

November 1994,<sup>50</sup> which report was subsequently been superseded by the King code of 2002.<sup>51</sup> It further on provides that the purpose of the King Report is to promote the highest standards of corporate governance in South Africa. The code of corporate practices and conduct contained in the King Report applies inter alia, to SOE's and agencies that fall under the Public Finance Management Act.<sup>52</sup> The protocol was first published in 1997, with a view to inculcating the principles of good governance in the SOE's and this very protocol constitute a substantial revision therefore in the light of both the King code and international developments.<sup>53</sup>

Gumede<sup>54</sup> discussed that the ownership of SOEs has peculiar features, which makes them susceptible to poor accountability problems. If a company fails shareholders will withdraw with little regard for the social consequences. Notwithstanding poor performance, even threat of ruining the fiscus, government will rarely allow SOEs to go bankrupt. This means that managers may feel little compunction about losing money in SOEs. In some cases, they may even run losses with the aim of securing more funding from the state. Governments often fail to hold executive managements of SOEs accountable and to enforce discipline and this may be perpetuated to the fact that cadre's are placed in positions of power. In private sector, shareholders could use the threat of bankruptcy, closure and hostile takeovers to discipline poor performing managers.

Nevondwe, Odeku and Tshoose<sup>55</sup> also contributed in that the public sector should not be exempted from the principles of corporate governance. The governance in the public sector will improve when public servants are held accountable and responsible for the activities of their department. Within its context, it is suggested that departments should

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<sup>50</sup> King Report I of 1999.

<sup>51</sup> King Report II of 2002; see also The South Africa's Protocol on Corporate Governance in the Public sector was published by the Department of Public Enterprise in 2002.

<sup>52</sup> Act 1 of 1999.

<sup>53</sup> South Africa's Protocol on corporate governance in the public sector, Department of Public Enterprise (2002) 3.

<sup>54</sup> Gumede W "South African State-Owned Enterprises: Boards, Executives and Recruitment" (unpublished Doctoral Dissertation, University of Witwatersrand (2012) 8.

<sup>55</sup> Nevondwe L, Odeku K & Tshoose I "Promoting the Application of Corporate Governance in the South African Public Sector" (2014) p 261-75.

have a reporting system to support good governance. This would prevent public servants from using their positions for personal gain, which normally is monetary gain. The principles of corporate governance should be welcomed in the public sector as they ensure that public servants are skillful and able to implement the vision and mission of the department, and national imperatives and not of personal gain.

The Commonwealth Association of Corporate Governance discussed the essentiality of leadership in respect to corporate governance, which is leadership of efficiency, leadership of probity, leadership with responsibility and leadership which is transparent and accountable.<sup>56</sup> It concentrates strictly on leadership which sets the tone from the top as per good corporate governance.

As per research by the Centre for Corporate Governance in Africa, for both the public and private sector the fundamental governance principles are relevant: accountability, honesty and transparency; these are the hallmarks of good governance and good government- it goes to the heart of the original root of the concept – the Greek word “kybernetes” (helmsman or steersman) helping a ship to reach its destination (performance) without running into troubled waters (conformance).<sup>57</sup> These governance principles are the essential factors that support and ensure an entity is sustainable and meets its goals.

Price Water Coopers<sup>58</sup> discussed the importance for companies, whether private or state-owned, which have been underscored by the global financial crisis, high-profile corruption scandals, monumental waste of resources and bankruptcy. Despite the noble intent for the creation of SOEs, in many cases and in many countries they are often less productive than companies in the private sector. All too often they have been used as places of patronage for ruling governments. In some cases SOEs function “like family

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<sup>56</sup> Commonwealth Association of Corporate Governance (1999) 3.

<sup>57</sup> Hanns Seidel Foundation, Rating Corporate Governance of State-Owned Enterprises, Centre for Corporate Governance in Africa (2012) University of Stellenbosch Business School.

<sup>58</sup> Price Water Coopers, State-owned enterprises: Governance responsibility and Accountability, Institute of Directors in Southern Africa (2011).

businesses, controlling or participating in the management” – the family in this cases being the leadership of ruling parties.

The definition of sustainable implies something enduring and capable of longevity. Sustainable development was first defined in the 1987 Brundtland Commission Report<sup>59</sup> as business “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”. It is a pattern of resource use that aims to meet immediate needs whilst preserving the environment so that these needs can be met not only in the present but also for future generations. For a business this means sustaining the company itself while sustaining the natural resources on which the company relies.<sup>60</sup>

Section 76 of the Companies Act<sup>61</sup> which is the legislation that provides guidelines with respect to standards of director’s conduct, it provides for section 3 which subject to subsections (4) and (5), a director of a company when acting in that capacity must exercise the powers and perform the functions of director-

- (a) In good faith and for a proper purpose
- (b) In the best interests of the company; and
- (c) With the degree of care, skill and due diligence that may reasonably be expected of a person-
- (d) Carrying out the same functions in relation to the company as those carried out by that director; and
- (e) Possessing the general knowledge, skill and experience of that director.<sup>62</sup>

On the other hand ethics is seen to be the foundation of good corporate governance and it is therefore referred to a set of rules that define right and wrong conduct and that

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<sup>59</sup> The World report on Environment and Development.

<sup>60</sup> Naidoo R “Corporate Governance: An Essential Guide for South African Companies” (2009) 246.

<sup>61</sup> The Companies Act 71 of 2008.

<sup>62</sup> The above stated section of the companies Act simply provides for avoidance of abuse, communication and exercise of power in good faith, in the best interests of the company and with a degree of care, skill and due diligence.

help individuals distinguish between fact and belief, decide how such issues are defined and what moral principles apply to the situation.

Corporate governance finds its basis under the African Ubuntu philosophy which signifies that an organization has an explicit commitment to serve the interests of both shareholders and non-shareholding stakeholders. The African Ubuntu philosophy emphasizes the importance of community, solidarity, coexistence and the inclusion of community members.<sup>63</sup>

As per the King III Report and the Constitution<sup>64</sup> which compels government in all of its forms, both through government departments and organs of the state, including state owned enterprises to adhere to principles of good governance.<sup>65</sup> This section<sup>66</sup> deals with basic values and principles governing public administration and it provides that there must be a high standard of professional ethics. In fact this standard must be promoted and maintained. State owned entities such as the SABC and SAA are included in the definition of “organ of state”. It is for this reason that the provisions of the Constitution as well as the legislation enacted in terms thereof are applicable to state owned enterprises.<sup>67</sup> Ethics are going to be addressed and interrogated as the foundation of good corporate governance of every entity or organization.<sup>68</sup>

South African Company law is currently the object of comprehensive review. One major areas of scrutiny is that of corporate governance; control over management is vital in the interests of the company itself, its shareholders and its creditors. Effective accountability should be balanced against the need to allow those who manage a certain measure of freedom and discretion in the exercise of their function.<sup>69</sup>

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<sup>63</sup> Khomba & Vermaak “Business Ethics and Corporate Governance: An African Socio-Cultural Framework” (2012), African Journal of Business Management Vol 6(9) p 3511-12.

<sup>64</sup> Act 108 of 1996.

<sup>65</sup> The South African Constitution Act 108 of 1996, see also section 195 of the Constitution.

<sup>66</sup> Section 195(2) of the South African Constitution Act 108 of 1996.

<sup>67</sup> Nevondwe L “Corporate Governance Principles: Lessons to be Learnt” 2012 The Thinker volume 44 p 16.

<sup>68</sup> Draft King IV Report on corporate governance in South Africa 2016.

<sup>69</sup> Havenga M “Fiduciary duties of company directors with specific regard to corporate entities” (Unpublished LLD dissertation University of South Africa 1995) 34.

Shamila Singh debated in his paper that in several organization for Economic Cooperation and Development (OECD) countries, including South Africa, public entities particularly state owned entities still represent a substantial part of gross domestic product (GDP), employment and, market capitalization. Moreover, public entities are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunication, whose performance is of great importance to broad segments of the population and to other parts of the business sector and consequently, the governance of public entities is critical in ensuring their positive contribution to a country's overall economic efficiency and competitiveness.<sup>70</sup>

#### **1.4. Aims and Objectives.**

Corporate governance is a system by which companies are directed and controlled.<sup>71</sup> This study aims to examine the reasons why SAA and SA Express as the biggest state-owned airlines in South Africa suffer and experience a frequent change in its leadership in both its board of directors and executive management.

To investigate and examine the reasons why tax payers continue to suffer as government continuously bails out the airlines from major financial losses suffered regardless of its continuous non- performance.

To investigate and analyze as to whether the airlines comply with corporate governance principles as set out in King III and the draft King IV Report underpinning accountability, sustainability and transparency and what mechanisms, if any are in place to remedy and action the lack of transformation in the aviation sector especially both amongst previously disadvantaged persons and what steps have been taken to ensure the airlines are held accountable for non-compliance with legislations and policies in place to address this issue.

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<sup>70</sup> Shamila S "The Determination of Board decision quality in South Africa: A case of Public Entities" (Unpublished LLD Dissertation University of South Africa 2012) 251.

<sup>71</sup> Loxton D" A new Landscape for Corporate Governance: Living with the Companies Act and King 3" Werkmans Attorneys (2012) p 7- 9.

### **1.5. Research Methodology.**

The research methodology to be employed in this regard is qualitative. There will be no questionnaires used in this work. The research is library based and focus will be on review of the literature and comparative study in trying to come up with solutions to the vast corporate governance challenges that the aviation sector is faced with.

In order to thoroughly address the problem, focus will also be on various textbooks, journals, newspapers, government papers, Acts, decided cases, internet sources and articles by different authors.

### **1.6. Scope and Limitation of the Study.**

This study comprises of five interrelated chapters. Chapter one is the introductory part of the study laying down the foundation.

Chapter two discusses the policy and regulatory frameworks while chapter three highlights the principles of corporate governance. Chapter four focuses on a comparative study. Chapter five is the summary and conclusion drawn from the whole study and recommendations thereof.

## CHAPTER TWO: POLICY AND REGULATORY FRAMEWORKS.

### 2.1. Introduction.

A state owned airline is a legal entity that undertakes commercial activities on behalf of an owner government.<sup>72</sup> The legal status of a SOE varies from being part of the government to being stock companies with the state as a regular stockholder.<sup>73</sup> The defining characteristics of SOEs are that they have a distinct legal form and they are established to operate in commercial affairs. While they also have public policy objectives, SOEs should be differentiated from other forms of government agencies or state entities established to pursue purely non-financial objectives.<sup>74</sup>

SOE's are deeply implicated in most fiscal problems of African governments because of their inefficiency, losses, budgetary burdens and provisions of poor products and services. Occasionally they achieve some non-commercial objectives, which are used to justify their poor economic performance.<sup>75</sup>

They often operate in sectors where there is a natural monopoly or where the government has strategic interest.<sup>76</sup> Public enterprises in South Africa have typically developed by following one or two paths. Some have purely historical roots in public service but now operate in competitive market, and others have been established by the government to serve the public good, provide services not offered by the private sector or regulate the private sector.<sup>77</sup>

Corporate governance embodies process and systems by which SOEs are directed, controlled and held to account. Its existence is ordinarily made possible by enabling

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<sup>72</sup> A State owned entity is national government business enterprise established in terms of national legislation fully or substantially funded either from the National Revenue Fund or by way of tax, levy or other money imposed in terms of national legislation and accountable to parliament.

<sup>73</sup> PWC, "State Owned Enterprises: Catalysts for public value creation?" April 2015, p 4.

<sup>74</sup> Ibid (note 73) above.

<sup>75</sup> Mwaura K "The Failure of Corporate Governance in State Owned Enterprises and the need for restricted Governance in fully and Partially Privatized enterprises: The case study of Kenya" (2007) Fordham International Law Journal Volume 31 issue 1.

<sup>76</sup> Wendy Ovens & Associates, "The role and significance of state owned entities, public enterprises and any other public bodies in the promotion of urban growth and development in South Africa", August 2013, p 4.

<sup>77</sup> Mr. J.G Zuma, Presidential Review Committee on State Owned Entities, Volume 1 p 3.

legislation, which provides for its establishment, control, powers, function and funding.<sup>78</sup> Governance is essentially about effective leadership based on ethical foundation whilst compliance as any other business activity should take place within the context of leadership and sound governance principles.<sup>79</sup> In addition to legislative requirements based on a SOEs enabling legislation, and the Companies Act, corporate governance with regard to SOEs is applied through the precepts of the Public Finance Management Act (PFMA) and run in tandem with the Protocol on Corporate Governance, which encapsulates the principles contained in the King III report and the draft King IV code of Corporate Governance. Governance oversight over SOEs vests in Parliament, the Executive and the Boards of SOEs.<sup>80</sup>

SOE's are required to comply with general corporate governance codes.

## **2.2. The South African Airways Act.**

This Act was enacted in order to give effect to the South African Airways after its transfer from Transnet,<sup>81</sup> Section 4 of this Act provides for the conversion of SAA into a public company having a share capital in accordance with the Companies Act;<sup>82</sup> it also makes provision for the Companies Act to register it in the companies register. SAA is strictly governed by this Act as it provides for how it became a public entity in terms of schedule 2 of the PFMA; how it came to own assets, liabilities, rights and obligations of which previously belonged to Transnet. This Act clearly defines and articulates who will take ownership of the new born entity and who will thus be accountable for it as an entity.

It further on specifies in section 6, the main objects and powers of SAA in that it needs to engage in passenger airline and cargo transport services, air charter services and

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<sup>78</sup> PWC, State owned companies: The new Companies Act, PFMA and King III in perspective- Steering Point no 4 Published August 2012.

<sup>79</sup> Ibid (note 35) above.

<sup>80</sup> Du Toit H "Governance Oversight role over State Owned Entities" National Treasury (2005) 1.

<sup>81</sup> Transnet SOC Ltd is a large South African rail, port and pipeline company, headquartered in the Carlton Centre in Johannesburg. It was formed as a limited company on 1 April 1990.

<sup>82</sup> Act 71 of 2008.

other related services; this means that SAA needs to comply with the Act and ensure that it operates its business within the realm and sphere of the objectives set out in the Act.

The Act also provides for borrowing of money or loan guarantee's by the airline, SAA may borrow money or issue a guarantee, indemnity or security, or enter into any transaction necessary to achieve its object referred to in section 6. This Act is the founding ground of South African Airways and it is crucial and mandatory for the airline to comply with the provisions of this Act.

### **2.3. Shareholder's Compact.**

A Shareholder compact is an agreement between the shareholder party and the subsidiary party and its purpose is to regulate the relationship between the shareholder as the executive authority and owner of the public entity and the Board of Directors as the accounting authority of the same public entity.<sup>83</sup> The shareholder's compact needs to be reviewed and adjusted on an annual basis, in line with the performance of the public entity over the previous financial years.<sup>84</sup> This shareholder compact must document the mandated key performance measures and indicators to be attained by the public entity as agreed between the accounting authority and the executive authority.<sup>85</sup> This compact finds its base from section 29 of the Treasury regulations<sup>86</sup> and it must be noted that it does not replace the strategic, corporate and business plans but is rather complimentary to all these. It simply describes the relationship between the signatories and identifies the behavior that would be required on both sides to support effective management and performance of the entity.

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<sup>83</sup> National Treasury, Guideline Framework for Corporate Planning and Shareholder's Compact, September (2002) 4.

<sup>84</sup> See Regulation 29.2 of the Treasury Regulations of departments, trading entities, constitutional institutions and public entities in terms of the Public Finance Management Act, March 2008.

<sup>85</sup> Irene-Marie, Esser and Adriette Dekker "The Dynamics in Corporate Governance in SA: Broad Based Black Economic Empowerment and the enhancement of good corporate principles presented at 2<sup>nd</sup> international conference.

<sup>86</sup> The National Treasury is a paramount body of state owned entities as all monies utilized by the entity are from the Treasury.

The South African Airways Shareholder's Compact records the objective of the airline as that of delivering commercially sustainable world-class air passenger and aviation services in South Africa, the African Continent and South Africa's tourism and trading partners. The delivery of commercial sustainability is enshrined in the compact, as is delivery on its financial targets.<sup>87</sup> This agreement is basically a contract between the shareholder and the company's board of Directors to forge a working relationship in order to address and achieve the objects of the entity as well as lay out the terms of reference for achieving its objectives. The shareholder compact basically provides a clear picture of what each party needs to do and who has to do it in this regard; how performance is met and to what extent it needs to be measured and evaluated. The compact promotes good governance practices by helping to clarify the roles and responsibilities of the Board and the Executive Authority and ensuring agreement on the mandate and key objectives.<sup>88</sup> This document provides a guideline of how business should proceed and what obligations are there in respect of which party.

#### **2.4. Public Finance Management Act.**

State owned entities fall within the ambit of this Act which means that they need to comply with additional provisions over and above those of the Companies Act. This Act focuses primarily on the aspects of financial management within public entities. The PFMA is the principal Act promulgated by the government to stipulate in detail the rules and regulations related to financial management and reporting to be followed and matters of SOEs, all other legislation is subordinated to the PFMA. Although the PFMA should be considered to its entirety sections 46 through 86 are of particular importance for financial governance issues.<sup>89</sup> Essential provisions are discussed and highlighted in order to zoom in on the aspects of good financial governance that have to be complied with.

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<sup>87</sup> South African Airways Group Integrated Annual Report 2014 p 10 -11.

<sup>88</sup> CSIR Annual Report 2008/09 p 102.

<sup>89</sup> Protocol on Corporate Governance in the Public Sector, Department of Public Enterprise 2002.

Section 49 of this Act specifically deals with Accounting Authorities which is essential for every entity; it thus states that *“(1) every public entity must have an authority which must be accountable for the purposes of this Act.*

*(2) If the public entity-*

*(a) has a board or other controlling body, that board or controlling body is the accounting authority for that entity; or*

*(b) does not have a controlling body, the Chief Executive Officer or the other person in charge of the public entity is the accounting authority for that public entity unless specific legislations applicable to that public entity designates another person as the accounting authority.*

*(3) The relevant treasury, in exceptional circumstances may approve or instruct that another functionary of a public entity must be the accounting authority for that public entity*

*(4)The relevant treasury may at any time withdraw an approval or instruction in terms of subsection (3)*

*(5) A public entity must inform the Auditor-General promptly and in writing of any approval or instruction in terms of subsection (3) and any withdrawal of an approval or instruction.”*

This section simply establishes and gives rise to the board as the accounting body of an SOE. It gives the board powers and authority to oversee and strategically drive and guide the entity. The board of an SOE in fulfilling its mandate needs to adhere to the above section in order to entirely fulfill and meet the principles of accountability, transparency and sustainability. This section assists in preventing confusion in the roles and duties of each body between the shareholder, board and management. This section clearly stipulates that the Board of Directors of any SOE is the accounting authority of that SOE; this implies that no other body will serve as the accounting authority except the Board.

*“Section 50: Fiduciary duties of accounting authority*

- (1) The accounting authority for a public entity must-*
  - (a) exercise the duty of utmost care to ensure reasonable protection of the assets and record of the public entity;*
  - (b) act with fidelity, honesty, integrity and in the best interests of public entity in managing the financial affairs of the public entity;*
  - (c) on request, disclose to the executive authority responsible for that public entity or the legislature to which the public entity is accountable, all material facts, including those reasonably discoverable which in any way may influence the decisions or actions of the executive authority or that legislature; and*
  - (d) seek, within the sphere of influence of that accounting authority, to prevent any prejudice to the financial interests of the state.*
  
- (2) A member of an accounting authority or, if the accounting authority is not a board or other body, the individual who is the accounting authority, may not-*
  - (a) Act in a way that is inconsistent with the responsibilities assigned to an accounting authority in terms of this Act; or*
  - (b) Use the position or privileges of, or confidential information obtained as, accounting authority or a member of an accounting authority, for personal gain or to improperly benefit another*
  
- (3) A member of an accounting authority must-*
  - (a) Disclose to the accounting authority any direct or indirect personal or private business interest that the member or any spouse, partner or close family member may have in any matter before the accounting authority; and*
  - (b) Withdraw from the proceedings of the accounting authority when that matter is considered, unless the accounting authority decides that the member’s direct or indirect interest in the matter is trivial or irrelevant.”*

This section emphasizes on the manner in which the board should act, behave or react and which qualities should a director resemble or possess in order to fulfill the interests

of the shareholder.<sup>90</sup> It gives guidance to the shareholder or whichever body that is responsible for recruitment, selection and appointment of the board to take into account the provisions of this section. In recruitment and appointment of individuals to serve on the Board; individuals that possess such qualities should be of preference in order to ensure that such section is not overridden or deviated from. This section should be read closely with section 76 of the Companies Act as provided above.

This section is contrary to the cadre employment/deployment policy which looks into centralizing and systematizing the deployment of loyal ANC cadres to all sectors of power including the economy, education, sports, arts and media so as to secure ANC control and hegemony.<sup>91</sup> This policy is largely utilized in recruiting and appointing directors to serve on boards and such individuals do not serve the interests of the entity but serve their own political interests; which thus brings about challenges and problems which in turn is contrary to good governance as experienced, skilled and competent board members are required to ensure appropriate oversight and successes of the entity.

The entity is exposed to leadership challenges as a result of members appointed through cadre employment and not through merit or as provided by the provision of this section thus this is the reason why there is a continuity of frequent change in leadership as well as company directors that do not deal and push the agenda of the company but of the body or party that employed them. The above section of the PFMA is entirely in support and should be read with section 76(3) of the Companies Act<sup>92</sup> which provides for the qualities that a director should possess in his or her duty as a director of the entity.

*“Section 51: General Responsibilities of accounting authorities*

*(1) An accounting authority for a public entity-*

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<sup>90</sup> Cassim F, Contemporary Company Law (2011) 36 ch 2.

<sup>91</sup> Thwala C “The African National Congress (ANC) and the Cadre deployment policy in the Post-Apartheid of South Africa: A product of Democratic centralisation or a recipe for Constitutional crisis? (2014) J Soc Sci 4(2) p 159-65.

<sup>92</sup> Act 71 of 2008.

- (a) Must ensure that the public entity has and maintains-*
- (i) Effective, efficient and transparent systems of financial and risk management and internal control;*
  - (ii) A system of internal audit under the control and direction of an audit committee complying with and operating in accordance with regulations and instructions prescribed in terms of sections 76 and 77; and*
  - (iii) An appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective;*
  - (iv) A system for properly evaluating all major capital projects prior to a final decision on the project;*
- (b) Must take effective and appropriate steps to-*
- (i) Collect all revenue due to the public entity concerned; and*
  - (ii) Prevent irregular expenditure, fruitless and wasteful expenditure, losses resulting from crime conduct, and expenditure not complying with the operational policies of the public entity; and*
  - (iii) Manage available working capital efficiently and economically*
- (c) Is responsible for the management including the safeguarding of the assets and for the management of the revenue expenditure and liabilities of the public entity.”*

The section stated above gives rise to the application of good corporate governance as it specifically provides that the board should ensure effective, efficient and transparent systems of financial risks; this means the finances of the entity are to be overseen by the board in ensuring that they prevent losses and ensure profit. In exercising their duties, the board should ensure that SAA performs accordingly achieving its objectives and thus reporting profits and fewer losses; and by doing so they will be managing

capital efficiently and economically instead of digging deep into taxpayers' pockets as the airline is always being bailed out of insolvency.<sup>93</sup>

*“Section 55: Annual Report and financial statements*

*(1) The accounting authority for a public entity –*

*(a) Must keep full and proper records of the financial affairs of the public entity*

*(b) Prepare financial statements for each financial year in accordance with generally accepted accounting practice, unless the Accounting standards board approves the application of generally recognized accounting practices for that public entity;*

*(c) Must submit those financial statements within two months after the end of the financial year –*

*(i) To the auditors of the public entity for auditing; and*

*(ii) If it is a business enterprise or other public entity under the ownership control of the national or a provincial government, to the relevant treasury; and*

*(2) The annual report and financial statements referred to in subsection (1) (d) must*

*–*

*(a) fairly present the state of affairs of the public entity, its business, its financial results, its performance against pre-determined objectives and its financial position as at the end of the financial year concerned.*

*(b) Include particulars of –*

*(i) Any material losses through criminal conduct and any irregular expenditure and fruitless and wasteful expenditure that occurred during the financial year;*

*(ii) Any criminal or disciplinary steps taken as a consequence of such losses or irregular expenditure or fruitless and wasteful expenditure*

*(iii) Any losses recovered or written off*

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<sup>93</sup> This is done through various loan guarantees from National Treasury to SAA in order to keep the ship floating.

- (iv) *Any financial assistance received from the state and commitments made by the state on its behalf; and*
- (v) *Any other matters that may be prescribed; and*

*(c) Include the financial statements of any subsidiaries*

*(3) An accounting authority must submit the report and statements referred to in subsection (1) (d), for tabling in Parliament or the provincial legislature, to the relevant executive authority through the accounting officer of a department designated by the executive authority.*

*(4) The relevant treasury may direct that, instead of a separate report, the audited financial statements of Schedule 3 public entity which is not a government business enterprise must be incorporated in those of a department designated by that treasury”*

The above section echoes the principles of good corporate governance as per the King code III and draft King code IV.<sup>94</sup> All the above sections of the PFMA are discussed as they are important sections that need to be adhered to for effective, efficient, transparent, sustainable and an accountable entity. The principles of transparent, sustainable and accountability are the core traits that ensure that a company or entity is a good corporate citizen of a state. As stated above this Act is the principal legislation for all the financial management of an SOE thus if any conflict arises or exists between the PFMA and another Act in financial matters, the PFMA prevails as stipulated in section 3(3) of the Act thus it is crucial that it is adhered to at all times by SOEs.

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<sup>94</sup> Draft King IV report of Corporate Governance of South Africa (2016) 2.

## 2.5. The Companies Act.

South Africa has a well-developed and formally regulated company law regime. All South African businesses are governed by the Companies Act no 71 of 2008 and its regulations. This current Act was promulgated in 2009 and it repealed the 1973 Act; this new Act aims to modernize the law, align it with international best practices and make it more business friendly,<sup>95</sup> especially by streamlining it with the South African legislation, such as the Promotion of Access to Information Act.<sup>96</sup> State owned companies/entities are new forms of companies introduced by Treasury and are governed by the Companies Act. Section “34 (1) makes provision for SOE’s in that public company or state owned company must also comply with the extended accountability requirements set out in Chapter 3 of this Act”

This Act deals and concentrates in different sections with the governance of companies relating to recording-keeping, appointment of directors, directors conduct and powers to act and type and number of meetings a company should conduct in order for both good corporate governance and compliance.

*“Section 66 provides for Board, Directors and other prescribed officers*

*(1) The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or the company’s Memorandum of Incorporation provide otherwise”*

This section specifically discusses the importance and sensitivity of every entity to be managed and directed by a Board which is thus the accounting authority of that entity. It symbolizes the need for every entity or company to have a board that strategically manages the entity; strategically managing the entity relates to the board ensuring that that the objectives of the entity are met by getting rid and managing all business risks as

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<sup>95</sup> <http://www.cipc.co.za>.

<sup>96</sup> Act 2 of 2000.

well as ensuring that the business achieves its aims, objectives and thrives as well as serve the community or stakeholders good.

Chapter 3 which provides for enhanced accountability and transparency specifies as follows:

*“Section 84(3) provides that in the case of state owned company –*

- (a) If there is a conflict between the provision of this chapter and the provision of the Public Audit Act 25 of 2005, the provisions of the Act prevails*
- (b) Despite the provisions of this chapter to the contrary, the state owned company is not required to appoint an auditor for any financial year in respect of which the Auditor-General has elected, in terms of the Public Audit Act of 2004, to conduct an audit of that enterprise; and*
- (c) In any year in which the state owned company is required by this chapter to appoint an auditor applies to that company, in addition to the relevant provisions of this chapter. Any requirement in terms of the Public Audit Act to have the appointment of the company’s auditor approved by the Auditor-General applies to that company in addition to the relevant provisions of this chapter”*

This Act deals extensively with ensuring compliance of the SOE to policies and procedures that govern it. This Act also makes provision for Section 76(2) and (3) which provides for standard of directors conduct, the manner in which a director should behave, act and exercise his duties and obligations as a director

*(2) “A director of a company must-*

- (a) Not use the position of director, or any information obtained while acting in the capacity of a director-*
  - (i) To gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or*



determined by reasonableness.<sup>99</sup> There has been limited adoption of the King Report and such is largely attributed to the fact that the national government departments already are struggling to comply with mandatory legislative requirements as per the PFMA as their minimum governance requirement.<sup>100</sup> Acting diligently and in the best interests of the institution by a director is also attributed by the fact that a specific individual in that spectrum possess the required skills, expertise and experience in order to deal with issues of that specific sector and in the long run ensuring the achievement of the goals of the entity.

## **2.6. The King I Report.**

In South Africa, corporate governance was formalized in 1994 by the publication of the first King Report on corporate governance; this report focused a huge amount of interest on South Africa's practices. The King Committee on corporate governance was formed in 1992, under the auspices of the Institute of Directors, to consider corporate governance, of increasing interest around the world, in the context of South Africa. This coincided with profound social and political transformation at the time with the dawning of democracy and the re-admission of South Africa into the community of nations and the world economy.<sup>101</sup>

The purpose of the King Report 1994 was, and remains, to promote the highest standards of corporate governance in South Africa unlike its counterparts in other countries at the time, the King Report 1994 went beyond the financial and regulatory aspects of corporate governance in advocating an integrated approach to good governance in the interests of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice. In adopting a participative corporate governance system of enterprise with integrity, the

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<sup>99</sup> Extra sure Travel Insurance Ltd v Scattergood (2003) 1 BCLR 598 (CHD).

<sup>100</sup> Moloi T "Assessing Corporate Governance Disclosures in South African national government departments: The State and Corporate Governance, Southern African Journal of Accountability and Auditing Research" (2015) Vol 17(1) p 1-10.

<sup>101</sup> Institute of Directors of Southern Africa, Executive summary of King Report of 2002 p 6.

King Committee in 1994 successfully formalized the need for companies to recognize that they no longer act independently from the societies and the environment in which they operate.<sup>102</sup>

## **2.7. The King II Report.**

In 2002, the second King Report on corporate governance was published. It contains a Code of corporate practices and conduct. Although voluntary, the Johannesburg Securities Exchange requested listed companies to comply with the King Report recommendations or to explain their level of non-compliance, in other words this code followed the “comply or explain” approach which meant that companies listed in the JSE had to apply with this code or explain reasons for non-compliance.<sup>103</sup>

This report applied only to certain categories of business enterprises which are companies listed on the Johannesburg Stock Exchange (JSE), Banks, financial and insurance entities as well as public sector enterprises governed by the Public Finance Management Act and the Municipal Finance Management Act.<sup>104</sup>

King II acknowledged the move away from the single bottom line which concentrated only on profit for shareholders to a triple bottom line approach which embraces the economic, environmental and social aspects of a company’s activities.<sup>105</sup>

The King II as per the King III brought about a major commercial and governance climate in South Africa, with companies battling the economic factors and working towards complying with the new corporate governance factors as per this report.

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<sup>102</sup> Dekker C, King Report on Corporate Governance for South Africa (2002) 2.

<sup>103</sup> Fernando AC “Corporate Governance: Principles, Policies and Practices, Pearson Education India” (2009) 111.

<sup>104</sup> Act 56 of 2003.

<sup>105</sup> [www.SAICA.co.za](http://www.SAICA.co.za) assessed on 18th December 2015.

## **2.8 The King III Code and Report of Corporate Governance.**

The King III report and its code apply to all entities in and that are a resident of South Africa, regardless of the manner and form of incorporation or establishment and whether such establishment is public, private, non-profit sectors.<sup>106</sup> The code represents a significant milestone in the evolution of corporate governance in South Africa and brings with it significant opportunities for organizations that embraces its principles. Its application, if adhered to will result in entity practicing good governance.<sup>107</sup> The King III follows the “apply or explain” approach wherein entities have to apply the code and best practices, and this is a more flexible approach as compared to that of King II.<sup>108</sup> The structure of King III is separated into the principles and the code and each principle is of equal importance and together forms a holistic approach to governance. The King III Report discusses nine principles of corporate governance that need to be adhered and complied with.<sup>109</sup>

## **2.9. Draft King IV Report on corporate governance for South Africa of 2016**

The King IV has just recently been adopted and is still fresh and in its early stages, it has four objectives which does not represent a significant departure from the philosophical underpinnings of King III, however there has been a refining of the concepts as provided in King III.

The definition of corporate governance in terms of King IV is merely the exercise of ethical and effective leadership by the governing body. King IV provides and emphasizes that ethics are the foundations of and basis of corporate governance. It continues to provide that such leadership includes overarching responsibilities of the governing body which are providing strategic direction, approving policy to put strategy into effect, providing informed oversight of implementation and performance and

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<sup>106</sup> Ibid (note 43) above.

<sup>107</sup> Corporate governance series: King III at a glance September 2009.

<sup>108</sup> Wiese T” Corporate Governance in South Africa” (2015) 1<sup>st</sup> Edition p 231.

<sup>109</sup> King III Report.

disclosing. Through analyzing and interrogating of this draft King IV it is more concerned and addresses ethics as the foundation and source of good corporate governance. It provides that the leadership of the governing body must direct and manage the entity into an accountable, sustainable and responsible one based on ethics. The King IV dwells and deliberates more into the how the future state of the organization will be in order to objectives of the King IV are still marching in the same margins as the King III as it still is promoting good corporate governance in the light of ethical culture, enhancing performance and value-creation by the organization, enabling the governing body to exercise adequate and effective control and building and protecting the trust in the organization and its reputation and legitimacy. The King IV preaches more about setting an ethical behavior which will ensure that all factors of a company are governed by ethics which is a crucial element of good governance.

The draft King IV upon close observance does not entirely differ from the King III.

## **2.10 The principles of Corporate Governance in the public sector.**

The objective of corporate governance rules is to improve the quality of leadership which boards are giving to the business. Corporate governance seeks to assist directors to understand what good governance requires of them.<sup>110</sup> The King III Report<sup>111</sup> on corporate governance in South Africa places them as it places South Africa on the forefront of governance internationally. Good governance involves fairness, accountability, responsibility and transparency on the foundation of intellectual honesty. This Protocol was accepted by Cabinet in 2003 and all public entities have been informed that they must comply with the principles contained therein. It is a code of conduct similar to the King Report on corporate governance and has not been legislated. It encapsulates the King II Report and aligns corporate governance principles to the PFMA, while striving to maintain the independence of SOE's. The government as

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<sup>110</sup> Bowman Gilfillan, Quick guide to corporate governance and King III (2010) 4.

<sup>111</sup> This report follows the "apply or explain" approach and this approach applies to all entities regardless of the manner and form of incorporation or establishment whether in the public, private sectors or non-profit organizations.

the major shareholder in SOE's is exposed to a wide range of risks associated with the operations of SOE's, which are either financial, reputation, political and operational risks.

It is thus the responsibility of each executive authority to ensure that these risks are identified, reduced and managed. SOE's must report and account their financial and non-financial performance to the executive authority, while maintaining independence in the conduct of their duties free from day-to-day involvement by the executive authority. The purpose of this protocol is to guide this relationship and the guiding principles are:

- (a) The Executive Authority should exercise policy control over the SOE's consistent with their accountability to Parliament and the public;
- (b) The Executive Authority should set clear objectives for SOE's
- (c) Any social service obligations that a SOE is to undertake should generally be specified through a Shareholder's Compact; and
- (d) The directors of a SOE should ensure the development of business strategies, policies and procedures and monitor management in the implementation thereof.<sup>112</sup>

## **2.11. Treasury Regulations.**

This regulations applies to all public entities listed in Schedule 2 of the PFMA, they cover a vast scope and requirements of what a public entity such as SAA needs to do in order to be in line with the regulations. The Treasury regulations issued in terms of section 76 of the PFMA provides for the implementation of good corporate governance practices in all public entities through the applications of part 9 of the regulations. This Act like the PFMA encompasses financial accountability and responsibility, it deals extensively with appointment of auditors, how they should function and operate as well form part of the system of SOE'S, It further on caters for the manner in which loans,

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<sup>112</sup> Du Toit H "G& O Presidency Discussion paper: Governance Oversight role state owned entities (SOE)" 2012 p 6.

loan guarantees can be issued and how SOE's should always maintain sustainability of the entity.

Treasury Regulations need to be adhered to at all times as they are based on National Treasury which is the body that deals with all financial management of government institutions which relate also to SOE's as they are entities owned and controlled by Government as its main shareholder.<sup>113</sup>

## **2.12. Broad Based Black Economic Empowerment.**

The BBBEE<sup>114</sup> Act is an Economic Empowerment initiated by the South African government in response to criticism against narrow based empowerment instituted in the country during 2003/2004.<sup>115</sup> While narrow based black empowerment led to the enrichment of a few previously disadvantaged individuals,<sup>116</sup> the goal of broad-based empowerment is to distribute wealth across a broad spectrum of previously disadvantaged South African society as much as possible. This Act<sup>117</sup> as amended is the principal legislation in South Africa with regard to BBBEE and it makes it obligatory for all government bodies and public entities to apply the generic BBBEE code of good practice.<sup>118</sup> SAA as one of the public entities that has shown non-compliance with regard to this Act regardless of it being the core in black empowerment as currently their statistics reveal that in 2012, 85% of SAA pilots are white, of which 7.6% are white females," the airline said in a statement, "This means that only 15% of SAA pilots are black, i.e. Africans, Colored's (mixed race people) and Indians. This clearly and loudly

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<sup>113</sup> National Treasury provides for guidelines in to how funds provided to government must be utilised and accounted for.

<sup>114</sup> Broad Based Black Empowerment is a socio-economic process that directly contributes to the economic transformation of South Africa by increasing the number of black people that manage, own and control the country's economy and diminishing income inequalities.

<sup>115</sup> The Broad Based Black Empowerment is a product of the Reconstruction and Development Programme (RDP) which sought to provide in order to rid of the inequalities caused by the previous apartheid regime.

<sup>116</sup> Africans, Coloureds and Asians/Indians.

<sup>117</sup> Broad Based Black Economic Empowerment Act 46 of 2013.

<sup>118</sup> [http:// www.enterprisesupplierdevelopment.co.za/unpacking-the-new-bbbee-act/](http://www.enterprisesupplierdevelopment.co.za/unpacking-the-new-bbbee-act/) assessed on 21 July 2015.

emphasizes the need for SAA to align this intervention to its transformation strategy." According to the 2011 census, whites make up 9.2% of South Africa's population<sup>119</sup> and in 2013 statistics still revealed that 793 pilots are currently employed at South African Airways (SAA), only 70 (8 percent) are female, of the 214 pilots employed at South African Express (SAX) only (21), 10 percent are cadets, compared to 181 male cadets, of which 48 successfully completed training, compared to 118 male cadets that also successfully completed training. The vision of a balanced society could never be attained if the country's interventions continued to entrench inequality.

"The relative absence of women in key sectors of aviation results from a deliberate act to keep out women from the sector. Government is giving us all the broad opportunities to be champions in aviation. We do not have any excuses to fail. "Gate-keeping practice belongs in the past. These have no place in aviation today. Equitable empowerment of women and blacks in aviation and aerospace is paramount, and we are not apologetic about it."<sup>120</sup> Something is clearly wrong at SAA, and something clearly needs to be done to remedy this. SAA's annual Turnaround Strategies addresses the crucial need to recruitment more black and women pilots in order to meet the required demographics however it seems such is just lip service as there has not been much change to this far.<sup>121</sup>

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<sup>119</sup> Ibid (note 16) above.

<sup>120</sup> Gabara N "Transformation in aviation still a major challenge" The South African Government Agency Newson 08 August 2014.

<sup>121</sup> Priscilla Themba, "South African Government Parliamentary Committee on Labour and Public Enterprise, Parliament concerned over lack of transformation at South African Airways" 19 February 2014.

## CHAPTER THREE: THE PRINCIPLES OF CORPORATE GOVERNANCE.

### 3.1. Introduction.

Corporate governance is defined as the system by which companies are directed and controlled.<sup>122</sup> It has its foundation in effective and ethical leadership<sup>123</sup> and relates to the principles and practices that are regarded as appropriate conduct by directors and managers.<sup>124</sup> It is also defined as a system by which organizations are directed and controlled,<sup>125</sup> this definition includes the sets of policies and the procedures that need to be followed by management and other stakeholders to assist the organization in achieving its goals<sup>126</sup> and not just only reaching its goals but being a good corporate citizen .

The function of corporate governance practices is essentially nothing more than a performance management system to ascertain whether the directors have discharged their duties and to assist them in the discharge of their duties. This essentially is about and relates to effective responsible leadership. Responsible ethical leadership is characterized by the ethical values of responsibility, accountability, fairness and transparency.

Globally corporate governance, risk mitigation and compliance have emerged as a discipline that needs to be understood thoroughly and effectively implemented by an organization to enable the achievement of its strategic direction optimally and to guide operational conduct. Failing to integrate good governance practices into an organization's strategy and structure is certainly grounds for disaster.<sup>127</sup> That is the reason we see the huge failure of SOE's in South Africa, this is due to the lack of integrating and applying good governance principles that govern and assist to guide the strategy of the entity making it a sustainable and productive one.

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<sup>122</sup> Defined in terms of the Cadbury Report 1992.

<sup>123</sup> King IV Report on Corporate Governance for South Africa, 2016 3.

<sup>124</sup> Cassim FHI, Cassim MF, Cassim R, et al Contemporary Company Law (2013) 473.

<sup>125</sup> As defined by the Organisation for Economic Cooperation and Development (OECD) of 1999 & 2004.

<sup>126</sup> Moloi T "Assessing Corporate Governance disclosures in South Africa's national government departments: The state and Corporate Governance SAJAAR 17(1) 2015 (3).

<sup>127</sup> Booyesen T, South Africa in the global context, Enterprise Risk April 2010 p 1 – 2.

The philosophy of King III revolves around leadership, sustainability and corporate citizenship; Leadership entails essentially effective direction and guidance of which is characterized by the ethical values of responsibility, accountability, fairness and transparency. Responsible leaders direct company strategies and operations with a view to achieve sustainable, economic, social and environmental performance,<sup>128</sup> they shape the future by making things happen and ensuring that they provide and cater for the next generation.

Sustainability<sup>129</sup> however encompasses that business, society and nature are interconnected in complex ways and sustainability of the company should be the primary moral and economic imperative, It is crucial and of great importance to ensure that a company remains sustainable in its operation as this is also one of the other factor that will ensure the success of the company; It is a pattern of resources that aims to meet immediate needs whilst preserving the environment so that these needs can be met not only in the present but also for future generations to come.<sup>130</sup> Sustainability seeks to encourage companies to take an appropriate long term perspective.<sup>131</sup>

Corporate citizenship merely provides that companies as legal persons should operate as persons in order to ensure sustainability and responsibility; this entails that for a company which is a corporate citizen should be responsible in the community that it serves or services in order to ensure its sustainability. A company being a corporate citizen basically means that it needs to fulfil its obligations to the broader society within which it operates.<sup>132</sup> In order for a company to be a good corporate citizen it needs to resemble characteristics of ethics, accountability, good governance, employment practices, community involvement and environment protection. Corporate citizenship has ensured that companies ensure they strike a balance between the needs of

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<sup>128</sup> Bowman Gilfilian, Quick guide to Corporate Governance and King III.

<sup>129</sup> Ramani Naidoo "Corporate Governance: An Essential Guide for South African Companies" (2009) 2<sup>nd</sup> Edition p 221; also defined by the 1987 Brundtland Commission Report as business development that meets the needs of the present without compromising the ability of future generation to meet their own needs.

<sup>130</sup> Ibid (note 84) above.

<sup>131</sup> IODSA, King Code of governance for South Africa 2009 p 10.

<sup>132</sup> Ibid (note 84) above.

organizational prosperity, the human needs associated with the company's business and the needs of the environment.<sup>133</sup>

The King III is inclusive and focuses on the good corporate governance principles in which each is regarded as important.

## **3.2. The Principles of Corporate Governance.**

### **3.2.1. Principle 1: Ethical Leadership and Corporate Citizenship.**

Ethical Leadership basically presupposes responsible leadership of the company taking into consideration ethics and moral therefore meaning that every company should have and be governed by ethics.<sup>134</sup> It implies that ethical leader(s) need to take regard of ethics between the company and the society in which it operates. Ethics and integrity is the foundation of and very reason of corporate governance.<sup>135</sup>

The notion of corporate citizenship is not new, but King III gives it more credence and concrete expression than ever before, while continually highlighting the unbroken chain that links ethical leadership, company strategy and sustainability. Ethical leadership presupposes that leaders or the board should be ethical in making decisions that affect the entity.<sup>136</sup> In acting ethically they need to practice "ubuntu"<sup>137</sup> or compassion as widely known, the policies of the institution should also ensure that they have policies and guidelines addressing this issues. Ubuntu is and has been developed to be a key principle underpinning good corporate governance.<sup>138</sup> Put clearly, good corporate governance is based on a clear code of ethical behavior and personal integrity

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<sup>133</sup> John Elkington "Cannibals with Forks: The triple bottom line of the 21<sup>st</sup> Century", 1997 p 8.

<sup>134</sup> Katarina Mihelie, Bogan Lipienik and Metk Tekavoic, "Ethical Leadership" International Journal of Management and information Systems; fourth Quarter 2014, Vol 5 p 31.

<sup>135</sup> King III Report at 20 paragraph 9.

<sup>136</sup> G20/OECD Principles of Corporate Governance, September 2015.

<sup>137</sup> Umuntu ngumuntu nga bantu which means compassion that one feels for the next person in that we do not exist alone we exist due to other people and we need to take in consideration their feelings when taking decisions that affect them. See also the case of SABC V Mpofu (2009) 4 All SA 169 (GSJ).

<sup>138</sup> TI Nzimakwe, "Practising Ubuntu and Leadership for Corporate Governance: The South African and Continental Dialogue", African Journal of Public Affairs, Volume 7 (4) December 2014 p 30-31.

exercised by the board,<sup>139</sup> where communications are shared openly. There are no opportunities in this environment for cloaks and daggers.

There must be ethical behavior in the exercise of dealings with fellow board members. These dealings must be dealt with in such a manner so as to ensure due process and sensitivity.<sup>140</sup> Sachs J said: “Ubuntu-botho is more than a phrase to be invoked from time to time to add a gracious and affirmative gloss to a legal finding already arrived at. It is intrinsic to and constitutive of our constitutional culture.”<sup>141</sup>

### **3.2.2. Principle 2: Boards and Directors.**

Boards and Directors are compulsory factor acting in the best interest of the company; they form the focal point of corporate governance with responsibilities extending to shareholders and other stakeholder’s. Companies should be headed by a board that directs, govern and be in effective control of the company. There are key governance responsibilities that directors are expected to consider which includes the role and function of the board and its committees, the composition and performance evaluation of the board and its committees, the board appointment process, director development and remuneration of directors, senior executives and group boards and company secretaries; this simply means that a company should have a board which as an oversight body and which should be strategically positioned with appropriate qualified and experienced individuals in appropriate positions,<sup>142</sup> this composition should include a majority of Non-Executive directors and a minimum of Executive directors.

The board in its entirety is the principal focal point of good corporate governance and in the other hand the directors have to exercise the utmost good faith, honesty and integrity<sup>143</sup> in all their dealings with or on behalf of the institution and always act in its

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<sup>139</sup> South African Broadcasting Corporation (SABC) and Others v The Democratic Alliance and Others [2015] ZA SCA 156.

<sup>140</sup> SABC V Mpofu (2009) 4 All SA 169 (GSJ) paragraph 64.

<sup>141</sup> Dikoko v Mokhatla 2006 (6) SA 235.

<sup>142</sup> Vodacom online report, Code of governance principles (King III) 2013.

<sup>143</sup> Section 76(4) of the Companies Act 73 of 2008.

best interests; The Court provided in the case of *SABC v Mpofo* that matters of confidential nature should be treated as such and not be divulged to anyone without the authority of the entity.<sup>144</sup> The board is the most central core of good governance for a company as it is responsible for ensuring success or failure of a company, and this entails the board to strategically align the company to ensure that it meets its goal and remains sustainable in its business.

The board of SAA has shown less interest in the fact that the airline is not doing too good financially as instead of being profitable it is however instead placing more strain on the government as it continues to request loan guarantees from government on which they remain unpaid as the entity makes losses instead of gains; this basically means that the board is not diligently exercising their fiduciary duties towards the state owned airline.

SAA has shown poor authority with regard to its executive director (Chief Executive Officer) it has failed as the entity to retain CEO's as the entity is being directed by an acting CEO's and this has been the practice for the past few years. This however does not paint the entity very well as there is no permanent responsible CEO directing the entity as it is only being subjected to acting CEO's.

### **3.2.3. Principle 3: Audit Committees**

The Board should ensure that there is an effective and independent audit committee appointed by shareholders at the Annual General meeting. The audit committee should be suitably qualified, skilled and experienced in order to fulfill a vital role in corporate governance, it should consist atleast three independent non-executive directors. The audit committee is vital to, among other things, ensure the integrity of integrated reporting and internal financial controls and identify and manage financial, IT and fraud risks.

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<sup>144</sup> (2009) 4 All SA 169 (GSJ).

In order to carry their mandate in full extent, audit committees should be suitably qualified to deal with their responsibilities of overseeing integrated reporting and coordinating the activities of the various assurance providers. Section 76(4) (d) and section 77 of the Public Finance Management Act.<sup>145</sup> The Audit Committee of every company should be a very proactive and dedicated committee which addresses one of the most pivotal functions of any company; it ensures the company reports on its businesses including shortfalls; it ensures that the internal controls of the company are effective and that risks either financial, technologically, fraud or administrative are effectively managed and controlled to prevent future occurrence.<sup>146</sup>

#### **3.2.4. Principle 4: The governance of risk**

The essential focus of the code is that the board should exercise leadership to prevent and manage risk from becoming a series of activities that are detached from the realities of the company's business." In this context, risk assessment and management are a common theme of corporate governance<sup>147</sup> and risk governance is substantially different to the requirement to implement risk management. Greater emphasis is placed on the board to ensure that it is satisfied with the management of risk through the frameworks and methodologies implemented to increase the probability of anticipating unpredicted risks.

The PFMA<sup>148</sup> makes risk management and responsibility of the organization's accounting officer<sup>149</sup> and they should have a policy and plan for a system and process of risk management; they also need to comment in the effectiveness of the system and process of risk management. The accounting officer should ensure that the company has policies, guidelines, procedures and processes in place that deals with detecting of

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<sup>145</sup> Act 1 of 1999.

<sup>146</sup> King III Report.

<sup>147</sup> Alan Calder, "Corporate Governance: A Practical Guide to the Legal Frameworks and International codes of Practice", Kogan Page, 2008 p 97.

<sup>148</sup> In section 38 (a) (i).

<sup>149</sup> Ibid note 58 above.

risks and measures on what steps should be taken in order to manage such risk and prevent it from continuous perpetuation.

### **3.2.5. Principle 5: The governance of Information Technology.**

Information Technology is largely described as the application of computers and internet to store, retrieve, transmit, and manipulate data, or any information often in the context of a business or other enterprise.<sup>150</sup> As information technology becomes an increasingly vital tool for businesses worldwide, the demand for use of IT continues to increase.<sup>151</sup>

The King III also recognizes that information technology (IT) has become an integral part of doing business today, as it is fundamental to the support, sustainability and growth of the organizations. Most communications, data storage as well as business creations are being done over the technology platform as it simplifies and expedites things. It cuts across all aspects, components and processes in business and is therefore not only an operational enabler for a company, but an important strategic assets which can be leveraged to create opportunities and to gain competitive advantage; as well as being a strategic assets to the company, IT also presents organizations with significant risks.

The strategic asset of IT and its related risks and constraints should be well governed and controlled to ensure that IT supports the strategic objectives of the organization. King III stipulates that in exercising their duty of care, directors should ensure that prudent and reasonable steps have been taken with respect to IT governance;<sup>152</sup> meaning that IT governance is the responsibility of the accounting officer, and this should be reported in the annual report<sup>153</sup> and furthermore it is the duty of the accounting officer to ensure that the institution has and maintains effective, efficient,

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<sup>150</sup> Osman Hasan, "Corporate Governance of Information Technology", published January 18 , 2015.

<sup>151</sup><http://www.floridatechonline.co.za> assessed on 14 March 2016.

<sup>152</sup> Vincent Tophoff "International Federation of Accountants, Revision of the OECD Corporate governance principles" 2013.

<sup>153</sup> Treasury Regulation no 5.2 of 2015.

and transparent systems of financial, risk management, and internal controls.<sup>154</sup> The IT platform has spread over to a large spectrum where there are a lot of users and abusers hence it is crucial based on the vast users of this platform to ensure management and preventative possibility of risk regarding important company data.

### **3.2.6. Principle 6: Compliance with all laws, rules and standards.**

Companies must comply with all applicable laws. Laws should be understood not only in terms of the obligations that they create, but also for the rights and protection that they afford. The board is responsible for the company's compliance with applicable laws and with those non-binding rules, codes and standards with which the company has elected to comply. One of the most important responsibilities of the board is to monitor the companies' compliance with the applicable laws, rules, codes and standards. Compliance to all applicable laws and legislations relates to not just its founding legislation or Act but it encompasses all legislations, policies that addresses and speak to any item relating to the company, its functions and governance.

For the past three years there has been non-compliance with the PFMA<sup>155</sup> and this has also been a major challenge facing SAA as a state owned entity; SAA has seen a continuous decline in PFMA non-compliance over the past three years.<sup>156</sup> In the year under review declines of 14.21 percent in irregular spend and 3.5 percent on losses due to fruitless and wasteful expenditure were further noted. This Act governs the management of finances in departments, parliament, provincial legislatures as well as public entities such as SAA. The Act states that all public entities listed in schedule 2 or 3, which is subject to change by the Minister, must appoint a person or body who will be held accountable for the purposes of this Act; the accounting authority in this instance

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<sup>154</sup> See section 38(1)(a) of the Public Finance Management Act 1 of 1999.

<sup>155</sup> Act 1 of 1999, This Act regulates the management of finances in national and provincial government. It sets out the procedures for efficient and effective management of all revenue, assets and liabilities. It establishes the duties and responsibilities of government officials in charge of finances. The Act aims to secure transparency, accountability and sound financial a management in government and public institutions.

<sup>156</sup> As reported by the Acting CEO, Mr. Nico Bezuindenhout in the 2013 Annual Audit report.

may either be a board or other controlling body or a CEO who must protect the assets and records of the public entity must do everything possible to prevent damaging the interests of the state;<sup>157</sup> this very same accounting officer must always act with fidelity, honesty, integrity and in the best interests of the entity. The Act further specifically and expressly states that the accounting authority of a public entity must keep full and proper financial records of the affairs of the company and must submit statements for auditing, either to the Auditor-General or by a registered external auditor. An annual report, fairly representing the state of affairs of the entity, must also be submitted to the executive authority.<sup>158</sup>

It is surprising how an entity governed by a specific Act fails to comply with the very same provisions that govern and apply to it, thus this means that SAA is not in compliance with the very same laws that is meant to govern it. It is quite unexpected for an entity which its governing laws provide that a board, CEO or controlling body should be accountable for the affairs of the entity and ensure interests of the shareholder are protected. With regard to SAA this entire controlling body is in place, it has both the board and CEO to ensure all the affairs and interests of the institution are protected hence it is disappointing to see this very same airline with so many controlling bodies still failing to protect the interests of the company and failing to make profit.

### **3.2.7. Principle 7: Internal Audit**

Internal Audit is basically concerned with evaluating and improving the effectiveness of risk management, control and governance processes in a company,<sup>159</sup> it helps the company accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.<sup>160</sup> King III effectively dispensed the notion of compliance-based, cynical auditing and embraced risk-based auditing. As this approach has matured over time,

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<sup>157</sup> Ibid (note 85) above.

<sup>158</sup> Section 55(1) (2) of Public Finance Management Act 1 of 1999.

<sup>159</sup> The Institute of Internal Auditors in South Africa at <http://www.iiasa.org.za/>.

<sup>160</sup> Ibid (note 158) above.

the imperative to appropriately position risk-based auditing is a central focus of King III. The repositioned risk-based approach directs internal audits to address strategic, operational, and financial and sustainability issues in its quest to deliver value to the company.

Value is now seen to vest in the relevance of a function. As such, the head of an internal audit needs to understand the organization's strategy and to direct the function accordingly. Governance is underpinned by an acceptance of accountability and responsibility of an action. Accordingly the chief audit executive is required to provide an annual assessment of an organization's control environment. This reflects the congruence of the introspection from internal audit fraternity and the call for improved governance in general and highlighting calls for internal audit to rise and deliver on its contribution to effective governance. The other important function the internal audit has to carry is to ensure integrated reporting of the company; that it reports holistically on its functions and business including losses as well.

### **3.2.8. Principle 8: Governing Stakeholder Relationships**

The stakeholder inclusive approach to corporate governance is not a new concept in the King reports and effective stakeholder engagement is recognized as essential to good corporate governance.<sup>161</sup> The days when boards could merely pay lip service to concerns such as corporate responsibility, ethical business practices and sustainability are over.<sup>162</sup> Stakeholder relationships provide a platform for the board to take into account the concerns and objectives of the company's stakeholder in its decision making, which is fundamental to the process of integrated reporting.<sup>163</sup>

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<sup>161</sup> This principle was brought about by the introduction of the triple bottom line approach from the single bottom line approach.

<sup>162</sup> B Fryzel, "Building Stakeholder Relations and Corporate Social Responsibility", Palgrave Macmillan 2011, p 126.

<sup>163</sup> Bob Tricker, Corporate Governance Principles, Policies and Practices third edition, Oxford University Press 2015.

### 3.2.9. Principle 9: Integrated Reporting and Disclosures.

Integrated Reporting and disclosure is set to become the way companies around the world report their performance. The aim of the integrated report is to clearly and concisely tell the story of the company, who it is and what it does and how it creates value, its strategy, opportunities and risks, its business model and governance, and the performance against its strategic objectives in a way that gives stakeholders a holistic view of the company and its future.<sup>164</sup> This kind of reporting is the holistic and integrated representation of the company's performance in terms of both its finance and sustainability.

The board should ensure that appropriate systems and processes are put in place in order to produce a report to stakeholders that give a complete picture of a company's financial and non-financial profiles in such a way that the report is transparent and reliable. In order to comply with the recommendations of the code reporting should be integrated across all areas of performance reflecting the choices made in the strategic decisions adopted by the board, and should include reporting in the triple context of economic, social and environmental issues.<sup>165</sup>

The board should be able to report forward –looking information that will enable stakeholders to make a more informed assessment of the economic value of the company as opposed to its book value.<sup>166</sup> Integrated reporting and disclosure is a means to foster stakeholder relations, annual reports have been justified on the grounds that they are the most important stakeholder documents produced by an organization on an annual basis. Any organization committed to promoting and maintaining corporate governance is expected to use its annual reports to communicate progress with stakeholders and public in general.<sup>167</sup> The Integrated report details in full how the company has performed both positively and negatively; it should also provide a report

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<sup>164</sup> The South African Institute of Chartered Accountants (SAICA) at <https://www.saica.co.za> (assessed on the 19<sup>th</sup> March 2016).

<sup>165</sup> Draft King IV Report of 2016.

<sup>166</sup> PWC, Corporate Governance – King III report, Steering Point Publication 2011.

<sup>167</sup> Ibid (note 82) above.

on how the board believes that in the incoming year it can improve the positive aspects and eradicate the negative ones.

SAA provides for integrated reports annually and subsequent to this reports, it always provides for turnaround strategies year in and year out. These strategies have been labelled to change the airline into a profit making however all the turnaround strategies have proved to be fruitless as the airline continues to be profitless and government bails it out from its sinking ship.

All the above discussed principles are and is the duty of the Board to ensure that everything is effectively achieved as they are the focal point of corporate governance and are accountable and responsible for the success of the company.

## **CHAPTER FOUR: A COMPARATIVE STUDY.**

### **4.1 South African Airways.**

South African Airways in partnership with SA Express, SA Airlink and its low cost carrier, Mango is the national flag carrier and largest airline in South Africa,<sup>168</sup> it is wholly owned by the government as the latter is its only shareholder. This airline has existed over 80 years and is well known as the pride of the country and of Africa by flying high the flag of South Africa. As popularly known SAA is the largest state owned airline in South Africa; it controls 26% of intra-African market followed by Kenya Airways, EgyptAir and Ethiopian Airline with 6% each. This airline has been profitless for the past eight years and regardless of this it has continued to exist and operate as money has been pumped in year after year in order to keep the airline alive.<sup>169</sup> SAA ownership vests on one owner which is the government as its only shareholder which was represented by Department of Public Enterprise but currently National Treasury is the lead. The government as the only shareholder is the only body or authority that is vested with power and authority to decide how and what needs to be done with the airline hence the reason they decide to pump it up with millions and billions even though it is a poorly financially performing entity.

### **4.2 Kenya Airways**

Kenya Airways traces its roots back to 1946 with the formation of the East African Corporation (EAA). Initially, EAA had a good reputation for service and reliability but with the formation of East African community, EAA passed into the joint ownership of the government of Kenya, Tanzania and Uganda. Shortly after the collapse of East African Community in 1976, EAA was placed in liquidation and Kenya Airways was incorporated in January 1977 as a company wholly owned by the Kenyan government

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<sup>168</sup> Op Cit Page 4.

<sup>169</sup> Bronstein V & Olivier M, As Evaluation of the Regulatory Framework governing State Owned Enterprises (SOEs) in the Republic of South Africa (2013) 3.

and it was then established as the national flag carrier of Kenya and acquired certain of the assets and staff of EAA.<sup>170</sup>

This airline still remains the flag carrier of Kenya; it was wholly owned by the government of Kenya until April 1995 wherein it was privatized in 1996 becoming the first flag carrier to successfully do so in Africa. It is the leading operator in domestic routes and it is currently a public-private partnership;<sup>171</sup> its largest shareholder is the government with 29, 8%, KLM with 26, 7% and the rest of the shares are held by private owners. Its shares are traded on Nairobi stock exchange, Dar se Salaam stock exchange and Uganda Security exchange.

Kenya Airways is widely considered as one of the leading sub Saharan operators from January 2013 and rated 4<sup>th</sup> amongst 10 operating in Africa.<sup>172</sup> In 1986, Sessional Paper number 1 was published by government of Kenya outlining government's need for economic development and growth; the document stressed the government's opinion that the airline would be better off if owned by private interests thus resulting in first attempts to privatize the airline.

In 1992, the public enterprise reform paper was published giving Kenya Airways priority among national companies in Kenya to be privatized. Kenya Airways which was privatized over 20 years ago has been profitable for years and contributed to growth in their respective tourism sectors.<sup>173</sup>

This airline as a private-public owned airline has shown to be a success over the past years ever since it was privatized, it has shown a lot of development with it making profit and refraining from government bail-outs. Privatization of this airline has also improved is corporate governance and positioned the airline in a competitive position. The sale of a major state-owned asset is usually a highly charged political event, and the two year process by which 77% of the shares of Kenya Airways were sold to a broad array of

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<sup>170</sup> <http://www.galbithink.org/topics/ka/profile> assessed on 24 July 2015.

<sup>171</sup> Owned by both government and private owners.

<sup>172</sup> <http://www.wikipedia.org/wiki/kenyaairways> assessed on 09 July 2015.

<sup>173</sup> Lawrence D, Some reasons for privatizing national airlines <http://blogsworldbank.org.PSA> 26 July 2012 assessed on 09 July 2015.

private investors.<sup>174</sup> The leadership is crucial in success of any company. It is the responsibility of leaders in an organization to ensure that employees are focused towards the goals of the organization.

Good leadership is measured by the ability to enable or lead the employee to attain the firm's goals at the same time. Previously the airline saw and experienced its decline due to lack of good governance as its board was constituted by mainly political appointees with no specific experience either in managing a business, in general or an airline in particular; this airline also lacked clear strategic direction and to top it all was sliding into bankruptcy as the government had to bail it out of its debts, it was thus resolved that the only way to improve performance of the airline was through commercializing and privatizing it. Kenya Airways is currently owned and managed by both government and private entities this thus means that there is a difference in ownership and control making it more functional and profitable as it is not hampered by political interferences that care less of sustainability, transparency and accountability.<sup>175</sup> Kenya's recent management ensures that it is a viable, flourishing and a lucrative African state owned entity.

### **4.3. Factors to take in account in compares' of the two airlines:**

#### **4.3.1. Oversight and Governance.**

With South African Airways its governance is vested in the board which is tasked with ensuring governance framework operating across a company however as a state owned company operating in a strictly regulated industry, the SAA board is committed to operating with the outermost transparency and higher levels of governance and accountability to the Shareholder. This board further on plays a vital role in ensuring that SAA meets its developmental obligations, while adhering to the strictest standards and operating in a manner that not only benefits the society which the company serves but

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<sup>174</sup> Kenya Airways: A case Study in Privatization [www.galbithink.org/topics/ka](http://www.galbithink.org/topics/ka) assessed on 25 July 2015.

<sup>175</sup> Essays, UK, A case study of Kenya Airways Tourism Essay November 2013.

also serves the Shareholder's interest.<sup>176</sup> Oversight and governance lies on the board it ensures that there are well-established governance structures in place. This means that with regard to SAA, both oversight and governance of the entity is placed on the same body meaning there is no separation of duties regarding oversight and governance.

The case is different with Kenya Airways as a public-private entity as oversight and governance lies in two different bodies; oversight in this instance is vested in shareholders whilst governance is vested on the Board of Directors who are strategically appointed to successfully carry the entity; this is a different approach with strictly 100% owned SOE's as both governance and oversight lies with the government which is also vested with the same power and authority to govern the institution.<sup>177</sup>

#### **4.3.2. Profits**

Profit is described as a financial benefit that is realized when the amount of revenue gained from a business activity exceeds the expenses, costs and taxes needed to sustain the activity.<sup>178</sup> SOE's are profit-making business and they need to make and report profits, annually SOE's are entitled to provide a report regarding its businesses, operations of the institution, its financials as well as changes; it is in this report that they provide their profits or losses of the institution.

Prior to 1996, Kenya Airways reported losses year in and year out however after it was privatized the status changed as it became a profit making business reporting profits in millions and billions. Ethiopian Airline in the other hand also suffered vast losses in profits due to poor corporate governance and lack of strategic direction however currently all this has changed when its governance was changed; this had a great positive impact on the entity as it reported profits made.

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<sup>176</sup> South African Airways Group Integrated Annual Report 2014 13.

<sup>177</sup> Mwaura K, The Failure of Corporate Governance in State Owned Enterprises and the need for Restructured Governance in Fully and Partially Privatized Enterprises: The case study of Kenya, Fordham International Law Journal (2007) volume 31, Issue 1.

<sup>178</sup> Defined in terms of Investopedia online dictionary.

The case is however different with SAA as they are reporting losses and not profit made. No strict measures are being taken by the shareholder when losses are reported as it is the only benefactor hence that is the reason no strict steps have been taken to ensure change in its poor performance.

#### **4.3.3 Board of Directors**

SAA has a board that consists of both Executive and Non-Executive board members as required by legislation however the challenge with regard to the board members is that they are appointed through the cadre Deployment policy which therefore sees the board being consisted by unexperienced and unskilled board who do not further the interests of the company but political interests of those that appointed them into position. This plays a very major role in disable the entity as the very same people who are placed in a position to ensure sustainability and success of the company they serve are not fulfilling their roles.

Kenya Airways on the other hand has a board of Directors constituted of experienced and skilled individuals who are ensuring that they further the interests and goals of the entity by making it a successful one. The private shareholders of Kenya airways will not permit politically appointed individuals to sit in their board and not further the interests and goals of the airways but that of their appointees.

#### **4.3.4 Conclusion**

There seem to be a lot of similarities with regard to all this airlines; Both airlines have and of which SAA is still 100% strictly owned by government. Kenya Airways was once 100% owned by government and it was clear that it was failing in its business hence it privatized a certain percentage of its shares. Both these airlines have each at some point depended or implemented turnaround strategies; SAA with its popular LTTS which commenced in 2013 plus action plans which have existed for the past 17 years. Kenya Airways as well launched its own turnaround strategies in 2013 is a clear indication that all state owned entities are susceptible to bankruptcy if unmanaged appropriately and

inefficiently and they can be a burden to taxpayers as they will be continue to suffer as they continue to be bailed out year in and year out in pursuit to stabilize and sustain it from sinking. With all this similarities amongst the airlines it crucial that they learn from each other; SAA needs to learn and taking tips from these two airlines on how it can effectively improve its own, apply good corporate governance principles and ensure transparency, sustainability, accountability and responsibility of this airline.

## CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS

The South African SOE's were previously regulated by two different legislations, which is the then Companies Act<sup>179</sup> and the previous Companies Act<sup>180</sup> however they are currently regulated by the new Companies Act.<sup>181</sup> Prior to the new Companies Act coming into effect, the government of South Africa in 1999 introduced a restructuring policy framework known as the Accelerated agenda towards the restructuring of the State Owned Enterprises.<sup>182</sup> This policy framework was designed to enable government to co-ordinate thinking on how to restrict and contain the excesses of SOE's. It also aimed at improving corporate governance and ensuring ethics and probity.

The other important legal framework is the King Code of Governance Principles (the Code) and the King Report on Governance for South Africa (King III) which was published on 1 September 2009 and became effective on 1 March 2010 (King 2010). It is therefore important to note that all these reports, King I, King II, and King III and the draft King IV of 2016 are all aimed at promoting good corporate governance in South Africa. However, King III report on corporate governance became necessary because of the new Companies Act no 71 of 2008 and changes made in international governance trends. Now the King III boldly declared that it applies to all entities regardless of the manner and form of incorporation or establishment, whether in the public, private sectors or non-profit.<sup>183</sup>

The Companies Act<sup>184</sup> being the driver of good corporate governance in South Africa was signed by the President on 8 April 2009 and gazetted in Gazette No. 32121 (Notice No. 421). This Act replaces the Companies Act 61 of 1973 and came into effect on 1 May 2011. Section 34(1) of Companies Act<sup>185</sup> provides that "In addition to complying with the requirements of this Part, a public company or SOE must also comply with

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<sup>179</sup> Act 46 of 1926.

<sup>180</sup> Act 61 of 1973.

<sup>181</sup> Act 71 of 2008.

<sup>182</sup> David Parker, David S. Saal, International Handbook on Privatization, Aston Business School, University of UK 1949 p 302.

<sup>183</sup> OECD guidelines on Corporate Governance of SOEs (2005).

<sup>184</sup> Act 71 of 2008.

<sup>185</sup> Act 71 of 2008.

extended accountability requirements set out in Chapter 3.” Chapter 3 deals with the enhanced accountability and transparency of companies including the state-owned companies.<sup>186</sup> Corporate governance is based on principles such as conducting business with integrity and fairness, being transparent with regard to all transactions, making all the necessary disclosures and decisions, complying with all the laws of the land, accountability and responsibility towards the stakeholders and commitment to conducting business in an ethical manner.<sup>187</sup>

In South Africa, a day hardly passes without news headlines and reports on mismanagement, maladministration and or financial irregularities in government departments and state owned enterprises. South Africa is said to have more than 300 state owned companies or entities and in general they are categorized as PFMA schedule 1, 2, 3 SOEs. The National Planning Commission states that after the 2004 general elections” government’s attention shifted away from its earlier efforts of privatizing state-owned entities to governing them.<sup>188</sup>

Furthermore SOEs were seen to have an important role to play in efforts to build a developmental state, in this regard SOEs are meant to support the state’s economic strategies by providing infrastructure to business or reducing unequal access to public services<sup>189</sup> hence it is of crucial importance that in order for government to successfully achieve this roles and successfully make profit it needs to rid of its many repeated challenges and problems and start focusing on achieving its main crucial goals rather than continue to dip deep into taxpayers’ pockets in order to salvage and bail out SOEs

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<sup>186</sup> Nevondwe L, Odeku O and Raligilia H, Ethics in the State owned companies in the Public Sector, A thin line between corporate governance and ethical leadership, Mediterranean Journal of Social Sciences (2014) Volume 5 p 663.

<sup>187</sup> Nevondwe L, Odeku K.O and Tshoose C.I, Promoting the application of corporate governance in the public sector.

<sup>188</sup> Overy N, Left in the Dark: Seeking information on Public Financial Transfers to ESKOM and other State-owned entities, International Budget Partnership(IBP), p 2.

<sup>189</sup><http://shadebe.wordpress.com/2012/11/06/inefficiencies-of-stateowned-enterprises-SOEs-accountability-and-wastage>, inefficiencies of state-owned enterprises (SOES), accountability and wastage.

from failing due to non-compliance with corporate governance principles that would ensure accountability, transparency and sustainability.<sup>190</sup>

In spite on the long standing inefficiencies, SAA is still the largest airline in Africa although Kenya Airlines have overtaken it as the best airline in Africa. It accounts for 25% of the total intercontinental capacity offered by African airlines, although that translates to 10% if all foreign carriers are added to the equation.<sup>191</sup>

It is evident as it has been observed from Kenya Airways that when governments sell off shares that they previously owned, there tends to be a tradeoff.<sup>192</sup> On the positive side, the companies generally tend to be run more efficiently. On the bad side yet positive note, the government is no longer able to use the companies to pursue political or social goals however when a company is privatized, it generally comes to be run more efficiently. The company no longer has government backing it up as; it now has to make a profit on its own. This is good for the economy as a whole because the taxpayers' money is no longer being used to prop up a company that is not profitable as it ought to be and the government is no longer able to use that company to try to improve society.

For example, a government might have used its ownership of the airline to ensure that the airline would serve places that could not support air travel on their own; the government might also have used the airline as a source of jobs for people from underprivileged groups. It is imperative for a company or entity to have a reputation for strong and good corporate practices as this attracts investors as when investors are not confident about the level of disclosure capital flows elsewhere.

Good corporate governance is important as it supports effective decision making based on a balanced framework of accountability that is founded on clear communication and

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<sup>190</sup> Gumede W "South African State-Owned Enterprises: Boards, Executives and Recruitment" (unpublished Doctoral Dissertation, University of Witwatersrand (2012) 43.

<sup>191</sup> Jens Flottau, Aviation week network, South African Airways struggles to remain viable 27 May 2013.

<sup>192</sup> Defined by the Online Cambridge Dictionary as a situation in which you accept something bad in order to have something good.

understanding of rules and responsibilities across the entity; with increased national and global competitiveness the growing market is faced with the challenge of attracting and retaining investment in order to participate more fully and actively in the global economy. A good corporate governance image enhances the reputation and makes it more attractive. By privatizing or following the privatization route the government gives up the ability to use the airline in these ways.<sup>193</sup>

SAA can learn a lot from Kenya Airways as well as other semi privately-publicly owned airlines, the latter semi-state owned yet it symbolizes and reports major profits annually, its corporate governance is good as it does encompass sustainability, accountability and transparency. It has plans in place that ensure sustainability for the next 15 years this is a clear reflection of good corporate governance and good strategic leadership in place who strategically plan for the future and ensure good reputation of the airline.

On the other hand by going the privatization route will be a great step for SAA to follow as it will bear fruits and produce profit instead of reporting losses and receiving bailouts from tax payers money; privatization would go a long way as this would also rid of many other challenges, such as removing politicians from the scene and replacing them with professional business managers with strategic goals who will drive and carry the airline into greater heights.

## **Recommendations**

South African Airways had been the best airline in Africa and was accounting for profits however things have recently changed in the past years due to poor governance and non-compliance of laws, rules and norms. This entity can still restore its place and position and continue to account for profits. SAA should follow suit as Kenya Airways has done and commercialize as well as privatize its airline by providing atleast a certain percentage of its slice to private owners but ensuring that it still remains the major

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<sup>193</sup> OECD, enhancing the role of Board of Directors in State Owned Enterprises: OECD Corporate governance working paper No 2, OECD Publications, Paris 2011.

shareholder of this entity. It only offers a smaller percentage of the cake slice and still remain the major shareholder of the airline.

This will save taxpayers from digging deep into their pockets to save the airline and it would also ensure the government does not have conflict of interest in playing both player and referee at all times.<sup>194</sup> If government as shareholder of SAA sells 51% of its slice or shares to private owners there will be immediate turnaround or change as private owners will ensure the entity is profitable in order not to lose that which they put in.

This will also rid of poor management problems as there will no challenges in leadership that is caught up in exercising their duties and in the same hand executing and satisfying political agendas.

The entity has seen the influx in resignation and dismissal of the board of Directors and of Chief Executive Officers; some of this candidates have been dismissed due to incompetence in executing their responsibilities. SAA has seen a frequent change in its management as well as directors, for the past 07 years the airline has changed its CEO's either through, resignations, suspensions and dismissals of which majority of them is caused by financial mismanagement of funds, In most instances, with each serving a period not more than 03 years; this has only been distributed as a means of African airlines failing to groom its leaders. The high turnover of airline CEO's in Africa is because of a failure to develop them into leaders suited for the job.<sup>195</sup>

One other factor that contributes to frequent change in leadership is cadre deployment which places inexperienced, unqualified and unskilled party politicians in strategic executive positions, State Owned entities should rid of this and have qualified competent and experienced individuals filling these positions, this will also improve the management of the entity rather than too concerned on political issues. This should be a crucial and strict requirement when recruiting, selecting and appointing directors and

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<sup>194</sup> Terry Marksman, Air Transport and the challenges for 2010, Southern African Transport Conference 09 – 12 July 2007 372.

<sup>195</sup> The SA Express CEO, Mr. Nyathi Ntshana said at a panel at the Airlines Association of SA annual general meeting held in Mauritius in 2014.

Shareholders should take this strictly and ensure they comply to it for the effectiveness of the institution.

The Board should also be strategically structured by both competent and qualified executive and non-executive directors. Directors that drive the entity into the right direction and that ensure compliance of good corporate governance principles. Directors should be well equipped and experienced in the field in which they will advise.

There should be alignment of state's policies and objectives, as per the King III Report that articulates the "apply and explain" principle, SOEs entity should be obligated to employ good corporate governance to ensure smooth running and functioning of the airline and they should be held to account if they bypass or not comply to the King III Report. Non-compliance of the PFMA and Companies Act is unacceptable<sup>196</sup> and should amount to repercussions when such is continuously repeated by state owned entities.

The Shareholders, the board of directors and the management should be aware of their distinctive roles and duties. There should be a clear separation between control, management and ownership of the entity.

Transformation polices and laws have been in existence to ensure companies and entities comply with them in order to be in line with current legislations and practices. SAA should ensure they employ and are in line with regulations and policies of the country and be in par standard with BBBEE Act by employing and appointing historically disadvantaged persons; this entails that they should ensure that there is an increase in recruitment, appointment and training of women, disabled persons and historically disadvantaged persons as a whole.

Funding through bursaries as well as skill development programmes must be made compulsorily available to these persons in order to fulfill and satisfy the transformation policies and laws of the Republic.

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<sup>196</sup> As reflected on the SAA annual Integrated Report of 2014.

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