

Regulation of the Use of Remuneration Consultants in South Africa: Proposals for Legislative Reform

Ophellia Matobobo*

LLB (cum laude) LLM

*LLD candidate, Department of Mercantile Law
University of South Africa, Pretoria, South Africa*

<https://orcid.org/0009-0000-9682-4474>

Rehana Cassim

*BA (cum laude) LLB (cum laude) LLM (cum laude)
LLD*

*Attorney and Notary Public of the High Court of
South Africa*

*Professor, Department of Mercantile Law
University of South Africa, Pretoria, South Africa*

<https://orcid.org/0000-0001-6179-2361>

Michele Havenga

BA LLB LLM LLD

*Attorney, Conveyancer and Notary Public of the
High Court of South Africa*

*Professor Emeritus, University of South Africa
Pretoria, South Africa*

<https://orcid.org/0000-0002-8487-309X>

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SUMMARY

Over the years, companies have turned to remuneration consultants for guidance on remuneration matters. Their assistance is often sought when companies' remuneration committees lack sufficient time, knowledge or data to decide effectively on executive remuneration. The assistance extends to accounting, tax and legal issues pertaining to executive remuneration. However, problems like potential conflicts of interest for remuneration consultants stem from factors such as the selection process, the duration of their contracts, and the services they provide to the company. A further challenge is benchmarking. Using remuneration consultants may contribute to excessive remuneration of executive directors, which in turn contributes to South Africa's substantial socio-economic problems. Accordingly, the use of remuneration consultants must be strictly regulated in South Africa. This article examines how remuneration consultants are regulated by the Companies Act 71 of 2008, the JSE Limited Listings Requirements, and the King IV Report on Governance for South Africa, 2016. It compares the ways in which remuneration consultants are regulated in the United Kingdom, Australia and the United States of America. This article argues that the use of remuneration consultants is not sufficiently regulated in South Africa, and it makes recommendations to help enhance this regulation.

KEYWORDS: executive remuneration, remuneration consultants, legislative reform, South Africa, legislation

1 INTRODUCTION

Over the past few decades, global executive-director remuneration packages have increased significantly, with remuneration consultants seemingly playing a significant role in this trend.¹ Remuneration consultants offer advice on executive remuneration to companies' boards or remuneration committees seeking such advice.² The consultants suggest structuring the desired amount of remuneration for executive directors, but do not necessarily recommend the actual amount.³ Generally, remuneration consultants are retained either by the board of directors or by the management of the company.⁴ Remuneration consultants are often sought by remuneration committees to aid in effective decision-making on executive

¹ Armstrong, Ittner and Larcker "Corporate Governance, Compensation Consultants, and CEO Pay Levels" 2012 17 *Review of Accounting Studies* 322 322; Kabir and Minhat "Compensation Consultants and CEO Pay" 2014 32 *Research in International Business and Finance* 172 173; Riaz "A Hybrid of State Regulation and Self-Regulation for Remuneration Governance in Australia" 2016 16(3) *Corporate Governance* 539 546.

² See Mongalo "Shareholder Activism in the United Kingdom Highlights the Failure of Remuneration Committees: Lessons for South Africa" 2003 120(4) *SALJ* 756 762; Van Zyl and Mans-Kemp "A Multi-Stakeholder View on Director Remuneration Guidance in South Africa" 2022 36(3) *South African Journal of Accounting Research* 205.

³ Kabir and Minhat 2014 *Research in International Business and Finance* 172; Thomas "Lessons from the Rapid Evolution of Executive Remuneration Practices in Australia: Hard Law, Soft Law, Boards and Consultants" in Thomas and Hill (eds) *Research Handbook on Executive Pay* (2013) 360.

⁴ Conyon "Compensation Consultants and Executive Compensation" in Baker and Anderson (eds) *Corporate Governance: A Synthesis of Theory, Research, and Practice* (2010) 285; Conyon "Executive Compensation Consultants and CEO Pay" 2011 64(2) *Vanderbilt LR* 397 403; Madlela and Lehloeny "The Regulation of Executive Remuneration in South Africa" 2016 42(1) *Obiter* 1 8.

remuneration.⁵ Remuneration consultants are thought to bring expertise and legitimacy to remuneration committees' decisions.

Using remuneration consultants may be necessary for various reasons, but potential conflicts of interest may arise. Remuneration consultants may face conflicts of interest in their desire to build good relationships for future hires, potentially recommending remuneration that favours the chief executive officer.⁶ Benchmarking is another associated challenge that makes executive remuneration rise unnecessarily.⁷ Effective regulation of remuneration consultants is crucial to prevent excessive remuneration of executive directors.

This article first examines the rationale for, and challenges associated with, the use of remuneration consultants. Secondly, the article explores whether there is adequate regulation of remuneration consultants in South Africa. Thirdly, the article compares South Africa's regulation of remuneration consultants with that of the United Kingdom (UK), Australia and the United States of America (USA). The UK was selected for comparative purposes because South African company law has historically been based on the English system.⁸ Australia was chosen because comprehensive disclosure requirements for remuneration consultants are required in that jurisdiction, and its company law is historically largely based on UK company law. The USA was chosen because it has strict regulations for remuneration consultants, some of which may form the basis for similar provisions to be incorporated in South African company law. The comparative analysis approach is supported by section 5(2) of the Companies Act⁹ (Companies Act), which provides that, to the extent appropriate, a court interpreting or applying the Companies Act may consider foreign company law. Lastly, the article suggests certain proposals for legislative reform of the Companies Act regarding the use of remuneration consultants.

⁵ Conyon, Peck and Sadler "Compensation Consultants and Executive Pay: Evidence from the United States and the United Kingdom" 2009 23(1) *Academy of Management Perspectives* 43 44; Kabir and Minhat 2014 *Research in International Business and Finance* 174.

⁶ Bebchuk and Fried "Executive Compensation as an Agency Problem" 2003 17(3) *Journal of Economic Perspectives* 71 78; Bender "Paying for Advice: The Role of the Remuneration Consultant in U.K. Listed Companies" 2011 64(2) *Vanderbilt LR* 359 362; Cadman, Carter and Hillegeist "The Incentives of Compensation Consultants and CEO Pay" 2010 49(3) *Journal of Accounting and Economics* 263 263.

⁷ Armstrong *et al* 2012 *Review of Accounting Studies* 322; Van Zyl and Mans-Kemp 2022 *South African Journal of Accounting Research* 205; Luiz "An Appropriate Regime for the Remuneration of Executives" 2006 39(1) *CILSA* 57 69.

⁸ In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa v Bestvest 153 (Pty) Ltd* 2012 (5) SA 497 (WCC) 26, the High Court confirmed that "[o]ur company law has for many decades closely tracked the English system and has often taken its lead from the relevant English Companies Acts and the judicial pronouncements thereon".

⁹ 71 of 2008.

2 RATIONALE FOR USING REMUNERATION CONSULTANTS

The use of remuneration consultants is quite common in South Africa and globally. Remuneration committees¹⁰ may lack the time, expertise and data to decide effectively on executive remuneration, and may thus need consulting advice.¹¹ Although the Companies Act does not compel companies to have remuneration committees,¹² companies listed on the Johannesburg Stock Exchange (JSE) are required to appoint them.¹³ Remuneration consultants often provide valuable market data and expertise in tax, legal and accounting matters related to executive remuneration, which companies often lack.¹⁴ These consultants act as independent parties in the remuneration-setting process, providing impartial advice to remuneration committees.¹⁵ They are regarded as conferring legitimacy on the decisions of the remuneration committee and acting as a form of risk management on behalf of the remuneration committee.¹⁶ Remuneration consultants also tend to provide current, comprehensive data that saves remuneration committees time by eliminating the need to search through multiple annual reports of different companies.¹⁷

The optimal contracting theory¹⁸ views directors as shareholders' agents, highlighting principal-agent issues such as misalignment of interests leading

¹⁰ A remuneration committee is a sub-committee of the board of directors that is appointed by the board to determine the remuneration of executive directors from time to time (Institute of Directors South Africa "Guidance for Remuneration Committees: A Framework for Remuneration Committees" (August 2020) https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/57F28684-0FFA-4C46-9AD9-EBE3A3DFB101/Paper_1_A_framework_for_remuneration_committees.docx.pdf (accessed 2024-02-05) 4.

¹¹ Kabir and Minhat 2014 *Research in International Business and Finance* 174; Kostander and Ikäheimo "Independent' Consultants' Role in the Executive Remuneration Design Process Under Restrictive Guidelines" 2012 20(1) *Corporate Governance* 64 73; Thomas in Thomas and Hill *Research Handbook* 356.

¹² S 72(1) of the Companies Act provides that companies may appoint any number of committees of directors, and delegate to any committee any of the authority of the board.

¹³ See par 3.84(c) of the JSE Limited Listings Requirements <https://www.jse.co.za/sites/default/files/media/documents/2019-04/JSE%20Listings%20Requirements.pdf> (accessed 2025-05-12).

¹⁴ Bender 2011 *Vanderbilt LR* 380; Thomas in Thomas and Hill *Research Handbook* 358; Kabir and Minhat 2014 *Research in International Business and Finance* 174; Mongalo 2003 *SALJ* 761–762.

¹⁵ Bender 2011 *Vanderbilt LR* 370.

¹⁶ Bender 2011 *Vanderbilt LR* 370; Ezzamel and Watson "Pay Comparability Across and Within UK Boards: An Empirical Analysis of the Cash Pay Awards to CEOs and Other Board Members" 2002 39(2) *Journal of Management Studies* 207 210; Main, Jackson, Pym and Wright "The Remuneration Committee and Strategic Human Resource Management" 2008 16(3) *Corporate Governance* 225 234.

¹⁷ Bender 2011 *Vanderbilt LR* 380.

¹⁸ This theory holds that there is a potential conflict of interests that may arise when a principal-agent relationship is formed and that remuneration can be used as a tool to align the interests of agent and principal (Jensen and Meckling "Theory of the Firm: Managerial Behaviour, Agency Cost and Ownership Structure" 1976 3(4) *Journal of Financial Economics* 305 308; Luiz 2006 *CILSA* 69; Marimuthu and Kwenda "The Relationship Between Executive Remuneration and Financial Performance in South African State-Owned Entities" 2019 23(4) *Academy of Accounting and Financial Studies Journal* 1 2).

to agency costs.¹⁹ It emphasises the importance of remuneration consultants in ensuring the alignment of directors' and shareholders' interests through designing executive remuneration packages that are attractive to executive directors.²⁰ According to this theory, companies can save costs by engaging remuneration consultants to design an optimal remuneration contract that aligns remuneration and performance and benefits shareholders and executives.²¹

In the authors' view, while remuneration consultants' data can assist remuneration committees in determining executive remuneration, remuneration consultants may at times overlook the company's financial state and the need for fair and responsible remuneration, owing to, for example, conflicts of interest. The use of remuneration consultants should, therefore, be minimised in companies and should be strictly regulated. Although the appointment of remuneration consultants has many benefits for companies, certain factors may hinder their ability to achieve their intended goals. These factors are discussed below.

3 CHALLENGES ASSOCIATED WITH REMUNERATION CONSULTANTS

There are certain challenges associated with appointing remuneration consultants. At the outset, conflicts of interest may arise. For example, when a chief executive officer (CEO) hires a remuneration consultant to advise the remuneration committee, the consultant may recommend favourable remuneration for the CEO in order to maintain good relations with the CEO and strengthen the prospects of being rehired in the future.²² Research indicates that CEO remuneration is typically higher in companies employing

¹⁹ De Wet "Executive Compensation and the EVA and MVA Performance of South African Listed Companies" 2012 16(3) *Southern African Business Review* 57–59; Steenkamp and Wesson "Executive Share-Based Remuneration in South Africa: Evidence of Alignment or Rent-Extraction?" 2021 30(1) *Management Dynamics* 1. Principal-agent challenges come with a principal-agent relationship, such as potential conflicts of interest. Agency costs are costs borne by shareholders in trying to ensure that executive directors do not act in their own interests to the detriment of the shareholders. These include monitoring costs, whereby shareholders gather more information about executive directors' actions (Jensen and Meckling 1976 *Journal of Financial Economics* 308; Allcock and Pass "Executive Incentive Pay Strategies in Entrepreneurial UK Initial Public Offering Companies" 2006 6(2) *Corporate Governance* 148–149; Panda and Leepsa "Agency Theory: Review of Theory and Evidence on Problems and Perspectives" 2017 10(1) *Indian Journal of Corporate Governance* 74–82).

²⁰ Conyon 2011 *Vanderbilt LR* 408; Tosi and Gomez-Mejia "CEO Compensation Monitoring and Firm Performance" 1994 37(4) *Academy of Management Journal* 1002–1008; Hill and Stevens "CEO Compensation and Corporate Performance" 1995 20(4) *Journal of General Management* 65–66.

²¹ Conyon 2011 *Vanderbilt LR* 408.

²² Bender 2011 *Vanderbilt LR* 362; Conyon 2011 *Vanderbilt LR* 410; Grosse, Ma and Scott "Evidence on Compensation Consultant Fees and CEO Pay" 2020 45(1) *Australian Journal of Management* 15–16; Kabir and Minhat 2014 *Research in International Business and Finance* 174–175; Riaz 2016 *Corporate Governance* 546.

remuneration consultants, who are often used to justify such high salaries.²³ Bebchuk and Fried make this claim about remuneration consultants:

“Compensation consultants have strong incentives to use their discretion to benefit the CEO ... Providing advice that hurts the CEO’s pocketbook is hardly a way to enhance the consultant’s chances of being hired in the future by this firm or, indeed, by any other firms.”²⁴

Another potential conflict of interest is that remuneration consultants often credit executive directors for good company performance and recommend above-average remuneration for them, but when a company performs poorly, they argue that remuneration should reflect industry levels and that performance data should be disregarded.²⁵ Remuneration consultants may also recommend paying amounts of remuneration that favour the executive directors at the expense of shareholders, for fear of having their contracts terminated or losing repeat business.²⁶

A further potential conflict of interest is that the contribution of remuneration consultants to remuneration matters may be influenced by their desire to solicit other consulting services from the company.²⁷ There are, however, mixed reports on the effect of using a remuneration consultant for multiple purposes. While some studies did not find any evidence that using a remuneration consultant for multiple services leads to excessive CEO remuneration,²⁸ other studies found that CEO remuneration tends to be higher when a remuneration consultant provides multiple services to the company.²⁹

Another challenge associated with remuneration consultants relates to their selection. The consultant’s reputation, often maintained through recommending high salaries for executive directors, is a crucial factor.³⁰ Personal recommendations and relationships, including those with non-

²³ Armstrong *et al* 2012 *Review of Accounting Studies* 322; Chu, Faasse and Rau “Do Compensation Consultants Enable Higher CEO Pay? A Disclosure Rule Change as a Separating Device” 2018 64(10) *Management Science* 4915–4915; Grosse *et al* 2020 *Australian Journal of Management* 18; Kabir and Minhat 2014 *Research in International Business and Finance* 173; Riaz 2016 *Corporate Governance* 546.

²⁴ Bebchuk and Fried 2003 *Journal of Economic Perspectives* 78–79.

²⁵ Bebchuk and Fried 2003 *Journal of Economic Perspectives* 79; Bizjak, Lemmon and Naveen “Does the Use of Peer Groups Contribute to Higher Pay and Less Efficient Compensation?” 2008 90(2) *Journal of Financial Economics* 152–168.

²⁶ Conyon 2011 *Vanderbilt LR* 410; Conyon *et al* 2009 *Academy of Management Perspectives* 45; Crystal “Why CEO Compensation Is So High” 1991 34(1) *California Management Review* 9–9; Kabir and Minhat 2014 *Research in International Business and Finance* 175.

²⁷ Bebchuk and Fried 2003 *Journal of Economic Perspectives* 79; Conyon 2011 *Vanderbilt LR* 424; Grosse *et al* 2020 *Australian Journal of Management* 19; Kabir and Minhat 2014 *Research in International Business and Finance* 174–175; Kostander and Ikäheimo 2012 *Corporate Governance* 73; Riaz 2016 *Corporate Governance* 546.

²⁸ Cadman *et al* 2010 *Journal of Accounting and Economics* 263; Goh and Li “Pensions as a Form of Executive Compensation” 2015 42(9–10) *Journal of Business Finance & Accounting* 1154; Grosse *et al* 2020 *Australian Journal of Management* 19.

²⁹ Conyon 2011 *Vanderbilt LR* 424; Grosse *et al* 2020 *Australian Journal of Management* 19; Murphy and Sandino “Executive Pay and ‘Independent’ Compensation Consultants” 2010 49(3) *Journal of Accounting and Economics* 247–247.

³⁰ Bender 2011 *Vanderbilt LR* 377; Mongalo 2003 *SALJ* 761–762.

executive directors or from various platforms such as seminars, also play a significant role in influencing the selection of remuneration consultants.³¹ It is submitted that these personal recommendations and relationships could potentially compromise the independence of remuneration consultants. Requiring remuneration committees to use remuneration consultants who have no relationship with any executive director is thus crucial to ensuring the independence of remuneration consultants.

A further challenge relates to instances where remuneration consultants are appointed for a lengthy period. As certain relationships are formed when remuneration committees use remuneration consultants – which could compromise their independence – it is essential to limit the duration of a consultant's service.³² When consultants work with a particular company for a long period, they gain a better understanding of the company's strategy and needs and may thus recommend remuneration that benefits the company. While changing remuneration consultants on a regular basis may provide diverse views and expertise, some studies show that constantly switching consultants may have adverse effects, such as a high increase in executive remuneration.³³ To find the optimum balance, it is recommended that companies should not hire remuneration consultants for longer than five years. We suggest that this is a reasonable period, allowing remuneration consultants to familiarise themselves with the company and yet maintain their independence.

Another problem that comes with using remuneration consultants is benchmarking.³⁴ Remuneration consultants often use their knowledge of other companies' executive remuneration to recommend remuneration for a company's executive directors, which often leads to escalation of executive remuneration through benchmarking.³⁵ Furthermore, remuneration consultants sometimes lack objectivity by failing to advise according to

³¹ Bender 2011 *Vanderbilt LR* 377–378.

³² Kostander and Ikäheimo 2012 *Corporate Governance* 73; Van Zyl and Mans-Kemp 2022 *South African Journal of Accounting Research* 205.

³³ Studies on the impact that changing remuneration consultants has on executive remuneration are inconclusive. For example, in the UK, it was found that switching remuneration consultants leads to higher executive bonuses, whereas in the USA, there was little evidence that switching remuneration consultants contributes to higher CEO remuneration (Goh and Gupta "Executive Compensation, Compensation Consultants, and Shopping for Opinion: Evidence From the United Kingdom" 2010 25(4) *Journal of Accounting, Auditing & Finance* 607–607; Conyon 2011 *Vanderbilt LR* 414–415; Conyon, Peck and Sadler "New Perspectives on the Governance of Executive Compensation: An Examination of the Role and Effect of Compensation Consultants" 2011 15(1) *Journal of Management & Governance* 15–29; Kabir and Minhat 2014 *Research in International Business and Finance* 172; Grosse et al 2020 *Australian Journal of Management* 18).

³⁴ Bender 2011 *Vanderbilt LR* 377; Van Zyl and Mans-Kemp 2022 *South African Journal of Accounting Research* 205.

³⁵ Armstrong et al 2012 *Review of Accounting Studies* 322; Conyon, Hass, Peck, Sadler and Zhang "Do Compensation Consultants Drive Up CEO Pay? Evidence From UK Public Firms" 2019 30(1) *British Journal of Management* 10; Conyon et al 2009 *Academy of Management Perspectives* 46; Murphy and Sandino 2010 *Journal of Accounting and Economics* 247; Van Zyl and Mans-Kemp 2022 *South African Journal of Accounting Research* 205; Luiz 2006 *CILSA* 69.

company-specific circumstances and by providing similar advice to all their clients.³⁶

It has been argued that remuneration consultants may set new benchmarks in order to gain more clients, which may potentially lead to excessive growth in executive remuneration.³⁷ For example, the 2008 financial crisis in the UK was attributed partly to the involvement of remuneration consultants in determining executive remuneration.³⁸ Significant evidence was found to link these consultants to an irreversible increase in executive remuneration in the banking sector.³⁹ A leading fund manager in the UK described remuneration consultants as follows:

“Generally, I would say they are a thoroughly bad influence. They are seen by fund managers as having extreme conflicts of interest: they are effectively paid by the board and are only seen to be doing their jobs if remuneration rises. In theory, remuneration consultants bring a certain level of objectivity to the task, but their existence allows companies to say they have done due diligence on pay, therefore it’s not their fault when benefits and performance do not match.”⁴⁰

Another critic of remuneration consultants opined:

“Executive compensation in the United States did not go out of control simply through some random process; it went out of control because of the actions – or inactions – of a number of parties. The first culprits in what will be a litany of culprits are compensation consultants.”⁴¹

It is submitted that the use of remuneration consultants is not problematic in itself and may be beneficial, but there are potential conflicts of interest that require strict regulation. The use of remuneration consultants can certainly benefit companies, but strict regulation of the industry is needed to prevent or at least limit any negative effects on executive remuneration.

4 THE USE OF MULTIPLE REMUNERATION CONSULTANTS

Companies frequently engage multiple remuneration consultants. For example, studies show that in a reporting year, 17 per cent of US companies use two or more remuneration consultants, while more than 40 per cent of UK companies use two or more consultants.⁴²

³⁶ Van Zyl and Mans-Kemp 2022 *South African Journal of Accounting Research* 205. See also Bender 2011 *Vanderbilt LR* 363.

³⁷ Peetz “An Institutional Analysis of the Growth of Executive Remuneration” 2015 57(5) *Journal of Industrial Relations* 707 714–715.

³⁸ *Ibid.*

³⁹ *Ibid.*

⁴⁰ Wachman “Angry Shareholders Ambush the Top Pay Bandwagon” (24 May 2009) *The Observer* (24 May 2009) <https://www.theguardian.com/business/2009/may/24/executive-pay-bonuses-royaldutchshell> (accessed 2024-02-05).

⁴¹ Crystal 1991 *California Management Review* 9 (emphasis removed).

⁴² Murphy and Sandino 2010 *Journal of Accounting and Economics* 250; Conyon *et al* 2009 *Academy of Management Perspectives* 49; Goh and Gupta 2010 *Journal of Accounting*,

It seems that the use of multiple remuneration consultants often leads to increased executive remuneration. It has been argued that companies employ multiple remuneration consultants to justify high executive salaries because if all the consultants recommend high executive salaries, this validates the final remuneration packages approved by the board.⁴³ Companies using multiple remuneration consultants tend to offer higher share-based remuneration packages, as recommended by these consultants.⁴⁴ Remuneration consultants often recommend complex share-based plans to clients, aiming to be seen as relevant and valuable, as companies may require their assistance in implementing these plans.⁴⁵ This pattern also leads to the increased use of share-based remuneration.

It is important to examine the fees charged by remuneration consultants, particularly when companies employ multiple remuneration consultants. Remuneration consultants often charge large sums for their services.⁴⁶ In South Africa, there is no readily available data on the fees paid to remuneration consultants, probably because this information is not required to be disclosed by any South African legal instruments. In 2020, the annual average fee paid to remuneration consultants in Australia was AU\$49 546 per consultant.⁴⁷ In 2022, the national average salary for a remuneration consultant in the UK was £55 803.⁴⁸ In 2022, the average remuneration consultant salary in the USA was \$89 213, with a typical range from \$81 184 to \$97 476.⁴⁹ It is crucial to ensure that the fees of remuneration consultants are properly regulated to ensure that companies do not incur the double cost of paying huge sums of money to remuneration consultants and – relying on their recommendations – also paying exorbitant amounts of remuneration to executive directors.

It is arguable that hiring multiple remuneration consultants can benefit companies by providing independent expertise on all the various aspects of executive remuneration, since the remuneration consultants specialise in different aspects of remuneration.⁵⁰ If a company employs a remuneration consultant who handles all the aspects of executive remuneration, it will be more challenging to justify the use of employing multiple remuneration consultants. It is further arguable that companies may benefit from using

Auditing & Finance 628; Kabir and Minhat 2014 *Research in International Business and Finance* 174.

⁴³ Kabir and Minhat 2014 *Research in International Business and Finance* 187.

⁴⁴ Bender 2011 *Vanderbilt LR* 368; Conyon *et al* 2009 *Academy of Management Perspectives* 52; Kabir and Minhat 2014 *Research in International Business and Finance* 173; Voulgaris, Stathopoulos and Walker "Compensation Consultants and CEO Pay: UK Evidence" 2010 18(6) *Corporate Governance: An International Review* 511 512.

⁴⁵ Bender 2011 *Vanderbilt LR* 369.

⁴⁶ See Kabir and Minhat 2014 *Research in International Business and Finance* 174.

⁴⁷ Grosse *et al* 2020 *Australian Journal of Management* 16.

⁴⁸ Glassdoor "Compensation Consultant Salaries in United Kingdom" (23 August 2022) https://www.glassdoor.co.uk/Salaries/compensation-consultant-salary-SRCH_KO0,23.htm (accessed 2024-02-05).

⁴⁹ Anon "Compensation Consultant Salary in the United States" <https://www.salary.com/research/salary/posting/compensation-consultant-salary> (accessed 2024-02-05).

⁵⁰ Bender 2011 *Vanderbilt LR* 390; Kabir and Minhat 2014 *Research in International Business and Finance* 174.

multiple remuneration consultants to provide advice separately to management and to the remuneration committee respectively, enabling them to determine the optimal level of executive remuneration.⁵¹ Nevertheless, the high costs of remuneration-consulting services, discussed above, necessitate a thorough examination of the potential benefits that companies can derive from employing multiple remuneration consultants.

5 REGULATION OF REMUNERATION CONSULTANTS IN SOUTH AFRICA

Section 72(2)(a) of the Companies Act allows a board committee to include non-directors unless the company's Memorandum of Incorporation or a committee resolution explicitly states otherwise. Such a person must not be ineligible or disqualified to be a director under section 69 of the Companies Act and may not vote on a committee-determined matter.⁵² Section 72(2)(b) of the Companies Act allows a board committee to consult with, or receive advice from, anyone, unless prohibited by the company's Memorandum of Incorporation or a resolution establishing the committee. It can be inferred that section 72(2) of the Companies Act permits remuneration consultants to be appointed, but the Companies Act provides no definition or any further guidelines to board committees on this matter. The recently published Companies Amendment Act 16 of 2024 (the Companies Amendment Act) is also silent on this issue.⁵³ Thus, there is no legal regulation in the Companies Act on the use of remuneration consultants in South Africa.

The King IV Report⁵⁴ requires the board of directors to approve a protocol for obtaining external professional advice at the company's expense on matters within their duties.⁵⁵ Principle 6: Recommended Practice 3 of the King IV Report suggests that the annual remuneration report's background statement should reveal the use of remuneration consultants and their independence and objectivity.⁵⁶ This recommendation, therefore, assumes the possible appointment of remuneration consultants. The King IV Report provides no further guidelines on using these consultants. The JSE Limited Listings Requirements are similarly silent on the issue. South African companies sometimes adjust the remuneration of executive directors following reports from independent remuneration consultants.⁵⁷ It is, therefore, crucial to ensure proper regulation of remuneration consultants to alleviate conflicts of interest that may come with their use.

⁵¹ *Ibid.* As suggested earlier, it is prudent for remuneration consultants to engage only with remuneration committees, and to give their recommendations to remuneration committees, in order to avoid a potential conflict of interests.

⁵² See s 72(2)(a)(i) and (ii) of the Companies Act.

⁵³ The Companies Amendment Act came into force on 27 December 2024.

⁵⁴ Institute of Directors Southern Africa *King IV Report on Corporate Governance for South Africa 2016* (1 November 2016).

⁵⁵ Principle 6: Recommended Practice 3 of the King IV Report.

⁵⁶ See Principle 14: Recommended Practice 33 of the King IV Report.

⁵⁷ For example, in 2011, Massmart adjusted the remuneration of executive and senior managers following a report by 21st Century Business & Pay Solutions, an independent remuneration consultancy (Massmart "Remuneration Policy" (2011) <https://www.massmart.co.za/remuneration/> (accessed 2024-02-05)).

6 REGULATION OF REMUNERATION CONSULTANTS IN THE UK

The UK has increased the disclosure requirements for companies employing remuneration consultants amid criticism of their involvement in remuneration committees. The UK Corporate Governance Code 2018⁵⁸ (the UK Corporate Governance Code) requires companies to disclose in their annual report the identity of any remuneration consultant they appoint, together with any other connections such remuneration consultant may have with the company or its individual directors.⁵⁹ The Directors' Remuneration Report Regulations 2002⁶⁰ requires UK companies to disclose in the directors' remuneration report the details of any person who provided advice or services to the remuneration committee that materially assisted the remuneration committee in its consideration of directors' remuneration.⁶¹ Companies must disclose any additional services provided by a remuneration consultant during the relevant financial year and whether the remuneration committee appointed the remuneration consultant.⁶²

In the authors' view, these disclosure requirements for remuneration consultants enhance their objectivity and fairness in advising remuneration committees. They also prevent inappropriate advice from damaging the reputation of remuneration consultants.⁶³ South Africa lacks these requirements. It is suggested that South African companies should be required to disclose pertinent information regarding the remuneration consultants they use.

7 REGULATION OF REMUNERATION CONSULTANTS IN AUSTRALIA

Section 9 of the Corporations Act 2001 (Cth) of Australia (Australian Corporations Act) defines a remuneration consultant as "a person who makes a remuneration recommendation under a contract for services with the company to whose key management personnel the recommendation relates, and who is not an officer or employee of the company."⁶⁴ The Australian Corporations Act usefully contains detailed provisions on remuneration consultants. Section 206K(2) requires a company's directors or remuneration committee to approve the prospective consultant before it engages in a remuneration consultancy contract. Failure to follow section

⁵⁸ Financial Reporting Council *UK Corporate Governance Code 2018* (2018).

⁵⁹ Provision 35 of the UK Corporate Governance Code.

⁶⁰ These regulations were made in accordance with s 257 of the previous UK Companies Act 1985 and apply to all listed companies in the UK.

⁶¹ See s 2(b) of sch 7A to the Directors' Remuneration Report Regulations 2002.

⁶² See s 2(c) of sch 7A to the Directors' Remuneration Report Regulations 2002.

⁶³ Bebchuk, Fried and Walker "Managerial Power and Rent Extraction in the Design of Executive Compensation" 2002 69(3) *The University of Chicago LR* 751 790; Grosse *et al* 2020 *Australian Journal of Management* 16; Murphy and Sandino 2010 *Journal of Accounting and Economics* 248.

⁶⁴ S 9 of the Australian Corporations Act.

206K(2) constitutes an offence.⁶⁵ While the Australian Corporations Act allows for remuneration consultants to be approved by the company's directors, it is suggested that remuneration consultants in South Africa should be approved by remuneration committees rather than by the board of directors because of the potential conflicts of interest that may arise, as discussed earlier.⁶⁶

Sections 206L(2) and 206L(4) of the Australian Corporations Act restrict the individuals to whom remuneration consultants may provide their recommendations. These provisions provide that remuneration consultants must directly present their recommendations to the company's directors, remuneration committee members, or both, and may not make any recommendations to individuals not in these positions. However, under section 206L(3), unless all the company's directors are executive directors, the remuneration consultant is prohibited from giving their recommendation to an executive director.⁶⁷ Section 206M(2) of the Australian Corporations Act requires the remuneration consultant to confirm by way of a declaration that the recommendation was made without undue influence by the executive director(s) to whom the recommendation pertains. It is an offence for the remuneration consultant to contravene section 206L(3) and (4) of the Australian Corporations Act, and the penalties imposed in the event of contravention are severe.⁶⁸

Section 206L(3) of the Australian Corporations Act is commendable in that it helps prevent conflicts of interest that may arise when executive directors engage with remuneration consultants by precluding remuneration consultants from giving recommendations to executive directors. However, it is not ideal to leave it to the remuneration consultants to confirm that the recommendation was made without undue influence by the executive director(s). The reason, as stated earlier, is that remuneration consultants may benefit from colluding with executive directors, so they may not reveal any influence that executive directors may have had in the recommendation made by the consultant. It is, therefore, advised that in South Africa, the remuneration committee should ensure that the executive directors did not unduly influence the executive directors, and should justify why it is satisfied with this fact.

The Australian Corporations Act contains certain disclosure requirements for remuneration consultants that must be disclosed in the annual directors'

⁶⁵ S 206K(4) of the Australian Corporations Act. S 206K(5) of the Australian Corporations Act states that an offence against s 206K(4) is an offence of strict liability. The section does not state the penalty for this offence. S 1311F(b) of the Australian Corporations Act states that if no penalty is specified for an offence under this Act, then 20 penalty units is taken to be the penalty specified for the offence. From 1 July 2023, until 30 June 2024, one penalty unit is AU\$192.31 ("Penalty Units" *Victoria Legal Aid* (07 July 2023) <https://www.legalaid.vic.gov.au/penalty-units> (accessed 2024-02-12)). This means that for the offence under s 206L(3) or (4) of the Australian Corporations Act the penalty would be AU\$3846,20.

⁶⁶ See discussion under heading 3 above.

⁶⁷ S 206L(3) of the Australian Corporations Act.

⁶⁸ See s 1311(1) of the Australian Corporations Act. The offence is an offence of strict liability (see s 1311A(1), read with s 1311F(a) of the Australian Corporations Act). The section does not state the penalty for this offence, but s 1311F(b) of the Australian Corporations Act (discussed earlier) applies.

report for listed companies. Section 300A(1)(h) of the Australian Corporations Act requires companies using remuneration consultants to disclose:

- (a) the name of the consultant used;
- (b) any other kind of advice or services rendered by the consultant;
- (c) the amount and nature of the consideration paid to the consultant for remuneration and other non-remuneration-related services;
- (d) the company's arrangements aimed at preventing the consultant from being unduly influenced by the executive directors to whom the recommendation applies;
- (e) whether the board is satisfied that the recommendation was made without undue influence from affected executive directors; and
- (f) the board's reasoning for concluding that the remuneration recommendation was made without undue influence from the executive directors.⁶⁹

These are stringent duties of disclosure that ensure transparency and accountability on the use of remuneration consultants. In particular, disclosure of all fees paid to remuneration consultants, including those unrelated to remuneration services, is commendable because this helps shareholders assess the reasonableness of the fees and the benefits to the company. There are no similar requirements in South Africa.

8 REGULATION OF REMUNERATION CONSULTANTS IN THE USA

The Securities and Exchange Commission Rules and Regulations (the SEC Rules) require listed companies that file with the Securities and Exchange Commission (the SEC)⁷⁰ to disclose information relating to remuneration consultants.⁷¹ Item 229.407(e)(3)(iii) of the SEC Rules requires companies to disclose the role of any remuneration consultants in determining or recommending the remuneration of executive and non-executive directors. Companies must disclose remuneration consultants' names, hiring methods, task scope, and directives for fulfilling contract obligations.⁷² Companies must also disclose any conflicts of interest with remuneration consultants, the nature of such conflicts, and the approach being taken to address

⁶⁹ See s 300A(1)(h) of the Australian Corporations Act, inserted by cl 19 of sch 1, pt 1 of the Corporations Amendment Bill 2011.

⁷⁰ The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation (U.S. Securities and Exchange Commission "About the SEC" (22 November 2016) <https://www.sec.gov/about> (accessed 2024-02-19)).

⁷¹ Regulations S-K are included as pt 229 in the Code of Federal Regulations (CFR). The particular rules for disclosure are set forth specifically under sub-items 402 (Executive Compensation), 403 (Security Ownership), and 404 (Related Party Transactions). See "17 CFR Part 229 – Part 229 – Standard instructions for filing forms under Securities Act of 1933, Securities Exchange Act of 1934 and Energy Policy and Conservation Act of 1975 – Regulation S-K" (2014) <https://www.law.cornell.edu/cfr/text/17/part-229> (accessed 2024-02-05).

⁷² Item 229.407(e)(3)(iii) of the SEC Rules.

them.⁷³ None of the instruments regulating executive remuneration in South Africa provides for similar requirements.

The SEC Rules require companies to disclose fees paid to a remuneration consultant only if the consultant provided additional non-remuneration services exceeding \$120 000.⁷⁴ The company must also disclose the aggregate fees paid to a remuneration consultant for determining the remuneration of executive and non-executive directors, and the aggregate fees for any additional services.⁷⁵ This means that a company using a remuneration consultant solely for advice, or recommendations on remuneration matters, does not need to disclose the fees paid to the consultant. This position is unlike the Australian one in which companies are required to disclose all fees paid to a remuneration consultant, regardless of the amount.⁷⁶ Since 2009, many US companies have avoided fee disclosures by not using remuneration consultants for non-remuneration services, raising questions about the reasons for their decision.⁷⁷

The fees paid to remuneration consultants significantly influence the recommendations made to their clients, with higher fees generally leading to more favourable recommendations on directors' remuneration.⁷⁸ South Africa does not require disclosure of any fees paid to remuneration consultants. This failure is a cause for concern. It is suggested that companies in South Africa should be required to disclose all fees paid to remuneration consultants, regardless of the amount and nature of their services. This recommendation aims to enhance transparency on the fees paid to remuneration consultants, enabling shareholders to evaluate the reasonableness of these fees.

In the USA, the remuneration committee, under the NYSE Listed Company Manual and NASDAQ Listing Rules, has the discretion to hire remuneration consultants and is responsible for their appointment, remuneration and supervision.⁷⁹ The company must offer adequate financing for the consultant's reasonable remuneration,⁸⁰ but there is no explanation of what constitutes "reasonable remuneration". It is submitted that requiring remuneration consultants to be hired by remuneration committees in their sole discretion is ideal because it alleviates potential conflicts of interest that may arise when executive directors get involved in the appointment of these consultants.

The NYSE Listed Company Manual outlines factors that companies should consider when choosing a remuneration consultant, and which focus on their independence. For example, companies should take into

⁷³ Item 229.407(e)(3)(iv) of the SEC Rules.

⁷⁴ Item 229.407(e)(3)(iii)(A) and (B) of the SEC Rules.

⁷⁵ *Ibid.*

⁷⁶ See under heading 6 above.

⁷⁷ Chu *et al* 2018 *Management Science* 4915; Grosse *et al* 2020 *Australian Journal of Management* 16.

⁷⁸ *Ibid.*

⁷⁹ See s 303A.05(c)(i)–(ii) of the NYSE Listed Company Manual and r 5605(d)(3)(A)–(B) of the NASDAQ Listing Rules.

⁸⁰ See s 303A.05(c)(iii) of the NYSE Listed Company Manual and r 5605(d)(3)(C) of the NASDAQ Listing Rules.

consideration whether the consulting company provides other services and the ratio of fees received to the total revenue of the consulting company.⁸¹ Companies should evaluate consulting firms' conflict-of-interest policies and potential business or personal relationships between remuneration consultants and committee members.⁸² Companies should also evaluate whether the consultant owns company shares and if there are any connections between the consultant or the consulting company and any of the company's executive directors.⁸³ The NASDAQ Rules require the remuneration committee to consider factors similar to those in the NYSE Listed Company Manual regarding the consultant's independence from management when selecting a remuneration consultant.⁸⁴ Although not expressly required, the rules encourage and emphasise the appointment of independent consultants.

There are no such rules or requirements in South Africa. It is submitted that South Africa should require remuneration committees to employ independent remuneration consultants to alleviate the challenges of conflicts of interest. The factors discussed above in the NYSE Listed Company Manual and the NASDAQ Rules may provide South African companies with useful guidance on choosing an independent remuneration consultant.

9 PROPOSALS FOR LEGISLATIVE REFORM IN SOUTH AFRICA

While it may be inferred that section 72(2) of the Companies Act permits remuneration consultants to be appointed, the Companies Act does not provide any guidelines regarding the use of remuneration consultants. The King IV Report and the JSE Limited Listings Requirements also do not provide any such guidelines. In light of the challenges associated with the use of remuneration consultants, as discussed in this article, it is submitted that the use of remuneration consultants is inadequately regulated in South Africa. It is submitted that regulatory provisions in the UK, Australia, and the USA should be considered, with necessary adaptations, in the drafting of guidelines for legislative reform in South Africa on regulating the use of remuneration consultants. It is proposed that the following legislative amendments should be introduced in South Africa:

- Companies must provide a rationale for hiring a remuneration consultant.
- Companies must provide a detailed explanation of the selection criteria and the reason behind the employment of a specific remuneration consultant, since personal relationships between executive directors and remuneration consultants could compromise the independence of remuneration consultants.
- A remuneration consultant should not be employed for longer than five years. It is submitted that five years allows remuneration consultants

⁸¹ S 303A.05(c)(iv)(A) and (B) of the NYSE Listed Company Manual.

⁸² S 303A.05(c)(iv)(C) and (D) of the NYSE Listed Company Manual.

⁸³ S 303A.05(c)(iv)(E) and (F) of the NYSE Listed Company Manual.

⁸⁴ R 5605(d)(3)(D) of the NASDAQ Listing Rules.

sufficient time to familiarise themselves with the company while maintaining their independence from the company.

- Remuneration consultants must be appointed and approved by remuneration committees rather than by the board of directors to avoid potential conflicts of interest.⁸⁵
- To further avoid potential conflicts of interest, restrictions should be imposed regarding the individuals to whom remuneration consultants may provide their recommendations, in that remuneration consultants should engage with and give their recommendations to remuneration committees only and not to the company's executive directors.⁸⁶
- The Companies Act should require companies to disclose the identity of the remuneration consultants they employ, as well as any business or personal connections such remuneration consultants may have with the company or its directors.⁸⁷ Companies should also be required to disclose arrangements aimed at preventing their remuneration consultants from being unduly influenced by the executive directors to whom a recommendation applies.⁸⁸ Such disclosure requirements would support objectivity in remuneration consultants' advice on executive remuneration.
- To enhance transparency in the fees paid to remuneration consultants and enable shareholders to evaluate the reasonableness of the fees, companies should be required to disclose all fees paid to remuneration consultants, regardless of the amount and nature of their services.⁸⁹
- Remuneration consultants must be independent of management. Companies should be required to justify the independence of the particular remuneration consultants that they employ. This would help reduce potential conflicts of interest associated with using remuneration consultants.
- Companies should be required to disclose whether they have used multiple remuneration consultants and justify the necessity and benefits of using multiple remuneration consultants.
- Companies should limit the use of remuneration consultants to remuneration services because of the potential challenges associated with remuneration consultants providing multiple services. Alternatively, companies should be required to justify using remuneration consultants for non-remuneration services and to explain the benefits of doing so by way of a narrative description in the background statement of the directors' remuneration report.

⁸⁵ This recommendation would align with s 206K(2) of the Australian Corporations Act.

⁸⁶ This recommendation would align with s 206L(3) of the Australian Corporations Act.

⁸⁷ This will align the Companies Act with provision 35 of the UK Corporate Governance Code, s 303A.05(c)(iv) of the NYSE Listed Company Manual and r 5605(d)(3)(D) of the NASDAQ Listing Rules.

⁸⁸ This will align the Companies Act with section 300A(1)(h) of the Australian Corporations Act.

⁸⁹ This recommendation would align with section 300A(1)(h) of the Australian Corporations Act.

10 CONCLUSIONS

The use of remuneration consultants may benefit companies by providing valuable market data and expertise in tax, law and accounting matters related to executive remuneration. At the same time, remuneration consultants may overlook the company's financial state and the need for fair and responsible remuneration. It has been argued in this article that the use of remuneration consultants is not in itself harmful, but that there are potential conflicts of interest associated with such use, as well as challenges associated with benchmarking. This article has argued that inadequate regulation in South Africa of the use of remuneration consultants in determining executive remuneration may contribute to the unwarranted escalation of executive remuneration. It was shown that the criteria used for selecting remuneration consultants, the use of remuneration consultants for non-remuneration purposes, and the use of multiple remuneration consultants may contribute to bias and impartial recommendations by such consultants.

The Companies Act, the King IV Report, and the JSE Limited Listings Requirements do not provide any guidelines regarding the use of remuneration consultants. In sharp contrast, the use of remuneration consultants is regulated in the UK, Australia and the USA. It was argued that South Africa lags behind these jurisdictions in regulating how companies use remuneration consultants. It is submitted that South Africa should implement regulatory measures on the use of remuneration consultants to curb excessive executive remuneration.

This article makes recommendations to improve the regulation of remuneration consultants in South Africa. These recommendations relate to companies justifying the use of a remuneration consultant, justifying the reason behind the employment of a specific remuneration consultant, and justifying the employment of multiple remuneration consultants. They also relate to requiring companies to disclose certain information about the remuneration consultants they employ, such as their identity and all fees paid to them, any connections they have with the company and its directors, and arrangements aimed at preventing remuneration consultants from being unduly influenced by the executive directors to whom a recommendation relates. Further recommendations relate to companies ensuring that remuneration consultants are independent, the use of remuneration consultants for non-remuneration services, the appointment and management of remuneration consultants, and the appropriate duration for which remuneration consultants should be employed. It is hoped that implementing and enforcing these recommendations in South Africa will improve the regulation of remuneration consultants and enhance the link between executive remuneration and company performance.