South Africa

Close Corporations 1985–1997: a statistical survey

by Professor J J Henning

The *Close Corporations Act* 69 of 1984 ('the Act') has proved to be one of the most remarkable innovations in South African company law (Jordan, *Review of the Hong Kong Companies Ordinance – Consultancy Report,* March 1997, at p. 2–18). The Act introduced a new form of incorporation for closely-held enterprises with several unique and innovative features, with effect from 1 January 1985 (see in general Naudé, 'The South African close corporation', *Journal for Juridical Science* (1984), at p. 119; Henning, 'Close corporations', *The Law of South Africa*, vol 7, pt. 3 (first re-issue) (1996) at p. 497–500; Ping-fat, 'Not too close for comfort', *International Corporate Law* (1992) at p. 17). The Act provides a simple, inexpensive and flexible form of incorporation for the enterprise consisting of a single entrepreneur or a small number of participants, designed with a view to meeting their needs without burdening them with legal requirements that would not be meaningful in their circumstances.

CONCEPT

The South African close corporation may startle traditional company lawyers. Under the Act a close corporation is a fully fledged corporation which confers on its members all the usual advantages associated with legal personality. It has the same capacity and powers as a natural person of full capacity. The ultra vires and constructive notice doctrines are inapplicable.

It is a closely-held entity in which all or most members are more or less actively involved. In principle there is no separation between ownership and control. Boards of directors and general meetings are not required. Every member is entitled to participate in the management of the business and to act as an agent for the corporation. Every member owes a fiduciary duty and a duty of care to the corporation. The consent of all the members is required for the admission of a new member. Capital maintenance requirements have been replaced by solvency and liquidity.

In principle membership is limited to natural persons. A close corporation may have a single member, as is the case with approximately 75% of all close corporations at present. Although the maximum number of members is limited to ten, there is no restriction on the size of a close corporation's business or undertaking, the number of its employees or creditors, the size of the total contributions by members, turnover, value of assets or, generally, the type of business and it need not be an undertaking for gain. The close corporation can cater for the unsophisticated and the highly sophisticated business person alike. It can also provide a viable mechanism for helping to bridge the gap between the formal and informal sectors of the economy. In this way the establishment of a wide range of business enterprises is effectively promoted.

NEED

The following are among the more important reasons advanced for a new legal form providing corporate personality for the single entrepreneur or small number of participants:

(1) Given considerations such as unlimited liability, lack of continuity, absence of legal personality and insufficient legal certainty, neither the sole proprietorship nor the various types of partnership, nor indigenous business forms like the *stokvel* or *mashonisa*, can meet most of the reasonable needs and expectations of the typical small businessman.

(2) Incorporation under the *Companies Act* 61 of 1973 offers the evident advantages of limitation of risk, perpetual succession and a regulated structure. However, as a result of the increasing complexity of the Companies Act (which, historically, developed primarily to deal with problems posed or needs experienced by large public companies), the incorporated company as a form of business enterprise has definitely outgrown the particular needs of small businessmen to a certain extent;

(3) The small private company is also subject to most of the complex provisions of the Companies Act. This is due partly to fear of possible misuse of the private company subsidiaries by public holding companies in a group context. The alternative of incorporating further exemptions for small companies into the Companies Act was considered unacceptable. It would only have increased the overall complexity of the Companies Act and would have aggravated the problem (see Cilliers Benade Henning & Du Plessis, *Close Corporations Law,* 1998, *at p.* 12);

(4) The Companies Act had, in effect, become inappropriate for the needs of the bona fide small entrepreneur.

OTHER OBJECTIVES

It has been emphasised that the introduction of the close corporation should not be regarded as an isolated event. It forms part of a larger process of economic, social, political and legal reform in South Africa, together with other components such as democratisation, deregulation, the advancement of effective competition and the advancement of small businesses. Statements such as these should evidently not be deemed to lend some measure of justification, albeit minimal, to the perception that, as far as other jurisdictions are concerned, the South African experience of the close corporation can be discredited conveniently as a development attributable exclusively to the vicissitude of political expediency:

'The point has been made about a proposal similar in kind to the Close Corporations Act that it was "a generally practical, well-developed one of the 'here and now' variety. It would do as much for small businesses as one could reasonably expect from a reforming approach which does not jeopardise existing assumptions as to how the law of business associations should be structured and what interest groups it should serve." Hence one finds it very difficult to agree with the view that with the Close Corporations Act "the legal system looked beyond the class interests of the business elite, doing justice to all classes, applying the moral imperative". Upon analysis, one's "excitement and great expectations" are merely those of a "black letter" lawyer faced with a first rate piece of "black letter" law.' (Larkin, 'Companies including close corporations', *1984 Annual Survey of South African Law*, at p. 322.)

The acceptance of this concept is borne out by the large number of close corporations that have been formed in the nine years since the Act became operational: more than 500,000 compared to approximately 130,000 companies of all types and forms.

In this way South Africa not only took a large step forward in order to provide effectively for the reasonable legal needs and expectations of the typical small business, but through the introduction of the innovative concepts of the Act, also made provision for a convenient blueprint for the reform of important areas of South African company law. Instances which come to mind are the ultra vires rule, the doctrine of constructive notice and the common law rules and statutory provisions relating to the maintenance of share capital (Henning, 'Closely-held corporations', *Journal of Contemporary Roman-Dutch Law*, at p. 101).

SIMPLIFICATION

In accordance with the awareness of the socio-economic and political importance of small businesses, the legal requirements under which the close corporation operates are basic, and far simpler than under the Companies Act. Simplification was a primary aim in the design and drafting of the Act. In volume and length its 83 sections contain less than the first schedule to the Companies Act. The mere fact that succinct administrative regulations have been issued under s. 10 and that s. 66 provides for the application of some provisions of the chapter on liquidation of the Companies Act, does not affect the validity of the conclusion that, in comparison to the Companies Act with its 443 sections, five schedules and comprehensive administrative regulations, a very considerable simplification has been attained.

Incorporation of a close corporation merely involves the registration of a single document, the founding statement, in which concise and simple factual information is stated under seven different headings. Reservation of a name, previously available as an option, is now required. The abbreviation CC or its equivalent – in any one of the ten other official languages – must be subjoined to the name of the corporation. The terms for close corporation and the suitable abbreviations have been identified, as shown in the table below, by the Director of State Language Services (see Notice 1225 of 1997 in *Government Gazette*, 18208, 22 August 1997).

Language	Term for close corporation	Abbreviation
Afrikaans	Beslote Korporasie	B K
Sepedi	Kgwebo e Kgotlangantswego	K K
Setswana	Dikorporasi tse di Tswaletsweng	KT
SiSwatiLi	Bhizinisi leli Valekile	BV
Sesotho	Kgwebo e Lekanyeditsweng	KL
Tshivenda	Dzikoporasi dzo valiwaliwaho	KV
Xitsonga	Ntirhisano wa Nhlangano	NH
IsiNdebele	Ikampani yaba-Thileko	KT
IsiXhosa	Inkampani yabam Balwa	KB
IsiZului	Kamphani yabamBalwa	KB

Since a close corporation has neither shares nor share capital, the legal position has been simplified considerably. A member merely owns an interest in the corporation, which is expressed as a percentage.

A lucid statement of a member's fiduciary duties and duty of care and skill is contained in the Act. The common law principles relating to the fiduciary duties and duties of care and skill in managing the affairs of the corporation are, to a large extent, codified in the Act, with the result that even the unsophisticated members know exactly what is expected of them and their fellow members.

In its original form the Close Corporations Bill, like the Companies Act, entrusted the Supreme Court with sole jurisdiction over close corporations in certain matters, for instance in respect of liquidation or the giving of relief in a case of unfairly prejudicial conduct. However, in view of the purpose of the Act and the cost and time factors involved in Supreme Court proceedings, concurrent jurisdiction was later conferred on magistrates' courts.

THE FUTURE

In 1997 the chairperson of the Standing Advisory Committee on Company Law released a press statement dealing with the imminent future development of corporate law in South Africa within the framework of five principal statutes. It is proof of the close corporation's meritorious performance that only four of the envisaged Acts will necessitate new legislation; the Close Corporations Act is to be retained in its present form as one of the five principal statutes.

Table 1. Cumulative annual registration (incorporation and conversion) of close corporations and companies.

Year	Close corporations	Companies
1985	15911	5848
1986	39298	11084
1987	68660	17757
1988	104752	25150
1989	146543	32357
1990	185462	39425
1991	220015	46040
1992	255020	52788
1993	288020	61559
1994	331813	73620
1995	387973	89160
1996	452797	108851
1997	524157	132800

Table 2. Registration (incorporation and conversion) of close corporations and companies.

Year	Close corporations	Companies	Ratio CC:Co
1985	15911	5848	2.72:1
1986	23387	5235	4.46:1
1987	29362	6673	4.40:1
1988	36092	7393	4.88:1
1989	41791	7207	5.80:1
1990	38919	7068	5.51:1
1991	34553	6616	5.22:1
1992	35005	6748	5.18:1
1993	33000	8771	3.76:1
1994	43793	12061	3.63:1
1995	56160	15540	3.61:1
1996	65006	19691	3.30:1
1997	71178	23949	2.99:1
Total	524157	132800	3.95:1

Table 3. Incorporations and conversions.

	Incorporations		Conversions	
Year	CC	Co	Co to CC	CC to Co
1985	9840	5836	6071	12
1986	16737	5188	6650	47
1987	24151	6395	5211	278
1988	31204	7061	4888	332
1989	37058	7207	4733	430
1990	36179	7068	2740	643
1991	33069	6815	1484	806
1992	33671	6748	1324	721
1993	31881	7957	1119	814
1994	42747	10909	1046	1154
1995	54815	14000	1245	1540
1996	63128	18281	1878	1410
1997	69120	22120	2058	1351
Total	483600	125585	40447	9538

Table 4. Liquidations and deregistrations.

	Liquidations		Deregistrations	
Year	Co	CC	Co	CC
1985	3057	9	3938	38
1986	2623	118	4744	401
1987	1625	281	5748	1110
1988	1280	271	5361	1711
1989	1051	399	4290	2004
1990	1057	631	4976	3936
1991	1150	738	5445	5335
1992	1037	1142	6342	6777
1993	1002	1226	6135	8058
1994	844	778	4376	7563
1995	764	963	3515	6806
1996	882	1210	2089	7323
1997	1265	891	2655	6071
Total	17637	8657	59614	57133

RESPONSE – THE STATISTICS

The close corporation has met with wide and enthusiastic approval despite a generally unfavourable economic climate, as appears from the following comparative tables. Mr M J Pienaar, Acting Registrar of Companies and Close Corporations, Department of Trade and Industry, Pretoria kindly supplied the information that appears in the tables above.

A few observers have deemed it fit to emphasise that close corporations enjoyed certain tax benefits until 1989, after which registrations began to drop. It is quite correct that registrations of close corporations showed a steady decline from 1990 to 1993. But it should be clear that this trend was reversed after the constitutional and political changes in 1994. In fact registrations of close corporations in 1994 showed a significant increase compared to the 1993 figure. This increase was sustained in the following years to the extent that registrations in 1997 were more than double those in 1993. Registrations of close corporations, in fact, increased from 33,000 in 1993 to 71,178 in 1997. It should also be borne in mind that registrations of companies showed a similar downward trend from 1988 to 1992. These statistics and the economic, social and political circumstances in South Africa during that particular period mean that the simplistic perception that the downward trend was maintained only in terms of close corporations and solely due to a change in its tax dispensation, should not be left unchallenged.

It has been suggested that close corporations are far more susceptible than companies to liquidation by the court as well as deregistration by the registrar, and that this may point to the possible abuse of the close corporation. Taking into account the relatively high failure rate of small businesses in general, especially in times of economic recession, the statistics in Table 4 do not seem to provide conclusive support for such an averment.

INTERNATIONAL RESPONSE

Developments in South Africa did not pass without comment outside Southern Africa (see Anon, 'Corporate Law; Recent Developments I', *International Business Lawyer* (1987), 77; Pingfat, *op. cit.*; e.g. Henning and Bleimschein, 'Die neue Unternehmensform der Close Corporation in Südafrika', *Recht der Internationalen Wirtschaft* (1990), 627).

Thus the Act was judged by Professor Uriel Procaccia of the Hebrew University of Jerusalem as '[a] recent impressive close corporation statute' (Procaccia, 'Designing a new corporate code for Israel', *American Journal of Comparative Law* (1987) at p. 589). Professor Len Sealy of Gonville and Caius College, Cambridge, described the Act as 'a model worth very serious consideration' and considered it to be a much bigger success than the 'unanimous written resolution' and 'elective regime' amendments introduced for private companies by the *Companies Act* 1989 (in a paper, 'Legislating for the small business', read at the *Company Law Reform Seminar* of the Institute of Directors on 7 December 1993). He succinctly contrasted the South African and Australian experience of the close corporation:

> *'The* [South African] *legislation shows that it is possible to do without shares, capital, directors, meetings, articles of association, annual returns and audit ... Australia endeavoured to go down the same road in the mid 1980s and did, in fact, enact the Close Corporations Act 1989. It was modelled initially on the South African precedent, but they* [the Australians] *kept wanting to build more and more of the traditional company into it, so it became a fairly lengthy piece of legislation. If that were not enough, it then incorporated by reference, huge chunks of the main Corporations Act. So it was not a successful venture.'*

A report on alternative structures for small businesses in the UK pointed out that the South African close corporation has been highly successful, inter alia because of 'its own intrinsic merit' (Chartered Association of Certified Accountants, *Alternative Company Structures for the Small Business* (1995) at p. 44).

In her comprehensive 1996 survey of company law in more than 12 jurisdictions as part of the review of the Hong Kong Companies Ordinance, Professor Cally Jordan stressed that the South African Close Corporations Act: 'has proved to be one of the most remarkable innovations in South African company law' and one, at that, which appears to have been singularly successful (Jordan, at p. 47–49).

CONCLUSION

In South Africa the notion is now firmly entrenched that differentiation between the small incorporated business concern and the large company is called for. This means that each may participate in the commercial activities of the country in the most efficient manner possible for the furtherance of the best interests, both individual and collective, of all concerned.

It is clear that the South African experience of the close corporation concept has in the main been very positive. The favourable and enthusiastic reaction of entrepreneurs exceeded the expectations of even the initiators of the Act. It has given a considerable and very necessary impetus to the small business sector in particular, while many large undertakings conducting business in the form of a close corporation are encountered in practice. Time will tell whether the experience of other Southern African jurisdictions will prove to be as positive.

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