



## DOES THE CURRENT GOVERNANCE FRAMEWORK OF THE SECTIONAL TITLE SCHEME INFLUENCE ITS GOVERNANCE PRACTICE?<sup>1</sup>

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**Abstract.** *This article investigated whether the current governance framework for sectional title schemes influences its governance practices. The primary goal was to examine the degree to which the rules of the sectional title schemes under the current governance framework are implemented and their impact on governance practices in managing those properties. Furthermore, the study investigate the effects of these guidelines on the overall governance procedures involved in administering sectional title properties. The research seeks to uncover gaps and issues within the governance structure that may impede effective property management by examining the alignment between mandated regulations and their actual implementation. The findings provided insights into how successfully the current rules enable or hinder good governance practices in sectional title schemes, with implications for policymakers, property managers, and stakeholders looking to improve. A practical recommendation was be made on the possibilities of closing the expectation gap encountered with the current governance framework.*

**Keywords:** *Sectional title scheme, body corporate, application of rules, conflict of Interest, Corruption, transparency and accountability, good Governance.*

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## 1. Introduction

The research findings presented in this article form part of the results of a comprehensive study done on the governance framework for sectional title properties in South Africa. This is the first article in the current governance framework of the sectional title scheme properties. One of the primary contributions of this study will be its capacity to empirically link governance frameworks with management behaviour regarding rule infractions while also providing useful insights and practical recommendations to improve the governance and management of sectional title schemes. The outcomes of this study can help to produce better policy suggestions to strengthen the governance framework of the sectional title scheme. Most studies conducted in this field did not consider the governance framework as one of the variables that needed to be examined to resolve problems within the schemes. The governance framework of sectional title schemes is particularly important for this study because it influences decision-making and policy execution. A solid governance framework can lead to improved decision-making, accountability, and transparency. It guarantees that all members of the corporate body follow the rules and regulations that govern the schemes. However, an inadequate governance framework can result in inefficiency and corruption. Therefore, this article will contribute to the body of knowledge about the governance of the sectional title schemes properties in South Africa. The study also adds to the overall advancement of property management practices by giving a critical evaluation of the current governance framework and increasing the understanding and practices of governance for sectional title systems.

This study's approach was based on the literature about incorporating good governance practices within the sectional title schemes and establishing the influence on bad governance, including the violations of the rules of the scheme by trustees and managing agents. This paper adopted three governance theories, namely: the agency, stewardship, and stakeholders' theories, to complement the approach used in explaining the variables of the study. The reason for adopting these three theories was that no previous studies conducted in South Africa adopted them in conducting research about the governance of the sectional title schemes. As a result, these governance theories will contribute to a better understanding of the management dynamics between property



owners, trustees, and managing agents, as well as provide a prism through which to evaluate the current governance framework's performance and improve rule execution.

The study was geographically limited to South Africa, which limits the applicability of its findings to other areas. However, this geographical focus may not fully represent the nations worldwide, making it advisable for similar studies to be conducted throughout the world to gain a more comprehensive perspective. Another significant limitation stemmed from the Privacy Act (POPI Act No. 4 of 2013), which prevents access to private information of sectional title schemes body corporates held by managing agents. Additionally, the study focused exclusively on residential sectional title scheme properties, omitting the examination of commercial sectional title scheme components within mixed-use properties managed by a single body corporate. This study will begin by providing a brief background on sectional title scheme properties in South Africa, followed by the research methodology. The rules of the sectional title scheme will also be discussed, followed by the scheme's current governance framework. The study will also discuss the impact of the legal and regulatory environment on sectional title schemes and governance practices in managing those properties, followed by recommendations and conclusions.

## **2. Background**

Before the early 1970s, the concept of shared ownership was not recognized in South Africa; it was impossible to obtain full ownership rights to a section of a building, such as an apartment or flat unless you own the whole building (Steenkamp and Lubbe, 2015). The introduction of the sectional title scheme Act no 66 of 1971 in South Africa came along with potential opportunities for people to own a portion of properties within the building. Prior to this Act people were not allowed to own portion of the building apart from owning the land where the entire building was built. By that time South African property law did not recognise a separate ownership of the building. Thereafter, South African government decided to repeal Sectional title scheme Act no 66 of 1971 and replaced by sectional title scheme Act 95 of 1986 to ensure that the scheme was regulated.

Due to land prices and demand for affordability houses, many countries have adopted sectional title schemes around the world (Fisher and McPhail, 2020). The South African government was



not exempted to those land challenges like the rest of the world. In South Africa, this Act was modelled from countries such as Singapore and New South Wales in Australia (Steenkamp,2017). So, the South African government adopted the sectional title scheme Act model from those countries to provide houses to the people in the country. The majority of black people were excluded from owning property in the country when this Act was introduced because of apartheid, which was rooted in property law. Ti (2020) agree that the sectional title scheme has the potential to alleviate some of the deleterious effects of apartheid by providing more housing and a platform to foster integration.

Despite the abolishment of the Group Area Act of 1966 in 1990 and the implementation of progressive housing policies in South Africa, whereby sectional title scheme was placed in the centre of the democratic government housing policies, to help by redressing the legacy of apartheid housing policies. There was outcry by many properties' owners regarding the governance of these schemes. The South African government's intervention was to introduce the Sectional Title Scheme Management Act no 8 of 2011 and Community Scheme Ombud Service Act no 9 of 2011 to mitigate these predicaments and their effects. Although the establishment of those Acts was meant to improve the sector, however, the sectional title schemes are still in crisis with governance issues. Baboola-Frank (2020) states that even though sectional title scheme is currently regarded as a profitable market, the governance of that scheme is still a challenge to many property owners. Steenkamp (2017) supports this claim that the sectional title scheme contains many unclear and contradictory regulations which pose a challenge to owners regarding the governance of the body corporates. In terms of section 37(1), the boards of trustees are required to prepare the body's corporate annual financial statements despite considering their skill levels. In addition, those contradictory rules of the scheme make trustees disregard it which lead-disregard it, which leads to poor governance of the scheme in general. However, one of the main problems with the sectional title scheme regulations in the country is the application of the rules.

Furthermore, the sectional title scheme allows the managing agent to open an account for the body corporate on their behalf while they are just employees of the body corporate. In addition, there are no consequences for trustees and a managing agent who disregard the rules of the schemes are no consequences for trustees and managing agents who disregard the rules of the



schemes, and many-body corporates find themselves in financial difficulties (Dlamini and Boshoff, 2017). It is these kinds of practices that undermine good governance principles of the sectional title schemes.

The main purpose of the study was to examine the degree to which the rules of the sectional title schemes under the current governance framework how they are implemented, and their impact on governance practices in managing those properties. There are a lot of theories for corporate governance on how organizations can achieve good governance. Although there many corporate governance theories used by different authors, agency, stewardship, and Maslow's hierarchy of needs are the best theories to explain the challenges of good governance of the sectional title schemes. The agency theory is best explained by Jensen and Meckling (1976), who noted that there are three things that cause agency conflicts, namely the opposing interests and goals between principals and agents, insufficient internal control measures to be used by principals, and information asymmetry. The agency theory advocates that poor corporate governance is caused by the separation of ownership and control, which results in information asymmetry, therefore, there is a need to align the self-interest of agents with the organisation's objectives (Almashhadani and Almashhadani, 2022). In terms of Section 6(1) of the Scheme Act, the corporate body must appoint the trustees, and all the corporate responsibilities are delegated to them. that is where agency problems arise because of this separation of ownership, which leads to information asymmetries. In addition, the agency theory is employed in this study because of its relevance to the structure of the sectional title scheme property hierarchy and the functions of managing agents, trustees, and property owners in terms of good corporate governance. The agency theory was adopted in this study to gain a better understanding of the contractual relationship between the agent (Trustees/ managing agents) and principal (Property owners).

Furthermore, the stewardship theory views governance from the legal perspective of the firm, where the separation of ownership occurs because the owners of the organisation hire the manager to act on their behalf or as stewards for the owners' interests (Thabane and Van de Venter, 2018). The stewardship theory advocates that managers of the organisation are left alone to do their job because owners believe their interests are aligned with theirs. The same applies to the body corporates of sectional title schemes, in terms of Section 40(1) and (2), where each



elected trustee must stand in a fiduciary relationship with the body corporate, without prejudice. So, the relationship between trustees and the body corporate is based on trust. In this study, the trust relationship between owners and management is the source of good governance because the interest of both parties is aligned with the objectives of the organisation.

This study further used the Maslow hierarchy of needs to better explain the issue of behaviour regarding the agent (managers and Trustees) and Principal (Owners) relationship within the body corporates. The Maslow hierarchy of needs was postulated in this study to provide further explanation of this issue. According to Numonjonovich (2022), the Maslow hierarchy of needs advocates that people perform best at work based on the level at which they are in the pyramid. So, this means that, a best performing manager is the one who is on top bottom level of pyramid in the self-actualisation level. Therefore, this pyramid of needs will further assist the body corporates in hiring well-developed managing agent whose interest will be aligned with the property owners to improve their scheme governance. Although all theories indicated in this study are best explain the governance of the organisation, however they do have some limitations on them. One of the limitations of agency theory is that it focuses more on agents self-serving interests while ignoring the fact that some agents may act contrary to that because they might be motivated by factors such as professional work ethics. The stewardship theory has been criticised in recent times, with the trust owed by the directors having been eroded by corporate scandals involving risk trading, no disclosure, and a lack of transparency and accountability by managers (Thabane and Van de Venter, 2018). However, most criticism of Maslow's hierarchy of needs is that people question its validity and why the focus of this pyramid is ethnocentric and based on self-actualisation needs.

### **3. Research Methodology**

The research design for this paper was based on secondary data and content analysis, and the data was acquired from public sources. The researcher used content analysis since it is a flexible method for examining text data (Smith and Marx, 2021). The search for secondary data in this study started from academic libraries at Tshwane University of Technology. The research specialist from the Tshwane University of Technology was used to assist in searching for relevant academic sources and archives from the university libraries. The secondary data for this paper



were obtained from sources such as journal articles, dissertations, thesis, and Google Scholar. Other institutional publications, such as Community Schemes Ombud Services and the National Management Agent Association, were also used to obtain relevant data about the regulations and application of sectional title scheme rules and the current governance framework of these schemes. However, in this study, the secondary data used were for the period between 2015 and 2024.

Furthermore, the data collected from various sources was consolidated to ensure similarities in formats. Then, all secondary data collected findings were compared with other sources regarding governance issues across different studies of the sectional title schemes. The researcher analysed the trend in rule violations or implementation by both trustees and managing agents and its impact on the governance practices of the schemes.

#### **4. The rules of the sectional title**

The Sectional Title Scheme Management Act no .8 of 2011 mandates that all sectional title property schemes be established, regulated, or managed by means of four types of rules: conduct rules, management rules, participation quotas rules, and exclusivity rules. The scheme Act grants the developers the authority to create rules prior to the foundation of the scheme or the establishment of the body corporates. These rules are legally binding for all members of the corporate body. Section 35(1) of the STSMA declares that the rules must provide for the control, management, administration, use, and enjoyment of the sections and the common properties. The STSMA further requires that all rules must apply equally to all owners of the units. The rules must accompany the developer's application for a sectional title scheme, which means that it is mostly formulated by the developer. Section 10(5) stipulates that the body corporate has 10 days to register changes to these rules after the establishment of body corporates when a resolution has been reached in a general meeting. These rules must be available for all body corporate members.

Section 10(2) indicates that the management, as well as the conduct rules, can be substituted, amended, or repealed by the corporate body through unanimous resolution or special resolution. This assertion was supported by CSOS Circular No. 2 (2018:2). The requirement is, however, a unanimous resolution of 85% or a special resolution of at least 75% of owners, calculated both in



value and number of the votes, must support the resolution. It could also be agreed to in writing by members of the scheme in case of unanimous resolution, which needs to be obtained in changing the management rules. Before submitting the amendment of rules to the CSOS for approval the body corporate must ensure that this matter was discussed and approved at a general meeting or special general meeting.

The implementation of the rules of sectional title schemes is subject to several limitations. According to Circular No. 2 of the CSOS (2018), the body corporate must ensure that the proposed changes to the rules are legal, reasonable, and equitable to all scheme members. The Ombudsman office must take the necessary steps to guarantee that the scheme's rules are in accordance with South Africa's constitution, while the board of trustees must enforce the rules. The rules of the scheme play an extremely critical role in creating a conducive environment for every member to enjoy. The rules of a sectional title scheme are good if they serve the intended purpose. Amending ineffective rules, however, can be quite challenging for property owners because of the requirements needed to approve such amendments.

The sectional title scheme comprises a co-ownership share, which determines the rights and responsibilities of each owner and their voting power in the administration of the development (Çağdaş et al., 2020). In terms of section 11(1) read with subsection (2) of the sectional title scheme section, the effect of a quota is to determine the value of the vote of the owners of the section. The participation quota in section 34(2) is read with this rule because it determines the contribution of the owners in terms of a levy. However, these rules are affected by the developer when the scheme is first registered. Thereafter, the body corporates can modify these rules under Section 11(2) to allocate a different value to a section owner's vote and modify their liability. Çağdaş et al. (2020) reveal that the most common approach to the determination of the ownership shares is based on equality, the relative size or relative value of each condominium unit, or a combination of these. The issue of participation quotas has an impact on how decisions are made within the sectional title scheme. When owners vote for unanimous and special resolutions, for example, the issue of participation quota determines the value of the owners' vote. Van der Merwe (2020) points out that this modification is subject to provisos. For example, in a situation where a sectional owner is adversely affected by such a resolution, written consent must be



obtained from the said owner. In terms of STSMA subsection (4), the quota of a section shall determine the value of the vote of the owner of the section in any case where the vote is to be reckoned in value.

Van der Merwe (2020) further explained that the participation quotas influence the governance structure of the schemes since owners with larger quotas have more authority and influence over scheme decisions. Also, the participation quota influences the outcome of decisions such as trustee elections, budget approval, and rule amendments. The unequal representation in body corporates, which is brought by participation quota, can create conflict among the owners because the majority owners might try to influence the direction of the scheme at the expense of minority owners. However, the rules of the sectional title scheme lay down the framework of the governance of the corporate body. However, the primary cause of poor governance within the schemes is a participation quota which can have a negative impact on all the section titles schemes resolutions.

In terms of Section 3(1) of STSMA, all members of the body corporate are liable to pay a monthly levy. However, the current ambiguous rules of the sectional title scheme are not clear or enforceable for defaulting owners. Under the current act, body corporate or trustees do not have the power to disconnect services such as water or electricity from any defaulting members. Failure to collect levies might result in insufficient cash for maintenance and repairs, causing building degradation and owner disputes. Therefore, the body corporates should be given the power to disconnect such services to all non-compliance owners to ensure that schemes are well maintained because their actions affect other members.

## **5. The current governance framework**

According to the Sectional Titles Act No. 95 of 1986, which regulates multi-unit properties in South Africa, the residential sectional properties are first managed, administered, and controlled by the developer before being transferred to the body corporate. In turn, the Act grants the body corporate the right to assign all its management responsibilities to the board of trustees for overseeing the management process, upon the formation of the body corporate. With this current governance framework, the board of trustees is the one who appoints the managing agent at the



trustees meeting, and these managing agents, as employees of body corporates, are the ones who open the account of the body corporate and invest their money on their behalf. Recently, there has been a sharp increase in multi-unit properties across the world, South Africa included. This growth has been accompanied by a governance crisis relating to the management and sustainability of these properties. Training of trustees was cited as the most effective measure to ensuring good governance; however, what remains unanswered is the existence of the association between governance framework for sectional titles and good governance practices and implementation of the sectional title rules and sound governance.

Due to the substantial number of contradictory and confusing legal aspects of the current sectional title legislation, there have been various incidents of fraud in the industry in recent times (Steenkamp, 2017). In many cases, a poor governance framework is always associated with ambiguous rules, which often lead to a lack of accountability and transparency. Therefore, this current study built on this gap and examined the degree to which the rules of the sectional title schemes under the current governance framework are implemented and their impact on governance practices in managing those properties. The fact that no research studies have yet been undertaken on the governance framework of the sectional title scheme properties and the practical operation of this framework. Therefore, this study warrants to be undertaken to bridge the gap in academic literature in the South African context.

## **6. The impact of legal and regulatory environment on sectional title schemes governance practices and management of those properties.**

The origin of the sectional title scheme property was based on the vertical subdivision of high-rise buildings rather than a traditional horizontal subdivision of the building or land (Harry, 2019; Izanda, Samsudin, and Mohsin, 2022). The developers decided to extend this rule into a mixed two-tier scheme which was not the original intention. As a result, the governance of sectional title schemes has been a challenge to many property owners for many years now because of this development, despite the benefits of solving the housing problems in many countries around the world. Therefore, there is a need for proper and good corporate governance practices in the management of these dwellings.



According to Salah (2021), the governance framework is there to encourage the efficient use of resources and equally hold people accountable for the stewardship of those resources. The governance framework of the sectional title schemes was thus meant to promote good governance because there is a higher credit risk in financing a poorly managed scheme. Therefore, to mitigate a dysfunctional corporate body, it is the responsibility of all stakeholders, including CSOS, to the best possible defence mechanism. The STSMA provides a way for judicial management of a scheme to protect owners in the event of poor administration, a body corporate's failure to uphold its statutory commitments, or if it becomes unable to pay its debts.

The expansion from vertical structures to the horizontal format led to the evolution of the governance framework. For the scheme to fulfil its intended objectives, there is a great need for proper governance. Van der Merwe (2018) states that the person who creates the governance document for the sectional title scheme must be familiar with the property to provide a succinct document that is appropriate for that specific building. Infighting between owners and trustees, weak regulations and rules of the schemes, poor maintenance, unscrupulous trustees, and poor cooperation between the trustees and management agents all contribute to the overall negative impression of the sectional title scheme that is presented in the literature.

Most issues with sectional title schemes are related to ignorance regarding the rules and regulations of the governing schemes. Ignoring these rules will render the property ungovernable (Johnson, Boipuso and Gaisi, 2016). Dlamini and Boshoff (2017) illustrated this concept through the example of the trustees of a sectional title scheme who embarked on a painting project, despite it being rejected at the AGM. In terms of section 39(1), the corporate body placed a restriction on the trustees, but they disregarded those restrictions without any consequences. Baboola-Frank (2020) also found that the sectional title rules that governed Indigenous people in relation to Aboriginal sectional tile rights in South Wales were riddled with controversy. Kyere and Ausloos (2019) pointed out that one role of corporate governance is to manage these conflicts between the principals and the agents. Salah (2021) concluded that an effective corporate governance system is vital because it helps to specify the distribution of roles, responsibilities, and resources among different stakeholders of the organisation. Good governance of the sectional



title scheme is a critical tool that could increase investments, economic growth, and adherence to organisational policies and procedures.

Aspan (2017), on the other hand, explained that one of the problems of implementing good corporate principles is that the conditions cannot be promoted within the organisation if it has not been well established. The implementation of management and conduct rules in sectional title schemes was intended to provide a conducive environment for good corporate governance. Steenkamp and Lubbe (2015) disagree with this assertion, revealing that the problem with many sectional titles schemes is that the corporate body is not being run like a business organisation because of the ambiguity of rules, inadequate enforcement mechanisms and conflict of interest of both trustees and managing agents.

Dlamini and Boshoff (2017) pointed out, however, that the lack of financial control measures and consequences for trustees who mismanage the funds leaves many body corporations vulnerable to abuse by the board of trustees. Since good governance is based on rules and policies, the lack thereof will lead to a failure to implement good governance within the organisation. This will also hamper the procedures of holding the board of trustees accountable, thus preventing good governance from thriving in the current environment (Lee and Yip, 2020) while causing financial stress and misconduct (Paulina and Barus, 2021).

Dlamini and Boshoff (2017) claimed that once trustees are appointed, they become a law unto themselves, which often puts the corporate body in financial jeopardy. Yau, Ho, and Li (2017) suggested that the reason for this behaviour is that they are striving to maximize their own profits or interests. They often do not have the best interest of the scheme at heart and engage in opportunistic behaviour using the scheme's resources. As such, the board of trustees views themselves as above the rules of the scheme which should be applied equally to all members (Gelter and Helleringer, 2018).

Another challenge to the implementation of good governance practices is the absence of a prescribed financial framework model. Therefore, this study intends to reveal all the problems that might be caused by this lack of a financial reporting framework for the sectional title scheme. The STSMA, rule 26(5)(b) states that the sectional title scheme properties can use any financial



standards framework, and the body corporate at AGM must appoint an auditor to audit their finances for their current fiscal year in terms of prescribed management rule 17(6)(j) (vi). According to Steenkamp and Lubbe (2015), the appointment of an auditor is done by the managing agent on behalf of the corporate body to audit themselves. The introduction of the sectional titles scheme Act no 8 of 2011 by the government was meant to solve the governance issues within the sectional title properties. However, this initiative has not yielded the desired results yet.

## **7. Recommendations**

The focus of this study was on the governance of sectional title schemes based on literature about the perceptions of the owners of these schemes. This makes the study unique since this approach was not used by previous studies. Based on the findings of the study, and considering how crucial sectional title programmes are to resolving housing issues brought on by a lack of available land, a series of recommendations and suggestions have been put forth to address various aspects of governance within the sectional title scheme industry.

Primarily, it is advisable that the government should mandate a corporate governance code tailored specifically for the industry, serving as a comprehensive management guideline. The Community Scheme Ombud Service (CSOS) is recommended to play a role in vetting trustees after their election by body corporates. To combat corruption and enhance transparency, the adoption of a procurement policy for hiring outside service providers is encouraged.

Furthermore, the establishment of a dedicated financial reporting system for the sectional title scheme industry is recommended. Eligibility rules and requirements for trustees and managing agents should be prescribed by the Act, and a performance contract between body corporates and trustees should be implemented. Consequences, including criminal charges, should be in place for trustees who violate body corporate rules, with CSOS coordinating with law enforcement.

Managing agents and trustees should be prohibited from preparing annual financial statements, instead relying on qualified accountants. Managing agents should no longer have control over body corporate finances, and an audit committee should be established to monitor financial reporting and ensure rule compliance. Clear segregation of duties should be emphasised, and the



application of management and conduct rules in residential sectional title schemes should be clarified.

The participation quota and voting system for the schemes need clarification, and technology should be integrated to grant members access to financial information. Mandatory provision of meeting minutes to CSOS for annual rule reviews is suggested, and a shift from a simple majority voting system to consensus is recommended to prevent conflicts of interest.

Legal remedies should be established to address trustees' transgressions, and CSOS should conduct on-site inspections. Encouragement of committee' formation, such as an audit committee, should be facilitated. The governance framework should be expanded to include an independent audit, excluding trustees. Inconsistencies in scheme regulations should be rectified to enhance management accountability. Lastly, the implementation of a consequences management plan is advised to curb corruption and fraud while ensuring the segregation of duties throughout scheme management for accountability. Additionally, altering the effect of the vote by participation quotas is suggested to maximise owner participation in body corporate decision-making.

## **8. Conclusion**

Considering the above discussion, this paper argues that there is a poor implementation of the rules of the sectional title scheme by both trustees and managing agents under the current governance framework, and this has an impact on governance practices in managing those properties. While efficient governance of a sectional title scheme depends on the meticulous execution and enforcement of rules. One of the main impediments to poor governance is the lack of consequences because the scheme rules are insufficient to correct the unethical behaviour by the scheme management. This lack of consequence management has led to fraud poor maintenance of the building and disputes among owners within the sectional title schemes. Sectional title scheme legislation anticipates transparency and accountability, as well as compliance with scheme rules by all members of the body corporate, to ensure the schemes' good governance. However, the regulations used to govern sectional title scheme rules are insufficient to promote good governance of this type of property. Therefore, both trustees and managing



agents violate the rules of the schemes because the current regulations are too vague to enable owners to hold them accountable.

The conclusion is further that the governance framework needs to be reviewed to address the many shortfalls pointed out by this study. In addition, the study has revealed that the roles of CSOS and EAAB were minimal and need to be expanded so that they can collaborate and improve the governance of this scheme. To solve the country's housing crisis, it is imperative that the sectional title scheme's governance be improved. The study proposes an expanded governance framework that can address these shortfalls and assist in making sectional title schemes a solution to the housing shortages in South Africa. The new structure will give the body corporate the power to appoint new boards of trustees, and independent Audit committee members. Although this committee will comprise property owners within the scheme who are not previous or current trustees, it will oversee the scheme's operation. However, this is in line with the agency theory argument that organisational structure is one of the causes of poor governance. Therefore, the proposed framework will improve the governance of the sectional title scheme because the current structure does not promote transparency and accountability in the management of the scheme.

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