

Can South African State Owned Companies succeed?

Lynn McGregor.

President Zuma in his 2014 State of the Nation address, points the way; “As we enter the second phase of our transition, we have to embark on radical socio-economic transformation.” “Change will not come about without some far-reaching interventions.” Deputy Minister Cyril Ramaphosa, talking about twenty years of an ANC government, added, “There are areas where we are learning, where we have made mistakes and also where we have hit the mark.” Government has come up with a National Development Plan. (NDP) The focus for the next five years is to “roll out the plan”.

Given the underperformance of many State Owned Companies (SOCs), ‘radical transformation’ could be the way to improve SOC performance. Improving the Corporate Governance of SOCs will go a long way to help roll out the plan.

SOCs play a crucial role in providing economic infrastructure. They provide vital services and products as well as providing employment and capacity building. Successful SOCs will put South Africa at a competitive advantage. Key to better company performance is good corporate governance. Good corporate governance provides the regulatory framework for acceptable practice, strategic direction and sound business judgement. As SOCs are primarily owned and led by Government, government departments and boards of companies are partners in providing corporate governance to ensure their success.

This article follows a longer Think Piece, “Improving Corporate Governance of SOCs”, which looks at practical ways in which better corporate governance could be implemented. It was a result of a study by Lynn McGregor and Nozizwe Madlala Routledge, a former Deputy Minister, of the interface between Government and SOCs over eighteen months, including interviews and meetings with the former Deputy President and a number of Ministers and their Department heads. It followed an SOE Ratings Project co-funded by the Centre for Corporate Governance at The University of Stellenbosch (USB) and the Hans Seidel Foundation, who also commissioned the Think Piece. Before this, Lynn McGregor led a number of USB Colloquia inviting business leaders to think strategically about improving corporate governance in S.A. Many of the issues they raised are similar to the ones mentioned in this article including the urgency to develop a sound infrastructure and to address lack of experience and expertise at board level.

McGregor has also had hands on experience as a board director, a chairperson and has run her own company. She has drawn on over twenty five years of working with Chairs, boards, CEOs, Executive Committees and Active Shareholders worldwide to improve results through better corporate governance. This included assessing and developing board and executive potential and improving interface between boards, shareholders and stakeholders.

WHY IS CORPORATE GOVERNANCE IMPORTANT?

When corporate governance works, it provides the safety net to ensure that the main components are in place to create successful outcomes. Corporate Governance is the process and system whereby companies are governed. Corporate Governors have legal and fiduciary (financial health) duty to check that all transactions are legal and conform to acceptable corporate governance practice. They are responsible for determining strategic direction and checking. It is their task to make sure that the CEO and the executive team delivers financial, social and environmental targets on time with no nasty surprises. While government is the main shareholder in SOCs, in many cases investors from the private sector will also contribute. Investors are more likely to invest in a company when there is sound corporate governance.

SOCs are different from the private sector because Corporate Governance includes both Government and Boards, with Government make final decisions concerning allocation of finance and the selection and retention of board members. Both groups are therefore involved with the process of governing companies. It is however important to remember that the quality of corporate governance depends on whether corporate governors have the capacity, knowledge, experience, expertise and integrity to make and carry out wise decisions in the interests of the shareholder, company and stakeholders including the public.

The key ingredients for good corporate governance of SOCs have been extracted from the revised Companies Act, the Public Services Financial Management Act, The King Reports and other sources of good practice including experience of 50 boards worldwide.

Main ingredients for good corporate governance

It suggested that for good corporate governance to be practised, five main components need to be present:-

- **Structures, systems and processes are in place**
- **The right mix of intelligence, knowledge, experience and expertise**
- **Regulatory Certainty**
- **Understanding and principles and practice of sound corporate governance**

If the Boards of all SOCs and those in Government involved with SOCs, practiced the principles enshrined in the Companies Act, standards of corporate governance would radically improve. The same applies to sound business judgement

Key Corporate Governance principles for SOCs. (Companies Act)

- Transparency.
- Accountability
- Efficiency
- Sound business judgement
- Regulatory certainty – conformance to regulations or good reasons for deviating

Given that these are State Owned Companies, it is also suggested that the oaths sworn by MPs should also be considered, in particular:-

- Obey, respect and uphold the Constitution
- Behave with honour and dignity.

Sound business judgement - Most common areas for board to monitor.

(List of most common areas resulting in high risk for Companies. Auditor General (2013))

- The quality of submitted financial statements and integrated company reports
- Whether levels of tolerance for audit disclaimers are too high
- Financial health
- Supply-chain management, including contracts and tenders
- Human resources management
- Information technology

Significant progress has and is being made.

Government has established what are considered world class regulations and corporate governance guidelines – The revised Companies Act and the Public Services Financial Management Act amongst other. The Presidential SOE Inter-Ministerial Committee is in the process of simplifying and updating structures, systems and processes. Departments such as the DTI and DPE are working closely with Chairs and CEOs to establish better practice and the DPE has created a comprehensive shareholder working framework that clarifies their roles and responsibilities as a majority shareholder. In the private sector the King 4 Report will update King 3. These reports have been influential when Government Acts have been produced.

While there is considerable progress, it is probably not enough to address the poor track record of many SOCs.

THE STATE OF STATE OWNED COMPANIES IN SA

It was difficult to get accurate detailed information because of lack of availability of information either from government or the companies themselves. Company Reports, while improving their appearance, do not often deal openly with problem areas. To get a general picture, information has been gathered from interviews with some ministers and their departmental teams, Government budget Reports, the results of an SOE Ratings project and media news. Even though the media has a reputation for misreporting, there are enough stories of poor performance for all information to be dismissed as media bias.

This combination of information has provided a perspective on how well SOCs are performing.

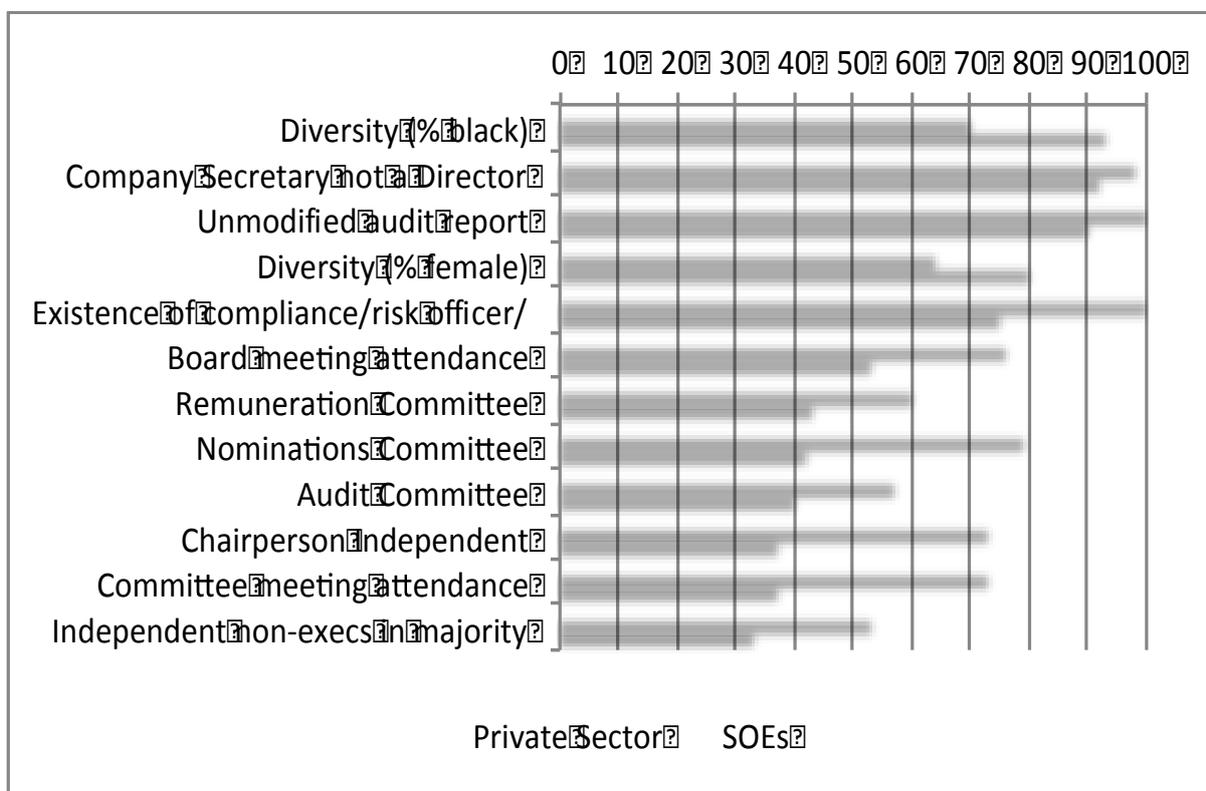
SOCs underperform in relation to the private sector

The USB Ratings Project was an initiative led by the Centre for Corporate Governance in Africa at the University of Stellenbosch, funded by the Hans Seidel Foundation. Lynn McGregor and former deputy minister, Nozizwe Madlala Routledge modified a Corporate Governance ratings matrix previously created for Public Investment Corporation, mainly for the private sector. McGregor and Madlala Routledge realised that the matrix would have some differences because of the role of Government in SOCs. Members of Government and SOEs were invited to a consultative workshop to check the relevance of the ratings. Once the matrix was finalised, the top 30 Schedule 1 and Schedule 2 (SOCs) were rated according to publically available information. The top five SOEs were announced in September 2012 and Denel was rated as ranking first.

The Ratings Matrix was based on what was considered good corporate government practice and companies were rated under 12 main headings. The purpose of the ratings exercise was to help companies compare their corporate governance performance against good practice. Generally, SOCs rated lower than the private sector under most headings apart from Diversity.

Corporate Governance Comparisons between Private and Public Sector

“Governance and State Owned Enterprises.” Centre for Corporate Governance in Africa, USB, 2012



The results of the project were limited. They were based only on publically available information, which was fairly scant and did not take into account difficulties the Companies

were facing For example, although Denel was rated first, what was not taken into account was that at the time it was in trouble because it facing bribery charges by the Indian government and had cited a government bailout as profit. It was also noted that there was a marked indifference both by government and by most of the companies indicating that ratings were not taken seriously. It is suggested that the reasons for this is that both Companies and Government at the time were struggling to deal with one crisis or scandal after another.

Poor track record of some South African key SOCs

Companies that have been in trouble over the last five years and have cost the billions of rands are numerous. They include Sasol, PIC and GEPPF, Armscor, Telkom, SABC, Eskom, SAA, Denel, the Post Office, Armscor and SABC, all companies crucial for infrastructure. Most of the problems could have been prevented had there been good corporate governance. Those responsible for governing State Owned Companies could have provided the necessary checks and balances and taken the right measures.

In looking at reports concerning the above companies, certain patterns emerged which provide an understanding of certain key problem areas, some of which were mentioned in the SOE Presidential Review. These fall under six main headings.

Same problems. Different stories

In examining the examples for similar patterns, it appears as if the patterns causing poor performance fall under six main headings: -

- 1. Corporate governance incompetence causes poor results**
- 2. Poor selection and development of Boards and Executives**
- 3. Constant turn-over of key players disrupts good practice**
- 4. Dysfunctional working relationships**
- 5. Inadequate structures, systems and fragmented processes**
- 6. Lack of moral norms resulting in corrupt practices**

(More detailed references of the Companies can be found in the Think piece, Improving Corporate Governance of SOCs, 2013.)

1. Corporate governance incompetence causes poor results

The examples indicate that boards either do not know what they are doing or fail to pick up problems or intervene in time.

Examples

Sasol - fined R534 million for charging excessive prices for propylene and polypropylene

Eskom - failed to produce profits. Requested a 16% price hike that was refused, electricity and gas prices amongst most expensive worldwide. Strategic direction and Capital Expenditure only determined in 2014, years after the problem was known. Nominated in

2013 for worst company in the world in terms of social responsibility Poor standards resulted in the company being seriously downgraded by Standard and Poors and Fitch and cited as having a poor credit rating.

Armcor - Former Defence Minister fired the former chair and deputy for failing to deliver equipment to troops deployed in the continent without going through due process. Not certain whether the board picked up delivery failures or had situation remedied.

One of the reasons for incompetence and therefore failure to deliver is the shortage of experience and expertise of board and executive directors partly as a result of Apartheid and partly because the development of directors has not been a priority. It is not surprising that the composition of boards and executive teams are problematic.

2. Poor selection and development of boards and executives

One of the most common grievances SOC boards have against government departments is their selection of board members. Government committees nominate board members and CEOs, supposedly but not always after consultation with the board. Boards accuse government ministers of making 'political' appointments without due consideration of the mix of knowledge and expertise needed on the board. The high turnover of directors together with poor company performance is evidence that succession planning, selection, development and retention of board members is well below acceptable standards. Not having a competent board or executive team is like telling amateurs to fly a jet without training or a licence.

Examples

GEPF. Example of imbalanced board, where the board consists of mostly political appointments, eight appointed by finance minister and six nominated through the public sector bargaining process. Chaired by an ANC MP, thus extremely difficult for independent directors to contribute meaningfully or for a CEO to get real value from the board.2014.

SABC. The Public Protector is investigating the permanent appointment of an acting COO as he had already been found guilty of misrepresenting his qualifications. She is also following allegations of 'maladministration and improper and unethical conduct' given that it appears that the post was not advertised and no candidates were shortlisted.2014

Telkom – Minority of independent directors. Danger of biased board.

One of the most common reasons is the lack of professionalism on the part of the selection committee, the board or the board's inability to be taken seriously. Another reason is that due process may not be followed leading to impulsive appointments without checking the competence of the candidate. Shortage of competent directors on the board and the executive means that necessary skills are missing. Without contingency plans to ensure that the necessary skills are provided, the constant turnover of boards and executive committees is likely to continue. It brings into question the general quality of due processes, the limited list of potential candidates and the ability of the chair and members of the nominations committee and indeed the boards, to make wise informed decisions. In many cases, it seems that succession planning is missing and that the induction of new board members and development of current directors is lacking.

3. Constant turnover of key players disrupts good practice

The corporate governance dance between government departments and boards needs to be well choreographed and the steps learned over time so that the process works seamlessly. This means that good practices need to be learned and sustained so that continuity of good practice is built up and embedded regardless of changeover of key players. In the early stages, competent leaders need to be present for long enough to make sure that skills are learnt and that good practice becomes habit that can be replicated.

Constant turnover of key players disrupts the necessary build-up of competencies and institutional memory of good practice behind the efficiencies that produce consistent and constantly improved results. Stopping and starting and having to adjust to new leadership that has to learn from scratch, slows progress down. This applies to boards and executives, departmental heads and Ministers and Deputy Ministers.

Examples of turnover of Boards and CEOs

PIC - CEO Elias Masilela resigned after recording concerns about a questionable deal

GEPF – CEO John Oliphant suspended for alleged unauthorised signing of a contract

Eskom – Board concerned about delay re shortlist for CEO without been given reasons. Acting CEO under suspicion for misconduct

Telkom - Five CEOs and four Chairs in seven years.

SAA - Eight of fourteen board members resigned in 2012. “Difficult working relationship with DPE”

Armcor – Completely new board in 2014. Previous Chair and Deputy dismissed. Complaint taken to the High Court by previous Chair and Dep Chair

Post Office – Large scale board resignations

Ministerial and Government Departmental changes

Stability and continuity is also undermined by cabinet changes.

Too many new ministers and not enough experienced ministers

The largest change-overs have come in 2014. There have been ‘sweeping new changes’ since the 2014 elections. Thirty five mainly new ministers is a large cabinet of inexperienced ministers. Most are new or re-assigned to new posts. Only a few ministers have retained their old posts such as Ron Irwin of the DTI. The former Deputy President, Kgalema Motlanthe has been replaced by Deputy President Cyril Ramaphosa. One the one hand, change brings new approaches. One the other hand, continuity of experience is lost, especially if there is also a turnover of deputy ministers and Director Generals.

Example

Department of Communications - In 2013, three ministers and four deputy ministers were replaced. The Minister of Communications was dismissed in 2013 and replaced. That

Minister was then replaced in 2014 after the elections. This means three Communications ministers in less than a year and a longer lead time to improve a dysfunctional department.

As with boards, the experience and competence of Ministers to carry out their corporative governance functions effectively are varied. There are some competent and experienced Ministers, but these are probably exceptions rather than the rule. Taking responsibility for SOCs entails particular knowledge ability to understand the conceptual value of good corporate governance. How well this is understood depends on the intellectual capacity and integrity of the Minister and DG, the quality of their advisors and how well they are briefed. Inexperience or incompetence can be risky, particularly if the department, advisors and nominations committees are inadequate. Lack of clarity of roles and lack of confidence in ability to deliver could be some of the reasons why there are so many disruptive working relationships.

4. Dysfunctional working relationships

Antagonistic, hostile, conflicting relationships and abusive power games take the focus away from collaboration needed to achieve good results. At government levels there are tensions and conflicts between some ministers and Director Generals. There are also problems in certain committee meetings and reports that that some chairs are difficult to work with. Poor relationships between some Ministries and Companies are common; often because boards feel that their work is being undermined and that they are not being treated with respect.

Examples

Armcor (2014) Chair and Deputy Chair argued in high court that their removal by the former defence Minister was ‘a serious violation of their right to dignity and just administrative action and that they had been dismissed without due procedure for political reasons.’

SAA (2012) Unworkable working relationships led to resignation of the board. "The board has just become untenable, our reputation and professional integrity had just been dragged through the mud without any clarification or support, and I believe this had reached a point where the relationship has been broken irretrievably." Reasons for this included frustrations that financial plans were not signed off in time and that “R5bil of R6bil requested “came too late”. The Board complained of insufficient consultation when nominations committee appointed Mr Kona as the new CEO. Because of past history the board were suspicious of the appointment.

Poor working relationships and bad tempers also come from impossible, slow and badly run bureaucracy, lack of integration and poor timing and synchronicity between different Government Departments. Too much complexity also provides fertile ground for corruption and corrupt practices particularly if mutual trust is lacking.

5. Lack of moral norms resulting in corrupt practices

The changeover from a struggle movement to running a government often means that former idealists erroneously take for granted that the population has inherited the same values and commitment to following the principles of democracy and human rights as enshrined in the constitution. If corruption becomes wide spread, the danger is that billions of Rands go into the pockets of the privileged and projects meant to improve infrastructure increasingly fail. The pressure to become corrupt is almost impossible to challenge. Cronism, cover-up, getting away with things and intimidation becomes prevalent. This is counter to what is needed for SOCs to perform well and to provide the services and products needed for economic and social growth.

There are the numerous examples of actual or alleged corruption both in Companies and in Government. One of the major problems has been the tendering process where illegal deals amounting to billions of Rands have been made. Conflicts of interest have either not been disclosed or ways have been found to enable people to take advantage of opportunities including forming companies owned by relatives or friends.

Examples

Ministry of Communications. The minister was found guilty in 2013 by the Ethics Committee and was suspended for two months pending enquiries. The Chair and Secretary of the Ethics Committee were given death threats to try to prevent them from making their announcement at the time designated. When the Minister was found guilty, some members of Parliament accused the committee of discriminating against 'a single mother' rather than understanding the gravity of lying. The guilty Minister was dismissed from her post but still allowed to act as an MP. She was on the list of candidates for re-election. While the facts might not be absolutely correct, what is significant is that Government did not give a strong enough message that what she did was unacceptable.

Denel - Government bailout cited as profit. Accused of bribery in India. 2012

Telkom – Fined R449m for bullying and anti-competitive practices. 2012

PIC (2014) – Investments were made to ailing loss-making oil Company Camac. Allegations made that payments were based on political considerations rather than in the interests of the public. Board refused to be accountable for the decision. CEO lodged his concerns and then resigned. 2014

The effect of corruption on SOCs is serious. If resources needed to deliver services are missing, can targets be met? If corruption is not strictly penalized, it sends an unacceptable message that fosters a culture of greed, bribery and cover-ups with resulting paranoia and obsessive secrecy. One of the symptoms of corruption is that people in power do their best to get rid of people who have integrity, leaving the pool of able corporate governors diminished. Ministers may be so busy fighting fires, dealing with hostile media, cleaning up after the last minister or sorting the Department that they are unaware of the reputational damage. The

development of any wide-spread culture of corruption is potentially the single biggest reason for financial losses and poor delivery.

Corruption in SOCs is only a small part of a bigger picture that spreads across 450 Public Entities. In 2013, the Auditor General, Mr Terence Nombembe reported that R 30.8 billion was “wasted on unauthorized, irregular and fruitless expenditure”. Irregular and unauthorized expenditure increased by 33% for public entities". According to Mr Nombembe, a serious problem was the high level of tolerance for audit disclaimers. “Due to the lack of public outcry and activism, the government was not dealing decisively with guilty parties.” “Insufficient information ... is where there is a high potential of illegal expenditure or attempts to hide illegal activities ... We should not have a situation whereby there is no knowledge of where money was spent by any government entity or departments."

Not only are South Africa’s economic ratings falling, but according to Transparency International, 2013 South Africa’s reputation for integrity fell from 64th in 2011 to 71st out of 117 countries in 2013. The Transparency International Barometer reports that well over 60% of South Africans interviewed, believed that corruption was getting worse. While it could be argued that corruption is a worldwide problem, it is still a choice as to whether South Africa wishes to continue going down this road. The greatest legacy any President or Government could leave would be to transform the culture of this country – and that includes SOCs

“RADICAL MEASURES WILL HAVE TO HAPPEN”

The poor track record of SOCs in the last few years indicates that radical interventions are necessary for South Africa to achieve world class status for its SOCs. The suggestion made here come observations of large corporations where transformation has succeeded. In all cases, change has to be positively championed, facilitated and followed-up from the top and then sustained by the next levels down. Successful results come from common vision, understanding and motivation, real collaboration from shared commitment and the willingness and resourcefulness to develop state of the art knowledge, expertise and skills.

In the experience of the writer, it is easier to achieve desired results in a positive way through inspiring leaders to give and receive of their best. What really produces results is a group of enthusiastic leaders in their different roles who work together to achieve difficult goals and actually win. The key to upgrading successful corporate governance of SOCs is simple and can happen in a relatively short time, but requires a new approach.

Because numbers of Ministers, Deputy Ministers, DGs, Chairpeople and CEOs of all the main SOCs are manageable, working collectively to achieve concrete results is highly possible. The more urgent the deadlines, the more the motivation to succeed.

Inspirational leadership combined with radical upgrade of competencies

When all key players pull in the same direction, with the same messages, outstanding results can be achieved.

1. Start with basic understanding of the principles and practice of corporate governance

In terms of improving corporate governance in SOCs, it helps to have a standard basic understanding of what corporate governance entails and means in practice. Every-one should be able to sing the same song. Essential to this is mutual understanding of the value of the key principles of corporate governance, adherence to the same interpretation of these principles and what they mean in practice. It is crucial to ensure that there is real understanding and commitment and not to take it for granted. Any concerns or differences are best openly discussed resolved. Knowing what is acceptable and not acceptable and what is expected can go a long way to improving behaviour.

2. Led by the Deputy President and spearheaded by the President

In their different ways, President Zuma and Deputy President Ramaphosa demonstrated their ability to win the hearts and minds of people. If they could apply the spirit, passion and focus that helped win freedom in the past to inspiring those responsible for governance of SOCs, outstanding results could be achieved within a short space of time. This is why it is suggested that a centre is set up in the Office of the Deputy President and that the Deputy President takes hands-on leadership and responsibility for this initiative and that it is given the backing of the President. The Deputy President also has the authority to insist that standards are being met across the board. Because the stakes are so high, it is ineffective to delegate the quality of training to standard HR people or trainers. The programme and facilitators need to be carefully selected; preferably also training and using experienced ministers, DGs and Chairs as mentors and coaches. Examples of good practice could use could illustrate guidelines for less experienced people.

3. Radical upgrade of competencies

It is suggested that as early on as possible, that understanding of principles and practices of corporate governance is followed by an intensive training programme to ensure that all the key players have basic skills in four main areas. If these are applied to achieving simple achievable goals within a year, such as achieving clean audits, improving standards of annual reports across all companies, or minimizing complaints, the better the results. Achieving basic skills to start with is better than too much complexity. Not all key players are equally experienced, knowledgeable or have the required expertise.

Leadership skills – Skills for motivating, directing and helping to make things happen

Collaborative skills – Ability to work together to problem solve towards a shared vision.

Competencies related to specific roles and responsibilities
Effective individual and collective management of time and energy

4. Regular reviews of progress and celebrations of successes

Finally, once key skills have been acquired and applied with success, the hardest and often forgotten activity is to remind people to follow up what they have learnt and to relate this to the achievement of results. Celebration of successes maintains momentum and enthusiasm and continued learning.

Back to the future

As a small child, the writer remembers going door to door with her parents to ask people to share their dreams of the kind of South Africa they would like. This was over fifty years ago and times have changed. However what will never change is the memory of the spirit and comradeship of those people, who together created a shared vision that inspired them to fight for a better country against all odds. A new ANC term in government gives an opportunity to re-generate and create the kind of winning spirit in 2014, experienced in 1994 with the first democratic elections and the winning of the Rugby cup.



“Steering the Ship Forward” in tough and difficult times makes reaching a safe harbour all the more rewarding.

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