Corporate Governance and State Owned Enterprises

By Lynn McGregor

Is it possible for South Africa's State Owned Enterprises (SOEs) to be evaluated as belonging amongst those in countries practicing world-wide best practice? Do we have the will or are we immersed in self-interest? Are the different aspects of Government and the Boards and executives capable of collaborating and if so, how quickly can this happen? The situation is urgent. For our economy to develop in a sound way we have to have an infrastructure that works and can compete successfully with the rest of the world. While there is considerable improvement, much more needs to be done both in Government and with SOEs.

This is a highly personal view about the performance of SOEs as mainly financial organisations based on over twenty years of evaluating and developing successful board and top executive performance. This includes working with Chairs, CEOs and Directors individually and collectively in a number of countries. Over the years a body of knowledge about what works well and does not work has been built up and methodologies have been created to optimise best performance. Our democratic institution is admired throughout the world, as are our corporate governance Acts such as the Public Services Financial Management Act, the updated Companies Act and guidelines for good practice as outlined by the King Reports, 1, 2 and 3. If we read any of these excellent documents, we should have a clear idea of what we should do. The challenge is implementation and how to improve the performance of SOEs so that we attract the right kinds of investment to enable the economy to grow in the way that benefits most of the population.

What is the state of State Owned Entities?

The public perception of State Owned Enterprises in South Africa has not been good. Too much money lost, too few clear audits, poor financial performance, planning and reporting, too many bail-outs, high turnover rates and numerous resignations amongst board members and CEOs have undermined sustainable corporate governance. Frequent court cases and scandals reflect self-interest rather than commitment to the wellbeing of the entity or the country. Ineffective corporate governance is costing us, the public, a huge amount of money and posing the danger of increasingly poor service.

Luckily public perception is not entirely accurate. Within the Government, excellent Acts and regulations relating to Corporate Governance have been passed, some Presidential Reviews reveal high standards of consultation and analysis leading to better policies. The summary of the comprehensive Presidential Review on State Owned Entities given by Minister Collins Chabane indicates that the Cabinet fully understands the overall situation, problems and key challenges that need to be met. Some government departments have displayed outstanding performance we can be proud of. Examples of these include SARS, the Auditor General, the turnaround of Public Services and Health. In terms of SOEs there have been examples of improvements. For example, the provision of electricity with fewer blackouts has made a huge difference. Our TV broadcasting standards, in spite of adverse publicity, have been consistent. More investment in local and regional transport companies is starting to improve transport services.

Unfortunately, because of uneven information, often difficult to obtain, it is not easy to know what is really going on, particularly if we are not often given explanations for major changes concerning SOEs. An example of this is the announcement by President Zuma on 9 July of a fourth cabinet reshuffle in his first term, changing three Ministers responsible for a number of SOEs. It would be interesting to know what he expects new Ministers to achieve during nine or ten months before a general election and whether he is positioning key Ministers for the significant restructuring of SOEs in the light of the Presidential Review on SOEs. Ministers such as Minister Gigaba, Ben Martins and Rob Davies are all accomplished Ministers, who in spite of difficulties with certain SOEs have achieved a significant amount in different ways. (See their statements for each Budget Vote Debate, 28 May 2013)

The Presidential Review on State Owned Entities

The final report of the Presidential Review was accepted by Cabinet on 30 April 2013 and was summarised by Minister Collins Chabane on 28 May. A comprehensive macro review of all state owned entities chaired by Ms Mangwashi Victoria Phiyega was conducted over 24 months and described a highly complex and chaotic situation. The PRC found that there were 715 commercial and non-commercial entities at different spheres of Government. Many of these are regulated by different Acts. "There is room to consolidate and rationalise" this huge number of SOEs and in some cases, disestablish certain enterprises and subsume them under Government Departments. Minister Chabane stated that many SOEs "are faced with significant weaknesses and threats that might become grave impediments to their optimum contribution."

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The Review recommends that the State should:

- Clearly define and communicate a consistent strategy of SOEs.
- Ensure policies and practices are in place.
- Ensure that effective contact between regulators, agencies, Government and SOEs is maintained.
- Define the purposes of SOEs.
- Adopt standardised monitoring and evaluation criteria modelled on best practice.
- Enable high operational cost effective performance of SOEs.
- Adopt a consolidated funding model for commercial SOEs and Developmental Finance Institutions. (DFIs).

An Inter-Ministerial Committee has been established to guide the implementation of the recommendations of the PRC. It is seen as a phased reform programme over time so that all the reforms can be implemented in the long term.

These reforms are sensible and, if implemented, will make a radical improvement to the ways in which SOEs are governed by Government and their Boards in the future. One of the major challenges will be to ensure that the time taken by this committee is not too long drawn-out and that agreement is reached concerning national priorities rather than a power struggle to cut up pieces of the cake.

Many of the findings of the Review were reflected in our own research. One of the key concerns is the lack of numbers of competent directors with skills, expertise and experience. The University of Stellenbosch Ratings exercise was an attempt to encourage SOEs to upgrade their levels of corporate governance.

The USB Corporate Governance Ratings Matrix

In 2012 in my capacity as Senior Fellow at the Centre for Corporate Governance in Africa at the University of Stellenbosch, I was asked to modify a Ratings Matrix for rating Schedule One and Two State Owned Enterprises based on publically available information. It was modified from a PIC/ Stellenbosch University Ratings Matrix for the Private Sector and was sponsored by the Hans Seidel Foundation. As the interface between Government and State Owned Enterprises was crucial, I asked Nozizwe Madlala Routledge, a former Deputy Government Minister, to work with me. We combined my experience as researcher and corporate governance advisor and consultant and her knowledge of government.

Our attempt to find out more

about the interface between SOEs and Government led us on a journey of discovery including meetings with Deputy President Kgalema Mothlanthe, Minister Collins Chabane, Minister Malusi Gigaba and his team, phone conversations with Minister Ben Martins and other Government Officials. We also attended a Government Roundtable to discuss the findings before the report was completed. They were extremely helpful and brought us up to date with how Government was working in relation to SOEs.

After a first draft of the Ratings Matrix, we held a workshop to invite SOE representatives and chairs of government committees to check the relevance of our draft to SOEs. What was significant was that although the workshop was attended by 26 people, there was a significant lack of Chairpeople attending even though they were responsible for the quality of the corporate governance of their boards. However, we were able to provide a final matrix to the satisfaction of those in the workshop. The matrix was based on basic governance principles and good practice in line with the King Three Report, the new Companies Act and the Financial Services Management Act. It provides an excellent set of indicators for SOEs who wish to check how well they are doing and in what areas they would like to improve.

The results of the 2012 ratings exercise were disappointing. Contrary to basic corporate governance principles such as transparency and accountability, there was a serious lack of public disclosure. In terms of Schedule One State Owned Entities, there was not enough data to make meaningful conclusions.

One key result was that State Owned Entities Performances were inferior to those of the Private Sector. Out of the following indicators for evidence of good governance in normal companies, SOEs rated better only in terms of diversity.

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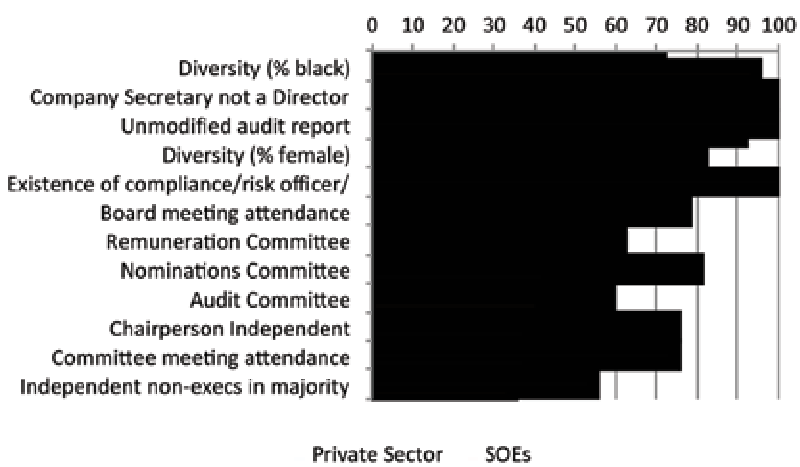
The ratings exercise would have been more useful if it had measured a healthy set of companies all following good corporate governance practice. What was not taken into account were the scandals, the numbers of unclean audits, resignations from the board and quarrels between some SOEs and Government Departments, the resignation of the board of SAA being one example. Denel, who rated first in terms of publically available information, at the time was facing a corruption charge in India and had been accused of including a Government bail-out as part of its profits. The next ratings exercise would need to be further modified to take factors like these into account.



Comparative Chart between the Private Sector and SOEs in the Report, 2012

It is not surprising that some of the media respond with outrage. However, many reports are subjective and not always backed up by substantive information even though the figures are shocking. Neither is due regard paid to those government officials who are honest, extremely hard working and are doing their best to improve the situation. The time wasted because of lack of transparency from the SOEs and Government and misinformation from the media could have been better spent problem solving.

The outcome of the Presidential Review and our meetings with the Deputy President and Government Ministers has led me to believe that many of the problems are not only familiar, but are also being addressed, even if slowly.

While the Presidential Review Committee Report on SOEs has gone a long way to address major limitations to improving performance, even if all these measures are implemented, more needs to be done to ensure genuine and sustained change. What is missing is consideration for the human factors necessary for effective implementation, including improving working relationships and communication between Ministers, Departments, Boards and Executives.

With implementation in mind, I would like to offer a working definition of some of the human qualities and skills necessary for the practice of good corporate governance. Although I have focussed on the Boards of SOEs, some of these qualities are also relevant to Government officials involved with SOEs.

The practice of good corporate governance

For the Board of an organisation, this includes providing perspective, strategic direction and ensuring that agreed financial and non-financial targets and goals are met in conformance with national and international regulations. Good corporate governance is based on basic corporate governance principles such as accountability, transparency, good business judgement and ethical behaviour. The concept of sustainability as described in King Three also includes social and environmental responsibilities. This is particularly relevant for SOEs as they have a clear mandate not only to perform effectively, but also to act as a vehicle for social development and employment.

Directors need to have the relevant balance of knowledge, understanding and expertise for governing that particular organisation. Board members are responsible for acting in the interests of the shareholder, the organisation and the greater good and not for their self-interest. The board as a whole, under the leadership of the Chair, is required to make timely high level informed decisions about key issues. The quality of decision making is dependent on the ability of the Chair to get the best from directors and the capacity of the board to arrive at a collective decision after rigorous discussion.

The board governs and provides overall direction and should not be responsible for the day to day micro-management. It is the board's job to ensure that the CEO and his or her team are capable of delivering and to take corrective measures if they are not. Whether companies are nationalised, privatised, or somewhere in between is a political decision. What is not contentious is that the infrastructure of the country has to be sound if economic development is to have a chance. This means that whatever the structure, the entity has to be well run and able to deliver successfully.

Practical implications for the key recommendations of the Presidential Review

- *Clearly define and communicate a consistent strategy of SOEs*
  Government language is often couched in a highly complicated legalistic style – necessary for formulation of Acts but difficult for others to understand. In terms of implementation, simpler, easy to understand communication is better. Government, some investors and SOEs all talk different languages and have different agendas. Different versions appropriate to each party followed by briefing and interaction to establish that they are really understood would help develop a common understanding and sense of purpose.
- *Ensure policies and practices are in place*
  If the principles behind the policies are clearly explained and understood, it is easier for people to take them on board, e.g. for boards - creating the right balance between profit generation and social development. If they are consulted about what these policies mean in terms how to reach particular goals, they are more likely to work.

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- *Ensure that effective contact between regulators, agencies, Government and SOEs is maintained*
  The simpler the better - according to strict co-ordinated schedules and clear expectations about what is expected and needed from each party.
- *The purpose of SOEs should be defined*
  Also define the reasons behind the purpose. Board members who fundamentally disagree should resign.
- *Standardised monitoring and evaluation criteria modelled on best practice should be adopted*
  Monitoring and evaluation criteria indicate what is expected in terms of performance and are essential. This has already been highly developed by Minister Chabane and his department. However, if a simple and inspiring description of what good practice means and looks like is provided upfront, before giving a detailed breakdown of criteria, that encourages and inspires, people are more likely to do their best. Overcomplicated material tends to be put in a drawer and forgotten. What is essential for successful implementation is inspired and consistent leadership that communicates, provides direction, educates and keeps people on track by following up plans and intentions, celebrating improved standards and achievements and helping people to learn from mistakes. Part of this is enabling people to learn to think and work as democratically as possible while at the same time being efficient and effective.
- *Enable high operational cost effective performance of SOEs*
  For this to work effectively in addition to implementing the Committee's recommendations, where relevant, two major initiatives are necessary. One is remedial and the other is to take active steps to put into place what is necessary for effective performance to take place.
- *Adopt a consolidated funding model for commercial SOEs and Developmental Finance Institutions*
  It is helpful to produce guidelines and briefings for less experienced SOEs in terms of what is expected and why. The Department could also provide support and help until a SOE has established good practice.

Remedial action for cost-effective high level performance

Remedial action has to be taken to deal with the antagonism between some SOEs and Government and to establish trusting and co-operative working relationships. This includes discussing and resolving some philosophical conflicts between business and government and finding new solutions to maintaining the balance between profit generation and social development mandates. What is the funding model in relation to this?

It is also necessary that misunderstandings and mistrust around the appointment and sacking of Chairs, directors and CEOs is sorted out to the mutual satisfaction of both parties. Clear roles and lines of authority need to be established and understood. Resignations often result from board members believing that their ability to do a proper job as a board is severely undermined.

Active steps that need to be put into place

Firstly, there needs to be a mutual understanding and agreement about values, purpose and commitment to Corporate Governance principles and guidelines by everyone. This needs to be followed up by consistent behaviour all round and zero tolerance of corruption, cronyism or any other corrupt practices.

Secondly, levels of competence need to be evaluated and developed. Coaching and training Ministers, DGs, Board Chairs, directors and CEOs to acquire necessary knowledge, expertise and skills should be obligatory and part of their appraisals. Unless they take time to do this, performance is likely to remain mediocre or poor. Learning should be part of the culture. As share-holder activists, Ministers and DGs have a right to specify the levels of performance they expect. It is also important that the Chair understands it is his or her duty to establish and improve standards of board performance.

Thirdly, CEOs should not be allowed to get away with incompetence, particularly in terms of planning. Last minute tame excuses about rising costs or strikes are unacceptable.

And finally, Integrated Annual Reports should be transparent, honest and mention any problems, pending court cases and what is being done about shortfalls. All SOEs should be rated along the lines formulated by USB and the top Entities recognised for good performance.

What not to do

- assume that people will understand what you are trying to communicate;
- behaviour that display arrogance, complacency, bullying or hostility;
- allow conflict and resentments to fester;
- accept any form of corruption or corrupt behaviour;
- continue to use ineffective advisors; or
- waste time and energy and lose productivity through burn-out.

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Key ingredients for good corporate governance

- good leadership;
- professional capacity to select and develop honest and competent people;
- shared values and genuine consistent practice of key principles;
- continuous learning, improved expertise and moving on from mistakes;
- effective working relationships;
- good communication – verbal, written and e-communication;
- quality, timeliness and wisdom of collective high level decision-making;
- avoidance of practices and behaviours that hinder effective implementation; and
- structures, systems, processes and regulations that only support good practice.

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Summary and conclusions

Although I am extremely worried about the short-comings of SOEs in terms of their current and past performance, there is evidence that many of the difficulties are going to be addressed. What I am most concerned about is that, owing to the time taken for decision-making and the general elections all this hard work is in danger of being overtaken by events and then forgotten. This would be good news for ruthless people who want to milk our national resources.

My experience indicates that if the practical human aspects are seriously taken into account, chances of success will be greater.

Finally, it is true that the state of SOEs until now has been like a roller-coaster – sometimes good and sometimes terrifying. Much work has to be done if performance is to be radically improved. Even more investment will have to be made to bring our most important SOEs up to best international practice. With willingness and enthusiasm across the board, it is possible that South Africa could rank amongst the best. For that we need exceptional leaders, which I believe we have in this country. Those that are already good should be allowed to provide continuity and those with potential or established track records need to come forward. At present there is some reason to remain cautiously optimistic. ■

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