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Corporate Governance in Africa's State-owned Enterprises: Perspectives on an Evolving System

Terence Corrigan[1]

RECOMMENDATIONS

- The legal and regulatory framework must be clear, coherent and implementable. This needs extensive research and consultation, and ongoing review of the systems. Consideration should be given to passing dedicated 'SOE Acts'.
- Where SOEs must venture into endeavours that cannot be justified commercially, the grounds and procedures for doing so must be properly set out, and defined in law.
- Appointments, particularly to boards, must be merit-based, and politicisation – whether for ideological or patronage purposes – must be avoided. In common with broader trends in corporate governance internationally, SOEs must acknowledge their responsibilities to all stakeholders, and resist the temptation to view these as represented collectively by government.
- Independent bodies for SOE oversight, regulation and board appointments is a good model – provided their independence is respected in fact. Where such bodies oversee both SOEs and private sector companies, scrupulous impartiality must be observed.

EXECUTIVE SUMMARY

The African Peer Review Mechanism's (APRM) Country Review Reports (CRRs) provide a unique overview of central themes in Africa's political economy, and the insights they provide into corporate governance are particularly useful. State-owned enterprises (SOEs) are a significant element in Africa's economies, and as such their participation in the corporate governance regime is important if they are to come into their own. Common problems, such as unformed regulatory systems, politicised board appointments and unclear mandates, demonstrate that considerable work still needs to be done to achieve a durable SOE corporate governance regime. Ultimately, this will be achieved through stressing the professionalisation of the continent's SOEs: recognising that they are companies and should be treated as such; depoliticising boards; and establishing clear regulations and mandates. SOEs should, in common with emerging thinking on the subject, structure their systems on the basis of good corporate governance principles.

INTRODUCTION

Notwithstanding the importance of private sector growth to countries' prospects, SOEs remain a conspicuous feature in many African economies. Occupying an often-uncomfortable space in which the imperatives of business jostle with demands for socially defined outcomes, they demand clear analysis and understanding. SOEs are potentially powerful tools in states' developmental inventories, and the manner in which they operate has considerable influence on the wider business and corporate governance landscape.

How are Africa's SOEs adapting to the demands of modern corporate governance? Africa's future prosperity and development depends on extensive growth in business, conducted with proper regard for ethics and accountability.

Recent global developments have raised the profile of SOEs. The 2008 financial crisis did significant damage to the image of the private sector and its reliability as a motor for development. Concurrently, China's growth model of 'state capitalism' has attracted numerous admirers. These developments have suggested that SOEs, supposedly less driven by the bottom line and more amenable to political imperatives, might prove the key to an economic step-change.

This policy briefing emerges from a recent research report on corporate governance, as seen through the eyes of the APRM's CRRs.[2] Looking at the six states of the Southern African Development Community that have undergone review – Lesotho, Mauritius, Mozambique, South Africa, Tanzania and Zambia – this briefing explores the role of SOEs in the emerging system of corporate governance in Africa.

SOES' CORPORATE GOVERNANCE IN PERSPECTIVE

Although constituted by 'public' resources and therefore – in some views – supposedly embodying the 'public' interest, SOEs are companies like any others. In countries emerging from statist economic systems, they are likely to be the largest domestic companies in operation, often running and managing countries' infrastructure. This quasi-monopoly gives SOEs great influence and makes them lucrative sources of patronage. All of this makes their conscientious involvement in the corporate governance regime crucial to its long-term success. In practice, SOEs are as prone to failings and non-compliance with legislation as their counterparts in the private sector. The Commonwealth Association of Corporate Governance comments:[3]

> In emerging and transition economies, the main or substantive commercial activity usually rests with the state enterprises. These enterprises often constitute the primary (and sometimes only) customer or supplier on whom an emerging private sector activity may depend. With the emphasis on encouraging the development of small, micro and medium enterprises, this has significant economic consequences. The conduct and efficacy of state enterprises can, therefore, act as a 'driver' of good corporate governance practices in ensuring that this permeates through to an emergent private sector.

The key corporate governance differentiator between SOEs and their private sector counterparts is their proximity to state power. SOEs are in the unique position of being the property of the same entity that is ultimately responsible for the legal and regulatory environment, and being under the direct influence of politicians rather than career businesspeople. The scope for favouritism and conflicts of interest is extensive. In addition, while a conventional view is that corporate governance is motivated by the drive to access finance (although poorly developed capital markets undermine this consideration in Africa), SOEs tend to be less affected by this – at least to the extent that governments are willing to back them.

Recognising this, the Organisation for Economic Co-operation and Development (OECD) has issued *Guidelines on Corporate Governance of State Owned Enterprises*,[4] one of the standards to which the APRM demands participating states conform. The guidelines' underlying approach stresses the need to avoid favouritism towards SOEs to ensure even competition between businesses in the private and public sectors. This requires a clear separation between the role of the state as owner and the state's other roles (such as market regulator) that may influence the environment. The boards of SOEs must act in the best interests of the entities they control, exercise independent judgement and treat all stakeholders equitably – in other words, fulfil the obligations to which effective boards in general are held.

The guidelines also recommend that SOEs' roles be clearly defined. This is especially so where they perform functions beyond generally accepted business norms; these should be clearly mandated by law or regulation and disclosed. SOEs should not be exempt from general law and regulations, while stakeholders – including competitors – should have the right of efficient redress for grievances.

SOEs in the APRM

SOEs face the same constraints as companies in the broader business community. Chief among these is that Africa's emerging corporate governance regime is severely undermined by key skill shortages, notably accountants and auditors.

SOEs arguably have to shoulder greater burdens than their private sector counterparts, due to their accountability to state structures. While in theory such arrangements ensure prudent use of public resources, in practice, general incapacities in government undermine this objective. The Lesotho CRR illustrates this. Some of its SOEs have gone for years without proper boards. Others are simply unable to fulfil their reporting obligations, resulting in available reports being years out of date. Consequently, the true state of these entities may not even be known to their managers or directors.

In a similar vein, the unique position of SOEs can add another layer of complexity to their operations. They may be subject to both public and private sector governance and management requirements. In South Africa, they are subject to the Companies Act of 2008 and the Public Finance Management Act, two sets of requirements that are not clearly aligned. In an unclear or inchoate regulatory environment, effective corporate governance is made more difficult and the space for malfeasance is broadened.

Boards

The governance challenge most frequently identified in the CRRs is the appointment of SOE boards. These appointments are ultimately in the hands of government, which can produce weak and conflicted boards when political factors intrude in the board selection. The Mauritius report, fairly typical in its assessment, comments: '[T]here is widespread recognition that the appointments of directors in SOEs are based on political considerations … This leads to questionable decisions and claims of political bias in business decisions … survey respondents also believe that directors often do not have the necessary technical expertise or qualifications for the positions they hold.'[5]

Board selection in SOEs will inevitably (and, as part of the duty of ownership, necessarily) involve a significant role for government. The OECD suggests various checks and balances that can be applied to mitigate this and ensure that fit and proper candidates are appointed. For example, a dedicated nominations body can manage the process, or nominations may be invited from different sectors. The OECD concedes, however, that it is impossible to insulate completely the process of board appointment from political interference.

The more important issues are whether appointments promote expressly political agendas, and whether boards are able to operate without undue political interference once appointed. Where overt politicisation occurs, some of the central tenets of good corporate governance are endangered. In societies with limited experience of multi-party politics, these risks are likely to be accentuated. The CRR on Mozambique notes the problem of ubiquitous links between the ruling party, the bureaucracy and business entities. South Africa has been similarly criticised, perhaps most notably in relation to the country's public broadcaster, where politicised appointment processes and factional disputes have produced ongoing corporate instability.

These issues are compounded by a basic structural problem. According to William Gumede of the University of the Witwatersrand, SOE boards have a more complex relationship with their shareholder (government) than do those of private sector businesses. Government may be inclined to bypass boards and intervene directly in corporate governance matters. There is also, he notes, 'a lack of clarity over the objectives, mandates and oversight of SOEs. There is often no clearly set-out requirements to serve on SOE boards, little transparent and objective board recruitment procedures, and no specific procedures for evaluation of the performance of board members.'[6]

SOE reform

For transition economies, what to do with SOEs is a crucial issue. The worldwide turn to market economies in the early 1990s was marked by privatisation, both complete and partial, as has been the case in Mozambique, Tanzania and Zambia.

In recent years, however, this strategy has been questioned. This reflects disappointment with the outcomes of privatisation processes, renewed belief in the role of the state and, to some extent, ideological hostility.

Among the CRRs, South Africa's experience is examined most carefully. This reflects its long history of SOEs and the ongoing commitment of its government to use them as agents of development. It puts forward a generally positive view of South Africa's SOEs. They operate, at least in theory, under corporate governance best practice, commercial legislation and public sector financial legislation. The South Africa CRR praises the strategy adopted by government to introduce market-style management while avoiding outright privatisation. With this altered mandate, which is in line with the pan-African orientation of the APRM, South Africa's SOEs have sought opportunities and are investing elsewhere in Africa.

The report also says that the 'difficulties experienced by those SOEs that are not playing at optimal levels must be acknowledged and confronted'.[7] This would appear to refer to some of the problems that have dogged South Africa's SOEs. Although generalisations should be avoided – South Africa has over 700 SOEs – high-profile failings have become familiar occurrences. It is an appeal that should be addressed in earnest.

African countries restructuring their SOEs may well find that the South African experience is at best a partial guide. South Africa's relatively strong economy (albeit suffering long-term retardation by the 1990s) gave it significantly more room to manoeuvre than did those of many of its peers. Privatisation, whatever its imperfections, remains an option and should not be discounted out of hand. However, changing the ownership regime of a country's SOEs will, on its own, not address all their problems, particularly when these relate to their operational effectiveness and ensuring probity. To do this, strengthening their corporate governance practices are a far more promising avenue.

CONCLUSION: STRENGTHENING SOE CORPORATE GOVERNANCE

While the importance of corporate governance for SOEs is well recognised in Africa, in common with much else in this field, it remains an incomplete project.

The necessary first step is to recognise that SOEs are companies and need to practice proper corporate governance. Part of this is accepting that SOEs need to be able to operate competitively and should not rely on state patronage for their viability.

It is furthermore increasingly recognised that a durable approach to corporate governance is based on adherence to principles. Legal and regulatory systems, important though they may be, are essentially a codification of these principles. Approached in this way, good corporate governance is integrated into business operations rather than being an extraneous afterthought or a 'tick-box' exercise. This too is a mindset that should be cultivated.

Perhaps most importantly, governments and SOEs must see good corporate governance as an asset to their operations, rather than a burden. In so doing, a good start would be made in setting them on a long-term path geared for development as well as growth.

ENDNOTES

1 Terence Corrigan is a political and governance consultant and SAIIA Research Fellow.

2 Corrigan T, Getting Down to Business: *Lessons from the African Peer Review Mechanism*, Research Report 17, South African Institute of International Affairs, August 2014.

3 Commonwealth Association for Corporate Governance, *Principles for Corporate Governance in the Commonwealth*, 1999, p. 16.

4 OECD (Organisation for Economic Co-operation and Development), *Guidelines on Corporate Governance of State Owned Enterprises*, 2005.

5 Panel of Eminent Persons, APRM, Country Review Report of the Republic of Mauritius, APRM Secretariat, July 2010, p. 279.

6 Gumede W, 'South African State-Owned Enterprises: Boards, Executives and Recruitment, Report to the South African Presidential Review Committee on State-Owned Enterprises', June 2012, p. 23.

7 Panel of Eminent Persons, APRM, *Country Review Report of the Republic of South Africa*, APRM Secretariat, May 2007, pp. 181–184.

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