CORPORATE GOVERNANCE -BOARDS OF PARTNERSHIPS AND STATE OWNED ENTITIES IN MINERALS, OIL AND GAS INDUSTRIES “A PERSONAL PERSPECTIVE BY SHEILA KHAMA”

Chapter 4 –Factors that Influence Board Effectiveness

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It is one thing for a board of directors to embrace the principles of good governance and to understand the challenges thereof, but it is entirely another to use this knowledge to effectively lead. In this respect, it is worth noting that effective corporate boards display certain characteristics, as detailed below. In the preceding chapters I discussed generic factors because these lay the foundation for corporate governance. But, given the sectors and target audiences for this book, this is not enough. So just as I dealt with matters that underpin good governance and corporate governance, I adopt the same approach in the chapter. I look at effective boards starting with generic issues and moving onto those relating to the sector and type of companies that are the subject of this book. I dwell on the question of how well SOEs and other companies in which the State has equity fare regarding the criteria.

Fit for Purpose*:* A board must be structured and composed to be fit for purpose. This means the type, culture and composition of the board must align to the business environment and goals. It also means that the people nominated to the board must collectively have the skills to lead the company. For State representatives, this means a clearly articulated mandate that speaks to the State's long-term aspirations. For instance, the 'old boys' club structure would not be appropriate in this case.

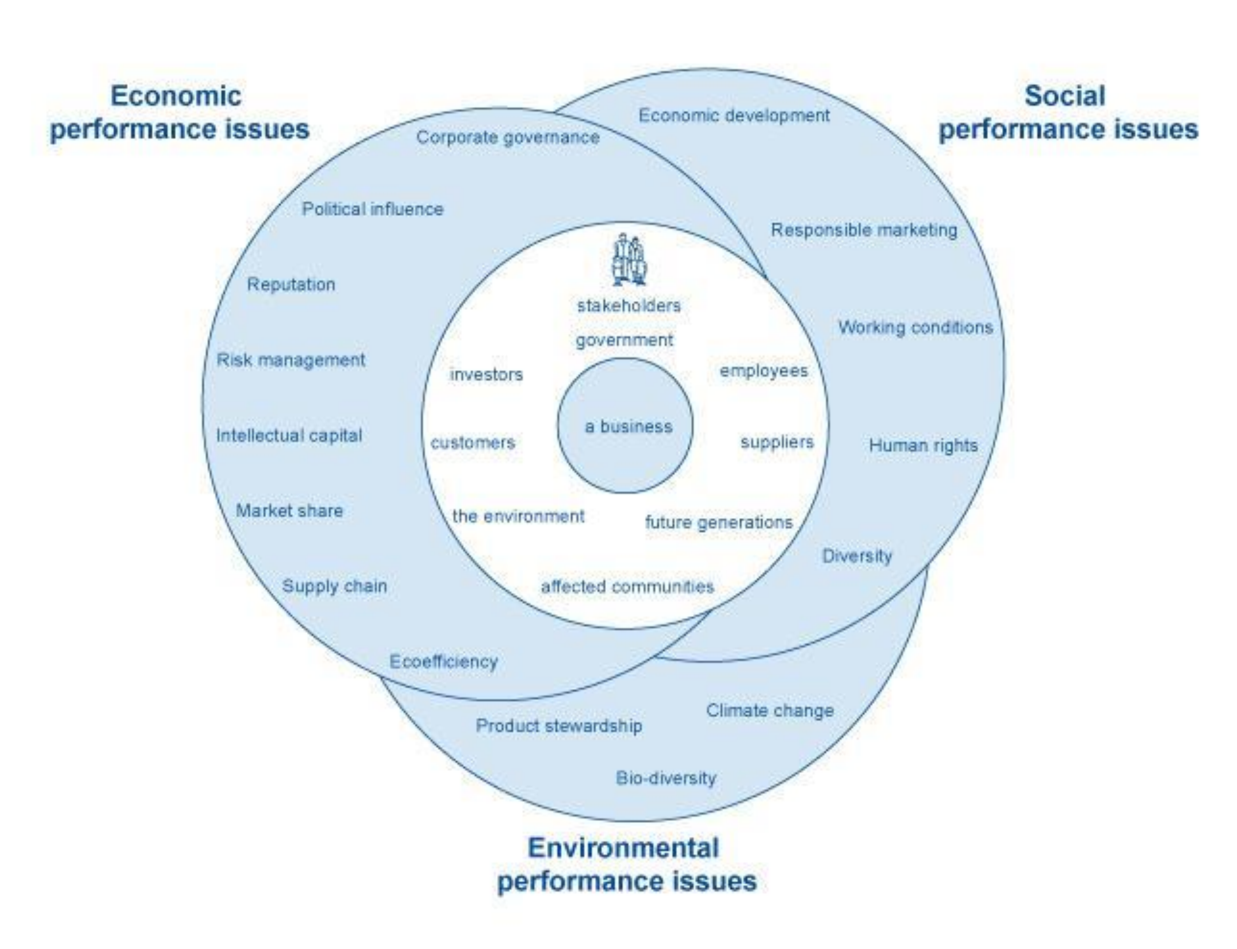
A Sense of purpose*:* It may seem self-evident that directors should display this quality, but it is not. Yet, a board of directors with a clear sense of purpose based on a well-articulated corporate mandate stands a better chance of effectively strategizing and providing leadership. On the other hand, a well-defined strategic direction to guide the performance of executive management is vital for containing risk and monitoring corporate performance.

Fully Empowered and Free of Shareholder Interference**:** Considering their role as custodians of corporate strategy, to be effective the individual directors must be fully empowered to exercise authority without undue interference by their principals. In SOEs, political interference can paralyze a well-structured, suitably composed, professionally competent, committed and ethical board. The directors can be reduced to a mere rubber stamp board. Yet, it is only through empowered individuals able to exercise free will that boards of directors can discharge their duties effectively. This requires that a relationship of trust exists between the shareholder and the individuals they nominate. However, in cases of SOEs, a common dynamic between the government nominee and shareholder is usually one of professional dependency, which does not bode well for independence. (*I shall revisit this matter when I discuss the subject of representatives of governments under Chapter 6.*)

Competency Based Board Appointments*:* Companies go to great length to find the right people with a mixture of skills and gravitas because this brings competency and corporate prestige. Both inspire market confidence and are desirable, especially for listed companies and other visible brands. Directors representing the State should (like those representing private investors) be subject to the same selection standards. They should be selected for their competency and not by reason of the public service position the individual happens to occupy. Yet, this is a very common criteria used to nominate appointees to boards of SOEs or to partnerships with private investors. The tendency to select representatives from the civil service is, in my view, particularly unwise, given the likelihood for political interference. Quite apart from this, confronted with the peculiarities of a private sector environment, this is not the best deployment of their unique and undeniable expertise.

Stakeholder Alignment: Ensuring that the company's strategy is aligned to expectations of its stakeholders is important for all companies but is particularly so in minerals, oil and gas sectors, which are subject to public scrutiny and a myriad of stakeholder expectations that require reconciliation. In these sectors, recognition and acceptance of the principle of shared benefits by the board of directors is an essential corporate value. While a winner-takes-all mentality may yield short-term gains, in the long run it severely limits the ability of the company to conduct business through lack of trust by stakeholders. Effective boards understand the importance of avoiding this by promoting a culture of value sharing with governments and communities. This can be difficult in a corporate environment in which executives are judged by what they deliver financially in the short-term on the one hand and expectations by governments and communities to immediately benefit from the resources projects on the other. It is the responsibility of the board to reconcile the divergent interests, including containing executive exuberance and avoiding the risk of long-term damage.

Diagram :3 Sample Business Stakeholder Mapping



Source: www.unido.org

Business Ethics: Actions of a board of directors that are grounded on sound business ethics provide a firm foundation for corporate governance. In sectors that rely on the extraction and trade of minerals, oil and gas resources, sound business ethics include but are not limited to a commitment to fair licensing regimes and fair product pricing, as well as transparent relations with host governments and communities. It includes long-term regard for the impact of the operations of the company on the physical and social environment and provision of resources to mitigate risk of unintended consequences. ESG ratings and their growing importance in financial markets is a good illustration of how essential this is. It requires the board of directors to continuously scrutinize the actions of the corporate executives to ensure that pursuit of commercial gain is not at the expense of environmental stewardship and employee health and safety, among other concerns. It also requires the commitment of the board to reward those who exhibit ethical behaviour while taking punitive action against those who disregard corporate values and business ethics. In the long run, such actions build trust with the public and increase chances for companies to secure the social license to operate. Armed with this knowledge, effective boards of directors of minerals, oil and gas companies champion the course for the highest ethical standards.

***Exclusion of Party Political Interests**:* Political parties and leaders of any political system come and go. The sovereign position of a country on the other hand is sacrosanct. The country's minerals, oil and gas wealth must be managed in a non-partisan way to serve the country and not the political interests of any political party or group in power. In this context, the board of directors is the gatekeeper. Board effectiveness requires that the process of appointing and/or nominating directors to boards of SOEs and any company with State equity be non-partisan. The least effective method is one that centralizes power around a political appointee, such as a minister of cabinet. Such discretionary powers breed corruption and cronyism. On the other extreme, some systems have no selection process as such and default to a piece of legislation that stipulates a position in the public service or political structure on an ex-officio basis. Botswana adopts this approach. This is passive and does not meet many of the more pro-active criteria I discuss below.

An effective selection method embodies several principles. The first and most important is a *decentralized* approach that allows for inputs across party lines and others in the shareholder constituency. A national assembly is good example. But it is not practical for a whole parliament to carry the task of selecting a nominee to a board of directors. Therefore, some delegation of duties - where the minister responsible uses an external executive search to shortlist and review for ultimate approval by a committee of parliament might be a more practical way. Another option is empowerment of corporate leadership through delegation of authority. In this case, the Chairperson of the board and a few senior directors are granted full responsibility to find the right candidates without the involvement of state officials or politicians. Denmark, Sweden and Finland use the latter approach, while Norway leans towards a mix of legal requirements for demographic diversity and corporate independence. Quite apart from containing corruption, such an approach makes boards more likely to be effective because they avail the principles of *continuity* and *stability* of the governance environment that does not depend on outcomes of political elections. Finally, a nomination and selection process that also addresses remuneration, to ensure that SOEs and partnerships can attract and retain talent, is indispensable to corporate performance through a competent board. While none of these approaches offers a perfect solution, an important consideration is that each excludes party political interests.

Innovation For Leadership: I reviewed many definitions of the term innovation and the one that resonated with me was on the Wikipedia page which defines it as "*a new idea, creative thoughts, new imaginations in the form of device or method*". Innovation 'is often also viewed as the application of better solutions that meet new requirements, unarticulated needs, or existing market needs'.[1] Based on the dynamic nature of the business environment of minerals, oil and gas sectors, it is clear that change is the only certainty. Change in governance standards, stakeholder expectations, technology, markets, levels of scrutiny and therefore the business environment. To keep up, effective boards must adopt more innovative approaches towards strategy and in relation to how it fuses all these factors a single coherently corporate ecosystem. As with most criterion, this also fits in the category of easier said than done. But it is also very unlikely that companies in minerals, oil and gas sectors can survive without placing innovation center stage. Yet, few elevate the matter to the board. In my quick search for instance, I have found very few that have a dedicated R&D sub-committee of the board. In cases where such a committee exists the notion of innovation is confined to the traditional science and technology space. However, my sense is that this is a gross oversight. Innovation in both the scientific, commercial and social sense is essential for the boards of the companies to contain risk and find new solutions to the myriad of issues facing them. (I shall revisit the subject of innovation again in the section of the book dealing with sustainability).

The eight factors described above are particularly important for SOEs and partnerships in which the State has equity. But others that are essentially across the board include; a diversity of individual director competencies, a good balance between executive and non-executive directors, timely receipt of information, regard for confidentiality, individual role clarity, avoidance of personal agendas, regular assessment of

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[1] Wikipedia

board performance and a balance between longevity and talent development in the board composition. See Diagram 3 below.

Diagram 4: *What Works in the Boardroom*