A personal perspective by SHEILA KHAMA

CORPORATE GOVERNANCE BLOG SERIES BOARDS OF PARTNERSHIPS AND STATE-OWNED ENTITIES IN MINERALS, OIL AND GAS INDUSTRIES

Blog 4

Factors That Influence Corporate Board Effectiveness

This blog was reviewed by Norman Mbazima, a Zambian businessman, former deputy non-executive chairperson of Anglo American Corporation of South Africa and former CEO of Anglo's Coal and Iron Ore Subsidiaries.

July 2025

1. Introduction

In the preceding two blogs, I discussed generic principles of governance, corporate governance and unique challenges in minerals, oil, and gas industries. But a general overview is inadequately to examine the range of issues pertaining to corporate governance. By the same token, it is one thing for a board of directors to embrace principles of corporate governance and to understand the challenges thereof, but it is entirely another to use this knowledge to effectively lead a company. Of importance if the fact that corporate boards are subject to different conditions some of which are within their control while others are not. So, in each of the blogs that will follow, I delve into different environments in which boards of minerals, oil and gas industries function and the impacts of these conditions on collective board performance and that of individual directors. Starting with this blog, I discuss factors that influence board effective in general. I examine external and internal factors and comment on ways in which these can either improve or impede the effectiveness of a board of State-Owned Enterprises (SOEs) and other companies in which a sovereign State has equity.

2. External Drivers of Board Effectiveness

Under paragraphs 2.1 to 2.5, I comment on external factors that are essential for board effectiveness. I suggest that a board must:

1) be ***fit for purpose,***
2) have ***a clear corporate direction,***
3) be ***fully empowered,***
4) be ***competent,***
5) be ***aligned with stakeholders.***

2.1

Fit for Purpose

A board must be structured and composed to be fit for purpose. This means the culture and composition of a board must align to the business environment and company goals. For State representatives, this means a clearly articulated national goal, a board mandate from an administration that speaks to the State's long-term aspirations and nominees that are chosen for their individual and collective abilities to contribute towards the national goal. This means ex-offico appointments, an *old boys* club board structure and a composition that is based on social affiliations or special interest groups would be inappropriate.

2.2

A Clear Corporate Direction

This might seem self-evident, but it is not. However, a board of directors without its own clear sense of strategic direction based on a well-articulated corporate vision cannot adequately guide executive management. By contrast, a board with a clearly stated vision stands a better chance of effectively strategizing, mitigating risk, and providing leadership. On the other hand, a well-defined strategic direction to frame operational plans is vital for achieving corporate goals and monitoring performance. But these latter frameworks are only possible when they are preceded by a clear direction from the top.

2.3

Fully Empowered and Freedom of Interference

Considering their role as custodians of corporate strategy, to be effective the board must be fully empowered to exercise authority without undue interference by shareholders as their principals. In SOEs, political interference can paralyse a well-structured, suitably composed, and competent board. In partnerships, shareholders whose actions interfere with the work of the executive to promote the interest of one shareholder over that of the company are equally counterproductive. This can ultimately reduce directors to a mere rubber stamp board. Yet, based on an agreed strategic direction, it is only through empowered boards able to act independently that directors can discharge their duties effectively. This requires that a relationship of trust exists between the shareholder(s) and individuals they nominate. However, in cases in which non-executive board nominees depend on their employer for professional advancement, their independence can be comprised. Either way interfering is neither the right thing to do nor does it bode well for board independence and ultimately effectiveness.

(I shall revisit this matter when I discuss the subject of representatives of governments under **Blog 6.***)*

2.4

Competency Based Board Appointments

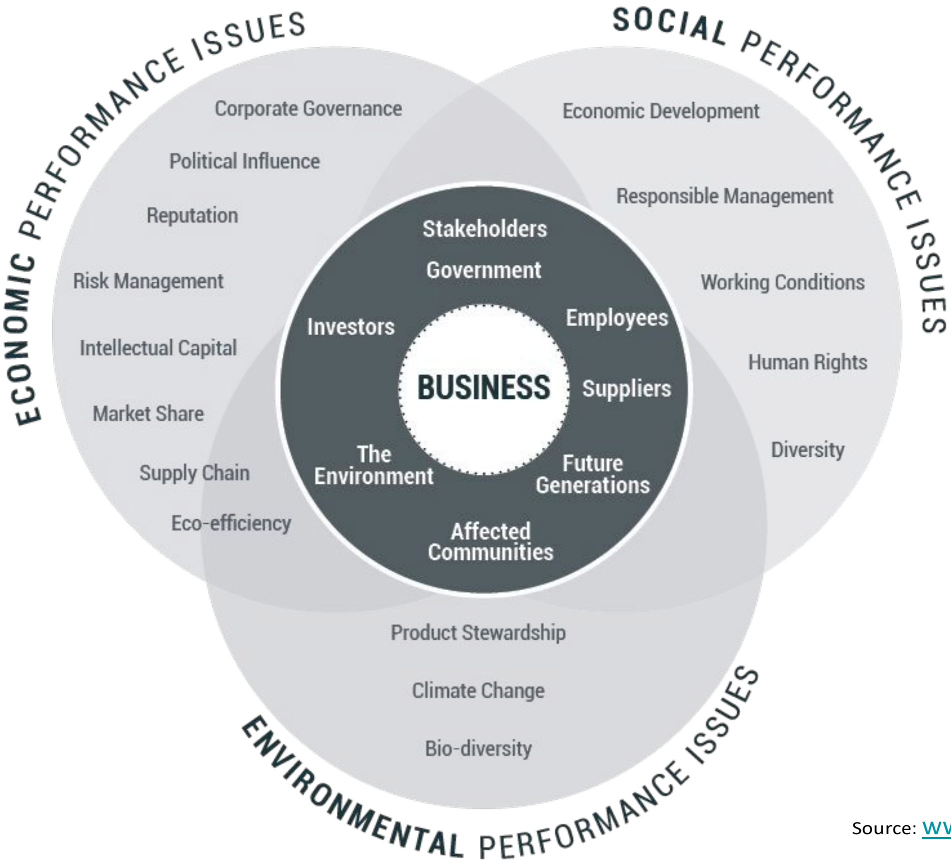
Though not always the case, most companies go to some length to find the right people to appoint to their boards. In the private sector, this process is usually supported by professional firms. In the end the board is usually made up of a mix of independent individuals with no relationship with either the company, shareholders, executives affiliated with the investor(s) or executives working for the company whose board is being composed. Directors representing the State are often selected consistent with their line function in the public service or investment arm of the State. Policies on the basis of which the selection of nominees is confined to public institutions is however unwise. The main reasons being that their line of work is unlikely to align with the business environment which means the skills of the nominees are not readily transferable to the boardroom as would be the case for industry executives. Therefore, confronted with the peculiarities of a private sector environment, this is not the best deployment of their expertise which are rooted in the public service. Yet, this is a common criterion used by governments to nominate appointees to boards of SOEs or to partnerships with private investors. In case of both company and public sector nominees, to the degree that their professional advancement depends on the will of those who nominate them, they can come under pressure from either shareholder as stated under *paragraph 2.3* above. In both cases, the result is either sheer lack of skills or an undermining of skilled personnel resulting in board ineffectiveness.

2.5

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. Expectations range from those of regulators, financiers, analysts, advocacy groups and the public all of which require alignment all be it to varying degrees. A mindset in which there is acceptance of the principle of a common destiny by the board of directors is a good starting point. 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 between shareholders, governments, and communities, among others. 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 the public to immediately benefit from the resource projects on the other. Nevertheless, it is the responsibility of the board to reconcile these divergent interests, including containing executive exuberance while speaking truth to political power if need be. *Diagram 1* below illustrates the complexity surrounding businesses.

Diagram 1: Sample Business Stakeholder Mapping



Source: www.unido.org

3. Internal Drivers of Board Effectiveness

Under paragraphs 3.1 to 3.5, I comment on internal factors that are essential for board effectiveness, namely:

1) ***a clearly articulated company vision and culture,***
2) ***compliance and regard for the law,***
3) ***sound business ethics,***
4) ***avoidance of conflicting interests,***
5) ***regard for innovation.***

3.1

A Clearly Articulated Company Vision and Culture

It is inconceivable that a board that has a clear vision for the company but stops short of clearly articulating it to the executive team and satisfying itself that the vision permeates throughout the company can be effective. This is the basis for company culture and values and both guide behaviour in company. Not only are these factors essential to inform policies, but they speak to the nature of what is acceptable and unacceptable behaviour on a daily basis and throughout the ranks. Importantly they result in synergy and improved performance.

3.2

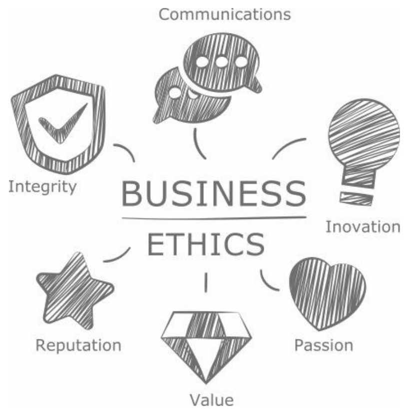
Compliance with the Law and Industry Standards

It is the responsibility of the board to ensure full company compliance with the laws of jurisdictions in which a company operates. This means compliance with the letter and the spirt of the law. The difference being that *'the letter of the law is what the law states while the spirit of the law is a social and moral consensus of the interpretation of the letter.'* [1] It is also the responsibility of the board to ensure compliance with industry standards and related international conventions. In both cases, it becomes clear why spelling out the values and ethos of a company is an essential moral campus. This is a basic of duty of boards and failure to abide it leads to ineffectiveness.

3.3

Business Ethics

The actions of a board of directors that are grounded on sound business ethics provide a firm foundation for board effectiveness through leadership by example. In sectors that rely on the extraction and trade of minerals, oil and gas commodities, 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 regard for long-term impacts of the operations of the company on the physical and social environment and provision of resources to mitigate risk of unintended consequences.



1. https://lsa.umich.edu/content/dam/orgstudies-assets/orgstudiesdocuments/oshonors/oshonorsthesis/Matt%20Gordon_Honors%20Thesis.pdf

ESG ratings and their growing importance in financial markets is a good illustration of how essential this is and will continue to be. This standard requires a board of directors to continuously scrutinize the actions of corporate executives to ensure that pursuit of financial results is not at the expense of environmental stewardship, 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, evidence of such actions can build trust with the public and improve prospects for securing the social license to operate. Armed with this knowledge, effective boards of directors of minerals, oil and gas companies champion the cause for the highest ethical standards by exemplifying corporate values.

3.4

Avoiding Conflicting Interests

An inherent feature of business-to-government relations is that this environment is underpinned by conflicting commercial and political interests that manifest in the boardroom. But private sector investors, political parties and leaders of any system come and go while sovereign entity and its natural wealth on the other hand is not subject to same cycles. Hence, a country's minerals, oil and gas wealth are ideally managed in a non-partisan way to serve the country and not short-term business or the political interests. In this context, an effective board of directors is an important part of the safeguards mechanism. Hence board effectiveness requires that whether nominated by a private or public investor, directors of SOEs and any company with State equity concern themselves with the wellbeing of the company and all company stakeholders equally. This is in contrast to the wellbeing of those who nominated them and their commercial or political survival. Otherwise, such board nominees tend to be reactive and lack long term strategic direction other than the abide the wishes of their masters. Overall, the relationship leads to conflicting interests and its characteristics fail to meet the criteria for an effective board as shown under 2.3 and 2.4 above. Instead, they are tantamount to a fundamental abdication of the State's responsibility and risks eroding the value of national assets. This tendency epitomises the political economy defined as; *'as a study of how politics affects the economy and how the economy in turn shapes politics'* [2] and exacerbates impacts of the *Resources Curse* discussed in **Blog 3**.

2. https://www.gov.harvard.edu/undergraduate/programs-of-study/political-economy/

3.5

Innovation

One of the many definitions of the term innovation available is *"a new idea, creative thoughts, new imaginations in the form of device or method"*.[3] Innovation has also been described as *'the application of better solutions that meet new requirements, unarticulated needs, or existing market needs'.*[4] 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 internal and external business environments. To keep up, effective boards must adopt more innovative approaches towards strategy and make it an integral part the corporate ethos. As with most factors that impact effectiveness, this one 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.

For instance, a quick search, finds 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, 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 fresh solutions to the myriads of challenges facing them. *(I shall revisit the subject of innovation again in the section of the Blog focusing on sustainability).*

4. Conclusion

While the factors described above are particularly important for SOEs and partnerships in which the State has equity, several others are applicable across the board. On the other had to be effective, boards of thes industries must also address many others. Namely diversity of individual director competencies, a balance between executive and non-executive directors, timely receipt of information, regard for confidentiality, individual role clarity, avoidance of personal agendas, regular assessment of board performance and a balance between longevity and talent development in the board, among others.

3. https://hives.co/en/blog/the-definitive-guide-to-innovation#:~:text
4. https://online.hbs.edu/courses/business-strategy/?

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This blog is part of on series on:

Good Corporate Governance in Oil, Gas and Mineral Industries.