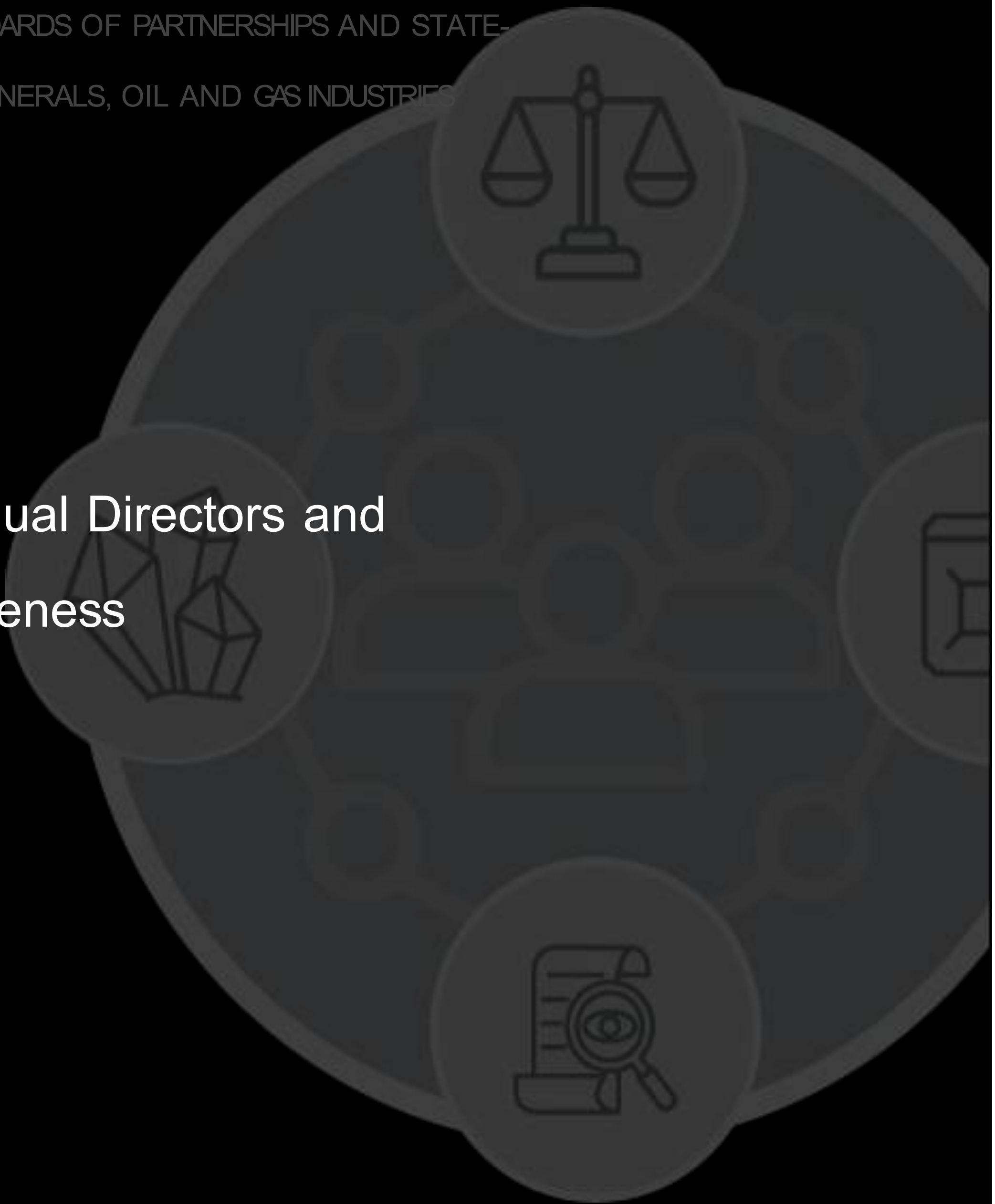
SK

A personal perspective by SHEILA KHAMA

GOOD CORPORATE GOVERNANCE

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



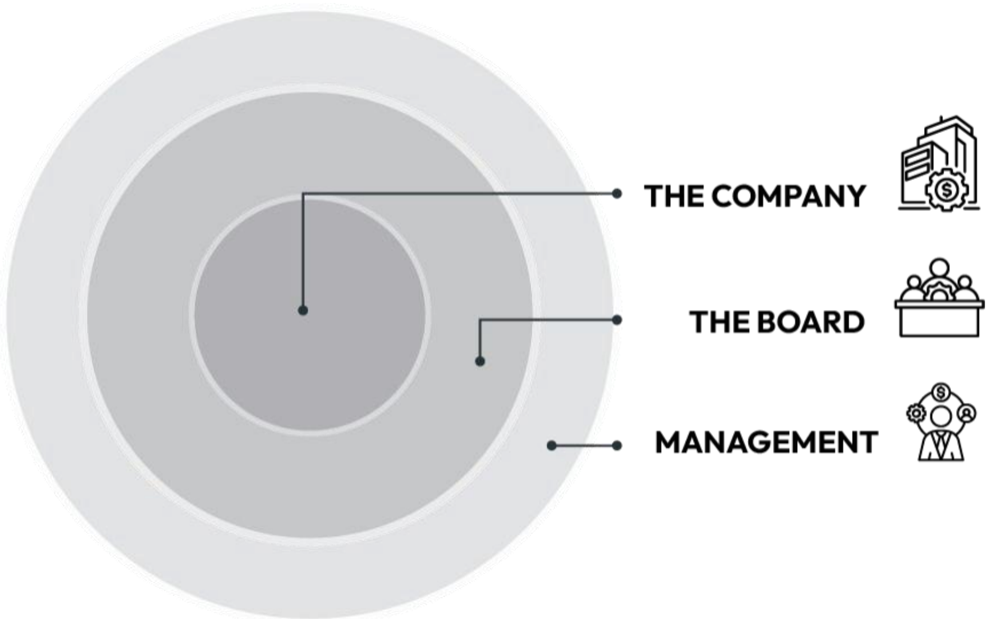
Blog 7

Role of Individual Directors and Board Effectiveness

1. Introduction

In *Blog 6* of the series, I suggested that to be effective directors need timely and full access to information. I also discussed the role of committees of the board in ensuring the effectiveness of the board as custodians of corporate governance. But there are other requirements least of which is the contribution of individual directors and executives. For instance Directors' voices must be audible and their wishes fully complied with. To succeed, a board of directors depends on the loyalty, diligence, guidance and support of their peers and executives. That said, certain office bearers in the corporate hierarchy are more critical. In the context of an effective board, the most important of these are the Chairperson, CEO, CFO and the Compliance Officer. In most cases, the structure and its hierarchy functions well, but in some instances it can be a disaster. There are several reasons for this ranging from weak leadership, an executive with a mission to undermine the board or one that is simply incompetent, overly ambitious or a combination of all five factors. Though these challenges apply across different industries and are not unique to the industries in question nor the type of companies under discussion, I deem them worthy of discussion given the level of public harm that might arise from any dysfunctionality in the corporate environment.

Diagram 1:
The Sum of the Parts



2. Chairperson of the Board

In terms of a conventional corporate board hierarchy, the first and most important officer is the Chairperson of the Board of Directors. The role of a chairperson can be described as **to lead the board and provide overall guidance to the organization by setting the agenda for board meetings, facilitating discussions, and ensuring the board effectively oversees the company's strategic direction, risk and governance systems**. The Chairperson also acts as liaison between the board and executive management, fostering a productive relationship and ensuring alignment on key objectives. Although the role of CEO and Chairperson are sometimes performed by one individual, in public companies in many parts of the world, increasingly the role is performed by two separate individuals.The goal is to separate the authority that appoints from the one that oversees the work of the executive management by placing the latter responsibility in the hands of the board which is chaired by a non-executive director. In cases where the two roles are held by one person, to ensure checks and balances, the chairpersonship of audit and remuneration committees is assigned to a non-executive director. This is because combining the role of a CEO and that of the Chairperson of the board into one can blur lines of accountability on matters in which the Chairperson potentially has a vested interest. Hence, increasingly in the UK the trend is to separate the two while in the US it is still common for the CEO to also be the Chairperson of a company. Regardless of which side of the argument an individual stands, all recognize the importance of an effective chairperson.

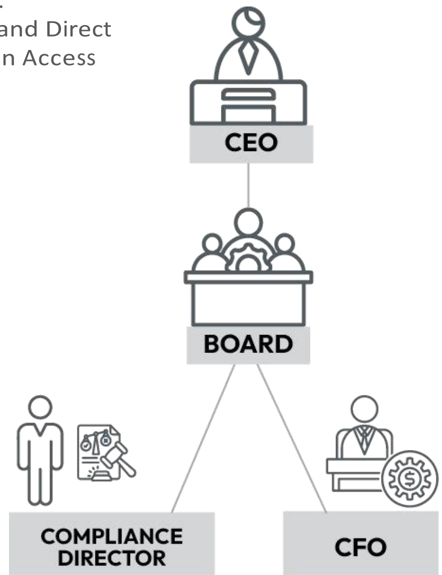
Importantly, t**he Chairperson's strategic leadership and assurance of compliance with the highest governance standards is vital for board effectiveness**. Through engagements with shareholders, market influencers, host governments, the Chairperson manages strategic relations. For instance, in case of differences between the board and shareholders, he or she can be an indispensable bridge builder. On an operational level, the Chairperson guides the CEO, leads the board, effectively convenes discussions and ensures compliance with due process. An active and engaged chairperson can also be the face of the company that actively champions corporate interests. **An effective chairperson is a reliable source of wisdom, a mentor and a confidant for the CEO and senior director. He or she can be a relationship builder, actively and constructively engaging multiple stakeholders to articulate corporate value proposition, align interests and build public trust.** In minerals, oil and gas SOEs or partnerships with the State, the Chairperson can also manage strategic relations with host governments, screening the CEO from political interference and leaving the CEO room and time to focus on day-to-day operations.

A chairperson is a champion, and can be an effective brand ambassador by embodying and living corporate values to inspire employees. Most importantly the Chairperson selects the right directors, provides direction to the rest of the board and demands performance of the highest level based on routine performance evaluation of the board collectively and of individually. On the other hand, a disengaged or domineering maverick chairperson is unhelpful the corporate governance principles and is a source of disunity.

3. Chief Executive Officer (CEO) and Chief Financial Officers (CFO)

The **role of the CEO is to ensure day-to-day implementation of corporate strategy in order to meet performance targets agreed with the board**. Though the role of the CEO is to deliver long term value it can often conflict with pressure to deliver short-term gains because he or she serves at the will of the shareholder representatives who appoint him or her. Nevertheless, as with the chairperson, he or she personifies corporate interests in and outside the company. In the context of the minerals, oil and gas sectors, public trust or lack of trust in the company can often be traced to the conduct and personal brand of a CEO as champion and the face of the company on a day-to-day basis.

Diagram 2:
Free Flow and Direct Information Access



Hence the importance of striking the right balance between the need to indulge the wishes of the shareholders and the necessity to protect public interest. Specifically, as an executive with day-to day access to company operations and information, the **CEO can enhance or undermine board effectiveness in many practical ways.** Firstly, the CEO controls and sanctions information flow between the executive team and the board.

In the event of a CEO who puts his or her personal ambitions and desire for power above the interest of the company, information can be used to serve the CEO while undermining the board, the shareholders and ultimately the public. Quite apart from selectively sharing information and adopting biased disclosure of information, by simply setting out an agenda for the board to highlight issues in line with personal goals, a CEO can significantly circumvent the board's leadership position and diminish its effectiveness. In cases of SOEs in minerals, oil and gas companies, a CEO who displays such behaviour can compromise national interests significantly. Consider the impact that an audit committee that does not have all the information it needs on company financials or geological resources and its impact on board effectiveness.

This behaviour (on the part of CEOs) is one of the explanations for what might appear to the public to be an overnight collapse of some multinational companies, despite the oversight and presence of competent groups of individuals on corporate boards and committees.

One explanation for such corporate demise is the fact that often the board is blind to the detrimental actions of overly ambitious CEOs until it is too late to intervene and for a board to effect change. **So, it is imperative that the CEO is aligned to corporate objectives and not driven by personal interests**. In the event of the latter, a board must assert authority and if need be remove the CEO.

Reference to the importance of timely and comprehensive information for the board needs to be nuanced. Some CEOs misinterpret this to mean lots and lots of information. Too much detail is very unhelpful because not only is a waste of valuable time, but it also burdens directors with having to find their way through unnecessary detail just so they can get to relevant information. What directors need upfront and with each paper presented is a statement indicating the purpose of the submission. Some important questions to answer upfront are, *what is being requested of the board? Is it to consider, decide, grant approval, note the information only or is there some other purpose?* This is ideally presented in the form of an abstract cum executive summary. It is also useful for the documents to be separated between essential reading material and mere background information. Either way, the more succinct, the better. It is also worth avoiding and limiting the use of complex terminology and acronyms. There is a difference between lecturing and informing and it is best not to lecture. A rogue CEO can deploy these tactics successfully unless the board is alert to them.

Finally, a good CEO knows that he or she was hired because the board believed he or she is capable and therefore avoids spending time showing off his or her skills. Yet some can feel the need to prove their knowledge. But what is helpful to the board is to simply get straight to point by focusing on the problem and explaining management's view of possible solutions for the board to deliberate. These expectations of the CEO also apply equally and in some cases even more to the CFO.

4. Compliance officer

From a statutory compliance perspective, the **Compliance Officer is an important bridge between the company and regulatory agencies.** As such together with other statutory appointees, he or she is a useful lens through which the regulators see the conduct and sometimes governance culture of a company. A progressive compliance officer and related professional associations can provide feedback to agents of the State on loopholes in national laws, leading to their strengthening for the benefit of all. As part of team effectiveness, the Compliance Officer can support the Chairperson with tools to induct new directors into the culture, legal requirements and procedures of the board. These are some of the important links in the corporate governance chain of command without which a board of directors can be ineffective. Suffice to say that there are other executives who are vital to company performance all be it for different reasons. However, in the context of board effectiveness, none are more critical than these four.

Finally, it is worth reminding the reader that, in an environment of partnerships and SOEs which is already politically partisan and subject to conflicting interests, **the independence and impartiality of the board and all other officers can be the difference between an effective and an ineffective board.**

Actions as simple as sharing confidential information with members of a favoured political party can cause untold damage to the company while undermining public interest. Equally, withholding information from representatives of one shareholder to bolster the position of another on the board is not only illegal and unethical but it can also be detrimental to company wellbeing. Doing this on an ongoing basis reverses the balance of power between the partners and directors relative to the very executive team that it is supposed to lead. Hence the importance of a unified front between the directors, clear and transparent guidelines for the selection of all office bearers with the potential to impact board effectiveness and oversight.

5. Public Officials and Corporate Governance

The position of the State as investors is often through jvs that are created based on laws that grant the State the right to equity in extractives projects developed in some jurisdictions. For instance, in **Guinea**, the minimum stake by the government is 10% free carried interest but can increase to 35%, subject to specific conditions. In **Ghana**, the state is entitled to 10% free carried interest for oil deposits. In **Botswana** the law stipulates the right for the State to acquire 15%, with an option to increase or decrease the shareholding subject to negotiated terms with the investor. However, a recent bill increased this entitlement to 25%.

In **Mozambique**, the laws that regulate solid minerals and hydrocarbons not only vest the resources in the state but provide for state participation. Article 8 (1) of the Petroleum Law No. 3/2001 provides that *"the state reserves to itself the right to participate in petroleum operations in which any legal person is involved"*. *(The Mozambique authorities do not stop here, however, but also insist on citizens acquiring equity).* Many governments perceive equity participation as both a vehicle for extracting greater value and an integral part of their responsibility to steward natural resource exploitation. **According to former President Festus G. Mogae of the Republic Botswana**, in that country[1] *"the vesting of minerals rights in the state has therefore allowed government to equitably spread services and development across the country.*[2] *Consequently, the government's take in the parlance of trade is now 81% made up of the variable royalty, tax and dividends"*.[3]

1. Petroleum Law No. 3/2001 of the Government of Mozambique.
2. www.debeersgroup.com
3. A Statement by His Excellency the Former President of Botswana, Mr. Festus Mogae at the African Development Bank's 2008 Eminent Speakers Programme, Tunis.

This precondition often also carries with it the right of the State to nominate representatives to the boards of operating entities. So, former President Mogae's statement though correct, only addresses fiscal benefits of state equity in Debswana, a 50:50 partnership between that country and De Beers Group. What is not captured in the Statesman's remarks is the strategic aspects of the value of the shareholding.

Botswana has been capitalizing upon this over the last 50 years through direct influence of decisions of the company's board of directors. But the leadership is fully cognizant of the fact that state equity alone is insufficient to ensure that it reaps the full benefits of the country's diamond wealth. Given the long life of such projects and the ever-changing economic and commercial environments, active involvement in the strategic decisions of the operating entities through the board of directors is therefore another important vehicle for capturing value. That said, effective leveraging of this position is easier said than done.

So, it is worth looking at the position of government representatives on boards of these partnerships too and their role in containing risk while maximizing value to the State. The position of governments is informed by several factors and the most important are percentage of equity, level of financial investment and the corresponding degree of influence that the government can exercise through its representatives. In cases where the State is the majority shareholder, these entities are likely to be subject to the same political environment as other SOEs. However, in cases where the State is a passive shareholder, with little to no financial investment in the project, the private investor typically performs a dominant role with respect to company culture, corporate governance and strategic oversight. In this case, the State's influence becomes negligible except as regulator. But this does not mean the State is not exposed to risk or that its representatives should drop their guard as future shareholder liabilities can still arise.

An additional factor in partnerships is the question of which party manages the operations on a day-to-day basis. In case of a minority State interest, in which the private investor also manages the operations of the partnership, again the influence of the State is lessened. Industry norms and market dynamics, and not the political economy, will have a greater impact on the corporate culture and approach to governance.

Based on the actions of the executives, corporate governance as relates to ability to raise finance, perceptions of risk, brand visibility and other sustainability challenges will likely influence corporate strategy and decisions of the board. Unless well thought out, this can limit the impacts of national policy and effectiveness of public voice. Limiting the impacts of national politicians can reduce impacts of the political economy. On the other had, it might also lessen financial risk because of higher levels of scrutiny and requirements for routine reporting by external financiers. Though not guaranteed, the outcome might be discipline in the boardroom.

But in the final analysis, only governance and vigilance, work.

The above therefore places the importance of having effective State representatives capable of performing the State's custodial role, center stage. This includes their legal responsibilities and maximizing the value of the State's equity. But this does not mean pulling in different directions because lack of synergy between shareholders can undermine the very value of a partnership (that is pulling collective resources together for mutual benefit). It also illustrates that having secured the shareholding thanks to national laws, State equity is not an end in itself but rather a means to an end. One of the undesirable consequences of passive State representation is that inaction translates into an incremental opportunity cost to the country through a failure to continuously capitalize on the State's shareholding.

Out of this emerges a very onerous task. These four factors illustrate this clearly and highlight the unique position of privilege that public officials enjoy relative to those they represent. Public officials have significant authority, the powers of discretion, a superior position relative to investors and, higher degrees of knowledge and capability. Such position of privilege suggests an obligation and expectations for the officials to abide by high performance and ethical standards.

It also implies that the officials cannot take their knowledge for granted. Instead, public officials need to consciously equip themselves in order to competently discharge their duties. It also means that, contrary to norm, as directors they cannot only act in the interest of equity shareholders but need to look beyond these when making decisions on the board. On the other hand, public officials are also potentially conflicted because some also regulate the sector and account to the public to ensure that the very private sector entities that serve as directors of comply with legal frameworks as an integral part of their public duty. At the same time, they work to attract investors and have an implied commitment (in law and policy) to protect investors through fair practices. This and their conventional roles is the source of potential conflict that requires clear separation of duties and a heightened sense of responsibility.

Quite apart from the need to avoid of conflicting interests, given the rising importance of ESG standards, officials need awareness of emerging and continuously changing governance standards. Regulators cannot afford to take corporate reports on health, safety and taxation at face value. It is essential to supplement the information with physical inspections and audits. For instance, site visits to operations to inspect equipment supplied by manufacturers helps validate compliance with safety standards and environmental management plans. On financial matters, rigorous tax and resource audits ensure that complex accounting techniques do not mask the true magnitude of revenue generated in order to deprive the State of public revenue while seeking to optimize investor returns. On the other hand, though the expectations of governments and those of corporates to optimize value is legitimate, the processes by which they respectively achieve this can sometimes be irreconcilable and requires fair adjudication by regulators.

An important part of the jigsaw puzzle in optimizing value is the natural resources deposit itself. Resources management requires skilled geological resource planners and managers to assess operations and ensure that companies extract minerals, oil and gas resources in line with conditions of licencing regimes. In all these cases, lack of in-house skills does not have to hamper the work of the regulator. Such services are readily available in the market and the State can outsource the work that need to be carried out periodically. But whatever the nature of the expertise required, it is vital to increase the capacity of regulatory and investment arms of the State to protect public interest.

Hence, the importance of the effectiveness of government officials as representatives on the boards of minerals, oil and gas companies in which the State has equity. The officials differ from other non-executive directors because as civil servants, the officials also have responsibilities that arise out of holding public office. Though conventional wisdom suggests that public officials, like all other directors, should act in the interests of the body corporate, under these circumstances, it is more likely that they act as *"a special interest group".* Special interest groups by nature represent a clearly defined constituency with specific interests and in this case the group comprises citizens. To appreciate the significance of burden of responsibility, it is good consider to the concept of *"a fiduciary"*.

Dictionary.com defines a fiduciary as *"a person to whom property or power is entrusted for the benefit of another"*. Further, that there are at least four factors that identify or qualify a relationship as a fiduciary one namely:

- the beneficiary has delegated authority to the fiduciary to act on its behalf;
- the fiduciary has discretionary powers over the beneficiary's assets or interests;
- the fiduciary is in a position superior to that of the beneficiary due to specialized access, knowledge or ability;
- the beneficiary trusts that the fiduciary with act in the beneficiary's best Interest.

Public officials account to a long list of stakeholders, including equity shareholders. But, being part of bureaucratic chain of command compels them to pander to the interests of line supervisors. This is unlikely to help officials navigate the day-to-day hierarchical structure in a way that frees them from the constraints of managing the challenges of the political economy. Ideally, to be effective, public officials who serve on a board should break rank with day-to-day public service and this requires being assertive and fully deploying the powers vested in them as directors.

6. Contribution of an Independent Director in avoiding Conflict

Given the relationship between civil servants and politicians and bi-partisan nature of decisions relating to SOEs and partnerships, the boards of these companies must find alternative ways to reduce adverse effects of political interference. One of these is through the appointment of independent directors to the board. Typically, an independent director is neither an employee of the company or shareholder, (or a member of the family in case of private companies).

Instead, according to TaxGuru webpage,

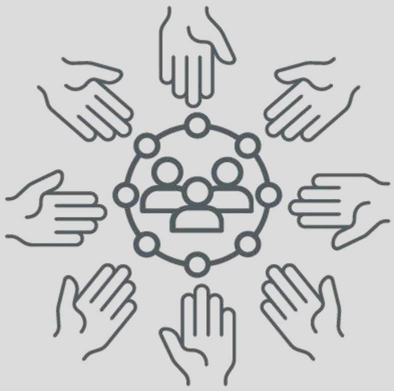
> *"An Independent Director is a Non-Executive Director who does not have a material or pecuniary relationship with company, except sitting fees, but is one who is enriched with appropriate balance of skill, experience, independence and knowledge of the corporate and assigned with the task to monitor and guide the Board in risk management, thereby improving corporate credibility and accountability."*

The concept of an independence implies free from contractual, material and ideological constraints emanating from pre-existing relations with either the company or the shareholder. This means that the independent director acts based on the interests of the company and its shareholders. In addition to avoiding conflicts of interest, an independent director can bring fresh ideas, skills experience and be a watchdog on board committees. The latter role is particularly important in relation to audit, risk, nomination and remuneration committees that are vulnerable to the biases of the company executives and shareholders. The rationale is that the executive team and those with a vested interest in the corporate culture and system of governance are not likely to also be able to objectively provide independent oversight.

The above notwithstanding, appointment of an independent directors has its own limitations. One of the challenges of independent directors is lack of day-to-day involvement in the running of the company nor affairs of State. This limits access to information on the internal environment, company operations and other matters that affect strategy and risk. Hence an independent director like non-executive directors is beholden to the very executives that the director is expected to oversee for information necessary to exercise independent judgment. The other is that the director's independence often comes at a hefty price based on their perceived value and demand for their expertise in the market.

In SOEs that often do not operate on market principles governments may find it difficult to justify fees to constituents. This notwithstanding, in case of a decision to strengthen the voice of civil servants on boards of SOEs and partnerships by moderating impacts of political interference through the civil service chain of command, appointment of independent directors is an option.

Diagram 3:
All Hands on Deck



7. Conclusion

While true that directors account collectively, directors also think and behave as individuals. This is based both on the unique ethos, experience, skills and knowledge of the individuals. It is the choices each director makes based on these factors that determines the contribution that each and all directors make to board effectiveness. As such it all starts and ends with the individual.

Sheila Khama is an experienced non-executive director of FTSE, Nasdaq, and Saudi Stock Exchange and AXS listed companies, a policy advisor, podcast host, and an associate fellow of Chatham House. She is former CEO of De Beers Botswana, a former NED on boards of Debswana and DTC Botswana and former compliance Officer Anglo American Corporation Botswana.

This blog is part of on series on:

Good Corporate Governance in Oil, Gas and Mineral Industries.

www.sheilakhama.com