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Why is SOE governance different from Corporates?
A look at how corporates and SOEs treat PEPs
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In a recent webcast I was asked*: "Is there a difference in the treatment and expectations regarding politically exposed persons (PEPs) on State-owned Enterprise (SOE) boards versus those appointed to corporate boards?" Specifically, the question posed to me asked what is the governance difference between Enoch Godongwana's*[1] *appointment as Chairman of the Development Bank of South Africa (DBSA) Board and Trevor Manuel*[2] *'s appointment as Chairman of the Old Mutual Board?*

This note contrasts these two roles, using the examples cited during the webcast.

Note: while we offer observations on the contrasts between these two scenarios, this commentary does not make any claims or statements about the abilities, competencies or suitability of either of the above appointees.

Governance is paramount in both cases

Futuregrowth has previously articulated our concerns relating to governance issues in certain SOEs over recent years:

1. Futuregrowth suspends new loans to state-owned-entities;
2. The role of governance in sustainable investing; and
3. SOEs, where temps run the show.

While much of our focus at Futuregrowth has been on SOE governance, this has not been to the exclusion of pointing out governance weaknesses and transgressions in South African corporates, such as:
How Steinhoff affected us normal folk and why no one raised the red flag;
A Bond Investor's Perspective on Regulation 28: Time for a Change.

While the consequences of governance failures in both corporates and SOEs can be disastrous, there are differences in how these might play out.

The question of motivation

In our initial body of work on SOE Governance (November, 2017), we noted:

> *"... SOEs, by their very nature as publicly-funded entities, are not subject to the same market discipline or shareholder oversight as other entities. The web of control governing SOEs is different from private firms in that participants' economic interests may be distorted for personal gain or patronage, and SOEs can easily be subject to political pressures. Each SOE has a unique mandate to fulfil, often occupies a near-monopoly position (e.g. water, electricity, transport), may be able to pass its costs onto consumers, and does not necessarily have to make a profit to stay in business. SOEs can become a burden on the state, and therefore all citizens. These factors all serve to elevate the importance of appropriate governance policies, processes and procedures for SOEs."* [3]

A central difference between companies (that are profit seeking) and SOEs (that have a variety of objectives) lies in the motivation behind behaviours. We know that directors and managers of corporates aim to maximise stakeholder (including shareholder) value through the generation of profits.

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[1] Enoch Godongwana is a member of the ANC NEC, and the Chair of the ANC's Economic Transformation Committee. He was appointed as Chair of the DBSA Board on 27/09/2019.
[2] Trevor Manuel was a member of the ANC NEC from 2007-2012 and was appointed as non-executive director to the Old Mutual plc Board in January 2016, appointed as Chairperson of Old Mutual Emerging Markets in March 2017. Following Old Mutual's "managed separation", he was appointed as Chairperson of the Board of Old Mutual Limited on 05/03/2018.
[3] Extracted from SOE Governance Unmasked, page 10 and 11.

With SOEs, it is not always clear what the motives for behaviours are – and could range from good-hearted developmental impact to nefarious patronage or malfeasance. Moreover, when power is concentrated in the hands of one person (i.e. a Minister), it is necessary that appropriate limits to that power are implemented. We have seen in recent history what has happened when these limits and safeguards are absent or overridden.

TAKE OUT

1. The directors of corporates are motivated to generate profits and increase stakeholder (including shareholder) value.
2. The motives of SOE boards are not always clear and experience has shown that they are easily open to manipulation and self-interest, often with scant accountability.

Duty of loyalty and duty of care

Directors of companies are required in common law, the Companies Act, and the King Codes on Corporate Governance to execute their duties in the best interests of all stakeholders. At the heart of this issue are the twin pillars of:

- the duty of loyalty (e.g. avoidance of conflict); and
- the duty of care (e.g. applying suitable competence, skill, diligence and attention).

Almost all instances of weak governance or governance transgressions are found in a breach of one of these two core duties. In the worst cases of malfeasance, the duty of loyalty is breached by conflicts of interests. In cases where conflicts (either actual or perceived) arise, the entity must ensure that it has robust and appropriate policies, processes, controls and behaviours to mitigate the risks introduced by the conflict that may arise between an individual's personal, business, political, or other interests vis-a-vis their obligations as a director.

In the context of the question posed at the start of this article, a possible conflict was noted in the composition of the DBSA Board, highlighting that as a PEP[4], Enoch Godongwana's chairmanship of the DBSA could give rise to conflicts of interest that would need to be appropriately managed. Should the same principles apply to Trevor Manuel's Chairmanship of the Old Mutual Board? The answer is yes and no.

TAKE OUT

Most governance transgressions tend to arise from either a conflict of interest or a dereliction of duty.

Key points of departure

The DBSA is a **state-owned entity**. Its sole shareholder is the SA government, and its mandate and deliverables are set by the shareholder representative ministry, which is the National Treasury, acting through the Minister of Finance. Thus, the DBSA should be run sustainably and for the national interest, but could easily become a part of the political apparatus due to a lack of independent stakeholder control.

Old Mutual is a **publically listed company**, and its mandate and deliverables are set by the Board - acting for all stakeholders, including shareholders, funders, employees and suppliers. As a private company, its lifeblood is driven by profitability, and its management, Board, and strategy are subject to continuous oversight by shareholders, lenders, customers, and society.

There are three fundamental points of departure between SOEs and corporates. It is important to understand these differences, and their possible impact on conflict management, when looking at the

[4] Politically Exposed Person

example of the appointment of Enoch Godongwana to Chair the DBSA Board and Trevor Manuel to Chair the Old Mutual Board.

1) The process to nominate and appoint directors:

Per the DBSA's 2019 Integrated Annual Report (IAR), the Human Resources, Remuneration and Nominations Committee[5] (HRNC) (a sub-committee of the Board) is responsible, inter alia, for recommending to the Board, potential candidates for membership to the Board. There appears to be no public disclosure of the CVs of potential candidates, nor of the process that the HRNC follows, in making these recommendations, although brief CVs are mentioned in the DBSA's SENS announcements when new board members are appointed.

Notably, the Minister of Finance alone approves the appointment of directors - and so, the decision to appoint any director to the DBSA Board, is made by the Minister. It is not clear from the DBSA IAR, once the HRNC has made their recommendations, whether its recommendations are indeed followed by the Minister of Finance, or what other criteria, checks and processes the Minister follows in making the final appointments. We believe there have been instances where such recommendations were summarily over-ruled (ignored) by a Minister.

At Old Mutual, the selection and appointment of directors is the responsibility of the Board, supported by recommendations from the Corporate Governance and Nominations Committee (a sub-committee of the Board). Nominations are proposed by shareholder resolution, and then voted on, by the entire body of shareholders at the AGM for a specified term. Shareholder resolutions for Board appointments include brief CV's of nominated members so that shareholders can assess the suitability of each nominee before casting their vote.

Per Old Mutual Limited's (publicly available) 2019 Integrated Annual report, at 31 December 2019, Old Mutual has over 460 000 shareholders, holding around 4.5 million shares.

Share ownership

At 31 December 2019

Public and non-public shareholding of ordinary shares

At 31 December 2019	Number of shareholders	% of shareholders	Number of shares	% of ordinary shares
Public	460,671	96.78%	4,557,113,062	96.78%
Non-public	30	3.22%	151,440,587	3.22%
Directors and associates	8	0.06%	1,974,339	0.04%
Employee Share Trusts	12	1.87%	87,905,926	1.87%
Black Economic Empowerment Trusts	9	1.15%	54,286,407	1.15%
Restricted	1	0.15%	7,273,915	0.15%

Source [6]

The decision to appoint board members (even assuming that not all shareholders will vote) is made by a wide body of shareholders, through a voting process. Trawling through the results of the AGM held on 24 May 2019, the appointment of Trevor Manual to the Old Mutual Board garnered a healthy majority of 3 488 824 463[7] votes.

[5] DBSA 2019 IAR, p126

[6] Old Mutual Limited Annual Financial Statements; For the year ended 31 December 2019

[7] https://otp.tools.investis.com/clients/uk/old_mutual_limited/rns/regulatory-story.aspx?cid=2404&newsid=1269572

While it appears that appointments to the DBSA Board are made by one person, appointments to the Old Mutual Board are made by many shareholders in a vote. The possibility of undue influence being exercised by the shareholder(s) is much less when the shareholding is widely held and appointments are made on a transparent vote.

Because the potential for conflict and political interference is greater in the case of SOEs, where all power vests with the Minister, it makes sense that appropriate appointment and conflict management processes need to be in place where there are no other obvious checks and balances to mitigate the risks inherent in this process.

TAKE OUT

1. The appointment of Trevor Manual to chair the Old Mutual Board was approved by a majority of a large body of shareholders in a transparent process.
2. The appointment Enoch Godongwana to chair the DBSA Board was made by the Minister of Finance alone, in a closed process. We believe that this implies that that additional governance processes need to be in place in this scenario.

2) Conflicts between political responsibilities and director responsibilities:

The second key difference exists in the political responsibilities of Enoch Godongwana and those of Trevor Manuel – and, as such, the possibility for conflicts of interest is probably relatively stronger on the former.

If we examine the available public information, when Trevor Manuel was first appointed to the Old Mutual Board in 2016, he was no longer serving on the ANC's National Executive Committee (NEC) and did not hold any public political office. While he may have remained an ANC member and been active in the political arena (as a member of the self-titled "ANC Stalwarts"), he has held no official responsibilities as a member of government nor as a member of any of the ANC's decision-making structures since retiring from active politics in March 2014[8]. Further, Old Mutual is a company that is owned by its shareholders and, as a privately owned company, is relatively independent of government. Therefore, we believe the risk of potential conflicts between political and fiduciary responsibilities in this case is reasonably low.

Contrast that with Enoch Godongwana, who currently serves on the ANC's National Executive Committee (NEC) and is the Chair of the ANC's Economic Transformation Committee (ANC ETC). The ANC ETC recently published a document[9], "Reconstruction, Growth And Transformation: Building A New, Inclusive Economy" which highlights the economic interventions necessary for job creation, growth and investment in the South African economy amid the Covid-19 pandemic. Central to these economic interventions is an "infrastructure-led revival of the economy with new investment in energy, water and sanitation, roads and bridges, human settlements, health and education, digital infrastructure and public transport". These economic interventions fall right in the ambit of the DBSA's mandate[10] and herein lies the potential for conflict.

In his duties as Chair of the DBSA, and also his membership of the DBSA Board Credit and Investment Committee (a sub-committee of the Board), Enoch Godongwana will have to ensure that he appropriately discloses areas of conflict and recuses himself from investment decisions where he may be conflicted between his responsibilities as ANC ETC Chair and his fiduciary duties as a DBSA director. As a

[8] https://www.ft.com/content/4b280868-a915-11e3-9b71-00144feab7de
[9] https://www.polity.org.za/article/anc-launches-economic-reform-paper-2020-07-10
[10] DBSA's mandate is set in terms of the DBSA Act, and is mandated as a "DFI with the primary purpose of *promoting economic development and growth*, human resource development and institutional capacity building *by mobilising financial and other resources from the national and international private and public sectors for sustainable development projects* and programmes in South Africa and the wider African continent."

fiduciary, he is obliged to make decisions for the benefit of all stakeholders (this includes the shareholder, funders, employees, creditors and others).

While there is little dispute that the DBSA, and other SOEs, are instruments of state policy, and should be run (as are corporates) for the benefit of all stakeholders as well as for the nation's benefit, the real danger is that such entities become instruments for patronage (e.g. jobs for cadres) or corruption (e.g. through mis-directed procurement or lending). Thus, the strength of the application of policies, practices, committee decision-making and oversight here is vital – as is appropriate conflict management, disclosure and recusal - to ensure that there is no undue influence for a particular investment, or for an investment to be made on anything but arms-length terms.

TAKE OUT

1. Trevor Manuel does not hold any political office in the ruling party, thus risks of conflicts related to political interests as chair of Old Mutual are low.
2. Enoch Godongwana's positions on the ANC NEC and ANC ETC automatically place him in a conflicted situation as chair of the DBSA and member of board sub-committees, which will require careful and diligent management.

3) Profits and bailouts

If the respective boards of DBSA and Old Mutual make unsustainable financial and operational decisions, the risk of financial failure is the same. The difference between the two scenarios lies in the aftermath.

In the case of the DBSA, the shareholder (i.e. the government) may decide to bail the entity out, either through direct cash transfers or through the provision of government guarantees - as we have seen countless times with Eskom, SAA, Denel, and other SOEs. These bailouts are effectively transfers from the fiscus (i.e. the taxes that we pay to the government) and can create a moral hazard, where unsustainable entities are propped up with sub-optimal outcomes for government spending and our fiscal position. Fewer houses, roads, schools and hospitals are built – and the state takes on increased debt and contingent liabilities to fund the bailouts. Moreover, recent history has shown that there are seldom negative consequences for the perpetrators of governance transgressions that have led to the need for a government bailout.

A company like Old Mutual does not have the option of a government bailout, and can only approach shareholders for additional capital via a rigorous, and likely contentious, process. The Board and management risk their jobs and remuneration if they make bad decisions: shareholders will vote them out. At the extreme, the company will face liquidation if bad and unsustainable decisions are made on an ongoing basis. The profit motive and market forces, while by no means perfect, do create a discipline to restrain errant behaviour.

TAKE OUT

1. Failing SOEs are more often than not bailed out by government – resulting in fiscal damage and very little accountability.
2. When corporates fail, the options are limited and the jobs of decision makers are on the line. This tends to regulate board and management conduct - to a degree, at least.

Elevated risks and responsibilities with SOEs

We are NOT saying that the appointments discussed should not have been made, that they are inappropriate, or that the individuals concerned are unqualified, unethical or unsuitable.

What we are saying is that for SOEs, there needs to be a greater awareness of the potential for conflicted decision making when politically exposed people sit on boards. These conflicts may be elevated in SOEs relative to companies.

Decisions made at SOEs may not always be in line with a (corporate) directors' duties or the mission of the entity, and hence may not be in the best interests of all the stakeholders.

With this awareness of elevated conflicts of interest, comes an increased burden of responsibility on the shareholder(s) and the board to ensure that appropriate and robust conflict management practices are deeply embedded in the organisation and actively practiced. We suggest further, that it is necessary, when transgressions occur, and when conflicts are not declared or appropriately managed, that there are swift and appropriate consequences.

Sources:
1. https://en.wikipedia.org/wiki/List_of_members_of_the_2007%E2%80%9312_African_National_Congress_National_Executive_Committee
2. https://www.politicsweb.co.za/party/results-of-the-elections-for-the-anc-nec-2012
3. https://en.wikipedia.org/wiki/List_of_members_of_the_2017-2022_African_National_Congress_National_Executive_Committee

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