

PART ONE

GOVERNANCE WORKSHOP FOR MINISTERS AND PRINCIPAL
SECRETARIES: ARUSHA 14 - 19 JANUARY, 1996

THE ROLE OF THE GOVERNMENT IN CORPORATE
GOVERNANCE - MANAGING THROUGH BOARDS

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Introduction

Corporate governance is the process and structure used to direct and manage the business and affairs of an enterprise. By process is meant the system for decision - making by the parties responsible for directing and managing the business of the enterprise and for making the decision - makers accountable. And by structure is meant the legal and administrative framework within which the enterprise operates. Thus the corporate process and structure define the division of power and establish mechanisms for achieving accountability among the shareholders, the board of directors and management.

The primary objective of any business is to earn a return for the investors. The owners of the business i.e. the shareholders, aim to enhance the value of their equity. The overriding responsibility of the board of directors and management therefore is to sustain an enterprise's financial viability to meet the shareholder's expectations. No matter what the ideological environment, that is the universal principle of corporate governance. The accountability of the board is to the shareholders, the owners of the business.

Prior to 1967, business in Tanzania was governed exclusively by the Companies Ordinance (Chapter 212 of the Laws of Tanganyika) passed in October 1932. Following the adoption of socialism in 1967 Parliament passed in March 1969, an all-embracing legislation, the Public Corporations Act, that empowered the President to establish public corporations, as and when he saw fit, to undertake any commercial activities for and on behalf of the state. These statutory corporations were to be owned solely by the Government either directly through the Treasury Registrar or indirectly through intermediary holding companies. In November 1976 the provisions of that Act relating to management were modified to provide for establishment of management committees for subsidiary companies in place of boards. The Public Corporations Act (No.17 of 1969) and the Parastatal Organisations (Modification of Management Provisions) Act (No.16 of 1976) provided the legal framework for the governance of state-owned enterprises in Tanzania until 1992.

Following the adoption of economic liberalisation policies in the mid-1980's these and related corporate laws had to be reviewed. In April 1992 the Public Corporation Act of 1969 was repealed and replaced by a new Public Corporations Act, 1992. What the new law did was to allow for Government's partial or total divestiture of its ownership of parastatals and redefine its role in the management of the economy. An extensive amendment to the Act passed in November 1993 established the Presidential Parastatal Sector Reform Commission (PSRC) to manage and oversee this programme.

Thus Tanzania's current corporate governance scene is in transition and posing extremely challenging questions. What should be the role of government in the economy and society? How far should the Government withdraw from ownership of commercial businesses? How should the boards of directors be constituted in partially divested parastatals? What should be their responsibilities? What about the boards of the retained parastatals? Can they be truly independent from management? How do we enforce board accountability for performance and results? These and other questions need urgent answers.

The Role of the Government

Any government's first responsibility in corporate governance is to create an enabling policy and regulatory environment for business. It must provide a vision for the business community and for every sector of the economy. That function no other agency can perform. An economic policy framework for growth and development in the long term, clearly defined and easily understood is a prerequisite for the creation of confidence in both local and foreign investors.

To our mind, the most urgent task of the new Government is to articulate and sell a well thought out vision of the Tanzania of the 21st century with which every citizen, both human and corporate, should identify.

Creating such a vision and translating it into practical development policy and programmes is no easy task. If that policy has to be enabling rather than inhibiting it needs skills of the highest calibre to work on it, advisably with inputs from all the important stakeholders in society, including the business community.

The new Government should therefore strive to build expert internal capacity for competent policy analysis, review, articulation and implementation. It should disseminate its vision, policies and other guidance to the private sector without discrimination and on a cost recovery basis. That would be its best contribution to proper corporate governance.

Once the correct policies are established they should be translated into laws, rules and regulations that can be enforced to ensure fair play. The simpler the better and the more widely understood and accepted. Areas that are of social concern for regulation include monopoly, safety, quality, tariff etc. The whole purpose of regulation, which is a prerogative of governments worldwide, is to create a level playing field for all investors.

Certain physical infrastructure such as highways, railways, airports, ports, schools, hospitals and the like cannot be built and operated on a commercial basis. They are too expensive or too important to be left to profit seeking businessmen. Some services also, such as research, sewage disposal, street lighting etc. are communal in nature. They therefore have to be provided centrally by the Government. Business requires these facilities to operate efficiently and effectively.

Finally business needs peace and security to thrive. Law and order are the public "goods" traditionally preserved for governments to provide all over the world. No corporate governance can take place in the middle of wars, civil strife, crime and other social unrest and insecurity.

Ideally the role of the new Government in the economy should be confined to these four main areas enabling to corporate governance especially in the light of the extremely scarce resources at its disposal. However, should the Government decide to invest in directly productive commercial enterprises then it should behave like any other shareholder, to which subject we now turn.

The Government as Shareholder

The Tanzanian Government will continue to own some shares in commercial companies for a long time to come. Experience so far has shown that the joint venture option with the Government as majority shareholder (Tanzania Portland Cement Company), or as a 50/50 partner (Tanzania Breweries Ltd) or as minority shareholder (Williamson Diamonds, Tanzania Cigarette Co., TANELEC etc) is the most politically acceptable privatisation mode. This means that for the foreseeable future most of the parastatals will continue to be part-owned by the Government.

Whether fully or only partly owning these enterprises the new Government as shareholder must resist the past tendency of interfering in their operational activities. The more so in those enterprises with private joint venture partners.

The only matters requiring decisions by shareholders in corporate governance are:-

- (a) fundamental change to the enterprises constitution and business;
- (b) election of directors;
- (c) election of auditors; and
- (d) where directors' interests interfere with those of the enterprise or shareholders.

Obviously the Government as shareholders will be keenly interested in the changing structure of shareholding especially when the stock market takes off. It will also be interested in the composition and performance of the boards of directors, especially in monitoring and objectively evaluating management performance. But the effective governance of these companies from the Governments point of view as co-owners will almost exclusively depend upon its behaviour as shareholder and the exercise of its rights as such.

Should the new Government wish to monitor corporate operations more closely then they should have their officials sitting on the boards of directors, especially where Government owns the majority of shares. However this should be in very exceptional cases. As a general rule civil servants and politicians should not be sitting on corporate boards of directors. Instead the Government should appoint non-civil servant and non-politician citizens, professionals of the highest integrity to represent the state as shareholder. The qualifications for appointment, which we come to below, should not be different from those for private sector shareholder representatives.

Logically Government as regulator of should not at the same time be an active player among commercial operators. This inherent conflict of interest only suggests that the ideal situation is for Government to restrict its direct role to civil conducive and to play its traditional social role of creating an environment government to private business operation as outlined briefly earlier on. Corporate governance is not and should not be the direct business of governments, just as civil governance is not and should not be the business of corporations.

The Board of Directors

The primary responsibility and sole reason for the existence of a board of directors is to manage or supervise the management of the business and affairs of an enterprise on behalf of the shareholder(s). A board of directors does not manage the business and affairs of a company - that is the responsibility of management. The board's role is that of stewardship and oversight. It is to manage and supervise the management of the company. The day-to-day operation is delegated by the board to the paid officers and staff of the company.

As stated at the outset it is the primary objective of the board of directors not only to increase the value of business for the investor shareholder but also to prevent the erosion of that value. The board therefore has to assess and manage the risks of the enterprises business as best they can to preserve the company's assets.

Board selection

A good board of directors is the first assurance of success for a company, and the most important qualification of any good board is that it must not only be but also be perceived to be capable of exercising independent judgement. This is a legal obligation. And by independence here we mean the ability to make an objective assessment of the merits of management's initiatives and management's performance in all circumstances, based on the absence of business or other relationships that would impair or compromise the ability of the director to exercise judgement in the best interests of the enterprise.

The integrity of a board is very much based on the integrity of the individuals constituting it. In the selection of candidates for board positions therefore full consideration should be taken of the individual's moral standing, education, profession, relevant experience, personality, time availability, involvement in non-conflicting businesses and other similar qualities.

Board Responsibilities

But perhaps even more important is the clear definition of the board's principal responsibilities so that every one member knows exactly what is expected of him/her. Typically the board of directors has the responsibility to:-

- (i) ensure that there is a strategic plan in place that maps out the medium and long term development of the enterprise;
- (ii) ensure that there is a system for monitoring and managing business and other risks to maximise potential returns to investors;
- (iii) appoint, train, motivate, reward and continuously improve performance of the top management of the enterprise. Particularly crucial is the appointment and care of the chief executive to spearhead the execution of the strategic plan;
- (iv) develop and maintain a clear external communication policy and system with all the stakeholders including the shareholders, customers, suppliers, financiers, and the general public;
- (v) maintain an effective internal information system to facilitate progress monitoring of the strategic plan implementation, financial flows etc.

These and other duties should be clearly explained to the board members through both formal and other training and briefing. The training of board members was neglected in the past as if they do not matter to the performance of a company. We are now entering an extremely competitive environment both internally and internationally. Unless the new Government realises this and takes urgent action to upgrade the quality of its nominees on the joint venture and other boards, our private sector partners and competitors will always have an edge over us. We will only have ourselves to blame for it.

Unfortunately Part IV of the Public Corporations (Amendment) Act, 1993 refers to the accountability of the boards of directors in the changing corporate environment but only in relation to the approval of corporate strategy and the annual report and accounts. It makes them answerable to the Minister for Finance, the Minister for the sector ministry and the PSRC all at once! This set up is certainly unworkable because of this diffuse reporting system. Small wonder that most boards are confused. Some even approve or condone criminal activities like asset stripping and get away with it just like that because no one seems to be sure exactly who should bring them to book between the TREASURY, PSRC and the sector ministry.

Board Accountability

It should be stressed that the board of directors functions as a unit. Its accountability should therefore be collective. A board composed of directors from different backgrounds relevant to the operations of the company is the preferred composition but interest or stakeholder group representation should be avoided as much as possible. People should be appointed to boards in their individual capacities and on pure merit.

Good corporate governance demands that the performance of the board be subjected to periodic assessment to facilitate accountability. Unfortunately we know of no single parastatal board that has a performance evaluation system in place for itself as a unit or for its individual members. Normally a board is appointed for a three year term and it is only after the full term of office that it can be replaced. Likewise there is no formal performance evaluation system for individual directors by the board itself or its appointing authority. However poor a member's performance on the board there is no objective system to bring the fact out and take remedial action during term.

The assessment of board performance should be made against the general business growth of the enterprise and against its responsibilities as outlined earlier on. This can be done by the appointing authority or by the board itself. The evaluation of the individual member's performance could be done by a board's committee of itself or by an independent consultant. Whatever the case we strongly believe that an evaluation of the performance of the board and its individual members is very important and should be carried out regularly for accountable corporate governance.

In some countries including Canada and the USA the law holds individual directors personally responsible especially when a company is in financial distress. Cases have been cited where directors were required to pay employee salaries for up to six months because the restructuring programme they had approved and supervised did not turn the company round as envisaged. To extend personal liability so far certainly is counterproductive because it will discourage capable individuals to accept board membership at such high risk. In such eventuality the entire board could simply resign rather than suffer the consequence.

Against such risks it is only reasonable that board members be remunerated adequately. What level is adequate is best left to the individual boards to decide. However as a general guide boards should ensure that the level and form of remuneration for their members reflect realistically the risks and responsibilities involved in being an effective director.

Summing Up

In the Tanzanian experience, the Government is the worst possible sole shareholder a commercial enterprise could have:

- It has inconsistent and often irreconcilable objectives, making the enterprise literally unmanageable;
- it is control - oriented by junior officers in the sector ministries and risk - averse, and enterprise is about risks;
- it appoints boards, to put it delicately, of mixed quality, whose primary loyalty is to the Minister who appoints them and not to the integrity of the enterprise;
- sometimes, it takes from even that board the power to reward, and, in some instances, to appoint its chief executive;
- it brings to the table no technological or marketing expertise or access to markets;
- lastly, and most importantly, it just does not have the money to support, as sole shareholder, the enterprises for which it bears sole responsibility. The Minister - Civil service - Board - Management - Owner - Regulator - Public watchdog - Policy maker - Decision maker - Supervisor RELATIONSHIP is too complex and diffused for effective performance of any company.

Boards are all different. Every board has to devise its own code of practice. The appended draft "Code of Best practice" provides some general guidelines.