Economic Commission for Africa
Southern Africa Office

An Overview of Corporate Governance and Accountability in Southern Africa

Economic Commission for Africa (ECA)
Southern Africa Office (SRO-SA)

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Acronyms and Abbreviations

AAC	Anglo American Corporation
ACSA	Airports Company South Africa
APRM	African Peer Review Mechanism
BP	British Petroleum
CACG	Commonwealth Association for Corporate Governance
CSR	Corporate social responsibility
EADS	European Aeronautic Space Company
GDP	Gross domestic product
HIV/AIDS	Human Immune Virus/Acquired Immune Deficiency Syndrome
ICMM	International Council on Mining and Metals
IPIECA	International Petroleum Industry Environmental Conservation Association
LuSE	Lusaka Stock Exchange
MMSD	Mining, Minerals and Sustainable Development
NEPAD	New Partnership for Africa's Development
NGO	Non-governmental organization
OECD	Organization for Economic Cooperation and Development
OGP	Oil and Gas Producers
SABC	South African Broadcasting Corporation
SADC	Southern African Development Community
SAPREF	South African Petroleum Refinery
SDCEA-DN	South Durban Community Environment Alliance-(Denmark's) Naturfredningforening
SEC	Securities Exchange Commission
UNECA	United Nations Economic Commission for Africa
UNCED	United Nations Conference on Environment and Development
WBSCD	World Business Council for Sustainable Development
WTO	World Trade Organization
ZAMTEL	Zambia Telecommunications Company
ZANACO	Zambia National Commercial Bank
ZCCM	Zambia Consolidated Copper Mines
ZESCO	Zambia Electricity Supply Corporation
ZNBC	Zambia National Broadcasting Corporation
ZSE	Zimbabwe Stock Exchange

Foreword

In recognition of the receding role of the State's involvement in economic activities, the United Nations Economic Commission for Africa (UNECA) has worked assiduously to promote the private sector as the engine of economic growth and poverty reduction in Africa. The organization's work has included research and outreach activities and assembling international, regional and country stakeholders to address impediments to private-sector growth. One topical theme of such activities and deliberations has been how all stakeholders can assist member States in devising, adopting and implementing sound corporate governance principles.

Furthermore, UNECA has recently created a unit within the Governance and Public Administration Division (GPAD) to focus on private-sector issues, key among these being the implementation of good corporate governance principles and practices. This reorganization is in line with the UNECA repositioning exercise that includes the promotion of regional integration in support of the African Union and NEPAD. In the past, UNECA's support resulted in the production of the *Guidelines for Enhancing Good Economic and Corporate Governance in Africa* in 2002, a document that was in response to a request by the Heads of State and Government Implementation Committee of NEPAD for UNECA to lend its expertise to develop the *Guidelines* for promoting good economic and corporate governance in the continent.

The current paper is thus a continuing endeavour by UNECA to promote an environment that is conducive to private-sector growth. The previous draft of this paper was presented as a background document to the *Workshop on Economic and Corporate Governance and Accountability* that was held during 7-9 December 2005 in Lusaka, Zambia.

I am grateful to Professor John Lungu (Copperbelt University, Zambia), a consultant, who prepared this paper, and to Doreen Kibuka-Musoke, Development Management Officer, who supervised the consultant's work. There are many other people whose insightful contributions underscored the issues outlined in this publication, including Dr. Caleb Fundanga, Governor of the Bank of Zambia; Professor Akinboade, Department of Economics, University of South Africa; Mr. Ejeviome Otobo, United Nations Office of the Special Adviser for Africa; Mr. Eugene Chandi, Institute of Directors, Zambia; Mr. Augustin Seyuba, Konkola Copper Mines, Zambia; Mr. Martin Kalungu-Banda, Office of the President, Zambia; Mr. Markus Reichardt, URS; Mr. Joe Matome, Debswana Diamond Company (PTY) Limited, Botswana; Mr. Chisha Mwanakatwe, Bank of Zambia; Mr. Mumba Kapumpa, Institute of Directors, Zambia; Mr. Lewis Musasike, Development Bank of Southern Africa, South Africa; Mr. John Machayi, Finance Bank, Zambia; Mr. David Govere, Director, African Business Round Table, Southern Africa Chapter; Mr. Armith Singh, Nedbank Group Limited, South Africa; Dr. Bwalya Ng'andu, Managing Director, Development Bank of Zambia; Mr. Phillip Armstrong, Head, Global Corporate Governance Forum; Mr. Ezekiel Sekele, Zambian Breweries; and Professor Carlson Anyangwe, University of Zambia. Their contribution enriched this paper and enhanced

UNECA's understanding of the progress being made towards implementing good corporate principles, as well as the lingering, daunting, legal, institutional and practical challenges to turning current corporations into good corporate citizens while also attracting new ones.

Finally, I wish to thank my GPAD colleagues for their invaluable comments on earlier drafts of the paper, as well as colleagues from the Publications and Conference Management Section (PCMS), Division of Administration, for editing, formatting and producing this paper.

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Section 1: Introduction

1.0 Introductory Remarks

1. Southern Africa has undergone rapid political and economic transformation in the past 15 years. While some countries that obtained political independence before 1990 implemented stringent controls in their economies and created a substantial State-owned enterprise (SOE) sector, the 1990s witnessed a complete reversal of those systems, encompassing the political as well as the economic spheres. Many countries in the region are democratizing the political environment, while embracing more liberal economic policies, and are in the process of privatizing or have privatized most SOEs.

2. During the period, they have embarked on programmes aimed at reducing State control in the economy and facilitating the functioning of markets. Countries that were hitherto closed political entities and economies have embraced policies that are more inclusive through black empowerment programmes, while those that, from the time of their independence, embraced market economics as a development guide are now trying to consolidate their economies because of the challenges coming from the transforming countries.

3. One of the most significant developments in the process of transformation has been the establishment of stock exchanges to facilitate the development of capital markets as their private sectors grow. Other than the Securities Exchange South Africa, most other countries established their stock exchanges in the 1990s. Each of the countries in the region is trying to become competitive in order to attract foreign investment as well as stimulate local investment.

4. The changes in political governance to democratic systems, even though still in their embryonic stage, have triggered and brought with them new standards of governance in the economic sphere. During this very period, countries have, at the request of the World Bank, produced medium-term expenditure frameworks to improve governance in public finance. They have also embarked on legislative changes to bring their economies in line with the market system: from State controls to State facilitation. These broad changes have also affected the way corporations operating in these countries are owned and operated. The withdrawal of the State from the running of most businesses has sharply defined the difference between shareholders and managers on the one hand and corporation directors and minority shareholders on the other.

5. The changes have also enhanced the role of the private corporation in national development. It should be recalled that the SOEs played a developmental role as the State was in control of their expenditure and investment decisions. The question being asked now is whether the

private corporation can play a similar role in national development, hence the importance of the concept of corporate governance in the debate.

6. This paper, while attempting to provide an ordered account of corporate governance issues in national development, is structured as follows: The next section reviews the concepts of political, economic and corporate governance, based on the assumption that corporate governance derives from economic and political governance. In the third section, the paper discusses the corporate governance standards that have been developed in line with the changed economic systems from State ownership to private ownership.

7. The paper further points out that, while some governance standards have been motivated by political changes, others have stemmed from changed ownership based on private property rights. The paper then provides an overview of the applications of these standards in the financial sector, the extractive industries and the State-owned enterprises sector (as there is still a substantial number of SOEs not yet privatized). The last section of the paper raises issues or challenges that need to be addressed in the corporate governance debate.

Section 2:
Corporate Governance: Conceptual Issues

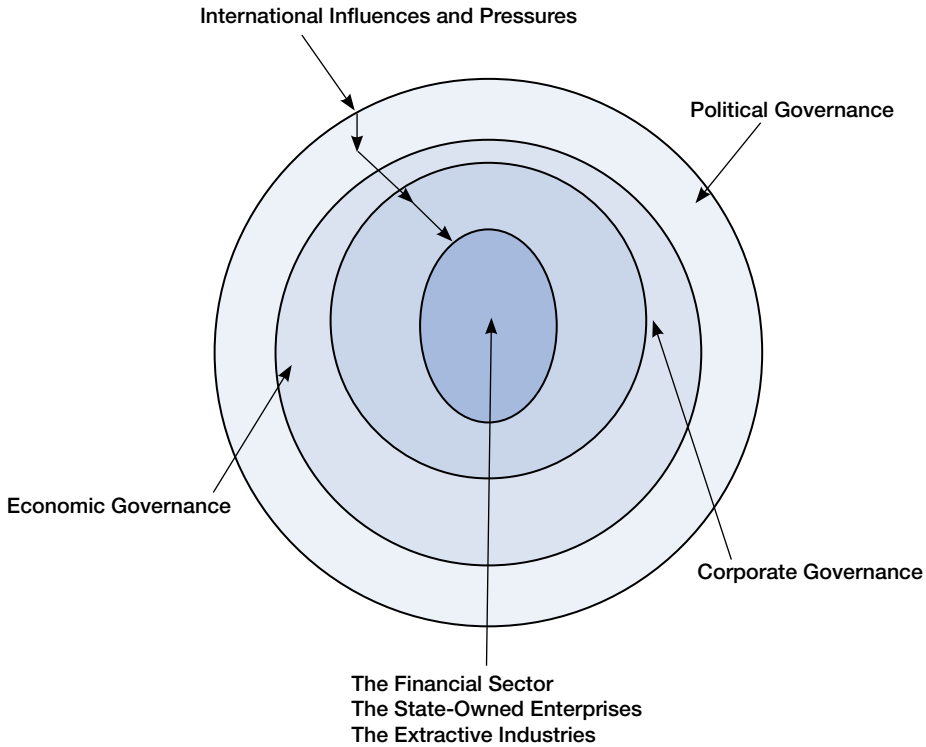
2.1 Introductory Remarks

8. Governance issues have taken centre stage in the development discourse and in particular on Africa's development agenda (Otobo, 2000). This is because most of Africa's problems have in the last forty-five years been linked to governance issues: principally the rule or control by the State. In this context, governance has been construed to mean political governance. This is because economic change or transformation is dependent on the willingness of the political elite to steer the economy in some preferred direction. Therefore, the poor economic performance of many States in Africa has been blamed on an inappropriate political environment, particularly poor governance. It is a well-known fact that the political environment defines the context in which economic governance and corporate governance are practised. Otobo (2000), states that the relationship between political governance, economic governance and corporate governance can be likened to concentric circles in which the political governance circle forms the outside, followed inwards by the economic governance circle, with the corporate governance circle at the centre, as figure 1 shows.

9. In this model, political, economic and corporate governance are all subject to pressure from international trends and influences. The collapse of the Soviet Union, for example, unleashed a series of changes and reforms in other countries. Political change came first, which brought with it new economic policies and governance standards for both the private sector and the public sector. At the centre of the concentric circles are the private and public operators who are pressured by the more general economic and political forces.

10. In economic theory, there are basically three types of economic systems modeled on particular ideologies. There is the free market economic system in which the market is the principal institution through which buyers and sellers interact and engage in exchange. The market system is modeled on the capitalist ideology. The polar opposite of the free market system is the centrally planned or command economic system in which the central government either directly or indirectly sets output targets, incomes and prices and it is modeled on the socialist ideology. The third is the mixed economic system, which may be influenced by eclectic ideologies. The mixed economy is the most common system, as the pure market and command economic systems do not exist in practice. It should, however, be pointed out that there is no economic system which exists without government involvement and government regulation.

Figure 1. Relationship Between Political, Economic and Corporate Governance.



Source: Otobo (2000), (modified by author).

11. It is this aspect of government regulation, as we shall see later, which becomes important in the corporate governance debates. The mixed economic systems are bound to either lean towards the free market or towards a centrally planned economic system, depending on the political ideology favoured by the political elite that will define the economic and corporate governance framework. While in a free market system the most important institution will be the private corporation, in the centrally planned systems, it will be the State-owned enterprise (SOE). In accordance with this theory, in a mixed economy there will be a mixture of both the private corporation and the SOEs.

2.2 Corporate Governance Defined

12. Literature on corporate governance in Africa is just emerging. While scholars in the developed economies have developed a large body of literature on the subject, that on Africa is still very thin. The Dearth of literature is partly due to the fact that the separation of management and ownership of modern corporations is a fairly recent development in large segments of Africa, as most economies were dominated by SOEs whose ownership and management structures

derived from a single source: government. With the current developments where ownership and management of corporations are being separated through the process of privatization of SOEs, the interests of those who effectively control the firm (management and the Board shareholders) may differ. According to Okeahalam and Akinboade (2003), the principal-agent relationship may be reflected in management pursuing activities which may be detrimental to the interest of the shareholders of the firm. According to them, the agency problem can only be resolved through the protection derived from good corporate governance. What then is corporate governance?

13. The concept of governance is very broad. This is because the issue of governance touches many areas of human operations, including how economies and the entities within a country are managed, the political and juridical methods of governing a country, and how disputes are resolved in particular communities. Corporate governance is, however, specific to business practice in private and public institutions. Oman (2001) defines corporate governance as referring to the private and public institutions, including laws, regulations and accepted business practice, which in a market economy govern the relationship between corporate managers and entrepreneurs (corporate insiders) on the one hand, and those who invest resources in corporations, on the other hand.

14. Others consider corporate governance as simply the prevention of theft (Nganga *et al.*, 2003). Shleifer and Vishny (1996), state that corporate governance deals with the ways suppliers of finance to corporations assure themselves of getting a return on their investment, how they make sure that managers do not steal capital or invest in bad projects. In other words, corporate governance is "*the mechanism through which outside investors are protected against expropriation by insiders*" (Shleifer and Vishny, 1996). Insiders, according to this definition, include managers, major shareholders (individuals, other firms, family interests or governments) as well as large creditors such as banks. Outsiders include equity investors, providers of debt and minority shareholders. Thus far, the divide in the discussion of corporate governance seems to be between insiders, those that have a management role in the firm (at either management or board levels) and those that have an interest in the firm but do not have any management roles, generally referred to as outsiders.

15. Nganga *et al.*, (2003) have tabulated the many forms that expropriation can take, including outright theft of assets, transfer pricing, excessive executive compensation and diversion of funds to unsuitable projects that benefit one group of insiders. Because of these forms, it becomes inevitable to prevent expropriation through appropriate corporate governance mechanisms and protect small investors from large ones, as well as debt providers from equity investors.

16. Although in the literature the discussion seems to centre on the relationships that develop within a firm, specifically concerning managers and investors, the concept of corporate governance is much broader than this. It also encompasses the relationship created between the corporation or firm with its shareholders, the workforce and at large.

17. Corporate governance also encompasses the setting of an appropriate legal, economic and institutional environment that allows companies to pursue long-term shareholder value and maximum human-centered development, while remaining conscious of their other responsibilities to stakeholders, the environment and society in general (Okeahalam and Akinboade, 2003). Conceived this way, corporate governance assumes a developmental dimension, thus explaining the interest that the discussion has generated around the world. Good corporate governance practices are now being associated with the advancement of whole societies. The provision of both public and private goods is affected by governance practices. It is also concerned with the processes, systems, practices and procedures as well as formal and informal rules that govern institutions. It concerns the manner in which the rules and regulations are applied and followed, the relationships these rules and regulations determine or create and the nature of these relationships.

18. It is clear from this discussion that corporate governance is not only about the maximization of shareholder wealth, but an effort to balance shareholder interests with those of other stakeholders, such as managers, employees, customers, suppliers of corporations' inputs and investors, in order to achieve long-term sustainable value and contributing to the economic development of the countries in which the corporations operate. Implied in this broad definition is the concept of corporate social responsibility (CSR). This is because good governance promotes efficient, effective and sustainable corporations that contribute to the welfare of society by creating wealth and employment. It promotes responsive and accountable corporations; legitimate corporations that are managed with integrity, probity and transparency and recognize and protect stockholders' rights. All these elements and the concept of corporate governance also stem from the concept of democracy.

19. Democracy can be seen as either a practice or a system of running government. As a practice, it refers to the rule of law and embraces the virtue of social equality. As a system of government, it refers to the rule by elected representatives. In other literature, it is defined as a government of the people by the people for the people. It implies that the population at large is instrumental and active in choosing its representatives in government. Therefore, in a democracy consent from the people is a necessary prerequisite or precondition for the formation of government. As Sampa (2001) has put it, "*the consent of the people is a must*." In a democracy, there is a general demand for more political rights, less arbitrary rule, and free and fair elections (Shattuck and Atwood, 1998).

20. There is also a demand for transparency and openness and a demand for information about how government is run. These are the ingredients of good governance. Good governance involves transparent and accountable management of human, natural, economic and financial resources for the purposes of equitable and sustainable development (Krebs, 2001). Good corporate governance derives from such a system of government.

Section 3:
Corporate Governance Standards

3.1 Introductory Remarks

21. A number of institutions and even countries or a grouping of countries have been trying to develop corporate governance standards to improve the way corporations behave and the way stakeholder interests are protected. Some of the most prominent efforts so far include the following:

- The Organization for Economic Co-operation and Development (OECD) Principles of Corporate Governance;
- The King Report on Corporate Governance for South Africa (2002);
- The New Economic Parnership for Africa's Development (NEPAD) Peer Review Principles;
- The Commonwealth Association for Corporate Governance – CACG Guidelines, Principles for Corporate Governance in the Commonwealth States and other standards such as those developed by the Benchmarks Foundation of South Africa.

22. In this paper, we only review the standards devised by the OECD, NEPAD and the King Report. The proliferation of guidelines demonstrates the need and requirement to control the power of corporations, in the hope that the directors and managers of these corporations will in turn understand that corporations and firms are not just about profit maximization, and that, as good corporate citizens, they need to meet some of the requirements of sustainable economic and social development.

3.2 The OECD Standards

23. The OECD standards recognize that international investment is of major importance to the world economy at large and that multinational enterprises play an important role in the investment process. Countries of the third world stand to benefit greatly from foreign direct investment and in particular from investment that is sensitive to the economic, social, and environmental development needs of local communities. The OECD standards therefore encourage enterprises to contribute to economic, social and environmental progress with a view to achieving sustainable development. To that end, these standards have produced a set of guidelines for multinational enterprises whose aim is to encourage universal adherence to a set of business principles or standards of corporate governance that promote information disclosure, good employment and industrial relations and protection of the environment, among other issues.

24. The European Union has since 1993 been promoting a fight against social exclusion by appealing to "*companies' sense of social responsibility*" concerning "*best practices for lifelong learning, work organization, equal opportunities, social inclusion and sustainable development*". As a result of these efforts, many international companies are beginning to promote corporate social responsibility practices in response to a variety of social, environmental and economic pressures. What are these general concepts, principles and indeed standards of good, desirable corporate behaviour and citizenship? They include the following:

- Enterprises are expected to contribute to economic, social and environmental progress with a view to achieving sustainable development.
- Enterprises must respect the human rights of those affected by their activities, including employees and host communities.
- They should encourage local capacity-building through cooperation with local communities, including local businesses.
- They should encourage human capital formation by creating employment opportunities and facilitating training opportunities for their employees.
- Enterprises must refrain from seeking exemptions not contemplated in the statutory or regulatory framework related to environmental, health, safety, labour, taxation, financial incentives or other issues.
- They must support and develop, uphold and apply good corporate governance principles and practices.
- They must develop and apply effective self-regulatory practices and management systems that foster a relationship of confidence and mutual trust between enterprises and the communities in which they operate.
- They must promote employer-awareness of and compliance with company policies through appropriate dissemination of these policies, including through training programmes.
- They must refrain from discrimination or disciplinary action against employees who make *bona fide* reports to management or, as appropriate, to the competent public authorities on practices that contravene the law.
- Encourage, when practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with good corporate governance and socially responsible citizenship.
- Lastly, they must strive to abstain from any improper involvement in local political activities.

25. In this paper, reference has already been made to the concepts, principles and standards that condition corporate behaviour. The following sub-sections discuss aspects of disclosure, employment and industrial relations and the environment as these cover both intra-company relationships as well as the social and natural environment.

3.2.1 Disclosure

26. Disclosure concerns issues of transparency in the activities that the enterprise is involved in as well as being accountable for the results of its activities to the employees, the government and the communities that are affected by the activities of the enterprise. Specifically, enterprises should ensure that timely, regular, reliable and relevant information is disclosed regarding their activities, structure, financial situation and performance.

27. Enterprises are expected to apply high-quality standards for disclosure, accounting and audit. These standards should be equally applicable to non-financial information, including environmental and social reporting.

28. The OECD standards (Mesnard, 2005) encourage enterprises to disclose material information on:

- The financial and operating results of the company;
- Company objectives;
- Major share ownership and voting rights;
- Members of the board and key executives and their remunerations;
- Material risk factors;
- Material issues regarding employees and other stakeholders; and
- Governance structures and policies.

29. Under these disclosure requirements, enterprises are expected or encouraged to communicate any additional information that may include information on systems for managing risks and complying with laws and on codes of business conduct and any information on the relationships with employees and other important stakeholders.

3.2.2 Employment and Industrial Relations

30. Under this aspect, the expectation is that enterprises will, within the framework of applicable laws, regulations and prevailing labor relations and employment practices, disclose information with respect to:

- The right of their employees to be represented by trade unions and other *bona fide* representatives of employees, and engage in constructive negotiations with such representatives, either individually or through employers associations, with a view to reaching agreements on employment conditions;
- Contribute to the effective abolition of child labour;
- Contribute to the abolition of all forms of forced or compulsory labour;
- Discrimination against their employees with respect to employment or occupation on such grounds as race, colour, sex, religion, political opinion, national extraction or social origin, unless selectivity concerning employee characteristics advances established

governmental policies which specifically promote greater equality of employment opportunity or relates to the inherent requirements of the job;

- Provide facilities to employee representatives as may be necessary to assist in the development of collective agreements;
- Provide information to employee representatives, to facilitate meaningful negotiations on conditions of employment;
- Promote consultation and cooperation between employers and employees and their representatives on matters of mutual concern;
- Provide information to employees and their representatives to enable them to obtain a true and fair view of the performance of the enterprise;
- Observe standards of employment and industrial relations not less favorable than those observed by comparable employers in the host country;
- Take adequate steps to ensure occupational health and safety in their operations; and
- To the greatest extent practicable, employ local personnel and provide training with a view to improving skill levels.

31. Lastly, provide reasonable notice of any changes in their operations which would have a major impact on the livelihoods of workers, in particular, in the case of the closure of the organization or part thereof, resulting in mass lay-offs and dismissals.

3.2.3 Environment

32. With regard to environmental issues, the general expectation is that enterprises should, within the framework of laws, regulations and administrative practice in the countries in which they operate, take due account of the need to protect the environment and public health and safety, and generally to conduct their activities in a manner that contributes to the broader goal of sustainable development.

33. In particular, these enterprises are expected to:

- Establish and maintain a system of environmental management appropriate to the enterprise, including the collection and evaluation of adequate information.
- Establish measurable objectives and, where appropriate, targets for improved environmental performance, including periodically reviewing the continuing relevance of these objectives.
- Regularly monitor and verify progress towards environmental, health and safety objectives or targets.
- Take into account concerns about cost, business confidentiality and the protection of intellectual property rights.
- Provide the public and employees with adequate and timely information on the potential environmental, health and safety impacts of the activities of the enterprise, which could include reporting on progress in improving environmental performance and engaging in adequate and timely communication and consultation with the

communities directly affected by the environmental, health and safety policies of the enterprises and by their implementation.

- Assess and address foreseeable environmental health, and safety-related impacts associated with the processes, goods and services of the enterprise over their full life cycle.
- Prepare an appropriate environmental impact assessment where these proposed activities may have significant environmental, health or safety impacts, and where they may be subject to a decision of a competent authority.
- Take into account human health and safety and not use the lack of full scientific certainty as a reason for not posting cost-effective measures to prevent or minimize any threats of serious damage to the environment, with full scientific and technical understanding of the risks involved.
- Maintain contingency plans for preventing, mitigating and controlling serious environmental and health damages from their operations, including accidents and emergencies, and mechanisms for immediate reporting to the competent authorities.
- Continually seek to improve corporate environmental performance by encouraging, where appropriate, such activities as:
    a. Adoption of technologies and operating procedures in all parts of the enterprise that reflect standards concerning environmental performance in the best-performing part of the enterprise;
    b. Development and provision of products or services that have no undue environmental impacts, are safe in their intended use, are efficient in their consumption of energy and natural resources, and can be reused, recycled or disposed of safely;
    c. Promoting a higher level of awareness among customers of the environmental implications of using the products and services of the enterprise; and
    d. Research on ways of improving the environmental performance of the enterprise over the longer term.
- Provide adequate education and training to employees in environmental health and safety matters, including the handling of hazardous materials and the prevention of environmental accidents, as well as more general environmental impact assessment procedures, public relations and environmental technologies.
- Contribute to the development of environmentally meaningful and economically efficient public policy through partnerships or initiatives that will enhance environmental awareness and protection.

34. From the foregoing discussion, it is clear that the OECD standards are not only about maximization of shareholder wealth. They are about corporations finding a balance between the profit maximization objective and their social and environmental responsibilities.

3.3 The King Report

35. In 1994, the King Report on Corporate Governance (King 1) was published. The report was aimed at promoting the highest standards of corporate governance in South Africa. Over and above the financial and regulatory aspects of corporate governance, the first King Report advocated an integrated approach to good governance in the interests of a wide range of stakeholders. Although this was a groundbreaking report, changes in the global economic environment and legislative developments necessitated its updating.

36. As a consequence, the second King Report on Corporate Governance for South Africa (Dekker, 2002) was produced. The report acknowledged that there was a move away from the single bottom line (profit for shareholders) to a triple bottom line, which embraces the economic, environmental and social aspects of companies' activities. The report stated:

> *"Successful governance in the world in the 21st century requires companies to adopt an inclusive and not exclusive approach. The company must be open to institutional activities and there must be greater emphasis on the sustainable or non-financial aspects of its performance. Boards must apply the test of fairness, accountability, responsibility and transparency to all acts or omissions and be accountable to the company but also responsive and responsible towards the company's identified stakeholders. The correct balance between conformance with governance principles and performance in an entrepreneurial market economy must be found, but this will be specific to each company."*

37. The King II Report has outlined specific governance standards starting from the board to the auditing function. Specifically it:

- Outlines the functions of the board. It recommends a unitary board structure composed of executive and non-executive directors, preferably with a majority of non-executive directors. The non-executive members should be independent of management in order to protect minority shareholder interests. While giving the board broad powers, it also gives it responsibilities of appointing a chief executive, complying with the laws, developing a corporate code of conduct relating to the behavior of directors and management, and also assessing the risk areas and performance indicators of the company.
- Makes a distinction between the board chairperson and the chief executive officer and adds that there must be a clear distinction between their roles. While the chairperson presides over the company shareholders, meetings provide overall leadership of the board, participates in the selection of board members, maintains relations with the company's shareholders and formulates annual plans for the board, the chief executive officer's task is to implement the decisions of the board. If, for any reason, the two roles have to be combined, then the deputy chairperson of the board must be a non-executive director and there should be a strong presence of non-executive directors on the board. All this is meant to protect minority shareholder interests. Further, should

the decision to combine the two roles be made, it should be publicized and reviewed annually.

- Defines the roles of both the executive and the non-executive directors. The directors should also be given some orientation and developmental education training in respect of their activities. It also recommends restricting directors and employees from dealing in company securities prior to any formal announcement in respect of its financial results or any other period where such dealings may be considered sensitive. The dealings of directors should also be regulated and monitored. Before any general meeting, the board must explain fully to the shareholders the implications of their recommendations as part of disclosure.
- Deals with risk management. The company's assessment of risk should address the following:
  - Physical and operational risks;
  - Human resource risks;
  - Technical risks;
  - Business continuity and disaster recovery;
  - Credit and market risks; and
  - Compliance risks.

38. The process of risk management should utilize internal controls as a measure for mitigating and controlling risk.

- Considers the functions of Internal Audit. According to the Institute of Internal Auditors, "*Internal Audit is an independent, objective assurance and consulting activity to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes*."

39. The King Report requires that companies have an effective internal audit function that has the respect and cooperation of both the board and management. For those boards not willing to establish this function, the Report urges them to fully disclose the reasons for that and publish such reasons in the company's annual report as well as disclose the internal controls in force. The internal audit function is necessary because management may not be in a position to adequately identify and monitor the risks facing the company.

40. If the board decides to establish an internal audit function, it must approve an "internal audit charter" which defines the purpose, authority and responsibility of the internal audit activity. Furthermore, internal auditors must be independent of the activities audited and should be objective in performing their work. As an internal watchdog, the internal auditors should furnish management with analyses, appraisals, recommendations, counsel and information regarding activities reviewed. They should further provide recommendations to mitigate future risks.

- Adds a chapter on integrated sustainability reporting. This concept has been interpreted to mean the achievement of balanced and integrated economic, social and environmental performance (the triple bottom line). The Report urges companies seeking to improve on their disclosure practices to recognize the importance of the relationship between an enterprise and its community. To this end, every company is urged to report annually on the nature and extent of its social transformation, ethical, safety, health and environmental management policies and practices. For any South African company, the Report urges the boards to disclose:
  (i) The strategy, plan and policies the company has in place to address and manage the potential impact of HIV/AIDS on the company.
  (ii) The company's formal procurement policies that take into account black economic empowerment.
  (iii) Whether the company has developed and implemented a definitive set of standards and practices based on a clearly articulated code of ethics.

41. Under integrated sustainable reporting, the King Report also deals with issues of societal transformation, which include the promotion of equal opportunities, especially for the previously disadvantaged, corporate training initiatives and employee development. It urges companies to take a keen interest in human capital development as this contributes greatly to the future prospects of the company.

- Discusses accounting and auditing, specifically external auditing. The external audit function provides an independent and objective check on the way in which the financial statements have been prepared and presented by the directors. An annual audit is therefore an essential part of the checks and balances required and is one of the cornerstones of corporate governance. This being the case, external auditors should:
- Observe the highest level of business and professional ethics and, in particular, their independence should never be compromised.
- Be objective and consciously aware of their accountability to the shareholders.
- Work with the audit committee, whose membership must be dominated by non-executive board members, who also should be financially literate.
- Treats compliance and enforcement issues as a matter between the board and the other stakeholders of the company. However, the King II Report is expected to apply to:
- All companies with securities listed on JSE
- Banks, financial and insurance entities
- Certain public-sector enterprises

42. From this review, it is important to point out that the King II Report drew attention to the importance of a properly functioning board of directors as a key ingredient of good corporate governance. It advanced many of the standards and principles advocated in the plethora of national codes that were adopted, particularly in the Commonwealth countries, following the release of the Cadbury Report in the United Kingdom in 1992 (Armstrong, Segal and Davis, 2005). The King Report was distinguished by its integrated approach to good governance with

regard to social, ethical and environmental practices to serve the interests of a wide range of stakeholders.

43. The King II Report, from which most of the review is abstracted, was prepared against the backdrop of changed circumstance in the South African economy and in global markets since 1994. It was also designed to elaborate on the practices of good governance as defined by the law. It must be emphasized that it was not intended to offer a substitute for the law, nor was it intended to make good the deficiencies of the legal regime-governing corporations in South Africa. Rather, where legal deficiencies were identified, the Report only made recommendations to the relevant authorities. Although little progress has been made at the legislative level in addressing the shortcomings identified by the Report, the King Report remains nonetheless a pioneering work in corporate governance literature.

3.4 The New Partnership for Africa's Development (NEPAD) Standards

44. The NEPAD was adopted in October 2001. This was followed by the adoption of the African Peer Review Mechanism (APRM). These two steps have been hailed as significant in the continent's decision to take control of its future. NEPAD recognizes the role that developed countries can play to help Africa back on the path of economic development and growth and also in the effort to reduce and eradicate poverty. However, the African leaders now appreciate that more aid or trade barrier reductions from developed nations will not be sufficient to pull the continent's poor (estimated at 46 per cent) out of poverty. The leaders realize that a complementary commitment to aid and the removal of trade barriers is necessary and this should take the form of good governance.

45. The corporate governance issues covered by the APRM can be grouped under five main objectives:

- Promoting an enabling environment and an effective regulatory framework for economic activities;
- Ensuring that corporations act as good corporate citizens with regard to human rights, social responsibility and environmental sustainability;
- Promoting the adoption of codes of good business ethics in achieving the objectives of the corporation;
- Ensuring that corporations treat all their stakeholders (shareholders, employees, communities, suppliers and customers) in a fair and first manner; and
- Providing for accountability of corporations, directors and officers.

46. While there might be discrepancies between theory and practice, the APRM remains a significant step to improve corporate governance practices in Africa. While many argue that it is premature to talk about corporate governance regulations in much of Africa where the private sector is very small and capital markets fairly underdeveloped, it can also be argued to

the contrary that any society requires a set of minimum conditions that can help attract foreign direct investment and also encourage local people to invest in productive activities.

47. Furthermore, the availability of a peer review mechanism has also enabled research into the area of corporate governance in Africa. Research is necessary because it will eventually bring out the strengths and weaknesses of each country and suggest ways of removing the weaknesses. It is worth mentioning that, because of the availability of the APRM, the South African Institute of International Affairs conducted research on the peer review mechanism in Malawi and Ghana. Their major discovery was that there was a gap between theory/legislative frameworks and actual application of those frameworks.

48. While in theory a contract between any two parties is enforceable before the law, courts lack capacity to process cases. This revelation was important for the two countries in their quest to improve their legislative systems. The NEPAD effort is also important in another way. It brings into the discussion of good governance the political will to change structures, which is necessary in the process of economic transformation. The five objectives need to be expanded and elaborated along the lines of the OECD standards or the King Report.

3.5 Influences from the Standards and the Need for Improved Institutions

49. In most Southern African countries, there has been a dramatic change in economic policies, from semi-planned economic systems to more market-oriented systems. In South Africa, the change has taken the direction of inclusiveness of black communities which in the apartheid era were excluded from mainstream economic participation. Most countries have liberalized their economies and are privatizing State-owned enterprises. While privatization involves a change of ownership and may give rise to good governance practices, there is also a need to develop institutions of a private market system (Gray, 1996).

50. Definitions of property rights and the rules, professions and organizations that support property ownership are being created. Legal frameworks defining property rights, private contract regimes, fiduciary liability, dispute-resolution mechanisms and rules of entry and exit for private firms are being established. Courts are being strengthened to enhance their independence in adjudicating commercial disputes. Watchdog institutions that provide critical information for markets to function, such as the credit-rating agencies and consumer protection societies, accounting firms and independent media, are being established or strengthened.

51. In summary, it is important to create institutions of corporate governance that work. These institutions comprise key actors and formal and informal rules. They include legislation that gives corporations juridical personality, determines corporate chartering requirements and limits the liability of the owners of a corporation to the value of their equity in the corporation, as well as legislation on the issuing and trading of corporate equity and debt securities, including laws

on the responsibilities and liabilities of both securities' issuers and market intermediaries such as brokers and brokerage firms, accounting firms and investment advisers. The actors also include a securities commission, which is a government body empowered to regulate the issuing and trading of corporate securities with the means to monitor and enforce compliance with security laws, and a stock exchange with properly laid-out listing requirements.

52. These are conditions which corporations must meet to be allowed to list and trade their shares on the exchange. Another major actor is a sufficiently independent judicial System, which can act without much delay. Other actors include professional associations of accountants and, stockbrokers and the Institute of Directors. These are important bodies because they help define and maintain standards of professional conduct. They include business associations, such as chambers of commerce, which can use formal and informal means to influence their members' behaviour; and finally, private and public monitors of security-market behaviour or actors such as the media. In the extractive industry, chambers of mines have become vital institutions of knowledge sharing within the mining industry.

Section 4: Corporate Governance in Practice

4.1 Introductory Remarks

53. Corporate governance affects all sectors of the national economy, including enterprises in the private and public sectors and also those in the financial sector. This section of the paper discusses issues in corporate governance in the financial sector, the extractive industries and State owned enterprises. It traces the incorporation of corporate governance practices into these sectors and raises challenges that require attention.

4.2 The Financial Sector

54. One of the most important sectors of any economy is the financial sector. It has various actors and provides regulations for conduct in the financial markets. In general, African financial systems have developed by following an established pattern, starting with money markets and then later the development of capital markets. Financial markets can be understood as a system composed of individuals and institutions, instruments and procedures that bring together borrowers and savers, no matter the location.

55. The financial markets can be divided into two major markets: the money markets and the capital markets. Money markets are markets for debt instruments with maturities of one year or less, while capital markets are markets for long-term debt and corporate stocks. The primary function of money markets is to provide liquidity to business, government and individuals to meet short-term needs for cash, while that of capital markets is to provide the opportunity to transfer cash surpluses or deficits to future years. It should be noted that this definition is broad and includes the mortgage market.

56. Money markets have been dominated by commercial banks which have been unable to provide long-term financing, due to the nature of the deposits which they hold. Commercial bank deposits are composed primarily of demand deposits, which cannot be lent for long periods of time. This constrains the deepening of financial intermediation because funds do not pass on from savers to lenders. The short-term nature of commercial banks' assets and liabilities as well as the regulatory reserve requirements in many countries render commercial banks incapable of supplying long-term capital, hence the need for the establishment of capital markets (Kibuthu, 2005). The commercial banks' incapacity to lend on a long-term basis has been exacerbated by investing in government treasury bills, which have crowded out the private sector. Many commercial banks hold large proportions of their asset portfolios in government bills. For these reasons, capital markets have emerged as better avenues for mobilizing domestic and international capital.

57. For capital markets to function properly, they require the establishment of a stock exchange, a clearing and settlement system, a legal system to enforce contracts and a system for providing information to investors on the viability of companies thirsting for investment. Furthermore, effective functioning of capital markets requires governance systems that give confidence to investors that their funds are safe. In short, capital markets facilitate the mobilization and allocation of medium-long-term funds for productive investment by providing a simple mechanism for transfer of funds and facilitating companies' access to a large number of local and foreign investors. Furthermore, they widen the array of financial instruments available to savers and investors and increase competition in the financial system.

58. In the past 15 years, with liberalization and privatization as the dominant themes in the development strategies of most African countries, the development of capital markets has become necessary and complementary to the development of the private sector. Most African countries have set up stock exchanges in addition to the older stock exchanges. In fact, while there were seven stock exchanges in Africa in 1988, including that of South Africa, their number rose to fifteen in 1995 and nineteen in 2002. In Southern Africa, most countries have established stock exchanges and their stock market capitalization has been increasing. The table below shows the market capitalization of stock exchanges in selected Southern African countries at the end of 2002.

Table 1. Stock Exchanges and Market Capitalization in Southern Africa in 2002

Country	Name of Stock Exchange	Stock Market Capitalization ($US million)
South Africa	JSE Securities Exchange	182, 616
Zimbabwe	Zimbabwe Stock Exchange	11, 689
Botswana	Botswana Stock Exchange	1, 717
Zambia	Lusaka Stock Exchange	231
Namibia	Namibia Stock Exchange	201
Swaziland	Swaziland Stock Exchange	146
Malawi	Malawi Stock Exchange	107

Source: Kibuthu (2005)

59. The major players in both money and capital markets are the central banks, the commercial banks, the stock exchanges and the securities and exchange commissions. While the roles of the commercial banks and the stock exchanges have been discussed, it is important to note that the central banks and the securities commissions also play important roles. While the central banks are the regulators of money markets, the securities commissions are regulators of capital markets. However, within capital markets, there are other regulators. We have already provided the example of mortgage markets. This simply means that there is need to synchronize legislation

of the mortgage market with those of other instruments and equally regulate the activities of the various regulators. Most good governance practices have been developed with an underlying concern for capital markets, even though the effects have been widespread. We now concentrate on developments in the capital markets of selected Southern African countries, starting with South Africa.

4.2.1 South Africa

60. As stated in the introduction to this paper, most Southern African countries have been undergoing political as well as economic transformation. In South Africa, since the discovery of mineral deposits in the late nineteenth century, the private sector has been central to the country's economic performance. This is still the case today. Until 1990, the South African economy was dominated by a small number of mining finance houses that controlled diverse activities and investments. They operated primarily in South Africa, on account of the stringent exchange control regulations and the political environment of the country. In effect, the proper functioning of the market mechanisms and the cultivation of a sound corporate culture of transparency and disclosure were largely stifled (Armstrong, Segal and Davis, 2005).

61. Armstrong, Segal and Davis (2005) state that the problem was further compounded by excessive rent-seeking both by government and private-sector management, often at the expense of employees and shareholders. This state of affairs was secured through a wide range of mechanisms, including intra-group transactions, control by blocs and other methods, which gave rise to a range of conflicting interests. At the same time, the capital and money markets were dominated by a small number of insurance and pension funds. At times mutual ownership structures developed, in which the same private-sector institutions were central. All other strategic sectors of the economy fell under State owned enterprises and governance was never given a serious thought.

62. After the dismantling of the racially based political system, South Africa experienced profound changes in its socio-economic fabric. The new Government liberalized the economy with special emphasis on capital market development and corporate renewal (Armstrong, Segal and Davis, 2005). It also started the process of privatizing some SOEs. Between 2001 and 2004, significant stakes in State entities such as Telkom, Transnet, Eskom and Denel, were to be put for sale to private investors. These four companies accounted for about 75 per cent of the total assets of the 15 biggest State enterprises in South Africa.

63. So far, these companies have had part of their stake sold: SABC Radio Stations (100 per cent), Telkom (30 per cent), Sun Air (100 per cent), Airports Company (25 per cent), South African Airways (20 per cent), Connex Travel (100 per cent), Transwerk Perway (65 per cent), Safcol KwaZulu-Natal (75 per cent), and Eastern Cape North (75 per cent). There are still many more firms to be privatized, such as ACSA (Aviation), Denel (Defence), Petronet (Pipeline Management) and Eskom. Corporate governance has very much been a feature of this process.

Being the single largest economy in Africa, especially in Southern Africa, South Africa is expected to play greater roles in the affairs of the continent, as witnessed by the role it played in the NEPAD and also the conduct of South African business interests operating in the subregion and the rest of Africa.

64. After the reforms, the South African financial system has emerged as a sophisticated and well-developed sector of the economy. The increased importance of financial services to the economy has resulted in increased investor activity on the local stock market by local and international investors (Armstrong, *et al.*, 2005). Foreign investors have played a catalytic role by applying pressure for market reform (see the model in section 2) and for higher corporate governance standards. Furthermore, South Africa has been admitted to the World Trade Organization (WTO), giving further impetus to domestic regulatory reforms towards a market-oriented corporate culture.

65. In South Africa, the King I Report helped raise awareness of what constitutes good governance. Some of the King II Report recommendations have now entered the Labour Relations Act (1995), the Basic Conditions of Employment Act (1992), the Employment Equity Act and the National Environmental Management Act (1998). Equally, the listing requirements of the Securities Exchange South Africa (JSE) have been extensively revised.

66. The JSE is about the oldest stock exchange in Africa. It is also the leading stock exchange in the Southern African region. The original Johannesburg Stock Exchange merged with the South African Futures Exchange and the Bond Exchange of South Africa, as part of the reform of the South African securities market. Since the JSE is the leading exchange in Southern Africa, there is now strong activity to enforce compliance among the exchanges in SADC with JSE listing requirements. This implies that the Botswana Stock Exchange, Malawi Stock Exchange, Namibian Stock Exchange, Stock Exchange of Mauritius and the Swaziland Stock Exchange need to comply. The Lusaka Stock Exchange is already modeled on the JSE.

67. The JSE has undertaken another comprehensive revision of its listing rules, which makes a number of the King II Report recommendations mandatory and applies the "comply or explain" principle with respect to conformity with the remaining guidelines. An interesting feature of the JSE is that market capitalization stands at approximately 1.65 times GDP (Armstrong, Segal and Davis, 2005). This is higher than that of developed countries such as the United Kingdom, France, Germany and even the United States of America. The King Report recommendations have also affected the banking sector, leading to changes in the Banks Act. These include a number of mandatory provisions of a governance nature and codification of the duty of care expected of a bank director and certain categories of executives in relation to shareholders and depositors.

4.2.2 Zimbabwe

68. Zimbabwe became independent in 1980 and has maintained a sizeable private sector. It has a stock exchange, the Zimbabwe Stock Exchange (ZSE), established under an Act of Parliament. The ZSE Act and the Companies Act regulate companies in Zimbabwe. Currently, there is no capital market regulator. Shares are transferred freely and shareholders' rights are defined in the memorandum and articles of association. Shareholders can vote by proxy and principally the voting is guided by the principle of one-share-one vote. The shareholders have graduated rights; those with about 5 per cent of share capital or 50 shareholders can compel the company to hold an extraordinary meeting, while those with over 5 per cent of share capital or 100 shareholders can demand an investigation into any issue. There are, however, regulations on the extent of foreign shareholding, which is limited to 40 per cent and no single foreign shareholder being allowed to hold more than 10 per cent of a listed company.

69. Despite Zimbabwe's adverse publicity on political governance, the country's commercial law system is perceived to be efficient and its commercial arbitration centre, established in 1995, is viewed as efficient and effective in resolving commercial disputes. Even though there is no capital market regulator, the ZSE has adopted listing rules based on those of the London Stock Exchange (LSE) and the JSE. The Institutes of Directors is also effective and enforces corporate governance standards derived from the United Kingdom Cadbury Report and the South African King Report.

70. The Commonwealth Secretariat has worked closely with the Institute of Directors to provide training to directors and shareholders. The current corporate governance standards include regulations on the minimum number of directors (2), the appointment of audit committees and the regulation that at least one of the directors must be resident in the country. Shareholder protection rules also exist. If an investor reaches a 35 per cent ownership threshold in a listed company, that shareholder is required to make an offer to the minority shareholders. Major decisions, such as removal of directors, mergers and acquisitions or voluntary winding-up of a company needs to be supported by 75 per cent of the shareholders. Accounting and audits follow international accounting standards. From a commercial point of view, corporate governance standards are high in Zimbabwe, even though the fear is that the political governance standards might spill into the area of commerce.

4.2.3 Botswana

71. Botswana is one of the few countries in African that has pursued policies based on free markets. The country has a stock exchange, the Botswana Stock Exchange, which is a self-regulating body with an eight-person committee. The exchange became fully operational in 2003, although prior to that date, Ernst and Young ran the exchange on behalf of the Government. By early 2004, the exchange had 16 listings. Listed companies in Botswana must comply with

the Botswana Stock Exchange Act 1994, the Companies Act 1959 and the Botswana Stock Exchange Member Rules and Listing Rules.

72. The majority of listed companies are foreign companies, with holding companies controlling between 70 and 75 per cent of the shares, which means that in effect only a small percentage of companies are floated on the local stock market. By 2004, there was no specific code of corporate governance in Botswana, although most listed companies have close links with South Africa and seek compliance with South African governance standards guided by the King Report. All companies are expected to comply with international accounting standards, as regulated by the Botswana Institute of Accountants.

73. There are a few shortcomings in Botswana's capital markets. Although minority shareholder protection is covered in the Companies Act 1959 and in the Listing Rules, the commercial code needs to be updated to cover governance issues. The other shortcoming is that the court system remains slow, with no special commercial courts. It can therefore take up to a year before some commercial cases can be heard. There is no special legislation that addresses commercial disputes and there is also a need to establish an independent regulatory body.

4.2.4 Zambia

74. Zambia has come full circle in terms of economic reforms, starting with a market economy before 1968, through nationalization in the period 1968 to 1991, and back to a market economy after 1991. During the period 1964 to 1968, nearly all enterprises were privately owned. The mining industry, which was the largest sector, then contributed over 50 per cent to government revenue and 66 per cent to export earnings. All the mines were in the hands of two multinational firms: the Anglo American Corporation and the Rhodesian Selection Trust.

75. After 1968, through the Mulungushi Reforms, nearly all the manufacturing industries were nationalized. This was followed by the nationalization of the copper mines through the Matero Reforms in 1969. Thus from 1968 to 1991, the State became the major player in the economy, owning about 80 per cent of the enterprises in the country. However, because of the economy's bad performance during that period, along with external and internal pressures, the country had to undergo reforms to return the State-owned enterprises to private hands. The political change in 1991 provided the necessary environment for the reforms. The Government liberalized the economy and started privatizing the State-owned enterprises. So far, about 259 SOEs have been privatized out of a portfolio of 282.

76. The mining giant Zambia Consolidated Copper Mines (ZCCM) was privatized after being parceled out into smaller units to introduce ownership diversity. There are still some enterprises that await privatization. These include the country's electricity producer and supplier, the Zambia Electricity Supply Corporation (ZESCO), the Zambia National Commercial Bank (ZANACO) and the Zambia Telecommunications Company (ZAMTEL). The Zambia National Broadcasting

Corporation (ZNBC) also still remains in Government hands. It will be interesting to see if one day, following the South African example, the ZNBC can also be privatized.

77. With privatization in process, the Government also started establishing institutions to support private-sector development. The most important institutions created have been the Lusaka Stock Exchange (LuSE) and the Securities Exchange Commission (SEC). As at December 2004, the LuSE had 12 listed companies and 10 quoted companies with a market capitalization of $US1,650 million. Even though the developments in listing seem appropriate for an emerging market, the participation of foreign investors at LuSE declined from 11 per cent in 2003 to 4.82 per cent in 2004. The participation of domestic investors on the other hand increased from 89 per cent in 2003 to 95 per cent in 2004. There was also a net foreign capita outflow of $US0.07 million by December 2004.

78. This simply means that more foreign investors sold their shares than bought. This is a worrying trend as one of the objectives of the exchange is to help mobilize foreign investment. It is also important to mention that none of the mining companies is listed locally and so the corporate governance code, which is now in force for listed and quoted companies, will not apply to them. However, it is important to recognize the link that LuSE is developing with JSE, which can be used to enforce such a code, as JSE requires that South African firms operating elsewhere conform to the code.

79. There are other mining companies operating in the country but registered in Europe and Asia. While the European-registered companies can be subjected to the OECD corporate governance standards, those from Asia seem to have a field day in Zambia, compromising both environmental and employee safety standards. A case in point is a Chinese firm that does not consider provision of safety boots to its employees as a necessity.

80. Most companies are also registered under the Companies Act, (Chapter 388 of the Laws of Zambia), which regulates the minimum number of directors in a firm. The Act also provides for a firm to determine its own memorandum of association and articles of association. These define the *modus operandi* of the company. The problem here is that, as long as many companies operate outside the realm of the Lusaka Stock Exchange, compliance with standards will remain elusive. This is because the Companies Act gives the board of directors the freedom to select accounting standards. This basically means that different companies can use different standards in preparing their financial statements, thereby limiting comparison of financial conditions and performance between companies.

81. In terms of the law, like most other countries in the subregion, Zambia has developed alternative dispute-resolution systems to decongest the courts of law. The system, however, does not seem to work well. It is important to mention that the business community has also established the Institute of Directors as one method of enforcing corporate governance standards in member firms. This seems to be working well.

4.3 The Extractive Industry

82. The extractive industries are those industries that remove or take out or obtain a natural resource from the earth for processing or outright sale. In the process of extracting, they may strip bare a piece of land and also affect other pieces of land through dumping of excess earth. They may also, during the process of extracting the natural resources, produce negative externalities in the form of solid waste, pollution of both air and water, activities which require monitoring, because total neglect can jeopardize the life support systems of the ecosphere on which humans depend. This calls for the inclusion of the concept of sustainability in the operations of the firm.

83. The concept of sustainability requires that the developments of today should be able to meet the needs of the current populations without destroying the resources that will be required in the future. This approach considers that long-term planning and the understanding of the need, to maintain access to the resources that make everyday human lives possible and the limits to the exploitation of such resources must be recognized. This understanding even becomes more important in the extractive industries. The approach to controlling or influencing the impact of industrial activity on the health of populations and the environment has undergone change in America and Western Europe. While in the old days there was a great emphasis on legislative and regulatory structures and the response of the industry was mainly reactive, now industry is mainly urged to develop effective environmental management systems.

84. The Earth Summit of 1992, the United Nations Conference on Environment and Development (UNCED) in Rio de Janeiro, created a global consensus on how governments and industry can cooperate in solving environmental problems that threaten the very life-support systems that mankind depends on for survival. For industries, the impact of emissions and effluents on the environment is increasingly being regarded as unacceptable. In many parts of the world, industries are being subjected to environmental standards (Lungu, 2005). In the extractive industries, environmental issues and corporate social responsibility rank highly, even though the thrust is to have enforcement taking place at industry level.

85. Generally, the extractive industries (oil, gas and mining) face enormous challenges in maintaining their so-called "social licence to operate", especially in developing countries. There is mounting pressure on the traditional boundaries of corporate responsibility. These pressures include appeals from the sustainable development agenda, rising expectations and demands from civil-society, political imperatives of home governments, conflicts between extractive companies and communities/civil society, and evolution of a corporate culture and values that respect the dignity of the human person. As long as natural resources extraction takes place in developing countries or in remote, mostly undeveloped places, the expectations from the public will be that the local communities and host countries should be able to benefit from the activities of extractive companies (Malaika, Lee and Koziell, 2003). One of the benefits will be to maximize financial rewards and minimize negative environmental impacts.

86. The challenges of maximizing economic benefits and minimizing negative environmental impacts are not new. Discussions have taken place in many different forums, and it is now clear that implementation and actions are far more important than words. Malaika, Lee and Koziell (2003) state that one way of addressing these challenges is via partnerships or relationships with key stakeholders. The term "multi-stakeholder processes" describes processes which aim to bring together all major stakeholders in a new form of communication, decision-finding (and possibly decision-making) on a particular issue (Malaika, Lee and Koziell, 2003). They are based on recognition of the importance of achieving equity, accountability and transparency in communication between stakeholders.

87. So far, however, it looks as if stakeholder dialogues and ways of feeding them into decision-making and concrete follow-up are mostly being organized and prepared on a rather ad hoc basis. According to Hemmati (2002), governments and inter-governmental bodies, industry, NGOs, local governments and other stakeholders are still trying out various approaches. What has been the response in the extractive sector to date? Malaika, Lee and Koziell (2003) state that, for a start, the World Bank Group has launched the *Extractive Industries Review* to discuss the Bank's future role in the extractive industries. This is work in progress, which aims to produce a set of recommendations that will guide the involvement of the World Bank Group in the oil, gas and mining sectors.

88. Another initiative has been the *Mining, Minerals and Sustainable Development* (MMSD) project. This is part of a global mining initiative, which has completed a two-year research project seeking to understand how the mining and minerals sector can contribute to sustainable development. Commissioned by the World Business Council for Sustainable Development (WBSCD), MMSD is a clear illustration of collective action, though it remains to be seen whether there is sufficient momentum for the reorganized mining industry association, the International Council on Mining and Metals (ICMM), to carry the work forward to the implementation stage.

89. In the oil and gas sector, the *International Association of Oil and Gas Producers* (OGP) joined forces with the International Petroleum Industry Environmental Conservation Association (IPIECA) in 2002 to produce a guidance document for industry practitioners. They produced a list of questions which they considered key to obtaining answers concerning the social dimension of oil and gas projects. Another significant initiative has been the "National Resources Clusters" of *Business Partners for Development* (BPD). This project has concentrated on how three-way partnerships involving companies, government authorities and civil-society organizations can be an effective means of reducing social risks and promoting community and regional development.

90. Furthermore, it is also important to mention that, in October 2002, the Royal Institute of International Affairs hosted a workshop on *"Sustainable Relationships: Financing and Monitoring Responsibilities"* under the Chatham House Rule. The workshop focused on issues covering

the socio-economic and environmental dimensions of sustainable development. The aim of the workshop was to see how far the extractive sector had come in the participatory process with regard to creating and implementing development agreements (Malaika, Lee and Koziell, 2003).

91. From these accounts, there is a noticeable development within the extractive sector and industry groups towards participation in "partnerships" and stakeholder processes to enable the industry to improve its management and implementation of key sustainable development issues. While these international efforts have been going on, the practice has been different.

92. In Zambia, for example, all mining companies have been exempted from environmental liabilities. This has meant that society is at the mercy of the mining companies when it comes to air, water and environmental pollution. While the mining companies claim that they are dedicated to implementing health, safety and environmental management systems consistent with international standards, the record seems to be different, based on the number of accidents in the mining industry as well as ongoing air and water pollution. It appears that the mining companies believe that their core business is to produce copper and the rest of the activities are unnecessary and avoidable expenses (Lungu and Mulenga, 2005).

93. While this thinking conforms with the profit maximization objective of the firm, it is important to realize that a firm or a corporation is a combination of people, physical assets and information and that the society in which the firm is located is a necessary stakeholder because it constitutes the immediate environs in which the firm operates. In South Africa, a non-governmental organization called the South Durban Community Environmental Alliance (SDCEA) in collaboration with Denmark's Naturfredningforening (DN), has tabulated cases of environment damage through water and air pollution and the effects this pollution has had on the communities surrounding the polluting firms. They have tabulated cases of pollution at the Engen refinery and SAPREF (Shell and BP) Refinery in Durban. Some of these firms may also be listed on various stock exchanges in the world and are expected to respect some of the recommendations of the King Report as well as the OECD standards, but to no avail.

94. These few examples from South Africa and Zambia are an everyday occurrence in most Southern African States, and indeed in Africa as the case for the oil industry in Nigeria more clearly illustrates. From this short account of the extractive industries, it is important to notice that environmental impacts are of concern to communities in the surrounding areas of a firm's operation much more than the ownership structures. This is because most if not all companies involved in the extractive industries happen to be multinational companies which in the main, have not desired local capital. Since they raise their capital requirements outside the countries in which they operate, their ownership structures do not affect such communities.

4.4 The State-Owned Enterprises

95. Despite the fact that most Southern African economies are now dominated by private-sector enterprises, the State-owned enterprises (SOEs) still play a very important role in these economies. In South Africa, the SOEs still account for about one quarter of the country's capital stock and generate approximately one third of all savings in the country on a gross basis (Armstrong, Segal and Davis, 2005). In Zambia, as mentioned earlier, three very important institutions (ZESCO, ZANACO and ZAMTEL) are still in public hands. Botswana also has a fair share of SOEs. This simply implies that the public sector plays a critical role in the allocation of resources in Southern African States.

96. This has considerable implications for corporate governance standards in the economy. In all these countries, the public-sector firms typically lack accountability for their performance. In Zambia, numerous serious cases of impropriety and financial abuse in the public institutions including local authorities, which go unpunished, have been reported. Even though premature, the testimony of the former ZANACO managing director on how managers in public institutions were instructed to take decisions without question is instructive.

97. A former head of a public institution in Lesotho was bribed by an international company to award contracts worth $US21 million on the Highlands Water Project. Many more European firms were taken to court to answer charges related to the same project. In South Africa, an investigation of the European Aeronautic and Space Company (EADS) revealed that EADS bribed senior South African officials and politicians to win defence contracts. The South African Government awarded EADS a $US50 million contract to supply naval radar as part of a multimillion-dollar package to buy helicopters, fighter jets and naval vessels from countries such as Britain, France, Sweden and Germany (Okeahalam and Akinboade, 2003).

98. These examples show how corporate governance standards can be flouted with the cooperation of politicians, and also demonstrates the weakness of boards and managements of SOEs. This is because board members in most instances are appointed by a Minister of Government and so will always tow the party line. Most chief executives are also appointed by the State, and so will always play the game of the appointing authority. Having been appointed through some ethnic criteria or cronyism, the boards and managements are normally incapable of resisting political pressures. It is well known that nearly all governments do have public auditors to detect impropriety in the public sector, including the SOEs. However, most of these offices often have no power to directly prosecute offenders.

Section 5:
Major Issues and Challenges of Corporate Governance in Southern Africa

99. Before concluding, it is imperative to point out the number of issues that have emerged from this discussion of corporate governance in Southern Africa. It is important to first of all point out that all the standards reviewed have included some standard requirements to protect the shareholders' wealth, such as the need to have a board of directors characterized by independence, willingness to answer hard questions, a diversity of membership, transparency in decision-making and accountability. Furthermore, it is important for companies to link executive compensation and bonuses to financial, social and environmental performance of the firm and to align them to community expectations of fair and reasonable compensation.

100. The standards also point to the need for companies to adopt plans for their environmental, social and financial operations, including effective evaluation tools. Within the board, the standards insist on including non-executive directors in all the standing audit, nominating and compensation committees. This is encouraged in order to protect the shareholders from expropriation. While these standards may be enforced in listed companies, they are hard to enforce in companies not listed on stock exchanges, unless various other pieces of legislation, including the Companies Acts, are revised to include corporate governance issues.

101. There is also a need to synchronize legislation on the capital markets to ensure that the problem of multiple regulators can be removed and to include mortgage markets. In some countries, the stock exchanges are self-regulated. It is important to have regulators to protect the interests of investors. To enhance compliance with standards, it is also important to strengthen the Companies Acts in all countries, since many firms are not listed or quoted on the various stock exchanges. Furthermore, in many instances, even though accounting bodies exist in nearly all countries, they also tend to be self-regulated. This is another area that requires regulation. Thus, it can be concluded that, generally, Southern Africa faces a regulatory challenge.

102. NEPAD has shown that there can be political will in enforcing good governance practices. However, it is important to strengthen the APRM in order to help standardize the business environment in Southern Africa, as countries appear to be at different stages of implementing the corporate governance standards. NEPAD should help adapt the OECD and King Report standards in all the countries. Thus, the second challenge is that of political will. The third challenge involves governments creating enabling macro and micro economic environments for formulating incentives to attract investment and being in constant dialogue with the private sector to remove any misconceptions that may develop. It is important for governments to guarantee property rights because they are the only institution that can do that. The fear in

Zimbabwe that political governance problems might creep into economic governance needs to be clarified, especially since this goes for every country in the subregion.

103. Enterprises in the extractive sector also face the challenge of improving their corporate social responsibilities. The negative picture so far painted about their pay practices, their attitudes towards the environment and the general perception created of their concentration on profit maximization needs to be improved so that firms in the extractive sector can also be seen as good corporate citizens.

Section 6: Concluding Remarks

104. This paper has attempted to define the concept of corporate governance. It does so by stating that corporate governance is not restricted to the way corporations are run and the distinction between management, board members and other shareholders. The paper argues that the concept is much broader as it includes the effects of the corporation's activities in general. In short, the concept includes the corporate social responsibilities of a corporation, not only as philanthropic activities, but also as the corporation's contribution to the development of the countries in which it operates.

105. The conceptual framework has also pointed out the importance of understanding the fact that forces outside the corporation also influence corporate governance standards. These include global pressures and pressures from the local political and economic environment. In this regard, the paper has outlined the corporate governance standards established by the OECD, NEPAD and the King Report for South Africa.

106. The influences of these standards on the operation of other corporate bodies in the subregion are apparent, even though a lot of work needs to be done. The influences of the King Report seem to be permeating to other countries through the links the stock exchanges are developing with the JSE. This is an important link for good corporate governance. However, work needs to be done to strengthen the corporate laws in most of the countries so that corporations can be compelled to conform to internationally accepted corporate governance standards. Most of these laws are not very strong on auditing as boards have powers to choose their own auditors and also their own auditing standards.

107. The paper has further discussed the applications of the standards in the financial sector, the extractive sector and the State-owned enterprises. It raises serious issues concerning the extractive sector, such as corporate social responsibility. It also notes that the emphasis on profit maximization has compromised safety and environmental standards, even though corporations claim to have their own programmes consistent with international standards. Overall, there is a strong movement in the Southern African region to improve governance standards at political and economic levels as well as within corporations. A lot more work is required to strengthen legislation to improve compliance.

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