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Corporate governance: A source of financial crisis in State Owned Enterprises (SOEs); lessons from Zimbabwe

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Abstract

The financial crisis of State Owned Enterprises has been subjected to public scrutiny in recent years, and there is much criticism in the existing corporate governance practices. This paper seeks to identify the governance practices that exist in State Owned Enterprises and their impact on financial performance for the period 2010 to 2020. The qualitative study used evidence from National Railways of Zimbabwe (NRZ), Air Zimbabwe and Zimbabwe Electricity Supply Authority (ZESA). The study also roped in the Ministry of State Enterprises and the Institute of Directors in Zimbabwe (IODZ). Data was collected using interviews and qualitative questionnaires administered to purposively selected sample, and analysed using the Braun and Clarke`s six step model. The study found that the government is interfering with the daily running of State enterprises through appointment of directors and executives, otherwise not by merit, which negatively affected independent decision making of the Board of Directors, and hence throwing these parastatals into governance malfeasance leading to a serious financial crisis. The study concluded that the government is manipulating appointments of executives and directors on the basis of political expedience and as well there are no enforcement and gate guard systems for good governance.

Introduction

Corporate governance covers a large number of distinct concepts and phenomenon and has been widely looked into through different dimensions in testing the validity of Agency Theory. In view of (Strine, 2010; Shungu, Ngirande, & Ndlovu, 2014; Organisation of Economic Co-operation and Development, 2015), the key points of interest in corporate governance include issues of transparency and accountability, the legal and regulatory compliance, appropriate risk management, and responsibility management as the international benchmarks for corporate governance. The incidence of corporate failure is a familiar occurrence with devastating consequences for all the stakeholders of an organisation particularly the shareholders, hence the need to regulate and harmonize the activities of organisations to ensure proper conduct of the people who are at the helm of the affairs of state enterprises, public limited and private entities.

In the global context, the headlines in the media since 2002 to the 2008 global financial crises in particular, portrayed a sad story of corporate governance or lack of it thereof, the effects of which are still being felt today. The demise of WorldCom, Anderson, Merrill Lynch, Enron, Martha Stewart, Global Crossing, Qwest Communications, Tyco International, Adelphia Communications, Computer Associates, Putnam, Boeing, Rite Aid, Xerox were as a result of lack of good corporate governance practices (Tribe & Morrissey, 2005; Crowther & Seifi, 2011). The falling stock markets (Malherbe & Genesis, 2001), were embroiled with corporate failures, creative and dubious accounting practices and abuses of corporate power. Many of the same companies exhibited actual management or governance risks such as conflicts of interest, inexperienced directors, overly lucrative compensation, or unequal share voting rights (OECD, 2014). The investigations indicate that the entire economic system upon which investment returns have depended upon, is showing signs of corporate governance stress that has undermined investor's confidence.

In the Zimbabwean context, corporate governance has been a topical issue in recent years with growing perception on corporate governance, corporate ethics and corporate compliance; that company directors and executives are self-interested actors, corruptly and fraudulently using their positions in the company to pursue their own ends rather than being focused on pursuing what is best for the company and its stakeholders (Zvavahera & Ndoda, 2014). This perception on corporate governance and its many attributes has shown that, the country has not escaped its share of corporate governance challenges since 2003 to date as postulated by (Gono, 2004) when he said that, the country has experienced an unprecedented financial crisis that has seen the demise of well established companies such as ENG in 2003. The financial crisis spread to some banks such as Century Bank; CFX Bank; Time-Bank; Trust Bank; Royal Bank; Barbican Bank and Intermarket Banking Corporation between 2004 to 2008 and also recently the collapses and scandals in the Genesis and the Renaissance Banks in 2012 as well as Interfin Banking Corporation, and Caps Holdings which all share some of the characteristics of the Enron and WorldCom scandals.

However, in more recent media exposures, some state owned enterprises, parastatals and other companies such as the ZBC, Air-Zimbabwe, GMB, ZESA, PSIMAS and NRZ among others have been rocked by various scandals (Moyo, 2016; Zvavahera & Ndoda, 2014). Among others these scandals included excessive Directors, and top management compensation, tender procedure violations and other fraudulent practices perpetrated by company executives (Moyo, 2016), which caused financial bleeding and crisis in the past, the effects of which are still experienced today. The major cause of these corporate scandals in Zimbabwe was centred mainly on bad corporate governance practice (Sifile, Susela, Mabvure, Chavhunduka, & Dandira, 2014) and this governance raise suspicion, on the impact of governance practices, on the financial performance of State Owned Enterprises. The study will have specific reference to NRZ, Air Zimbabwe and ZESA.

Statement of the problem

State owned enterprises in Zimbabwe are characterized by corrupt business conduct that include fraud, graft, nepotism, bribery, abuse of power, ghosting, favoritism, bid rigging and embezzlement among other key indicators which comprise the lack of effective governance. These negative institutional unethical experiences have resulted in public officers failing to observe principles of effective corporate governance such as transparency, equity, accountability, responsibility, independence, fairness, discipline and respect, leaving companies they superintend over short of declaring any dividends year in year out. These practices have left the general public dumbfounded on the future of state owned enterprises in Zimbabwe. One wonders whether there exist, any corporate governance standards the companies are complying with and whether corporate governance practices have any bearing on such corporate entities' financial performance.

Objectives

By drawing upon relevant theories in literature that concern systemic poor corporate governance practices, this study is guided by the following objectives:

i. To identify the extent to which corporate governance practices exist in state owned enterprises
ii. To assess the effect of corporate governance practices on financial performance of state enterprises

Research questions

i. In what ways Zimbabwe State Enterprises does or does not practice corporate governance?
ii. What is the effect of existing corporate governance practice on financial performance of State Enterprises?

Corporate governance in brief

Corporate governance is as old as companies are and has had a wide range of interpretations since its evolution. In a more comprehensive way, corporate governance is seen as executive and management practice that gives direction to the enterprise (Madekutsikwa, 2015; Feizizadeh, 2012; Solomon, 2007), overseeing and controlling both management and executive actions and with satisfying legitimate expectations of accountability, transparency and regulations by interests beyond corporate boundaries. It becomes clear that corporate governance is not limited to shareholders of a business but goes beyond to include the interests of other stakeholders.

One would note that the directors are a key characteristic of good corporate governance mechanism (Shungu, Ngirande, & Ndlovu, 2014) and are regarded as officers of the company in many countries. According to literature, board size, composition, committees and board diversity are an instrument for measuring the effectiveness of the governance practices (Shungu, Ngirande, & Ndlovu, 2014; Enobakhare, 2010), since the directors play a key role in all aspects of the firm, be it administrative or operational. Corporate governance extends managing processes and structures to voluntary governance practices (Ansie Ramalho, 2016) and these obviously are Corporate social responsibility functions.

The governance processes and structures (Maune, 2015) define the divisions of power and establish mechanisms for achieving accountability and transparency between board of directors, management and shareholders while protecting the interests of and accounting for the effects on other stakeholders. Other stake holders include employees, customers and the community depending on the nature of business of a firm.

Most developed and developing countries have developed their own corporate governance codes which include among others the rules based Sarbanes Oxley Act of United States of America, the principles based Cadbury reports of United Kingdom and the King reports of South Africa. These topical frameworks were developed following the demise of the world giants Enron, World com, Parmalat among others, the (Shungu, Ngirande, & Ndlovu, 2014) causes of which erupted from poor governance. Likewise, Zimbabwe put in place its corporate governance code, the Public Entities Corporate Governance Code Act No 8 of 2018 (Minstry of State Enterprises, 2018) (hereinafter called the ZimCode), which is an adaption of the King IV report.

The ZimCode has ten chapters which look at application of the code, ownership and control, board of directors, governance and risk, information management, conflict resolution, compliance and enforcement issues, stakeholder relations and the role of government (Minstry of State Enterprises, 2018). Of interest, the ZimCode addresses many comply or explain, governance issues, from which the important highlights include among others multiple directorship, board chairman limits, decentralised corporate power, role of the board, conflict of interest and executive remuneration. The ZimCode aim to adapt corporate governance to culture based on integrity and self-policing.

Corporate governance practices in SOEs

The significance of State Owned Enterprises in the development of the country in different economic facets, which operate in pursuit of the government`s economic, political and socialistic goals cannot be overemphasised (Chavhunduka & Skwila, 2015; Chimbari, 2017). The government of Zimbabwe is losing a lot from state-owned enterprises' mal-performance while at the same time the same government is providing millions of dollars through the national budget, trying to resuscitate their operations. It therefore calls for high levels of effective governance within the public sector to ensure efficient use of state resources, high standard of accountability that promote stewardship of national resources and the improvement of administration and service delivery (Chimbari, 2017; Wadie, 2013).

It is of paramount significance to note at this stage that bad governance which has been taking place since independence has landed the country to this poor positon, we are today. Corporate governance codes have been in existence, for implementation for the time immemorial (Maune, 2015), whether developed by or for Zimbabwe, but none of them have been followed. The malpractice remained rampant in state enterprises, with parastatals such as Premier Service Medical Aid Society (PSMAS) (remuneration scandal), Zimbabwe Broadcasting Services (van and remuneration scandals), and Air Zimbabwe (insurance scandal) (Chimbari, 2017) being victims of bad governance, to mention but a few. These state owned enterprises are involved in a wide range of bad governance activities that include among others tender procedure violations and bid rigging, excessive executive remuneration, corruption and gross lack of accountability.

The role of the state is to ensure governance is carried out in a transparent and accountable manner with necessary degree of professionalism and effectiveness (Madekutsikwa, 2015). The state`s focus as the owner should be on aspects of remuneration, audits, board nominations and monitoring systems (Organisation of Economic Co-operation and Development, 2015). It therefore implies that the state should not interfere with the board decisions for political and other mileage and respect board`s independent decision making for high level of stewardship.

It is undeniable in Zimbabwe that the state is excessively involved the appointment of State Owned Enterprises ‘board of directors, which breeds a fertile ground for bad governance through interplay between politics and governance. More often than not (Chimbari, 2017; Zvavahera & Ndoda, 2014; Madekutsikwa, 2015) these executive appointments have been riddled with cronyism, where appointment or disappointment of members is based on political expediency and rarely on pure merit.

In addition, Chimbari (2017) posits that there isn`t an effective system to enforce our [principles based governance practice. The Zimbabwe Anti-Corruption Commission (ZACC) which should be exercising this role as enshrined the constitution of Zimbabwe, has been undermined by political forces. History tells us that ZACC to date has failed to secure a single criminal conviction for those found wanting on bad governance, all because of partisan politics by wanting executives.

The governance system cannot be effective too when it is not supported by robust whistle blowing framework, to expose misconduct and governance malfeasance. The Organisation of Economic Co-operation and Development (Organisation of Economic Co-operation and Development, 2015) underlines that the protection of whistle blowers who disclose wrong doing in governments is recognised as the core of public sector integrity framework , it is an essential element (Chimbari, 2017) for safeguarding the public interest, promoting a culture of accountability and in many countries including United States of America and United Kingdom, providing a crucial reporting of misconduct, fraud and corruption. In Zimbabwe whistle blowers have no legal protection or otherwise which further leaves state owned enterprises more exposed to bad governance.

Effects of existing governance practices on financial performance

Previous research shows that companies that insist upon the highest standards of governance reduce many of the risks inherent to an investment in a company (Shungu, Ngirande, & Ndlovu, 2014; International Finance Coporation, 2004) and in a similar view good governance reduce the risk of financial crisis which can have devastating social and economic costs. More over Enobakhare (2010) opines that good corporate governance can lead to better relationship with all stakeholders and thus improves labour relations as well other social improvements.

Most of the State Owned enterprises have not reported a profit over the last decade of operation, instead they are draining the national budget year in year out in trying to resuscitate their performance. Governance malfeasance affects among others productivity (Zvavahera & Ndoda, 2014), market, cash flows and asset generation, hence financial performance as measured by financial position, cash flows and comprehensive income is always on stake.

Research methodology

This qualitative study focussed on three state owned enterprises namely National Railways of Zimbabwe (NRZ), Air Zimbabwe and Zimbabwe Electricity Supply Authority (ZESA). The study also roped in the Ministry of State Enterprises and the Institute of Directors (IODZ) representatives. Data was collected from a purposively selected sample of 58 respondents using a qualitative questionnaire (with open ended questions only) and interviews. Qualitative questionnaires were administered to 50 respondents and interviews to 12 respondents proportionately represented in relation to chosen classification (Directors, Managers, Ministry and IODZ). The population of the study comprised of 21 Directors, 169 managers 4 ministry officials and 12 IODZ officials. Data was presented using narratives and a thematic analysis was done using the Braun and Clarke`s 6 step model.

Presentation of results

In analysing data, the researcher came up with four themes which appear of paramount importance in this study. The themes are corporate governance practices present, the governance practices expected but absent and the consequences of mal-governance. Governance practices present as a main theme has its own subthemes as discussed below.

Existence of Board of directors and its committees

The results indicated that state owned enterprises have properly constituted Boards of Directors. In addition, the responses indicate that expected most important board committees exist, which include the audit committees, nominations committees and the remuneration committees. The results are consistent with the requirements of the ZimCode and the King Report. Some respondents appeared indifferent though, if the board members are aware of their mandate, with these alarming levels of bad governance rocking the state enterprises being witnessed.

Board independence in state owned enterprises

Independent decision making of the board has emerged as a critically important theme from data collected. The results indicate that boards do not have independent decision making owing to a number of factors. The responses indicate that appointment of directors and boards is not based on merit, instead political affiliation is first considered. One respondent had to say, "it is disheartening to find a minister dissolving a board of a parastatal before term expires, leaving the executives who are the architects of mal-governance, worse off goes on to appoint a group of dishonest officials, with political muscles into the board, definitely we are heading these parastatals to demise". This is an indication that government influences the decisions made, through its power to appointment or disappoint, thus the appointee will always implement policies that serves best his master, which may not be the best for interests of the company, its shareholders and stakeholders. These results are consistent with the findings of Chimbari (2017) and Zvavahera and Ndoda (2014).

Committee role in state owned enterprises

“How would a board approve a salary of half a million United States dollars for an executive? Where is the audit committee? How does a remuneration committee come up with such gross salary scales? That`s day light robbery at the expense of service delivery”, most of the respondents remarked. These remarks show that the board committees are not exercising their roles, hence approve excessive executive remuneration. In some cases, the board members are also involved while in others, it’s as a result of ignorance and lack of legitimate power. These results are related to nomination influences of the state discussed above. Some respondents were even advocating for jail terms for both the directors in office and perpetrators of such governance malfeasance.

Accountability in state owned enterprises

This also emerged as a significant theme that is not practiced in state owned enterprises. The respondents called for the long arm law to be exercised in pursuit of those involved in governance malpractices. The results indicate that the directors and executives appointed to leading positions find an opportunity to enrich themselves at the expense of service delivery. The findings are also similar to those of Madekutsikwa (2015).

Consequences of mal-governance practice in state owned enterprises.

The effects of mal-governance on state owned enterprises also emerged from analysis of responses. The results show that bad governance affect production, the market, company assets, cash position and earnings. At the end the enterprise becomes unable to fund and perform its daily operations. Responses indicated that state enterprises as a result are characterised by huge amounts of debt. The findings are consistent with those of Shungu, Ngirande, & Ndlovu (2014), International Finance Coporation (2004) and Enobakhare (2010).

Conclusions

In light of the findings above, the study concludes that the government is perpertrating governance malfeasance in state owned enterprises by manipulating appointments on the basis of political partisianship. This has effects on independent decision making of appointees during the discharge of their duties.

The study further concludes that there are no enforcement systems of corporate governance practices and as well there are no proper gate guard systems, well supported by legislation. This leaves the state enterprises exposed to mal-governance by directors and executives.

Recommendations

The study recommends that the government should impliment the appointment proceedures in principle as stated in the Zim Code. The government must leave the board to exercise independent decesion making.

The study further recommends that the governement should put mechanisims of gate keeping and enforcing our comply or explain principles based governance practices. The mechanisims must provide adequate legislative support that enable appropriate institutions to deal with governance malfeasance.

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