BOARDS OF STATE OWNED ENTERPRISES

Why and how do boards of SOEs differ from other boards?

Boards are chosen by shareholders so that they supervise companies and make sure that strategic objectives of company owners are met. They also have to make sure of the integrity of information coming out of the company and that the company is paying enough attention to all of its stakeholders. Boards hence lie in the heart of corporate governance. This is evident when we look at codes of corporate governance as we see that boards take a big share of provisions covering aspects such as board composition, responsibilities, committees, remuneration, etc.

While the role that boards play and the way in which they function may be somehow straightforward in privately owned companies, it is quite different when the owner is the state. Then the whole system of how the board is chosen, how it functions, and even how it is assessed, is very different.

The Impact of Goal Difference

Boards serve to achieve the overall objective(s) of the company. Private sector companies are usually measured against the achievement of one ultimate goal: profits. This means that the main criteria the board uses in such companies to assess policies and courses of action is how such policies or actions will help the company to achieve sustainable profit. To ensure the sustainability of profits, boards in private companies do have to take non-financial considerations, such as reputation and stakeholder management, into account to maintain their license to operate, but usually these non-financial considerations serve to purpose of profit.

State Owned Enterprises, on the other hand, have multiple social, political, economic, and financial objectives. These objectives rarely carry the same weight. Priorities will differ from

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time to time based on so many factors that we cannot cover here. What complicates things further is that in many cases these objectives conflict with one another. Focusing on social objectives will normally be at the expense of financial objectives and so on. Even when governments establish companies to achieve profits, political and social pressures usually make it impossible to focus on profits as the main objective. SOEs are sometimes used to create jobs for the unemployed, and sometimes for the unemployable, they are used to provide low price goods and services to the poor, or to prevent monopolies of some national resources or strategic goods, etc.

Oversight Challenge

The multiple conflicting objectives phenomenon has a direct impact on boards of SOEs. It makes their oversight role somehow ambiguous. On what basis can board members then assess strategic policies? Which objectives carry more weight than others now? Will there be changes in such weights in the near future?

Some of these companies will fall under political pressure to take certain decisions or to adopt certain policies that boards may not be able to refuse or even to examine freely or thoroughly. Examples include making certain investment or entering into joint ventures. Less strategic examples include introducing certain new products or services, using certain inputs or specific suppliers, serving certain markets, or using specific pricing structures. In an ideal world, such decisions are proposed by the management and discussed by the board. While the board should hold the management accountable for the outcome of their policies, in the examples given above, this cannot happen. The question then becomes "to what extent can the financial performance, or even the overall performance, of the company be attributed to the management or to the board itself"?

Therefore, one of the recommendations of the SOE guidelines on CG released by the Organization for Economic Cooperation and Development, the OECD, is that the government must have a clear vision for its ownership. In other words each government must ask itself "why do we own this company"? The answer to that question will then be reflected on how the board can assess the policies and management of that specific company. The ownership objective is also used to evaluate the success or failure of the board. The OECD guidelines state that if the government is to use an SOE to achieve social or political objectives, this can happen with two conditions; it must be disclosed properly and the cost of doing so must be calculated and paid for by the government not by the company itself.

Director Independence & Fiduciary Responsibility

Another dilemma for SOE boards is independence and integrity. When shareholders elect the board, they make sure that the board understands the mandate of the company. The board is then left to do its job and is evaluated annually. In SOE boards, the board is usually appointed by politicians or by Ministers or by senior government officials. Many appointed directors are in fact themselves public servants coming from different government bodies. This exercise raises some concerns about board independence and whether SOE directors are loyal to the companies that they serve or to the executives and officials who appointed them there. If appointed directors are not qualified enough or if they lack the experience needed to be effective board members, then there is a possibility that they become "shadow directors". In other words, if directors are not qualified enough or they do not have free decision making powers, it is actually the politicians and Ministers who are influencing board decisions. From the legal stand point, however, it is the board that is liable for whatever decisions it makes.

It is therefore strongly recommended that there is a transparent way to nominate and choose directors of SOEs. This reduces chances of poor selection of board members. Qualified directors will understand their fiduciary responsibility and legal consequences of their decisions and could be more reluctant just to act as “shadow directors” of politicians and high ranking government officials.

SOE Boards and the Free Market Mechanisms
One of the key challenges facing boards of SOEs is to oversee the company’s “Market Distortion” effects or to what extent are company policies compatible with the free market mechanisms. Such mechanisms aim to create market conditions that promote fair competition among companies operating in the same market. In many countries, depending on the laws f each country, SOEs can seriously damage the way in which markets function. This can take various forms. Sometimes SOEs have preferential treatment from banks, this may cause crowding-out effect for other companies in the market. Sometimes SOEs are immune against bankruptcy, so they can afford pricing levels that their competitors cannot afford. Another example of market distortion is when SOEs have a preferential treatment as suppliers to the government or to other SOEs. Therefore, SOE boards have to be careful in assessing the impact of their companies’ policies on the market as a whole and whether such policies will benefit the customers and will create a healthy environment for current and new comers or will it ruin the market.

Conclusion

The above are just examples of the key differences between being a director in a joint stock or a privately held company and an SOE. SOE board members often find themselves on boards of companies that have many of the above long-existing problems and that have various explanations of why they existed and why they still exist. Once appointed as a board member, directors are expected to deal with all problems, even for chronic and long lived ones that existed long before you joined. Long gone are the days during which SOE directorship was an honorary position or a prize for senior public servants. Political pressures accompanied by fiduciary responsibility should make one think carefully before agreeing to serve as a board member in an SOE.

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