BOARDS OF DIRECTORS OF STATE-OWNED ENTERPRISES: TRENDS AND INTERNATIONAL BEST PRACTICES

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State-owned enterprises (SOEs) are an essential element in the international economic architecture. Across the OECD area and in emerging economies they continue to dominate certain segments of the economy that matter greatly for the downstream competitiveness (notably in the utilities sector) and provide essential public services. In consequence they face growing public demands to improve their performance. Countries which have been serious about professionalising state ownership have shifted from perceiving SOEs as little more than extensions of the state administration, to focusing their attention on improving corporate governance, including by strengthening the role of boards of directors in company stewardship and performance.

The widespread "commercialisation" of SOEs in recent decades has progressed largely in line with internationally accepted good practices, such as the OECD

Guidelines on Corporate Governance of State-Owned Enterprises (the "SOE Guidelines).[1] Across the OECD area and in a growing number of emerging economies, governments have made efforts to professionalise boards of directors and to assign them greater powers and autonomy. The role of SOE boards is changing from previously serving as oversight bodies entrusted with compliance toward increasingly driving performance and strategy-setting. In general these approaches have borne fruit. Most countries report better quality board discourse and ultimately improved performance. This article discusses some of these dynamics and reviews recent trends in board practices drawing on international best practices[2] .

Part I: Board dynamics

In any corporation boards of directors play a fundamental role in corporate stewardship and performance, and in determining corporate strategies and

[1] OECD (2015), OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264244160-en

[2] The practices in this article are based on OECD research drawing on practices in over 30 economies. See OECD (2013), Boards of Directors of State-Owned Enterprises: An Overview of National Practices, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264200425-en.

monitoring managerial performance. Arguably, boards have an even more important role to play in SOEs as one of the key differences between the function of a board for a state-owned and privately-owned enterprise is the fact that the State as a shareholder may be driven by objectives other than a return on shares. Properly constituted and managed boards can "add value" by taking into account these various perspectives and help management make better decisions.

The characteristics of a value-adding board are: 1) responsiveness to management's need for direction; 2) bringing skills and perspectives that management may be lacking; 3) encouraging the development and examination of a range of options, bearing in mind risks; 4) being objective; 5) encouraging and listening to in-house expertise; 6) looking forward to the future, and taking the long-term view; and 7) thinking strategically. Ultimately, adding value means developing more and better interaction with the executive management, and working in a structured manner with the government as an owner. However, in some countries SOE boards are not adequately empowered to assume such a role, circumvented by direct ministerial appointments of executive management and/or are bypassed through informal channels of communication and instructions. This may detract from the value-adding of boards. Worst cases involve appointed CEOs taking instructions directly from political circles, circumventing the board of directors and leading to a significant weakening of corporate (and public) governance. Other cases to be avoided is the where individual board members act as custodians of the government interest from within the boardroom.

According to the SOE Guidelines, the State should inform the board of its objectives and priorities through proper channels. Depending on the SOE and country practices, this can be an iterative process in which the SOE and the State, via the ownership function, respond to proposals and jointly develop the strategy. In other cases, high level outcomes or expectations are defined by government, and a strategy is developed by the board and management to achieve these outcomes. Regardless of the method, going through proper channels will raise transparency and accountability, and avoid compromising the board's fiduciary duties.

Part II: Board practices

As SOE boards become more professional the issue of boardroom efficiency moves to the forefront. It has become important to identify directors fulfilling demands for skills and competencies. The average board size has shrunk, the role of directors as "team players" has grown and, the role of the chair has been strengthened. However, it has also led to an increase in the workload and time commitment, which has in some cases posed challenges in recruitment and remuneration. These issues are covered below.

Establishing well-structured and transparent board nominations

Overseeing the board nomination process is among the primary responsibilities of state acting in its capacity as owner. According to the SOE Guidelines the starting point for effective SOE boards is to ensure a well-structured and transparent nomination framework. However, achieving this in practice is far from uncontroversial. Historically, the nomination of SOE boards has proved to be one of the more contentious policy challenges in SOE reform. Politicisation of the appointment process for patronage or to protect special interests served by the SOE's operations remains an impediment to consistent and transparent processes in some jurisdictions and can undermine competition and the legitimacy of the recruitment process. Ultimately, political interference is bad for business: it results in excessive turnover, a lack of the right skills on the board, and takes away from the possibility of attracting fresh faces or innovative persons.

Even if the formal nomination power resides with individual ministers or the cabinet and/or executive powers, many jurisdictions have prevented ad hoc political intervention by establishing administrative procedures and/or borrowing from private sector good practice for the board nomination process. These methods, according to the SOE Guidelines should involve the sitting SOE board as well as non-state shareholders (where they exist), and can include setting minimum qualification requirements; relying on head hunters and maintaining databases of pools of directors; establishing nomination committees; and using board evaluations to identify future board needs.

Composing boards that are professional, objective and independent

SOE boards of directors should be composed so that they can exercise professional, objective and independent judgment[3] . SOEs must strike a delicate balance when choosing directors, so that the board can effectively steer the SOE toward meeting the interests of both the enterprise and its shareholder. This includes, for example, deciding whether or how many representatives from the State to include on the board, as well as the types of skills, experience and characteristics directors should have to achieve company goals. This does not imply that the State should be passive in its ownership role. It implies that the proper conduit for State influence is communicating clear and implementable objective to the boards of directors.

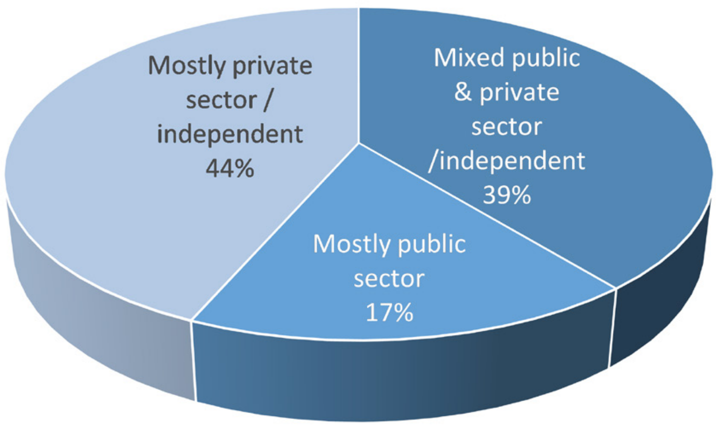
[3] Board "independence" should not be confused with "independent" directors. An independent and objective board is one that operates under a legal framework, which is subject to public governance and that is designed based on board profiles. Independent directors (subject to national definitions) are individuals who are not directly representing any particular stakeholder interest in the company, but who are sought to bring certain skills and competencies to the board.

Many jurisdictions have moved towards limiting the number of seats reserved for public servants towards a greater reliance on independent directors and persons with relevant commercial experience (See Figure 1). There is growing consensus that, under no circumstances, should ministers, state secretaries, or other direct representatives of, or parties closely related to, the executive power be represented on SOE boards. Many countries also limit the number of board positions – with the ideal set between five to seven members – and increasingly jurisdictions are promoting gender diversity either through quotas or by setting indicative targets. Employee representation on boards generally follows private sector practices, but can differ for some SOEs.

Board induction, training and remuneration practices

To enhance SOE board professionalism and performance, the SOE Guidelines include specific recommendations on director training and remuneration. The Guidelines recommend that directors receive an induction to inform them of their responsibilities and liabilities. A small number of jurisdictions complement their induction sessions by encouraging on-going professional development for individual directors or on a board-wide basis. These trainings focus on thematic areas where supplementary training is needed, for example on accounting standards, tax codes, or laws, regulations and other areas of relevance.

Figure 1.Board composition in state-owned enterprises in the OECD area



Sources:

1. OECD (2013), Boards of Directors of State-Owned Enterprises: An Overview of National Practices, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264200425-en

2. OECD (Forthcoming), Compendium on SOE Governance. OECD Publishing, Paris.

Ideally, remuneration schemes for SOE boards should reflect market conditions. In practice, remuneration for SOE boards in a majority of OECD countries falls below market levels. Among OECD countries surveyed, over 70% have set a limit to remuneration rates for SOE boards. Nearly a third of these (29%) said that, at least anecdotally, remuneration levels impacted the board recruitment process. In some cases, this reflects ceilings imposed by public sector remuneration schemes.[4] For others, it reflects a choice to avoid public controversy over excessive pay in the public sector.

Conclusions

After over a decade of implementation of the OECD SOE Guidelines the results are clear: better boards seem to protect governments from operational missteps, political fallout, and allow them to better gauge and manage the risks of operating an enterprise in a commercial environment. Yet, even where governance reforms have shown good results, expectations of SOE boards continue to grow. Governments, the public, and financial markets continue to demand better performance. This means continuing to improve board dynamics which empower boards to create value. It also means having the right mix of skills and competencies on the board, reinforcing board independence and efficiency, while ensuring that SOEs are shielded from undue political interference.

About the OECD Guidelines on Corporate Governance of State-Owned Enterprises

The OECD works to ensure that state-owned enterprises operate in a sound competitive and regulatory environment to promote efficient and open markets at the domestic and international level. It advances national reforms in countries across the world, guided by the internationally-agreed OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines). The SOE Guidelines give concrete advice to countries on how to manage more effectively their responsibilities as company owners, thus helping to make state-owned enterprises more competitive, efficient and transparent. First developed in 2005, the Guidelines were updated in 2015 to take into account developments since their adoption and to reflect the experiences of the growing number of countries that have taken steps to implement them.

Access the SOE Guidelines: http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm

[4] OECD (Forthcoming), Compendium on SOE Governance. OECD Publishing, Paris.