INTERVIEW WITH
FRANK DANGEARD

What is it like being an independent director on the board of a state-owned enterprise? Frank Dangeard is someone who knows. A Frenchman brought up in New York who started his career as an investment banker in London, he has experience of SOE boards in several countries as part of a wide-ranging portfolio of directorships. He served, in various capacities over the last 20 years, on the boards of Thomson, Orange and EDF in France, of Telenor in Norway, and he is also on the board of the state-controlled RBS in the UK. As an investment banker earlier in his career, he was involved in preparing several companies for privatisation in the UK, France and Spain.

Contrary to what many outsiders might expect, he says that being an independent director on the board of a state-controlled enterprise is not just about battling the dead hand of cronyism and political patronage. Instead it can be a rewarding experience
with opportunities to exert real influence as the company seeks to navigate its way through the complex interaction of often conflicting interests. The opportunity arises because governments themselves often find it hard to define a unified position. However, if the board is to strike the right compromises, the government must be willing to allow the freedom to oversee the business on its behalf.

Theory and practice

“In theory”, “he says, there shouldn’t be a difference between being a director in state-owned and privately owned companies. Basic governance rules and the quality of decision-making are not differentiated by the type of ownership. So, in many cases where SOEs have strong boards, there need not be much difference between the two.”

“In practice, however, a state company board is different in three respects. First, companies with a significant or dominant shareholder are different from those that are widely owned, whether the dominant shareholder is a government, a family or private-equity. Second, within the SOE category, the state is often not only a shareholder, but also a regulator and a customer, so it has multiple roles, which can be in conflict with each other. Third, there really is no such thing as ‘the State’. There are different government departments with different views, so there is usually no one single state point-of-view.”

This creates an opportunity for the independent director. “If the state has gone out of its way to employ outsiders on a board, it’s unlikely that they will be asked, or can be expected, to serve no purpose at all.”

Stay conscious of the dynamics

“You can have a fair amount of influence, but you have to be conscious of the dynamics,” he continues. “There are state representatives and often others as well, such as unions and the management itself. You have to build bridges because, quite often, they cannot build bridges themselves considering who they are representing.”

Trade unions, for example, may have a particular position determined by their national group, so they cannot react positively to suggestions from management, even if the trade union representatives privately agree that these make sense in the context of the company. In those circumstances, he says, the independent director plays a positive role both behind the scenes and in the full board meeting itself. The eco-system is quite complex, but after all the background work is done, the board discussion can still influence the final outcome.

The critical point is whether there is a desire on the part of the state to have its participations managed through the boards of the companies in its portfolio. Some countries, he notes, have created institutional arrangements to increase the chances that this might be the case, such as UK Government Investments in the UK and the Agence des Participations d’Etat.
in France.

So does this mean focusing on the formal terms of reference for the board? Not really, he replies. “That document may provide a foundation, but the culture, practices and expectations are what matters. Is this a system where the state would like its participations to be managed largely by boards? If a company is listed, this also points towards boards taking a more important role.”

Chairman’s role

What about the character of the Chairman? “Many SOEs still combine the role of chairman and chief executive,” he says, in which case a lead independent director is essential. But whether they are separated or not, the Chairman (or the lead independent director) plays a significant role in ensuring that the board is taking governance seriously and in helping the management respond to all the constituencies who sometimes cannot be seen to agree.”

The size of state ownership

Does the size of the state’s holding make a difference to the dynamics of the board? “Not in the traditional, legalistic, sense - The more important questions are whether the state itself is of one view, and who the other shareholders are.”

“If you have more than 50 per cent you control the AGM and the board, but the reality is a little more complex. Quite often different government departments will have different views on things like strategy, financial discipline, procurement, or employment policies. That said, if there is a single view, imposed for example by the strongest department, the state can still be calling the shots at a stake of 30 or 40 per cent, since the private sector shareholders are unlikely to present a unified front. In my experience, things only really start to change when the state falls to around 20 per cent or less.”

State versus family

Based on all of this it could appear that an outside director has more scope for influence in a state-owned enterprise than in a family business where there is a single shareholder with a single view. “Perhaps,” he says, “though families can also be very complex.” It comes back to the fact that as a dominant shareholder the state does not always have a unified view. This puts the management in quite a strong position to push the case for what it wants to do. “The downside is that it takes a lot of time and effort, but if you sincerely want to do so, you can generally align all the different constituencies around one position.”

“With a family-owned company, the controlling shareholder often has a very strong view and this is also the case with a private equity owner. Then it’s much more difficult.”

Causes of failure

“Too often failures in SOEs are attributed to government interference, when it’s more likely that management and the board
have simply not been able to navigate the system, do their job properly and make a difference. The cases of personal intervention by an individual in a position of authority are actually pretty rare – they exist, of course and unfortunately, but are not the norm. More often I have seen ministries intervene because of failures of managements and boards. The problem is that, once they are landed with a job they did not want in the first place, government departments are not very good at running companies. However, I don’t know of a company that has been run to the ground because of the system of state-ownership itself.”

This also means that privatisation, or at least a listing, makes sense because it helps clarify priorities. “For many years the socialist government in France was against privatisation, but then accepted that, if there was a good industrial (as opposed to financial) reason, like the opportunity for expansion through an acquisition or a merger, then the state could be diluted below 50 per cent and the company could be privatised.”

Conflicts

Yet surely there are always conflicts between a state owner and private minority shareholders?

“Conflicts can also exist between market investors themselves - say an activist investor and a long-term value fund. The role of the board is always to resolve such conflicts. And they exist also between government departments – say the finance ministry wants dividends and another ministry wants to preserve jobs. Caving in to the demands of one category of shareholders is not a good way to run a company for the long term and in the interest of all stakeholders.”

“The board has to compromise, but this is not necessarily a fudge. I don’t find any of this problematic as long as the board balances conflict on interests properly. And when the various interests can’t align themselves on their own, a strong board and a good management have a chance to bring everyone along by setting the direction.”

Privatisation

“A move to privatisation is almost always a good thing – most companies have no business being state-owned, and the state has no business owning most commercial enterprises. The actually level of private ownership is less significant than the actual presence of private sector shareholders. The simple presence of outside shareholders reinforces the consensus that the board must play its role and there will be an expectation of transparency which means that processes will have to be explained.”

“This doesn’t mean political influence stops, but there will be processes in place that are likely to reduce the risk and negative impact of interference around key decisions, including for example the appointment of directors, the appointment and assessment of the chief executive, and the dividend policy. It would be naïve
to think that listing means an end to government influence – but it’s a bit more complicated and a bit more difficult for a minister or government department to assert disruptive control.”

So what does the market think? Investors like the guarantee implicit in state ownership that the company will never go bust while partial privatisation brings in commercial discipline. This could be the best of both worlds, but he thinks that such a view is disingenuous. “The reality is when you invest in an SOE, you should know what you’re doing. At times an SOE will do things which a private company would not do, though it’s unlikely this will carry on for a long time. Conversely the stability of a supportive shareholder enables a company to transform itself and plan for the longer term, something the market does not always have the patience to see through.”

Expectations on flotation

“What people focus on first is the enhanced level of financial transparency and disclosure. Quite often this takes a few years of preparation. It’s not that SOEs don’t unusually have proper accounts – most of them do – but the level of disclosure and transparency expected by the market is something they are not used to. This extends also to other aspects of financial and operational discipline, like internal controls.”

“The second thing, which is quite often a shock, is the way in which management is exposed to the public scrutiny. An ability to communicate with the outside world is important.

“Finally, as you think about privatisation, you need to think about the composition of the board. A board which is right for a business that is wholly-government owned will not be the right board for a company which is listed, or partially-listed. This opportunity to get a good board in place is often missed. In my experience, directors whose only experience is in the wholly state-owned sector will not function well once the company is listed.”