Boards & Directors of SOEs: how are they different?

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HAWKAMAH
THE INSTITUTE FOR CORPORATE GOVERNANCE

About us

- Hawkamah is a non-for-profit governance institute, owned by Dubai International Financial Centre, working to improve corporate governance frameworks & practices of governments and companies across the MENASA region and beyond.

- We help build sound organizations, reform corporate sector, assist banking and financial sector, and promote good governance. We assist companies to develop sound and globally recognized corporate governance frameworks. Hawkamah helps also in building qualified directors and top executives who are able to apply corporate governance in their organizations.

- Our strength lies in our research and years of experience in the region, our world-class experts, and proximity to the countries and companies of the MENASA region.

- Hawkamah' cycle has 4 key elements; awareness, working with regulators, working with target organizations, and capacity building.

Hawkamah Profile #in Numbers

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Hawkamah's ESG Impact

150
Our ESG Index covers yearly the TOP 150 companies of the S&P Pan ARAB Composite Index.

100+years
Total Experience of our International Advisory Board Members in governance & boards globally

30+
International Strategic Partnerships and associations

Hawkamah's Graduates

1000+
Trainees

Hawkamah's Publications

50+
Publications on corporate Governance

15+
Different countries

5
different sectors

- Listed companies
- State Owned
- Family Owned
- Financial Institutions
- Government entities

Hawkamah's Projects

200+
Governance assignments

https://www.hawkamah.org/

Corporate Governance

"Corporate governance is the system by which companies are directed and controlled...."

Sir Adrian Cadbury, UK, 1992

"Procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making..."

OECD, European Central Bank, Annual Report, Glossary, Frankfurt, 2004

Principles of Corporate Governance

Responsibility

- Of the owners
- Of the board
- Of the top management
- Responsibility towards stakeholders

Accountability

- Of the Management
- Of the Board
- Of the majority shareholders

Fairness

- Protect Owners' rights
- Treats all Owners, incl. minorities, equitably
- Fairness to all Stakeholders

Disclosure & Transparency

- Ensure timely and accurate disclosure on all material matters, such as:
  - Financial info
  - Ownership
  - Governance

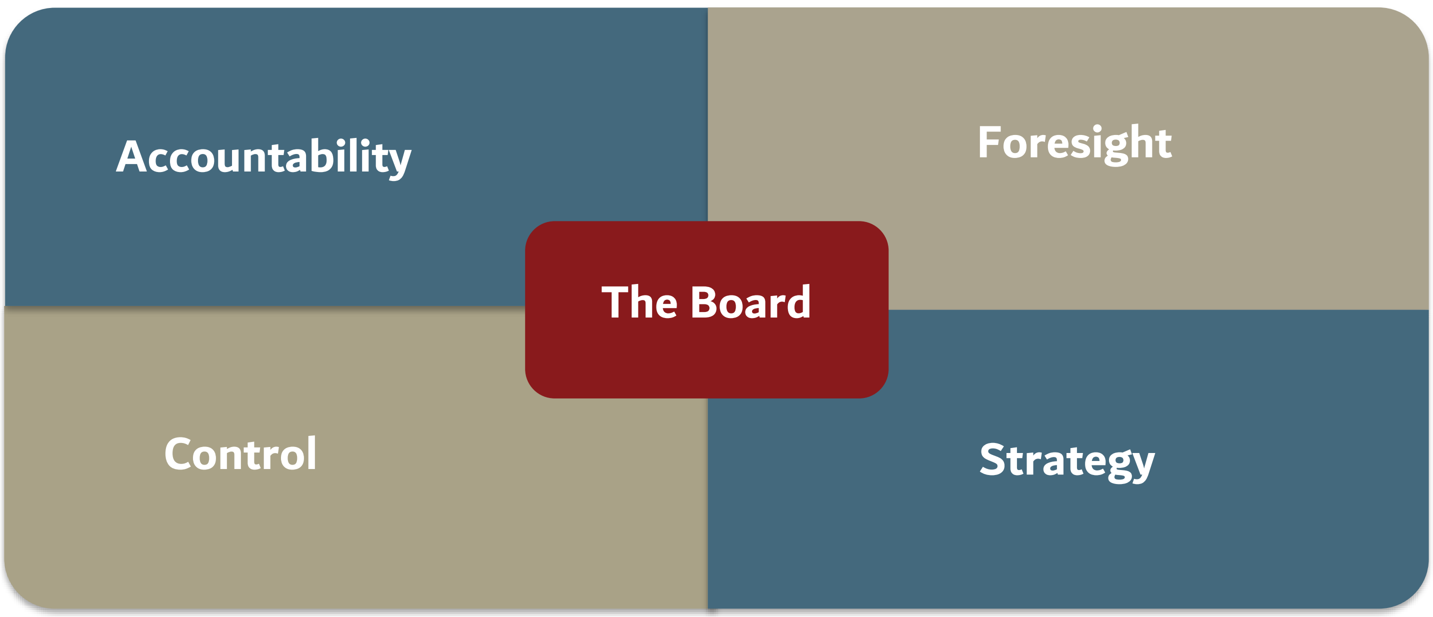
Governance of SOEs, a brief background

The OECD published its first guidelines on corporate governance in 1999. Those guidelines were directed mainly to listed companies and financial institutions.

Few years later, the OECD recognized the fact that the State-Owned Enterprise sector still plays an important role in the economies of most of the OECD countries. Therefore, in 2004, the OECD issued its first guidelines on corporate governance of “State Owned Assets”.

Those guidelines were updated in 2015 and were called “OECD Guidelines on Corporate Governance of State-Owned Enterprises”, 2015 Edition.

The Role of the Board



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Board Empowerment

Board empowerment requires a number of actions, including :

- Clarifying the role and responsibility of BoDs, including fiduciary responsibilities, such as the duty of care and the duty of loyalty
- Monitoring of senior management (including the CEO) that directors are expected to carry out through a specific framework that could then be communicated through an awareness and capacity building program.
- Prioritizing the issues that need the attention of the Board to ensure focus on items of material nature and issues related to its governance responsibilities.
- Undertaking Board evaluation to identify existing mix of competences and skills and to specify new profiling for new Board positions.

SOE Boards play a critical role in effective governance

- Boards play a central function in corporate governance and performance of state-owned enterprises.

- The board has an ultimate responsibility, including through its fiduciary duty, for developing corporate strategies and overseeing SOE performance. In this capacity, the board acts fundamentally as an intermediary between the state as a shareholder, and the company and its management.

- Both boards as a whole, and directors, of SOEs are different in many ways. Following are some of the major differences, when compared to regular listed companies.

1. Loyalty & Fiduciary

- As per the OECD recommendations, SOE boards should be charged with the duty to act in the interest of both the state and the companies.

- In the context of listed companies, boards are loyal only to their companies, not even to the shareholders who elected them.

- This dual loyalty creates many conflicts and results in great deal of blurred responsibilities.

- SOE boards are frequently conflicted when making major decisions and discussing strategies and projects.

- Directors may find it quite difficult to act in the best interest of the company when they are asked to consider “national interests”

2. The Process & Independence

- SOE boards are usually appointed using a process that is either controlled or heavily influenced by politicians, Ministers, or by senior government officials.

- Many of the appointed directors are in fact themselves public servants coming from different government bodies.

- SOE boards therefore lack true independence, and sometimes even the right qualifications, to be effective.

- Some countries allow for labor representation on SOE boards, boards then become more political and less effective.

3. SOE Boards and the Free Market Mechanisms

- SOEs can seriously damage the way in which markets function.
- Sometimes SOEs have preferential treatment from banks, officially or not, 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.
- SOEs sometimes have a preferential treatment as suppliers to the government or to other SOEs.
- The challenge for SOE boards is to ensure fairness for all stakeholders and to make sure that the management is not abusing such privileges in a way that can create more chronic problems for the company and economy at large.

4. Goals, Supervision & Accountability

- State Owned Enterprises have multiple social, political, economic, and financial objectives. These objectives rarely carry the same weight, and they are normally conflicted.
- How are key positions in SOEs filled? Do boards have the power to change top executives based on their competences?
- 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.
- What is it actually that an SOE board (and director) accountable for? How is it measured? How are they compensated?
- External audit is usually challenging as well, it focuses on financial and procedural issues rather than on serious governance challenges facing companies

Dysfunctional Boards common in SOEs

Shareholder board

‘Trophy’ Board

‘Yes-men’ or ‘rubber stamp’ Board

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Recommendations

- First thing, as per the OECD guidelines, identify the rationale for ownership.
- Making sure that no exceptions are given to SOEs. Fair competition must be protected through regulations and enforcement.
- Such exceptions extend to all laws and regulations such as environmental and governance.
- Either not using SOEs for non-economic objectives, or separating the cost of doing so, publishing it, and deciding who should take it, as per the OECD recommendation.
- Establishing, and auditing, the right systems that enable using qualified, truly independent directors who have clear mandates and hold them accountable accordingly.

CONCLUSIONS

- Governments should focus on regulation, enforcement, and creating a healthy economic environment.
- The private sector is far more capable of conducing economic activities, given the right regulation is enforced.
- State should be the owner in exceptional cases, for specific reasons, and for a limited time.
- Governments, sometimes in good faith, kill the private sector by competing against it.
- SOE boards are full of conflicts, we should at least try to get qualified, independent directors who are able to handle conflicts more independently than public employees and trophy board members.

THANK YOU

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