Boards of Directors of State-Owned Enterprises:
An Overview of National Practices

Chapter 6

Boardroom efficiency

As SOE boards become more "professional", the issue of boardroom efficiency moves to the forefront. A well-functioning board takes responsibility for setting strategy and creating value, acting as a collegial entity with a shared responsibility. One implication is that it has become more important to identify directors that answer concrete demands for skills and competencies in individual boards. In the course of the process of professionalisation, therefore, the size of boards has generally shrunk to more manageable size, the role of directors as "team players" has grown and, partly related to the previous point, the role of the Chair as a convener and co-ordinator has been strengthened, so too has the role of board committees. However, it has also led to an increase in the workload and time commitment of directors, which has in some cases created problems for board recruitment and potential remuneration.

Although the *SOE Guidelines* do not deal explicitly with the issue of boardroom efficiency, it does pronounce itself on a number of key issues that fit into the broader issue of efficiency. Moreover, boardroom efficiency is unsurprisingly gaining importance among SOE owners. SOE board should consider is whether it makes an effective and efficient contribution to the function of the enterprise and to the fulfilment of the objectives that the State owner has communicated. This starts with defining the role of the board and its composition (as covered in previous chapters), but it also involves other aspects such as team dynamics, workload, size and structure (role of the Chair and respective committees) which are covered by the remainder of this chapter.

Team dynamics

Team dynamics of a board is an important aspect in improving board efficiency. On the one hand behavioural characteristics of individuals contribute to boardroom efficiency (as suggested by the quote cited in Box 6.1), on the other it is the working environment created by the team dynamic created by a group of members together. This is not only influenced by the perception of its board members as to their role, but also in terms of what their added value is. In order to contribute to the efficiency of the board, it follows that employee representatives should act as part of the board team, as opposed to the

Box 6.1. **Perspectives on boardroom efficiency**

"Boards often resemble families with each person appearing to have a particular role. Some boards also have director 'cliques.' Upon joining a board, directors should think about their role on the board and where they fit. New directors should work to establish themselves by leading with their unique skills. For example, a director with a strategic background could ask questions about how well the company analyses what its competitors are doing and how it's operating structure compares to theirs. It can be difficult for new directors – particularly those in the minority – to find their voice on a board. New directors should strive to bring a different perspective to build credibility and avoid "add-on' comments. Directors may need to work extra hard to make their mark and avoid exclusion from debates on issues that do not directly relate to their minority status."

Source: OECD (2008), *Using the OECD Principles of Corporate Governance: A Boardroom Perspective*, OECD Publishing, Paris, *www.oecd.org/daf/ca/corporategovernanceprinciples/40823806.pdf*.

representatives of the constituencies which appointed them. These factors will influence whether the board, acting as team can have an impact on the performance of the company.

A typology for SOE boards suggested by an earlier OECD study reflects all these different factors which influence the team dynamic and can determine whether a board can be effective (Table 6.1). The team dynamics of a board can be broadly classified in four categories: *i)* the conduit board, which runs the SOE as an extension of a government department and relays directions given by ministers; *ii)* the subjugated board which is dominated by a powerful CEO/ Chair; *iii)* the effective board; and *iv)* the symbolic board which is circumvented and uninvolved (adapted from Frederick, 2011).

Table 6.1. **Team dynamics on SOE boards**

Type/function	The conduit board	The subjugated board	The effective board	The symbolic board
Decision-making powers	Board functions as an extension of a governmental department	Approves without contest or consideration Does not consider alternatives	Board makes performance-related decisions	Circumvented and powerless Not consulted on decisions by either management or owners
State vs. Company orientation	Focus on state expectations versus needs of the SOE	Limited strategic focus Relies on information fed by executives	Strategic focus	Unable to influence orientation
Relationship with executive management	Limited role of non-executive board members Relays directions given by Ministers	Limited role of non-executive board members Dominated by executives	Board is actively overseeing management Significant role for non-executive directors	Not privy to key discussions between owners and management with all decisions taken by owners
Value adding	Compliance/ conformance checking	Does not see its role as adding value	Value adding with visible board influence and presence	Lack of recognition, influence and impact

Source: Adapted from Frederick, W. (2011), "Enhancing the Role of the Boards of Directors of State-Owned Enterprises", *OECD Corporate Governance Working Papers*, No. 2, OECD Publishing, *http://dx.doi.org/10.1787/5kg9xfg6n4wj-en*.

Workload

As in the private sector, the expectations of SOE boards seem to grow inexorably. The most visible manifestation is the increase in the workload and the time commitment that board members face. The workload of a board member is a reflection of both the number and complexity of issues that it needs to consider. Today, boards must consider increasingly difficult technical issues including risk and risk management, financial instruments, financial reporting, systems of control, etc. Other issues may be less technical but challenging from a conceptual perspective such as corporate social responsibility. Furthermore, boards are increasingly expected to look to the future and anticipate events.

Board members can now expect to work from 10 to 25 days per year, and the expectations of board chairs are much higher. Depending on the size of the company, a chair can expect his/her time commitment to run from 40 to 90 days of service per year (OECD, 2008), and where special circumstances (such as a crisis) exist this may be even more. Only a few countries have developed or are developing specific guidelines for how the work of SOE boards should be conducted. The only requirement usually established by the Company Law or in specific SOE related legislation, concerns the obligation for minutes of board meetings and the number of meetings to be held per month or year, which varies from twice a month in Turkey to once a year in Austria.

The level of organisation of the board will also affect work load and therefore efficiency. As such an important aspect in keeping the work load reasonable is to ensure that board meetings are set well in advance, with a clear agenda and with set dates (much of this relies on the Chair of the board as discussed below) (OECD, 2008). Boardroom efficiency is also reflected in the level of preparedness of directors. For example the board can contribute their perspectives to the discussion base on their experiences, but this should also be coupled with adequate knowledge of the company's business and the conditions in which it operations. The workload expectations for board members should also factor in time invested in researching the industry of the company, how it operates, how it makes money, any specific non-commercial objectives that it be required to undertaking, in addition to understanding its competitors (OECD, 2008).

Size limits

Determining the right size of the board is an important issue with respect to promoting board efficiency. It is not possible, nor is it appropriate, to recommend a one size fits all approach when looking at board size in the public sector. However, size does matter as is supported by the *SOE Guidelines*. Large boards can result in unwieldy processes and lack clear direction (as is the case for SOEs in some jurisdictions), whereas boards which are too small may not fully reflect the needs of the company. In other jurisdictions, such as Portugal and Hungary cost savings are a key motivator in reducing the size of boards; whereas, in Switzerland, board size is identified in one of its Corporate Governance Principles requiring slender structures for governing bodies.

As a general rule, board size should be developed taking into consideration factors such as an entity's size, complexity, risk of operations and the needs of the board. Furthermore, over time the optimal board size may vary in line with changes in its functions or the needs of the board. Nevertheless, there does appear to be consensus in the approach of jurisdictions to the optimum board

SOE *Guidelines*, Annotations to the Guideline VI on board size

To encourage board responsibility and in order for boards to function effectively, they should follow best practices adhered to in the private sector and be limited in size. Experience indicates that smaller boards allow for real strategic discussion and are less prone to become rubberstamping entities.

size: a large number of OECD economies identify the optimum board size as somewhere between five and eight members (see Table 6.2).

Table 6.2. **Maximum board size**

	Maximum size	Minimum
Austria	20	–
Belgium	–	12
Brazil	6	–
Canada	12 (maximum)	9
Chile	7	3
Denmark	–	3
Finland	10	3
France	18	9
Germany[1]	n.a.	n.a.
Greece	7	–
Hungary[1]	7	3
Israel	12	–
Italy	5	3
Korea	15 (informal)	–
Latvia	3	–
Lithuania	15	3
Mexico[1]	n.a.	n.a.
New Zealand	9	2
Norway	–	3
Poland	–	3
Portugal[1]	–	–
Slovenia	–	3
Sweden	9	3
Switzerland	10	5
Turkey	–	6
United Kingdom[1]	–	–

1. Depending on the company.
Source: Country submissions to OECD questionnaire.

The role of the Chair

The crucial element in promoting board efficiency and creating an effective board is the chair of the board. It is the chair's task to build an effective team out of a group of individuals. This requires specific skills, including leadership, the capacity to build and motivate teams, the ability to understand different perspectives and approaches, the capacity to diffuse conflicts, diplomacy and personal effectiveness. The chair of the SOE must also interface between the State, the board, and the executive. Its role in liaising with the ownership function is seen as an important channel of communication. Finally the chair must understand the business and ensure compliance with all legal and statutory obligations.

Good practice: The key to the board efficiency is a Chair who can build an effective team by exercising leadership, diplomacy and a deep understanding of the business.

Some jurisdictions highlight the importance of the Chair in board functioning. These are usually reflected in their board guides covering not only the SOE sector but the broader public sector. Depending on the jurisdiction the Chair will fulfill more or less functions. At minimum, the following roles should be assumed by the Chair:

- setting the board agenda;
- facilitating the flow of information and discussion;
- conducting board meetings and other business;
- ensuring the board operates effectively;
- liaising with and reporting to the minister or ownership function;
- reviewing board and organisational performance; and
- induction and supporting of board members.

SOE chairs are contributing in new and evolving ways, for instance in enhancing the board composition and selection procedures. *First*, in some countries chairs are involved in conducting gap analyses of boards (i.e. in determining what board member profiles are required to strengthen the board), and in interviewing candidates to help assess personal and behavioral characteristics. *Second*, in other cases chairs have the capacity to express reservations regarding nominees and override government proposals based upon an expression of justified concerns.

A final observation is that the role of chair requires a significantly greater contribution in time than that of other board members. Workload needs to be taken into account when considering the accumulation of board roles and in remuneration.

The use of board committees

The *SOE Guidelines* posit that when necessary, SOE boards should set up specialised committees to support the full board in performing its functions. Annotations to the Guidelines further indicate that the setting up of specialised board committees could be instrumental in reinforcing the competency of SOE boards and in underpinning their critical responsibility in matters such as risk management and audit. They may be also effective in changing the board culture and reinforcing its independence and legitimacy in areas where there is a potential for conflicts of interests, such as with regards to procurement, related party transactions and remuneration issues.

SOE *Guidelines*, Guideline VI.E on board committees

"When necessary, SOE boards should set up specialised committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration."

The use of specialised board committees in SOEs has increased, in line with practices in the private sector. The type of special committees that boards make use of can vary between companies and industries and includes: audit committees, remuneration committees, nomination committees,* strategy committees, ethics committees, and in some cases risk and procurement committees. Even in countries where audit committees are not commonly used other board-linked bodies may in practice perform a similar function.

Good practice: Specialised committees can contribute to the efficiency of the board, but should not detract from the responsibility of the full board.

The existence of specialised committees should not deprive the full board of its responsibilities in the matters concerned; however, it can contribute to the efficiency of the board by ensuring that technical issues are dealt with by members who are adequately independent, trained or informed. When setting up board committees, general practice would suggest that they are chaired by a nonexecutive and include a sufficient number of independent members. The proportion of independent members as well as the type of independence required (e.g. from management or from the main owner) depends on the type of committee, the sensitivity of the issue to conflicts of interests, and the SOE sector. The audit committee, for example, should be composed of only independent and financially literate board members.

* The prevalence of nomination committees is briefly discussed in Chapter 2.

Good practice: Board committees should be made up of independent and technically literate board members to ensure efficiency.

In most jurisdictions board committees are not mandatory; boards are free to set up such committees, based on the Company Law and according to their governance needs. Where they exist, the composition and duties of committees are defined by the board, and are published in Annual Reports (OECD, 2005). Though not prescribed by concrete reform measures, the ownership agency in France has actively encouraged government-invested companies to establish audit, strategy and remuneration committees. Finland, too, does not require committees, but it has recently (since 2007) has encouraged the establishment of remuneration committees, with the purpose of ensuring competitive and incentive-consistent remunerations in SOEs. In Korea, however, board audit committees are required by law for commercial SOEs (OECD, 2011).

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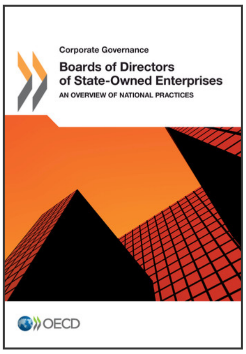
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