

THE BOARDS OF SEMI-STATE COMPANIES

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In a previous article [MacCormac, 1982] it was stated that, apart from its strictly legal duties and obligations, the board of directors has two main functions, namely (a) to appoint, monitor and support the chief executive, and (b) to evolve the objectives of the company and to develop the relevant strategies with the management, including the approval of the structure for implementation. From an analysis of the substantial correspondence following the publication of the article, it is clear that board members and senior executives in the public and private sectors agree broadly that these are the main functions. In this article detailed attention is given to the composition of the semi-state company board, with particular emphasis on investigating whether the functions are the same as those of private sector boards, whether it can fulfil them adequately and whether effectiveness in the semi-State sector can be realistically measured. Attention is also directed to certain areas worthy of research so that we may be better informed of the role of boards of semi-State bodies and develop more realistic approaches to their composition and operation.

An historical perspective of the evolution of boards of directors provides some indicators on the rationale of the board's role. When the concept of the board was written into the early Companies Acts of the British Parliament (1844 onwards) there was an implied recognition of its representative role. Members were to be elected by the shareholders to the board in order to direct the affairs of the company, principally because the body of shareholders was too big to fulfil the roles of direction and management. In the nineteenth century the board was usually chosen from amongst the shareholders and in most companies the holding of a minimum number of shares was specified as a qualification for board membership. The board was by definition a smaller group than the totality of shareholders, and it reported back to all the shareholders on the operation of the company. Apart from this, however, the board was recognised as the supreme authority in the firm by statute and by tradition. Its authority, flowing from the shareholders, is subject only to the courts of law in instances of conflict.

In the early days boards were composed of shareholders, and therefore there was no formal question of management representation. This only

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occurred when the chief executive was an owner of a significant portion of the equity (which was frequently), but the board rarely included any other member of management except perhaps a member of the main shareholders' family. Similarly, boards did not include non-executive directors who were not shareholders, nor, of course, did they include any worker representatives. Seen in this light, it is easy to understand the rationale behind the composition of boards of semi-State companies, but their framework has been altered to a greater extent than those in the private sector.

Appointing Board Members

In the case of the semi-State company the shareholder is the Minister who carries the responsibility for the relevant Department of State. He holds all the shares, either through nominees in cases where the company is formed under the Companies' Acts, or where the corporation is formed by statute, (the Statutory Corporation, e.g., the Electricity Supply Board) the total share capital is held directly by the Minister. In both instances the Minister acts for the government or State as the controlling shareholder, and therefore he, or the government on his advice, appoints the members of the board.

In private sector companies a director, once elected, indicates each year to the general meeting of shareholders whether he is willing to be re-elected or not, and if he is, in most instances his re-election is a formality. A new director is normally co-opted by the board prior to the general meeting and, subsequently, confirmed by the shareholders. The board therefore has a substantial role in the choice of new directors. It can judge the skills it may need, the desirable age bracket of the new director, and may, if the shareholders so approve, renew itself in a logical and well thought out fashion. On rare occasions there may be a shareholder challenge to board compositions and this usually follows from special or particular circumstances, such as the arrival of a new significant minority shareholder or group demanding representation, or in cases of partial failure and/or reorganisation. The chairman is always appointed by the board and, when required, will be clearly concerned with the selection of a new board member with the requisite qualities and skills.

No such practices exist in semi-State bodies. The Minister (or government) appoints the chairman for a period of five years which may be renewed, and similarly appoints the members of the board for fixed terms after which such appointments may or may not be renewed. The Minister normally neither seeks the advice of the board on individual appointments or renewals, nor do boards indicate to their Department of State the desirable profile of a new director to fill a vacancy in terms of his skills or attributes. Boards of semi-State companies do not therefore partici-

pate in, nor consider, renewal processes. This factor undoubtedly needs to be taken into account when considering the effectiveness of such boards. Research on non-executive board composition, as structured by different departments and governments, with the focus on the skills, experience and qualifications of board appointees, their age pattern and reappointment, would provide much needed factual information necessary in the analysis of public sector board membership and perhaps disclose some weaknesses in the system.

The Israeli Experience

Practice in Israel provides an interesting contrast. There is an independent unit attached to the Ministry of Finance, — the Government Companies Authority — which suggests names to the appropriate government department. No person can be a member of more than two state boards and each board is composed of two-thirds senior government officials, executives of other state companies or other state employees, and one-third private citizens. The average number of directors is twelve but there is a range of between seven and twenty. The membership of the state board is terminated if a member does not attend, for any reason, four consecutive meetings. The boards are required to meet at least six times each year, and on the question of remuneration, it is interesting to note that in Israel, up to 1978, no payments were made to directors of government companies. However, in view of the parlous state of many government companies ("if you pay nothing you can expect to get nothing."), a new policy was introduced. Since 1978, fees, on a comparable basis to those paid in private industries for non-executive directors, are paid to the government appointees. One other interesting principle in the public sector in Israel is that directors retire by rotation and in no instance does the board all reach retirement at the one time. This ensures that no one minister has the power to appoint the whole board of a nationalised industry.

The Worker Director Experiment

Two other characteristics of the membership of semi-State boards, the worker director and the representatives of management, require comment. In the early days of company boards, neither the workers nor managers were represented, and similarly, the semi-State companies and statutory corporations as they were created, had no such representation. All directors were non-executive, except in some instances where the chairman was appointed on a full-time basis. With the passing of the Worker Participation (State Enterprises) Act (1977), it became the practice for the appropriate minister, in respect of the seven named semi-State companies, to appoint the chief executive to the board; this has also become the practice in other State companies. However, other members of management were not appointed to the board, with the result that

with the appointment of worker directors (four out of a total board strength of twelve) the combined management view of a problem could be represented only by the presence of the chief executive. It would be of interest to research the opinions of senior management, including chief executives, with regard to this imbalance of representation from a management perspective.

The worker director experiment is too recent to pronounce any considered judgment on its success or failure. It is clear, however, that this system should be monitored and that some analysis should be made of board decisions and debates which take place with such directors in order to judge the efficacy of boards where they are present. It may be that practice varies substantially from assumptions and "informed" opinion.

The Chairman of the State Board

A key figure in the operation of semi-State companies is the chairman. His role, apart from the typical chairman functions, involves substantial contact with the appropriate Minister and in periods involving dramatic changes in objectives or strategies this will also involve a relationship with other members of the government. The chairman is also responsible for the presentation of his board's view to the public and this may be of crucial importance, as not only does he need to justify or defend the service provided to the public, but, also to present, publicly, the case for the appropriate level of investment by government. Governments are influenced by public opinion and the development of such opinion is a major function of the chairman of a nationalised industry or semi-State body. Indeed the extent to which a Minister exercises control depends on the degree to which the company's activities impinge on the public e.g., the effect of change in prices on economic indices or the effects of a redundancy scheme on a local area.

The position of full-time chairman seems to be an anomalous one unless the incumbent is also the chief executive with management reporting directly to him. It would be preferable, however, to have a part-time chairman of the board to which the chief executive reports, and to have the chief executive as the head of management, and as a member of the board. It is difficult to understand the circumstances where there is a full-time chairman and a chief executive fulfilling separate roles. Some research on the separation of duties in such instances would be revealing and may disclose contradictions which could lead to reconsideration of the principles of appointment.

Appointing the Chief Executive

The appointment of the chief executive is agreed to be a major, if not indeed the major, function of the board. A great deal of thought must be

given to the qualities needed in the individual, his ability to exercise an effective transition of control from his predecessor, his acceptability by management and his overall capacity to evolve objectives, agree them with the board and develop and amend strategy. Apart from looking at the acceptability of outsiders, a board will normally be concerned with the evaluation of senior management personnel as possible candidates. If the chief executive is the only management member of the board this evaluation is more difficult, as members of management only come to meetings for certain board items on which they have particular expertise and it is difficult for board members to appreciate abilities and qualities, particularly those of overall judgment.

An even more peculiar and difficult situation arises where the board does not have the power to make an appointment as chief executive, but where the government reserves to itself, or the Minister, the power to make the appointment. The board may have a role in the recommendation of the name of the chief executive to the Minister. This role may be one recognised by custom or it may be laid down in the legislation, but in all such instances it is clear that the Minister makes the selection and is not bound by the recommendation coming from the board. If one holds the view that one of the principal functions of the board is the appointment of the chief executive and guidance in the choice of his team, then an important element of board control is absent from some of these semi-State bodies.

Setting Objectives

The board of a semi-State body also may be constrained in the evolution of its objectives. In some instances objectives of a very general character are laid down in the appropriate legislation. It remains for the board to express workable objectives in a quantitative fashion. In other situations the overall objectives may be deduced from the general purpose for which the concern is established and subsidiary objectives may be spelled out in detail by the board. Some Departments of State strongly believe that these objectives are subject to ministerial discretion but some boards consider that they have the power to evolve objectives and strategies, (including even a diversification strategy or the alternative use of its resources). All boards, however, seem to be agreed that a Minister should, at least, have sight of the objectives and his critique of them should be carefully considered by the board. In fact, in some instances, the appropriate Minister gives no particular reaction to a set of objectives and/or strategies and the board assumes, therefore, and probably correctly, that ministerial acceptance is implicit.

The Issue of Control: State Versus Board

In theory the board of an industrial concern looks after the interest of its shareholders and has responsibility to a lesser extent to the other consti-

tuents surrounding its organisation. Such a board, however, is supreme in its power. It is only in very rare instances that there is direct interference by the shareholders and these instances are rather formalised in the non-election of the chairman or director at the annual general meeting or in instances, rarer still, where the shareholders call an extra-ordinary general meeting to object to an element of policy as evolved by the directors. The board of the semi-State company, however, is not supreme or sovereign in the same way. Admittedly an analogy may be drawn in that the appropriate Minister of State is the sole shareholder in the company and if he disapproves of the way in which the company is being manager or of its strategies, the Minister has the ultimate power to dismiss the whole board and appoint a new one.

There are many factors which will influence whether the Minister makes full use of his powers directly or whether he delegates control to the board with little interference in their activities. Such exercise of power or interference will be not only ministerial but governmental. A major ministerial decision in relation to a semi-State body may be made at cabinet level and will certainly be influenced by overall governmental considerations.

The factors influencing effective board control are numerous. The board of a profitable semi-State body will have greater effective control than that of a loss maker, particularly if the profits are large enough to fund the capital requirements of the particular body. This is in a sense the same as a firm in the private sector which must fund its own requirements through borrowing or retained profits. Borrowings in a semi-State company may, of course, be subject to ministerial permission and in most instances will also require a government guarantee to the lender even if the debt equity ratios are still within satisfactory limits. When a semi-State company, therefore, needs additional funds, the shareholder, i.e., the Minister, will normally lay down quite restrictive conditions for the use of the additional funds. The board, having taken a decision to make a particular investment, will find itself in the position of having to defend its decision to the appropriate department before permission for additional borrowing is given. There is an ill-defined, hazy area in the capital allocations procedures of semi-State companies which are funding their major expenditures out of retained profits. Whether the Minister has any say in such allocations has never been quite tested. It is here then that the real State control takes place over the broad strategy developed by the semi-State company and where the major difference from practices in the private sector in board operation may be seen to occur.

Board Influence in the Loss-Making Semi-State Company

The loss making semi-State company is inevitably in a tighter system of control and the board is in the difficult position of being unable to exer-

cise its normal functions. The emasculated decision process of a loss-making semi-State body is rather like the firm in the private sector where the receiver is the decision taker, or where the financial institutions are in effect the policy makers. The board can evolve, in consultation with its management, some parameters for the forecast losses and then agree those losses with the appropriate Department of State. In doing this, however, the strategies to achieve these loss-making levels are examined in great detail and the board finds itself as a mediator between the ministry and the management of the concern. The real powers are vested, however, in the Department, since power is totally allied to the availability of finance, and the one continuing source is either subsidy or State-guaranteed borrowings. In such circumstances the major valid functions which remain with the board are control and measurement of performance against forecast, the discussion and analysis of reasons for major variances and continued updating forecasts of future losses. Any elements of strategy to curtail losses must in effect be discussed and agreed with the appropriate Minister. It is indeed questionable whether the board of a major loss-making public sector firm fulfils any valid function.

In the case of the loss-making private concern the shareholders interfere by appointing board members and voting on major restructuring issues. Because of the number of shareholders the formal arrangement is for these decisions to be made at an annual or extraordinary general meeting. Shareholders also influence policy in a direct fashion where they have board representation. The Minister's position is equivalent to a sole shareholder with representation on the board. In practice, he usually uses this power to maintain a possible veto on any decision. While this is obviously his right, it may not be the best for the company.

Finally, effective board control will be affected by the philosophy of the government in power. More left-wing governments are inclined to provide assistance to semi-State bodies with fewer conditions attached to that assistance. More right-wing governments, while perhaps pursuing a goal of privatisation, have a marked tendency to interfere in policy formulation. Furthermore, they are usually much less sympathetic to loss-makers.

Would the board of a semi-State body function in a similar manner to that of a company in the private sector if appropriate ministers delegated full control to an effectively structured board? It is at least desirable that the interface between the board and the Minister should be clearly defined and that the board should understand the limits of its power. When neither the Minister nor the board can take final decisions on objectives or on strategy, the effectiveness of semi-State bodies can be called into question and measures of performance become meaningless. Clear definitions of board authority would be an improvement and in areas where the

real control is a departmental one, this should be recognised. In such circumstances, what is the role of the board?

REFERENCE

MacCormac, M., "The Role of the Board of Directors and Board Practice", *Journal of Irish Business and Administrative Research*, April, 1982, Volume 4, Number 1, pp. 22-39.

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