

"Is there a set formula for good corporate governance ? "

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Ladies and Gentlemen,

I should start off by stating that I do not claim to be an expert on this subject.

What I hope I can contribute is my experience in addressing issues of governance for state agencies ranging from bodies with less than 50 staff to those exceeding 10,000. My perspective is that of a person working in a central Department with practical experience, supported by some legal and academic knowledge of the subject.

Private Sector models - Boards

The first thing I want to do is point out that the governance models we have adopted in Ireland for the public sector agencies tend to be based on the template used for private sector companies and in particular those that apply to large UK and USA commercial companies whose shares are publically traded. (The notable exceptions are of course the traditional models used in central Government Departments and local Government authorities.)

The basic governance framework for most State agencies therefore involves a Board appointed by a Minister and a permanent staff headed by a chief executive.

This private sector model was invented in recognition of the fact that a large, diverse group of shareholders don't have the time, interest or expertise to run a company and you need some one to represent their interests, monitor the management and ensure that the chief executive doesn't run away with the shareholders' money. The chief executive is accountable to the Board who are accountable to the shareholders at the AGM. This model has survived and thrived for several centuries for companies dealing with vast sums of money in very complex circumstances.

On one level it seems a very odd choice to use this model for public sector agencies. In the public sector there is only one shareholder, the State, and it does have the time, resources and expertise to monitor an agency. Why appoint a Board of part timers who may or may not have particular expertise or a special interest in looking after the interests of the only shareholder.

There was also a view that certain activities should be moved away from the direct control of Government Ministers who are politicians. Certainly in the 21st century Government Ministers are much more accountable than the Board or Chief Executive of a State Body. From the point of view of a Minister as a politician establishing a public sector is a bit mad - If the things go wrong the Minister will get the blame but if political goodies are being dished out the agency will get the credit.

There was some notion that giving bodies some semblance of independence was good administration. How can any company be independent if all the shares are controlled by one individual.

Certainly the public and the media don't accept the view that the Minister for Health and Children is not personally to blame for every day to day action of the HSE.

The natural tendency of all organisations is to maximise their independence and minimise their accountability. Agencies can use the formal structure of the Board as a buffer to keep the central Department at bay, disempowering the Department officials and refusing to give information except through the highest channels.

They can blame the dead hand of the central Department and a refusal to provide adequate resources for any failure and will actively use the media, interests groups and politicians to support their case.

In some cases the greater resources and expertise available to the agency is such that the central Department is effectively powerless.

Of course, central Departments have their own armoury to keep agencies in check. And while I have seen all the tricks used at some stage or other, relationships are in fact normally quite good between public sector agencies and their sponsoring Department or at worst there is a healthy tension between the two sides.

The really serious difficulties arise when the normal relationship with the sponsoring Department breaks down and the sponsoring Department has not retained some effective mechanism of control (for example control over their budget). In such cases serious governance difficulties can arise in the form of direct refusal to

implement Government policy, refusal to account, poor performance or various abuses.

In such a case the Minister and central Department are faced with very restricted options. Effectively you

- either grin and bear it and swallow the fact that you have to defend an agency that is out of control

or

- take the nuclear option and fire the Board or Chief Executive.

Very few Ministers are either brave enough or foolish enough to take this latter approach and with good reason. If an agency has got so bad that the Board or Chief Executive has to be fired it usually means people are looking for the Minister to resign as well. If things are not so bad in the public eye, then the Minister will normally be accused of some political or other unworthy motivation if he tries to get rid of the Board. It is a lose - lose situation.

Notwithstanding these very logical objections, the private sector model of a board and chief executive does offer some real advantages:

- Public companies are where the money is, their governance gets the most attention, it is familiar and is easily accepted as best practice.

- The actual practice in both the private sector and the public sector goes is generally more flexible than the formal structure suggests. For example in reality fund managers who control large blocks of shares do not operate through the shareholders' AGM but have direct access to and influence over company management. Similarly the Minister's civil servants who may or may not be represented on the Board normally have direct access to and influence over the management of a State agency;

- The proper Board members do actually bring valuable added value to the governance of State agencies. I am on three boards, all three are competent but in the case of two of them the Board members bring real added value to the agencies which otherwise would not be available to a public sector body.

- The existence of a Board imposes a useful discipline on chief

executives as they have to report on a regular basis to a body that can dismiss them. In agencies or line departments with no Board, the person in charge may not face a regular reporting on performance structure.

Mullarkey

During the 1980s there were quite a few spectacular disasters with big companies involving very large sums of money. There were concerns that investors were losing confidence in the governance arrangements of publicly traded companies. In 1991 the London Stock Exchange established a committee chaired by Sir Adrian Cadbury to look at the problem and it produced the first corporate governance code of the modern era and spawned a whole series of such codes throughout the world. In the UK it was followed by 4 or five subsequent reports leading eventually in 2003 to what is now known as the Combined Code which applies to companies listed on the London and Irish Stock exchanges.

In Ireland, two particularly relevant documents for corporate governance in the public sector are the "Code of Practice for the Governance of State Bodies (2001) published by the Department of Finance and the Report of the Working Group on the Accountability of Secretaries General and Accounting Officers - frequently referred to as the Mullarkey Report and published by the Department of Finance in 2002. Both documents draw heavily on the work done in the UK for the London Stock Exchange on corporate governance.

Going back to my theme of following the private sector model, the Cadbury report stated its aim was to help raise the standards of corporate governance and the level of confidence in financial reporting and auditing. Because of the separation of ownership and control the focal point of such codes of best practice has been on the board of directors which is charged with monitoring management on behalf of the shareholders. The OECD was one organisation that promulgated codes of corporate governance. Their first production was stated to "focus on publicly traded companies" but they stated they might be a useful tool to improve corporate governance in non-traded companies, for example privately held and state owned enterprises. In 2005 the OECD went further and approved guidelines on the corporate governance of State owned enterprises. These were aimed predominantly at those enterprises engaged in commercial activity but and I quote "They are also useful for non commercial State owned enterprises".

The question of the universal application of such codes is addressed in that the approach taken by Cadbury and followed through in most codes of corporate governance was the "COMPLY OR EXPLAIN" principle. The code sets out what is generally best practice but acknowledges that it may not be best for a particular company or organisation. If that is the case you have to consider what is generally regarded as best practice, make an informed decision that it is not best practice for your organisation and then explain that decision so everyone knows where they stand.

In this context I want to give you two examples where a conscious decision was made not to follow the traditional model of a Board of management for a State agency.

Example 1 - One involves a branch of the Department of Justice with a staff of over 400 which had always operated separate from the HQ of the Department but not in any structured way. We have appointed a chief executive and are putting in the structures for it to operate as an executive agency of the Department. However it is still in its infancy and a conscious decision was made to allow the chief executive to build up the capabilities of the organisation before we considered the question of a Board. Our experience is that if you have an executive agency involved in certain areas of the criminal justice system, it can cause serious accountability problems if you have agencies headed by a Board of management. I will expand on this point in a minute. Management boards can be suitable where the body is intended to act independently but in other cases we have found that establishing an executive agency which is directly accountable to the Minister but which has an advisory Board can produce the best of both worlds.

The checks and balances associated with good governance have costs and they can be substantial. For example about 40% of the work time of the HQ staff of the Department of Justice goes on accounting for itself to the Dáil, media, Comptroller and Auditor General Freedom of Information requests etc. You have to balance those costs against the potential benefits. A Board can bring significant added value but there is no point in imposing it if the structures are not in place to meet basic administrative needs.

Example 2 - A more dramatic example of a decision not to follow the private sector model of a Board and chief executive occurred with the Garda Síochána. While the governance arrangements for a police

force could follow the standard model there is an added dimension.

They have the power to carry arms, to arrest people and to use physical force. As a result all western democracies have governance arrangements to ensure that the power of the police force is limited and subservient to the democratically elected representatives. They are an arm of the Executive and have to be directed by the Executive and coordinated with other State agencies.

In the USA, the UK and most of continental Europe they have a multiplicity of police forces. One reason for this is to ensure no one police force can usurp too much power. Where they have a single powerful police force, they bring in outsiders to head up the force.

For example the Commissioner of the New York police cannot be appointed from the New York police and is accountable directly to the elected mayor. In Denmark no policeman can make it beyond the rank of Superintendent - above that level state lawyers are appointed and the police are accountable directly to the elected Minister.

In Ireland we have a single state police force which also encompasses the powers given to state security and intelligence agencies. The governance arrangements for the Garda Síochána are set out in a 2005 Act and a deliberate decision was taken to follow the international practice of the police commissioner reporting directly to the elected Minister rather than following the private sector model of the chief executive of the police reporting to a Board. The dangers of loss of direct accountability was considered to outweigh any benefits that a Board would bring to the equation.

Going from the specific to the more general, the Department of Justice, Equality and Law Reform has about 25 different "agencies" under its wing. They differ significantly in purpose and size. At one end of the spectrum we have appeal bodies, where independence from the Department was essential, or other bodies engaged in work with little or no policy input or political implications and with little interaction with the Department. Then at the other end of the spectrum there were agencies where a lot of policy and political input was required on an almost daily basis. I was involved in an exercise in trying to divide them into 3 or 4 different categories and then establish a template determining the appropriate governance arrangement for that type of body. The models used ranged from the classic statutory, independent Board to non statutory executive agencies operating separately from the Department with their own identity but still legally part of the Department. For a variety of reasons that exercise did not quite succeed. However our analysis did show that one size does not fit all.

The moral of the story is there is no set formula for good corporate governance. You cannot blindly follow the standard governance arrangements but you cannot ignore them either. Comply or explain.

What is Good Governance in the Public Sector ?

Before I finish off I want to make two practical points.

Firstly I want to define "governance" from the point of view of a Minister. My definition, follows best management practice and focusses not on the inputs but on the output as Ministers are focussed on results.

- "Bad governance" requires two elements. The first element is a matter of luck - some disaster strikes an agency which is splashed all over the national media and it can happen to any organisation. The second element is where bad governance has left the Minister and the agency floundering with no credible excuses. It involves a public failure normally involving something like a complete failure to provide a service, a death due to negligence, a major loss of public funds or wholesale corruption. Fortunately these are rare.

- It is to be distinguished from "Near miss governance" where there is a disaster of similar scale but you have sufficient safeguards in place to put forward a credible excuse. The Minister gets criticised but he or she does not have to resign or fire the Board. Unfortunately the nature of life in the Department of Justice is that you develop a certain expertise in crisis management so I am quite familiar with near misses.

- "Good governance" is where the agency doesn't cause waves, has the necessary boxes ticked and the service it provides is of a sufficient standard that it does not provoke public outrage on a regular basis. Some will give the impression that they are actually an excellent organisation. In reality it is frequently just a question of random chance whether the governance of an organisation is really going to be tested. As a result there are lots of bodies out there which are badly governed but have been lucky never to have been tested.

- "Excellent governance" is found in agencies where all the elements work together to provide a genuine world class service with

appropriate checks and balances. Such agencies are of course also quite rare.

The last point I wish to leave you with is the key to good corporate governance. I can tell what it is but I cannot tell you how to get it.

In my experience, and it is confirmed by my readings of governance in private sector firms, by far the most important factor in the governance of an agency is the personality of the Chief Executive - the head of the agency.

If you get a good chief executive an organisation can really develop and improve. If you have a really bad chief executive you are heading for disaster.

A good strong organisation can carry a mediocre chief executive as long as there is no major crisis but a bad chief executive will undermine any organisation if not got rid of.

The single most important role of a Board in the governance of a body is therefore to make the call as to if and when the chief executive should be replaced. This is a very difficult decision

Getting rid of a chief executive is not easy, can be costly and carries the risk of plunging an agency into crisis but there are times when it has to be done.

Yes you have to keep an eye on the money. Problems frequently arise with procurement, payroll and the odd IT project going out of control. However the biggest single influence over the organisation, its culture and its ultimate success is the chief executive. Chief executives have to be nurtured, encouraged, supported and given advice. The very bad have to be dealt with.

I will finish on that cheerful note.