
CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES AND THEIR ROLE IN THE SOCIETY: HOW HAS IT CHANGED DURING COVID-19?

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Abstract

We can start talking about the COVID-19 pandemic as an unprecedented shock that has required unique responses from many corporations. Understanding how they have responded is of first-order importance for the fields of corporate governance, corporate finance and stewardship. While some insights begin to emerge, others will take time and depend on more complete data sets to become available, such as financial statements and governance records for 2020. Such data typically come from annual reports and proxy statements. US companies with an end of the fiscal year on December, 31 hold their annual meetings in the spring. They typically file their annual reports by the end of March, but in 2019, some 30 percent of the 7,000 reports were filed in April and later. While firms also publish quarterly data, most release comprehensive annual data only 90 days after their fiscal year end, so the earliest date that a large sample of data on US firms will be available is April 2021. These dates may be similar or even later for firms in other countries.

1. INTRODUCTION

In fact, in such a unique and rapidly changing business environment, it becomes increasingly important to secure effective communication to ensure that business decisions are taken efficiently.

Is your board of directors technologically equipped to have virtual meetings and do they need guidance and support to ensure virtual meetings run as smoothly and efficiently as possible? If not, or should such meetings not be possible, are your directors empowered to take resolutions in writing or appoint proxies if needs be and are relevant arrangements in place (electronic signature arrangements, etc.)? Could any tax issues arise as a result of such courses of action?

Was your annual general meeting (AGM) scheduled to take place in the midst of this crisis? One could consider holding these virtually in order to avoid undue disruption and the risk of missing regulatory deadlines and incurring default penalties. With the exception of listed entities, which are enabled by the listing rules to allow their shareholders to participate in general meetings by electronic means, Maltese law is silent on this matter.

2. ADMINISTRATION AFTER COVID-19

Undoubtedly, day-to-day administration will see a marked change. With many businesses are implementing remote working arrangements, companies should consider how administrative tasks are to be completed going forward.

For instance, how is original documentation to be received and processed as may be required at law or in terms of company policy? Is there a contingency plan to cater to this? How will filing deadlines be respected? Is your business equipped with the necessary technological solutions to submit documentation electronically, where possible? Does your business provide for the electronic signing of documentation?

Also, does the company rely on a specific individual as the sole signatory to its bank accounts or to prepare payroll for its employees? And if so, should the board consider appointing other individuals in such posts in case that single individual becomes unavailable to attend to his/her responsibilities due to confinement?

These concerns need to be addressed as soon as possible in order to secure the proper day-to-day functioning of the particular business.

3. BUSINESS CONTINUITY AND DISASTER RECOVERY POST COVID-19

As the Malta Financial Services Authority (MFSA) has highlighted in its recent stakeholder consultation on corporate governance, business continuity management is integral to good corporate governance.

The current scenario should thus act as a stark reminder of the importance of having adequate strategic management processes capable of identifying potential threats, advance planning and the safeguarding of critical business functions in the event of disruption.

Many businesses nowadays have continuity and contingency plans in place, the efficacy of which is now being put to the test. Adequate contingency planning should also provide for remote working, clear channels of communication and the protection of business relationships.

By way of example, what if the company's main suppliers are unable to supply components that are crucial to the company's manufacturing or provision of services? As far as possible, these concerns should be proactively addressed, especially in light of the duty that directors have to exercise reasonable care, diligence and skill, and this involves assessing and minimising the risks in similar extreme situations.

4. DIVIDENDS, LIQUIDITY AND INCENTIVES DURING COVID-19

Has your company recently declared dividends that have still not been distributed or are you currently deciding about dividend distributions? Bearing the current uncertainty and adverse market conditions in mind, it might be prudent to take a step back and gauge the market, public and stakeholder reaction.

In this sense, it is also important to act in a manner that is in sync with both internal (management, employees, etc.) and external sentiment. Liquidity and working capital requirements may naturally come under strain at such time and consideration will need to be given to cashflow management, banking arrangements and refinancing as well as available assistance/incentives including moratoria.

5. CONCLUSION: RETHINKING CORPORATE GOVERNANCE FACING COVID-19

Many public companies are experiencing a dramatic fall in their stock price in light of the global financial crisis. There is no doubt the current crisis will expose the attitudes of corporates to employees — and therefore society. So says Simon Lowe, consultant at Grant Thornton and chairman of its Governance Institute, describing the potentially seismic impact the pandemic could have on board and corporate behaviour, and on governance, long term.

It's strong and, for many, hopeful stuff. And he's not the only one predicting a radical shift. "I think it will be a game changer", says Helen Pitcher, chair of Advanced Boardroom Excellence and non-executive director (NED) at United Biscuits and C&C Group. "Because you can already see the winners and losers in terms of businesses being seen to act responsibly and getting recognised for this. And it will take people a long time to go back to brands they feel haven't done the right thing" ("How marketers responded", 2020).

Coronavirus is, then, dividing organisations into two distinct groups. One comprised of leadership teams perceived to have acted for

the greater societal good: hotels making rooms available to the homeless, manufacturers retooling to produce medical supplies, airlines redeploying staff to hospitals... And another featuring those who've asked staff to work while furloughed — Sports Direct, for example — or failing to cut executive pay and shareholder dividends in line with using government and taxpayer money to furlough workers on 80 per cent pay.

This all means responsible business has been brought firmly to the fore. While investors and boards have been taking ESG (environmental, social and governance) factors ever more seriously as part of wider corporate governance and risk oversight activities in recent years, the focus has predominantly been on governance issues — for example, board composition — and the environment. Now the 'S' is apparently having its day.

Alex Edmans, professor of finance at London Business School and author of *Grow the Pie*, explains that while the financial crisis didn't change corporate behaviour and governance as positively and dramatically as some might have hoped, this time will hopefully be different. Edmans has long advocated for boards to adopt a 'pie growing' rather than 'pie splitting' mentality when it comes to executive pay and responsible governance — something the current crisis has helped highlight the value of, he feels. “The financial crisis was a more 'us versus them' thing; the bankers caused it and everyone else suffered. Whereas this crisis has affected everybody. The more 'us versus them' the crisis, the more into pie splitting you get. But here you've even got big rivals like Apple and Google working together...”, he says (Roper, 2020).

“There was already a movement towards businesses serving wider society”, Edmans adds, explaining that now because some firms haven't been able to generate commercial revenue because of lockdown restrictions, they've had to focus on generating or 'growing' different kinds of value or 'pie' — principally social capital. “Some companies can't split the pie because they have no money”, he says. “They've had to think more innovatively about growing it” (Roper, 2020).

All potentially profound, long-lasting shifts. But there have also been a fair few smaller, more immediate, logistical changes to the way corporate governance is conducted — but which could nonetheless have a significant impact long term. The most obvious that people professionals sitting on boards as human resources directors (HRDs) and NEDs will have experienced over recent weeks is board meetings being held remotely throughout the crisis. For Edmans, this seemingly small, the short-term change could actually be the final deciding factor in whether companies truly embrace the value of the remote working long term, and whether they do so properly: “If boards realise that even senior advisers can do their job remotely, then they should be much more willing to allow employees to in general” (Roper, 2020).

He adds the levelling effect remote board meetings could have on the way these are conducted, and the power of more frequent board catch-ups long term. One of the concerns with board meetings is that if memos are sent out ahead of time, people start discussing them and influence each other. So remote meetings could lead to more innovation because it means no one is skewed ahead of time.

“Conversations between boards are now more frequent. I think that’s important because otherwise they end up being what I call ‘intensive care discussions’, so about an emergency. But if you’re meeting on a more ongoing basis, even in normal times, you can nip issues in the bud” (Roper, 2020).

Nick Ulycz, chief operating officer at Domestic & General and former head of HR UK at HSBC, points out the power of a diverse board at times of crisis — something he feels did shift meaningfully in the wake of the 2008 financial crash. “The composition of boards fundamentally changed off the back of the financial crisis; it is inevitable the same will happen here”, he says. “And I think boards did become much more cognisant of the risk that their judgement could be subject to external scrutiny” (Roper, 2020).

Pitcher agrees both board diversity and accountability will hopefully only be enhanced by the coronavirus crisis. First, a potentially permanent shift to more meetings involving a remote element could open up board positions to a wider cross-section of prospective members. Second, the more relaxed tone board discussions have had to adapt (as a result of children and pets intruding even on these most high-level discussions) should change board culture to feel more inclusive, she says.

Despite concerns, this AGM season could be a less transparent affair — with reports of FTSE firms holding meetings with just two shareholders present, and campaign group ShareAction writing to the government asking it to ensure such changes are only “a temporary solution” — Pitcher is similarly encouraged that greater use of technology could enhance AGM accessibility long term. “How many small shareholders receive their AGM notice and throw it in the bin and don’t even bother to vote? So this might, with a bit of better education and communication, open the process up to more people”, agrees Lowe (Roper, 2020).

However, along with the list of positives that could emerge from the outbreak, the economic fallout could put good, society and workforced-minded corporate governance at risk. Though he feels there’s certainly the possibility of significant positive change, Lowe is also sceptical about whether this will happen in reality: “The counter is around the impact the crisis is having on profitability, because when you’re faced with the choice of helping the environment and society or improving profits, and there’s no in between, it’s going to be profitability every time” (Roper, 2020).

Andrew Kakabadse, professor of governance and leadership at Henley Business School, worries such grave threats to business survival, staff wellbeing and corporate reputation will push some to become overly compliance-focused: “For many people, governance and compliance are synonymous. But governance is oversight and it has two legs: compliance and stewardship. This is where boards sit back and say ‘what are the strengths of the company? Where can we provide advice and support?’” (Roper, 2020).

Though much has been made of the huge silver lining COVID-19 has brought in demonstrating the long-term viability of widespread home working, there are concerns some boards may be tempted to roll this out permanently purely to cut real estate costs — and in a way that harms employee wellbeing, career development, and senior decision-making and governance. “Some of that personal contact is really important in exercising good governance”, says Martin Tiplady, CEO of Chameleon People Solutions and former HR director. “You can do it to some extent remotely, but you can’t do it remotely permanently necessarily” (Roper, 2020).

While people-related elements such as culture, stakeholder engagement and employee voice have risen up investors’ and boards’ agendas over recent years — in no small part because of their increased prominence in 2018’s new Corporate Governance Code and other similar guidance — there’s also a danger these could slip back below the radar where firms are distracted by business survival, says Tiplady. And yet, equally, this could be people and culture’s — and indeed the HR profession’s — time to shine, he adds (Roper, 2020).

Good leadership teams should realise ‘HR issues’ around staff wellbeing and organisational culture are now more important — and more vital to good governance — than ever, says Ulycz: “For a board of seasoned business leaders, they have to see that culture is critical in delivering on strategy, customer service and reputation” (Roper, 2020).

Ed Houghton, head of research and thought leadership at the CIPD, agrees: “From a governance perspective, the crisis has really brought into focus the importance of active leadership and engagement by boards on workforce issues, including employee voice, health and safety, and fairness” (Roper, 2020).

Central to issues of fairness of course is executive pay — another opportunity for HR to offer expert advice. “It’s difficult to see how boards won’t need to address issues such as fair pay”, says Houghton. “For executives, this may mean core and variable pay models evolve. For example, they may incorporate more KPIs directly linked to COVID-19 recovery and workforce issues” (Roper, 2020).

Edmans similarly hopes the crisis could catalyse what he sees as a long-overdue shift to a greater emphasis on long-term equity over base salary. “If the CEO is paid according to the long-term health of a company, they will do things like invest in workplace wellness”, he

says. “Unilever, for example, has done some great things during the crisis and it’s perhaps no coincidence that [former CEO] Paul Polman’s pay package was designed to outlast his tenure, so it made sure he developed a culture that continued to be purposeful after he left” (Roper, 2020).

Execs taking salary cuts have undoubtedly been the only responsible short-term reaction to the crisis, says Edmans. But a more important long-term shift will be increased emphasis on ‘pie growing’ (encouraged through long-term equity) rather than ‘pie splitting’ by redistributing a relatively negligible amount of CEO core salary to the wider business and workforce, he adds.

Most crucial, perhaps, will be connecting the dots between exec pay and wider workforce remuneration and working conditions — something the Chartered Institute of Personnel and Development (CIPD) and others have long lobbied firms to achieve by greater HR involvement in exec pay discussions and RemCos (remunerations committees). “I think a lot of this will depend on how significant the economic impact is for the average citizen and worker”, says Ulycz. “People found bankers’ pay egregious after the financial crisis when they were experiencing house repossessions and losing their jobs. That’s where there has to be a link between public sentiment, the experience of the average employee and executive pay” (Roper, 2020).

So both the long-term opportunities for — and risks to — good governance brought about by the pandemic could present a vital chance for HR to make its mark at the very highest level. “Increased attention and interest from the board on workforce matters will only benefit the profession”, says Houghton (Roper, 2020).

“There will likely be a greater appetite for people data and analytics as boards look to increase their awareness and oversight — and ultimately look to leaders in the profession for their expertise” (Roper, 2020).

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