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Public-sector corporate governance: British Columbia's best-practices reforms

Though certain governments still use patronage appointments to fill vacancies on public-sector boards, that practice is changing, albeit slowly. The province of British Columbia has set a best-practice example by implementing new guidelines that ensure that directors are chosen for their expertise and competency. This author describes those guidelines.

By Elizabeth Watson

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In the last several years, there has been a renewed focus on the need to recruit effective directors. Although structure and process are necessary elements of effective governance, most experts agree that the key to improving corporate governance is selecting the right people to serve on the board - directors who have the competencies and personal attributes to effectively drive corporate performance and ensure integrity and accountability.

While much of the debate about corporate governance has focused on publicly traded companies, the principles are just as important, if not more so, in the public sector. Every day, public sector corporations make decisions that significantly impact Canada's economic, social and cultural well-being. They manage billions of dollars in assets and liabilities and oversee the delivery of critical services such as health care, education and public utilities.

This means that the appointment of unqualified directors (through patronage or not) is no longer acceptable. As

is occurring in the private sector around the world, public sector jurisdictions must reform their appointment practices to ensure that directors are selected for their competencies and commitment to effective governance.

In Canada, the province of British Columbia is taking a lead in public-sector governance reform. The province's new process for recruiting and appointing directors to public sector corporations is leading edge and may be considered a model of best practices for both the public and private sectors. This article will discuss these reforms.

Why are public-sector appointments important?

While private-sector corporations play a very important role in our economy, public-sector corporations arguably have a more direct and significant impact on economic, social and cultural life. In addition to running businesses and utilities, public-sector corporations are involved in areas such as health, education and worker protection.

In Canada, there are 41 federal Crown corporations (not including subsidiaries), employing 70,000 people (*2000 Report of the Auditor General of Canada*). In aggregate, (excluding the Bank of Canada), they manage \$68 billion in assets and \$61 billion in liabilities. They include entities such as the Canada Pension Plan Investment Board, which oversees \$14.3 billion in Canada Pension Plan assets.

In BC, 31 Crown Corporations manage \$32.7 billion in assets, \$40.7 billion in liabilities and employ more than 20,000 people. In addition, six Health Authorities oversee the delivery of \$6.2 billion in health services (approximately 25 percent of the provincial budget) and employ 95,000 people. The BC Workers Compensation Board manages \$8 billion in assets, oversees an annual income of \$1.5 billion and looks after the workers

compensation scheme for 1.9 million workers.

Some argue that good governance is even more important in the public sector than the private sector. Most public-sector corporations do not compete in the traditional way, and therefore, their performance is not driven by factors such as market share, industry

originated in the arts community in Renaissance Italy where a patron exhibited power and control by being able to make an appointment, and the appointee received prestige and public recognition through association with that patron. In 1881, U.S. President James Garfield was assassinated, allegedly because he failed to give his assassin a patronage appointment.

Eliminating patronage does not mean prohibiting the appointments of those who publicly support the government. Rather, it means establishing an appointment process that is driven by the recruitment of those individuals who have the competencies required to build an effective board.

benchmarks or share value. Consequently, their performance is measured not just by financial metrics, but others that are more difficult to measure. For these reasons, directors must tackle their jobs with focussed intensity to drive the best possible performance of the organization while at the same time hold it to account financially and ethically.

A history of public-sector performance

In most jurisdictions in Canada and throughout the Commonwealth, there is no systematic process for recruiting directors to public-sector corporations. Appointments are made or recommended by ministers on an *ad hoc* basis depending on that minister's understanding of the role of directors. Often, these decisions are based solely on whether nominees are affiliated with the party in power or political factors such as gender, geographical or cultural representation on the board.

The common complaint is that patronage appointments do not provide public-sector organizations with appropriate leadership. The classic definition of a patronage appointment in this context, and the definition used in this article, is one that applies to an individual who is not qualified for the job but who is nevertheless appointed based on political considerations rather than the knowledge, skills and experience required.

Patronage appointments are not a new concept. They

Although modern day supporters don't have guns, many of them believe that being publicly recognized as a "player," perhaps by being appointed to a significant board, is a prerequisite for their continued support. Many political parties believe it is appropriate to appoint a party supporter to a significant position as a reward for past service or loyalty.

In *Making Boards Work, What Directors Must Do to Make Canadian Boards More Effective* (McGraw-Hill Ryerson Limited, 1997), Ivey emeritus professors David Leighton and Donald Thain stated that, as if a matter of common knowledge, the selection criterion for appointments to Crown Corporations was "services rendered to the government political party, often 'political hacks,'" and that the primary role of Crown Corporation directors was, "public relations, rubber stamps and political window-dressing. The position is usually a reward for political services rendered."

The *2000 Report of the Auditor General of Canada* stated that the process of appointing directors to Crown corporations was weak and required special attention. It quoted statistics that indicated that only 18 percent of the Crown corporations viewed a specific skill set to complement the board as the top criterion for selecting directors; 65 percent of Crown corporations viewed geographic representation as the top criterion.

This problem is not unique to Canada. In a 2003 study

released by Australia's National Institute for Governance, the authors, professors at the University of Canberra, stated that "... the appointment process is an important factor in board performance as it determines the level and mix of skills on a board. Ministerial control over this process occasionally produces a desirable skill mix, but more often appears

Exceptions

Comments in this article about past appointment practices in BC and elsewhere are a reflection neither on any individual appointee; nor do they reflect a view that all individuals appointed to boards were unqualified.

Individuals who serve on public-sector boards must understand the responsibilities and expectations of directorship and be educated about the unique aspects of serving in the public sector.

to result in appointments that do not take into account the skill needs of the organisation."

The United Kingdom has an independent Commissioner for Public Appointments whose job is to ensure that appointees selected reflect the criteria established for the position. While this office can monitor process and may help eliminate patronage, it cannot ensure that there will be an appropriate mix of competencies and behaviours on a board. The selection criteria are established by individual ministers that may mean, again, that the criteria are ad hoc, depending on that minister's understanding of the role of directors.

Eliminating patronage does not mean prohibiting the appointments of those who publicly support the government. Rather, it means establishing an appointment process that is driven by the recruitment of those individuals who have the competencies required to build an effective board.

A legitimate consideration in the director appointment process is an individual's commitment to the government's general policy direction for the corporation. For instance, if the general policy direction were for a public sector corporation to be privatized, it would make no sense to appoint directors who would use the resources of the corporation to oppose that policy. Instead, the government would be looking for directors skilled in all of the issues that should be considered in the privatization process, and who can add value by bringing independent and diverse points of view on such issues to ensure that the corporation performs at the highest possible level.

Many qualified people have been appointed to public-sector boards and some of those boards have themselves put in place an appropriate recruitment and selection process. However, while individual cases of competency-based recruiting practices do exist, the problem remains that the underlying appointment process in most jurisdictions is not structured to ensure competency-based appointments.

Ineffective boards: Inherent risks

By definition, boards lacking the requisite mix of competencies and behaviours will be less effective, to the detriment of the corporation and, in the case of public-sector corporations, to the public at large.

At one end of the spectrum, ineffective boards may cause little direct harm to the organization. Management runs the corporation and the board adds little or no value to the process. At the other end of the spectrum, ineffective boards may actively work against the best interests of the corporation through ignorance or by pursuing a personal or political agenda. This can have devastating consequences that could easily rival the scandals in the private sector.

The example of the "Fast Ferry Fiasco"

In BC, the "Fast Ferry Fiasco" is a recent example of how poor corporate governance and ineffective boards can have catastrophic results.

The facts of the Fast Ferry Project are fully

documented in the BC Auditor General's 1999 report: *A Review of the Fast Ferry Project: Governance and Risk Management*.

In short, the government decided to purchase three high-speed aluminium catamaran car ferries from BC-based companies at an initial estimated cost of \$210 million. The initial board appointed to oversee the construction included three independent directors from the private sector with relevant skills and experience in marine construction.

Over the first 10 months of its operations, the board:

- asked repeatedly for a full budget;
- stressed on several occasions the need for a contract between CFI and BC Ferries;
- asked to receive regular reporting against an approved budget, showing both forecast costs to complete, and variances;
- asked for a construction schedule;
- pointed out that the original budget was for a different type of ferry, and questioned both that budget and the latest changes to it;
- stressed the need for a risk analysis of the current scope of the project; and
- noted that forecast costs continued to rise, and that the scope of the program had increased without an increase in budget.

Their requests were consistently ignored or only partly met, with the result that the board resigned. A new board was appointed. The governance systems put in place to oversee the project were inadequate. Two years later, it was determined that the project was significantly over budget (the final cost was more than \$450 million) and the ferries were not suitable for their intended use. Eventually, the ferries were shrink-wrapped in plastic and stored under wraps for several years until they were sold by auction for \$18 million. The net loss to the taxpayers of British Columbia was \$430 million, not including the cost of all of the reports and lost productivity in responding to public outrage at the debacle. The fiasco became a lightning rod for discussions on the lack of appropriate governance and contributed significantly to the defeat of the NDP in British Columbia in 2001.

Missed opportunities

Fortunately, decisions made in ineffective boards are not this catastrophic. In many cases, the management team is able to carry on and get the job done without significant board input. However, this is not good enough. In these cases, we will never know what opportunities the organization missed and what it might have been able to accomplish if it had had a value-adding, high-performing board.

Credibility

A risk inherent in the patronage appointment process is the perceived lack of credibility. If qualified individuals are appointed as the result of a transparent competencies-based process, then political affiliation will be a secondary consideration in the minds of the public, even if the appointee is politically affiliated with the government. However, if the same people are appointed under a patronage-based system, and the individuals do not have significant credibility in the area in their own right, the public will likely dismiss the legitimacy of the appointments and the credibility of the decisions they will make.

British Columbia appointment process: Key process

The BC government currently appoints over 2,500 people to approximately 350 boards, agencies and commissions.

When the current government took office in June 2001, Premier Gordon Campbell established the Board Resourcing and Development Office (BRDO) (www.fin.gov.bc.ca/abc). After reviewing best practices in director recruitment and selection in the private and public sectors around the world, the BRDO put into writing a process to implement these best practices in the BC public sector. Appointment guidelines for Crown Corporations and Crown Agencies were published in August 2001 and provide the foundation for appointments in all sectors.

The BC government has developed a recruitment and selection process that recruits the right mix of directors to public-sector boards. This is a leading edge process that is the equal of the best director recruitment practices

in the private sector and is more rigorous and strategic than what is found in most other public-sector jurisdictions.

The following are some highlights of the BC board-building process.

Competency matrix

All corporations are required to think strategically about the issues facing the corporation and, from that, to identify a matrix of competencies that sets out the required skill set for the board of directors as a whole. The purpose of the competency grid is to identify a diverse array of skill sets that will add value to the leadership of the corporation. The particular skills and experience sought change, depending on the issues facing the corporation and the skills required to complement the management team.

When a board position becomes vacant, the board is required to identify the specific skills sought for that position. Again, it is expected that the skills identified for the vacancy will be part of strategic consideration of the overall, diverse skills required on the board.

Personal attributes

In the recruitment process, close attention is paid to the behaviour and personal attributes of potential directors. This is a critical factor in building a good team. Importance is also placed on a candidate's commitment to corporate governance and his or her understanding of the responsibilities of directors today.

During the recruitment process, it is emphasized that becoming a director on a public-sector corporation is a job not a social appointment. The responsibilities of directors are enormous and it is important that individuals understand the required time and commitment. As part of due diligence, directors of crown corporations are asked to commit to a Charter of Expectations.

Work with the chair/board

If a new board is being created, the chair is identified first. The BRDO then works with that chair to establish the competency matrix and to recruit and evaluate

potential board members. If the recruitment is for a singular vacancy on a board, BRDO works with the Chair and/or governance committee to identify and evaluate potential candidates. The CEO may be involved in the evaluation or referencing process but the entire board is responsible for the recruitment process.

While it is ultimately the government's responsibility to appoint directors, ideally, after consultation with the board, the board should be satisfied that the appointee has the skills and knowledge to enhance the effectiveness of the board and will be a good fit with the board culture.

Pro-active search for candidates

The goal of candidate identification is to identify as many potential candidates as possible that have the required competencies and are expected to contribute effectively to the board. Elected officials normally do not sit as directors on BC public-sector boards.

Candidates are identified from a variety of sources and any person who is interested in serving on a particular board may make his or her interest known by submitting a resume and expression of interest to the BRDO. For specific vacancies, boards are encouraged to identify potential candidates. In addition, BRDO retains a national executive search consultant to provide ongoing search and referencing services. For a vacant position, as many as 20 to 40 candidates are considered.

All candidates are assessed against the vacancy skills profile and those candidates having the required skills and qualifications are invited to submit to a due diligence process.

Due diligence

The due diligence process for each candidate includes a review of the candidate's probity, identification of potential conflicts of interest, and a declaration by the candidate accepting his or her fiduciary and other responsibilities to the corporation. All candidates who wish to be considered for a position on a public-sector corporation must complete a written Candidate Profile and Declaration.

The formal due diligence process has been particularly

helpful in identifying potential conflicts of interest. In a number of cases, people have either withdrawn their candidacy or have not been appointed based on concerns arising out of the process.

Diversity

It is well documented that a diversity of professional skills, experience and approaches to problem solving is critical for effective board performance. In addition, there is a feeling that the membership of public-sector boards should reflect the cultural and geographical makeup of the population.

The challenge is to make sure that token or unqualified appointments are not made simply for reasons of gender, culture or geography. Rather, the recruitment process should be undertaken in such a way that it facilitates the consideration of people from these minority populations based on the particular skill sets sought. BRDO undertakes a diligent search process, including searching in non-traditional places, to ensure that qualified candidates are identified from many diverse communities.

British Columbia has been successful in recruiting high-level executives that have not been on the radar screen. This includes women. While in the private sector, around 7-10 percent of directors are women, they represent approximately 40 percent of the directors on BC's boards. These are not token appointments but highly qualified executives and professionals who are well regarded by their peers on the board.

Building the talent pool

Boards are normally structured with a mixture of seasoned board directors and others who are very senior and skilled in their professions but may not have had extensive board experience. The intention is to build the talent pool for the next generation of private and public sector directors for BC and elsewhere.

To date the feedback on this strategy has been positive. Several newer directors have been identified as potential candidates for major corporate boards across the country.

Transparency

The BRDO publishes the names, terms and full biographies of all appointees to all public sector boards on the BRDO web site. By publishing this information, members of the public and other interested parties can review and assess whether the board members appear to have the requisite skills and experience for the positions they hold.

BRDO uses its web site to provide transparency and accountability to the public. The BRDO web site annually receives over 1.2 million visits by over 50,000 different users.

Quality control

BRDO is the central agency responsible for coordinating and recommending all public sector board appointments and provides a level of consistency and quality control to the appointment process in two ways.

During the recruitment and evaluation process, BRDO works with ministers and boards to identify and recruit candidates. Because BRDO has expertise in the area of corporate governance and board building, it is able to bring this expertise to the process and to provide advice in this area, regardless of the ministry involved.

Secondly, after the recruitment and evaluation process is complete, BRDO is required to endorse the appropriateness of every candidate before the appointment instrument is presented to the appointing body (minister or cabinet) for final approval.

Commitment to best practices

BRDO approaches appointments within the context of an overall commitment to best practices in corporate governance. Appointments are not made in a vacuum - each appointment is made for the specific purpose of enhancing the overall effectiveness of the board.

In addition to appointments, BRDO encourages and supports public sector organizations to adopt best practices in corporate governance. These include things such as:

- position descriptions for the board, chair,

individual directors and committees and written documents that outline the board's process and structure;

- board composition and succession plans;
- appropriate orientation and ongoing director education;
- board, chair, committee and individual director evaluation processes;
- separation of the Chair and CEO except in exceptional circumstances; and
- a board plan for evaluating and compensating the CEO, and for CEO succession.

KEY CHALLENGES

In the end, politicians remain responsible for public sector board appointments. Therefore, a change to a competencies-based process can only be implemented with their support and leadership. A key challenge is to recognize the pressures on politicians to continue the old way of making appointments and assist them to deal with the change.

Politicians need to be better educated about the role of boards and the value they can and should provide. They also need to understand best practices in corporate governance, why they are important, and the role appointments play in creating highly effective boards.

In addition to politicians, the many public servants who have day-to-day dealings with boards and are often asked to participate in the appointment process also must be educated about the role of public sector boards, the importance of corporate governance and the requirement to recruit directors based on required competencies.

Individuals who serve on public-sector boards must understand the responsibilities and expectations of directorship and be educated about the unique aspects of serving in the public sector.

Finally, there must be excellent communication and trust among the politicians, public servants, and boards so that they can effectively carry out their respective roles in governing the organization and the appointment process.

Keys to success

Change to the public sector appointment process requires political leadership. When the government changed in 2001, Premier Gordon Campbell was committed to recruiting the best and brightest minds to BC's public sector boards. Without this commitment and support from the highest political office, change would not have been possible.

Another key success factor in the new appointment process is the requirement that all appointments be handled by a central agency. In this way, BRDO ensures consistency of process and consistent quality in appointments. Locating BRDO within the Premier's office helps emphasize the commitment to the competencies-based process.

BRDO's use of an executive search consultant to identify and reference potential candidates brings the rigour of executive search into the director recruitment process, provides additional linkages to the private sector and expands the pool of potential candidates.

The due diligence process helps set the tone for the appointment. People better understand the responsibilities of the appointment when they are asked to consider conflicts and personal probity and declare their commitment to board responsibilities.

Another significant key to the continued success of the new appointment process is the ongoing commitment to best practices in corporate governance. Appointments are viewed as an integral part of the overall objective of creating a highly effective board.

Benefits of a competency-based process

Strategic appointments bring results. By recruiting highly effective boards, government obtains much-needed leadership and decision-making skills to enhance the performance of public-sector corporations and ensure appropriate oversight and accountability.

In British Columbia, boards created under this new process have taken a lead in improving financial accountability, attracting and retaining top-level managers, implementing strategic change and changing corporate culture.

A competency-based recruitment process also has indirect benefits. It opens up opportunities for talented new directors, who may have been overlooked under traditional recruitment methods, which, in turn, expands the pool of experienced directors. In addition, establishing high standards for public-sector boards helps set a high standard for corporate governance practices generally in the country.

It is hard to understand why any government would not act quickly and decisively to implement the systems necessary to recruit the most qualified directors available.

Government must pursue excellence in leadership in every area over which it has control. This includes ensuring that public sector corporations have the tools they need to capitalize on opportunities to create wealth, provide necessary social services and improve our overall quality of life.

While politicians may not have previously known what criteria to use in recruiting directors, that should not be the case today. There is widespread discussion of this issue and much reform taking place in the private sector. It is time for the public sector to look at its own processes and reform them as required to ensure that directors are selected for their competencies and commitment to effective governance.