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Strategic Governance: A division of labour in New Zealand Companies

A 152.800 (100 point) Thesis in partial fulfilment of the requirements of the degree of Master of Business Studies at Massey University.

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ABSTRACT

Much of the research in the disciplines of strategic management and governance has taken place in the United States where the Chairman of the board is frequently carrying the position of Chief Executive Officer. To date, New Zealand studies into these disciplines have largely been anecdotal.

This research examines the strategic management and governance processes adopted by the executive management and board in twelve large New Zealand companies. Although some of the data categories were structured prior to analysis by the questions, a grounded theory approach (Locke, 1996) is adopted for the synthesis and evaluation of the data. Semi-structured interviews were conducted with both the CEO and Chair of nine of these companies. Questions focused on board composition, governance processes and roles in developing and executing strategic management. The transcripts were analysed manually and using NUD*IST thematic coding software. Ten concepts were synthesised from the interview transcripts and the questions that created them.

The strategic governance processes within these companies satisfied both the Chairs and the CEOs apart from two notable aspects. First, the political agenda of the Government as the shareholder of crown-owned companies impeded the appointment of non-executive directors who

could fully deliver to the commercial expectations of the companies. This was compared to companies with and without major shareholders who did not report problems. Conflicts of interest were adjudicated subjectively by the Chair according to the assessed risks involved. Additional services provided commercially to the company by directors were also open to potential conflicts. One characteristic that was evident was the positive working relationships between the Chairs and CEOs of these companies. The research also presents a number of interesting issues, revelations and opinions by these officers.

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remain anonymous but hopefully will have gained benefit from their participation.

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1. CHAPTER ONE - INTRODUCTION

1.1 Research Background

Why undertake research on corporate governance? Early in 2002 the discourse on governance and leadership was gathering momentum in the global business world. The common belief of academics and monitors of fiduciary accountability was that problems of company accountability, governance and leadership, particularly those relating to ethics, were contributed to, especially in the United States, by the duality of the chief executive[1] and chair[2] appointment. The executive who was leading the board as the monitor of company performance was also leading the executive management team and the business operations.

As an experienced executive recruiter involved in the appointment of CEOs and non-executive directors including chairs, the researcher was concerned that the processes linking these two executive groups must have integrity and be in the best interests of the organisation. Further, the belief was held that having the two groups with no overlap of

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1 "Chief Executive Officer". The CEO is the executive responsible for leading, directing and managing the executive management and through them, the company.

2 "The Chair". Reference consistently made to "Chair" can refer to 'Chairperson', 'Chairman', or 'Chairwoman'. It was made gender neutral to preserve anonymity. The Chair is the member of the board responsible for leading it as the supervising director, the chair of meetings and director responsible for liaising with the Chief Executive.

membership enabled the board to be a better watchdog of the organisation and that newly appointed CEOs should make one of their first tasks that of "managing the board" as Michael Useem (2001) advocated.

Reports from Cadbury (1992), Greenbury in 1995, the Hampel Committee in 1998, Higgs and Smith in 2003, the Sarbanes-Oxley Act 2002, and guidelines set by organisations such as the OECD (1999), Commonwealth (1999), GRI Steering Committee (2002), and Winter (2002) in the EU have all contributed to a plethora of expanding corporate governance rules and prescriptions. Many were created to address the need of restoring investor confidence (Hogan, 2003). Stock exchanges, including NYSE and NASDAQ in the US, have added to the plethora of rules for listed companies. In New Zealand the NZ Stock Exchange listing rules were redrafted in 2002 in an attempt to lessen the possibility of a company failure from poor corporate governance processes.

Whilst corporate governance mechanisms can provide shareholders with some assurance that their agent, namely, the manager, will work in the shareholders' interests, many shareholders ignore, don't understand, or fail to monitor their application. The internal governance mechanisms include an effectively structured board, compensation contracts that align the manager's interests to those of the shareholder, and concentrated ownership holdings that lead to active monitoring of

executives. However, external mechanisms, including the market of the company, and external controls are activated more when internal mechanisms fail (Daily et al, 2003).

In mid-2002 the demise of Enron, Global Crossing, Worldcom and other less-publicised failures generated a witch-hunt for those responsible. Particularly targeted were the external auditors as they were seen by the public to be the external governance watchdogs acting on behalf of the shareholders in respect to financial integrity and stewardship. Enron had the trappings of prescribed governance but a lack of quality governance, failure of performance and conformance, and confusion of the director/manager role.

Pressures on companies to establish and maintain high standards of corporate governance have never been greater. Increasingly boards are looking to ensure financial and legal processes enable rigorous, analytical monitoring.

Before and after Enron's failure US companies began separating the function of the Chair from that of the CEO. Other independent governance structures, such as outsider-dominated boards, enhanced integrity of auditors, and more rigorous information flows, all point to the rising expectations of higher standards of company behaviour.

In New Zealand there has been increasing debate on the structures and processes of the executive and board that are best suited to ethical and responsible business management. Self interest, greed and dishonesty at the senior executive or board levels contributed to many failures of businesses in the 1987-1989 period. Boards supported remuneration packages for executives including executive directors which did not necessarily align with company performance. Auditors are now being expected to attend annual meetings of shareholders and be available to answer shareholder questions. Good governance may not prevent business failure but it may reduce the possibility of failure and certainly remove much of the scandals associated with that failure.

1.2 Structure of this Research

Small and medium enterprises in New Zealand, particularly those lead by the major shareholder, have their CEO as both head of the board and of management – usually as the "Managing Director" or Executive Chair. Duality of the chief executive and chair is seldom found in the major New Zealand companies.

As this research has as a key paradigm, the absence of duality of the Chief Executive and Chair, it focused on the exclusive groups, namely, the interviews were undertaken with dyads: the non-executive Chair and CEO who is not also a director on the board. It was decided to interview companies registered in two major cities, Auckland and Wellington, for economic and practical reasons.

The study took as its population the largest New Zealand companies measured in terms of revenue. In compliance with the State Sector Act 1988, the CEOs of crown-owned organisations are not allowed to be directors of their company, although they can be members of subsidiary boards.

This research used a grounded theory approach to:

> ***identify what Chairs and CEOs, as matched pairs or dyads in large New Zealand companies, consider are the key issues and processes in the area of strategic planning and corporate governance.***

The relationships between these two executives, the level of autonomy between these two exclusive groups in running the businesses, the degree of monitoring exercised by shareholders as well as by the boards, were all assessed. The roles and relationships of the non-executive chair, that is, not a member of the executive management of the company, and the CEO, who is not a director, were examined in the processes of strategic management and governance in major companies in New Zealand. These dyads enable the identification of the different perspectives of the leaders of these two groups, leading to a greater understanding of these subject areas. Whilst duality could have been created as a variable it was fixed as a condition in creating the sample.

Examination was made of the setting of the strategic plan; the reporting on the performance against the plan; the appointment of directors; the organisation of the board meetings; and, the application of governance mechanisms including conflicts of interest and other governance issues, together with the relationships with the shareholders and the influence of different shareholder groupings.

Also examined were differences in opinion between the CEO and Chair on major issues, as well as those areas of common understanding. Note that, because each interviewee knew that the other executive in their company was being interviewed, there was unlikely to be a high level of dissonance expressed by either executive, towards the other person or to the other group. This factor may have had the detrimental effect of ameliorating the reported manner of both the relationship and the processes adopted. The interviewer ensured that the comments, opinions or information from the interview of the first officer in the dyad were not referenced in the interview with the second officer. Further the interviews addresses processes and responsibilities of each of the officers but opinions were not sought on how the other officer being interviewed was performing the function for which they were accountable.

2 CHAPTER TWO - LITERATURE REVIEW

2.1. Agency and Stewardship Theories.

In large companies, unlike small- and medium- sized enterprises, the ownership and control is not fully coincident, and conflicts of interest can arise between these two groups: An opinion first put forward by Adam Smith (1776). The separation of owners, namely shareholders, and the establishment of the owners' representatives, the board, whose primary task is to direct the company for the owners' benefit, not only allows each of these three groups to earn a return but may also ensure the company will survive (Denis & McConnell, 2002). When ownership and control are separated (Berle & Means, 1932), managers have the opportunity to pursue their own interests ahead of those of the owners, who have the need for profits, and in doing so create agency costs. As absentee investors their assets are being managed by the executives for profit and a return.

Agency theory, the most dominant theoretical framework in corporate governance research (Lyall, et al, 2003), argues that owners' interests require protection by the separation of the incumbency of the roles of executives and directors, that is, duality of the Chair of the board of directors and the CEO, is not supported by agency theory (Jensen & Meckling, 1976).

Eisenhardt (1989), in her excellent review and clear evaluation of agency theory, emphasises the significance of self-interest in the organisation's leadership. This is a characteristic that is becoming increasingly evident in writings of American company failures and the incentives and self interest of CEOs. Whilst conflicts and agency issues 'appear' to exist in the New Zealand business environment, they are described in far less public arenas, remaining instead within the confines of the company board and executive management. Agency theory suggests that the governance mechanisms should align the interests of managers with shareholders (Fama & Jensen, 1983). Further, proponents of agency approaches describe managers as risk averse and inclined to discipline and monitor (Sundaramurthy & Lewis, 2003).

Kunz and Pfaff (2002) comment on the scepticism towards agency theory in that a principal (shareholder, or director as representative) might be worse off when providing an incentive contract to the agent (the CEO). Agency theory can be contrasted to the collaborative or stewardship theory platform. Stewardship theory gains increasing attention and support from researchers who believe management more frequently aligns itself with the interests of shareholders and that the officers of a company are more altruistic, rather than self-serving and opportunistic (Daily et al, 2003). Stewardship argues that shareholder interests are maximised by shared incumbency, in these roles

(Donaldson & Davis, 1991), supporting the duality of company leadership (Wheelan & Hunger, 2002).

One needs to ask, is the CEO acting in the best interests of the shareholder or are other influences placing the CEO's interests ahead of the other interested parties? Is the concentration of power in an organisation, together with the need to separate ownership and control, an agency problem between top managers and shareholders which then becomes a corporate governance problem?

2.2. Corporate Governance.

During the late 1990's the topic of corporate governance gained very practical importance, particularly in the United States, when debate escalated about the inefficiency of the existing governance mechanisms in advanced market economies. The comparative inefficiency between the systems of the US and UK, and those of Japan and Germany, and the move of corporate governance away from the legal provisions which give boards control over the management (John & Senbet, 1998) has prompted reliance on other mechanisms.

Whilst the basic principle of corporate governance is that the shareholders elect the board of directors, who in turn select top management, this is far from being a clear 'uninfluenced' process. The

common practice in listed public companies in New Zealand is for the board to be elected by the shareholders from the "slate" approved by the top management or proposed by the existing board. Often an appointment to a vacancy is made between Annual General Meetings with the interim appointee being reappointed for the full term, usually three years, at the AGM. It is unusual for shareholders to unseat this "sitting director" at the meeting. Thus we find those responsible for corporate governance, namely the board of the company, in affect being selected by themselves. In some organisations the chief executive is selecting or at least influencing the selection, subject to board approval of those who will monitor his/her performance. The board's effectiveness in its monitoring function may well be determined by its independence and composition (John & Senbet, 1998) but if the chief executive is the prior determiner of that group, can the governance structure really be said to be independent?

Gregory (2001) gives a more international flavour to that of Wheelen and Hunger on matters of board composition and responsibilities. He notes the use of nominating committees as a mechanism for reducing the influence of the CEO in the appointment of directors in the USA where the Chair is usually the CEO and in the UK where the CEO is also the Managing Director (p. 442).

Westphal (1997) found that changes in board structures which increase board independence from management, such as separating the Chair

and CEO roles, result in CEOs endeavouring to get alongside and persuading board members. Such influencing processes reduce the effects of structural board independence on company strategy.

It could also be said that the influence of the CEO on the appointment of directors leads to management domination of a board by using defacto power to select and compensate directors, possibly through additional consulting emoluments, and by exploiting personal ties with them (Baysinger & Hoskisson, 1990). Those who challenge the effectiveness of board governance strongly advocate the appointment of a majority of the board through an independent process so directors are independent. This is a desirable governance mechanism, especially if they are to be selected under a process that is independent of the influence of management. The embedded assumption to note is that the independent directors must remain 'independent' and are not to be captured by management. In crown-owned companies, the process for making director appointments are prescribed by the State Sector Act 1988 and strongly influenced and decided by the Government. The influence that CEOs and Chairs of these organisations have in the appointment of directors is examined in this research.

Many writers have looked at the impact of top management compensation on governance processes (e.g., Cyert et al, 2002; Sten, 2003). There is consensus that the compensation for management should encourage them to think and operate in accordance with the

interests of the shareholders. Thus compensation should incentivise the increase in shareholders' value not just revenue and not just short-term financial performance. This is a governance mechanism that is not examined in this research but which could be the subject of future research.

What are these corporate governance mechanisms? They are more than "a relationship among stakeholders that is used to determine and control the strategic direction and performance of organisations" Hitt et al, 1999, p.351). Fundamentally, corporate governance is a portfolio of decision-making mechanisms to guide company managers and directors in acting responsibly as agents of the providers of capital. There are a number of such mechanisms by which outside investors protect themselves against the insiders, be they managers, directors or controlling shareholders. Just as there is no guarantee that good corporate governance will lead to good business performance, so, no one mechanism can be relied upon to produce good governance. Different countries, for example, Japan and Germany, have different governance mechanisms which have developed, sometimes over many hundreds of years, to fit both the cultural environment as well as the historical development of business systems (Charkham, 1994). Likewise China is now developing stronger governance processes based on family and business relationships and in small- and medium-sized businesses. These relationships often go beyond prevailing cultural influences. Rajan & Zingales (2000) suggest that the focus of corporate governance should in fact shift from

alleviating the agency problems between managers and shareholders to studying the mechanisms that give the firm the power to provide incentives to human capital.

Corporate governance can be looked at from a legal perspective in that when the legal system does not protect investors, corporate governance and external finance do not work well (La Porta, 2000). Alternatively, it can be viewed as an ethical mechanism in that it should take into account consideration of the interests of all stakeholders, not just shareholders (Hitt et al, 1999). With so many different stakeholders in an organisation, which stakeholder should be the primary beneficiary of good corporate governance? Elaine Sternberg (1994, p.20) defines corporate governance as "ways of ensuring that company actions, assets and agents are directed to achieving the company objectives established by the company's shareholders". Whilst this could be considered a very narrow definition, and does not support good governance by integrating the pursuit of community wellbeing or environmental stability, it emphasises that corporate governance involves the principal's agents and outcomes. Gregg (2001) agrees with this focus on shareholder interests. The move of companies, especially crown-owned organisations to report on the triple bottom line, acknowledges that the shareholders do not have exclusivity on a list of stakeholders.

International research has examined the impact of good governance processes on company performance. In Italy, companies with high corporate governance standards outperform the Borsa (Hoschka, 2001) and generally perform better (Newell & Wilson, 2002). Investors are rewarded better when they invest in companies with good governance practices. Felton, Hudnut, and van Heekeren (1996) add that CEOs and senior managers also place a higher premium on companies with good governance.

The failure of companies to meet shareholder expectations has resulted in the company leadership being called to account. This has lead to an analysis which embraces the whole of the corporate governance structure and processes, the functions, the independence, composition and performance of boards. Attention has been targeted on the role of independent directors, as the watchdogs of the company executive, and as agents of the shareholders. The balance on the board between independent directors, executive directors, interlocking directors and directors' alignment with the activities of the organisation (namely, accountants, lawyers, family members, advisors, bankers – especially in Germany, Japan and Italy) are closely monitored, together with an examination of the conflicts of interest that directors have on an ongoing basis and with issues that arise in the business of the organisation. This is a focus of the questions asked of participants in this research. The challenges arise from investor groups, stockholder associations and investment funds, notably in the United States, to examine the impact

and significance of the duality of their leadership structure. In New Zealand the investment funds and significant investor groups, including the Shareholders' Association are exercising greater influence on the performance of the leadership of companies than has occurred in the past.

2.3. New corporate governance codes.

The past five years have witnessed a proliferation of corporate governance guidelines and codes of "best-practice" designed to improve the ability of company directors to hold management accountable (OECD, 1999). Gregory (2001) describes the modern trend of developing new corporate governance disciplines in the early 1990s in the United Kingdom, United States and Canada particularly referencing the 1992 Cadbury Report, the first clear code of corporate governance. Mervyn King's two reports from South Africa (2001) have also become key reference documents. He ascribes that the main function of a board is to maximise the value of the owners' investment and that governance guidelines need to emphasise the duty of the board to represent shareholders' interests. Many organisations throughout the world have defined appropriate codes of governance practice for company boards (Worldbank, 2002; Cadbury, 1992; CACG, 1999; OECD, 2000). Some governance codes are linked to listing all legally mandated disclosure requirements (ICGN, 1999).

Most governance guidelines and codes of best practice assert that the board assumes responsibility for the stewardship of the company and emphasise that the board responsibilities are distinct from management responsibilities although they differ in the level of specificity.

A firm's corporate governance affects both its economic performance and its ability to access low-cost capital. The responsibilities and functions of company boards are, therefore, receiving greater attention from the perspective of capital acquisition. According to authorities (ICGN, 1999) major strategic modifications to the core business(es) of a company should not be made without prior shareholder approval. Nor should major company changes, which dilute the equity or erode the economic interests or share ownership rights of existing shareholders. Thus the strategic management of the organisation is a key mandate of the board of directors. This is the second aspect covered in this research.

2.4. Duality.

Much has been written about the role of the Executive Chair: The Chair and CEO being one position in a company. However, duality in companies is not found to be a determinant of poor performance. On the other hand, poor performance may result in blame being attributed to a dual title holder. Often when performance declines, management and the board retain closer ties within each group, but develop a distinction

and increased separation between those managing and those monitoring (Sundaramurthy & Lewis, 2003).

Some commentators believe the duality of the Chair/CEO appointment has a positive impact on company performance (Harris & Helfat, 1998; Dahya & Travlos, 2000) whilst others a negative one (Baligna et al, 1996). Duality can provide clear-cut leadership and better implementation of the decisions (Stoeberl & Sherony, 1985; Anderson & Anthony, 1985, Boyd, 1995; Baliga et al,) and more efficient information flows (Brickley et al, 1997).

Since the late 1990's there has been a strong push in the United States for the separation of these two roles, with the chair an outsider and not an executive of the company (Miller, 1997). It is also being suggested by the Blue Ribbon Commission of the National Association of Corporate Directors in the US that the number of boards on which directors may serve be limited, that the terms of board members be limited to get fresh ideas, and that a governance committee comprising no executives nominate new directors and set and monitor board performance (Miller). These aspects will be touched on in this research but are not prime areas of investigation. In 1997 about 10% of the 500 largest American firms had separate chairs and CEOs, and since then the process of separation has continued to gather momentum.

Leadership duality triggers conflicts of interest, particularly in the role of the board as a monitor of CEO performance (Dalton & Daily, 1998). While having one person occupying the two roles facilitates communication, the board's knowledge of operational aspects of the organisation, and consistency of the strategic vision, relies on the independence of other directors, particularly those independent directors, to challenge the plans and strategies, to provide fresh thought and new initiatives, and to audit the performance of the executive management. Especially if in doing so they challenge the Chair. One can ask whether there are independent directors in any but a minority of companies in New Zealand, as the pool of available competent directors is considered very small. Whilst interlocking directorships are prevalent there is reasonable independence in title in the larger New Zealand companies' directors, although the small and medium enterprises have few independent directors. Whether these 'independent' directors are independent in thinking and not captured by either management, dominant directors or a strong Chair has not been researched in New Zealand. The relationship of directors with the companies in this research was evaluated.

2.5. New Zealand Research.

Investment funds and other stakeholders now expect corporate governance guidelines and codes of best practice to be in place in the organisations in which they invest and increasingly annual reports of

companies around the world now include a statement on governance. In New Zealand fund managers would like to see more independence in the governance processes and structure, particularly in the number of independent directors and in the CEO's role in the selection of new directors (Chiu & Monin, 2003).

New Zealand writers have been quick to support the international opinions on governance but comparatively little research was undertaken in New Zealand until 2000. Surveys have been undertaken on the source of directors, their attendance at meetings and qualifications to be a director (van der Walt, 2001). More recently, literature reviews have been undertaken relating to board performance appraisals (Ingley & van der Walt, 2002) and a definition of diversity has been explored (van der Walt & Ingley, 2003).

Others (see Cahan & Wilkinson, 1999) have examined possible changes in the composition of boards due to the advent of the 1993 Companies Act or examined governance in the public sector hospital and health services (Barnett et al, 2001). Gaynor (2002) has been critical when governance processes have not been adhered to, for example the remuneration committee of GPG, a large NZ listed company, comprising only executive directors which means executives were setting their own compensation.

Reaction to company failures and the heightened awareness of company leaders to the implications of poor governance has also increased. One area that has attracted attention has been that of conflicts of interest. The Companies Act 1993 simply states that any conflicts of interest on an issue "have to be declared". The director does not have to leave a meeting nor does the Act require the director not to vote or take part in the discussion. In this research the opinion of Chairs was sought both in how their boards approach this matter and set policies and whether such matters arise at all in the course of the board relationships.

In the state sector in New Zealand the rules for the appointment of directors, and governance processes have been laid down by the Crown Corporation Monitoring and Advisory Unit, "CCMAU", (Appendix E) and for Crown Entities by the Office of the Auditor-General (Controller and Auditor-General, 1996).

Shareholder relationships with crown-owned companies relate primarily to the interface with the shareholding Ministers both directly and through the crown agencies: The Treasury and CCMAU which is part of Treasury. Usually the Chair assumes the mandate for keeping the Ministers regularly informed as they, without fail, wish to have 'no surprises', (Appendix E, clause 5.1) and thus be provided with the answers to all questions and issues that may arise in these companies for which they are held accountable. A confidential quarterly report is

provided to the Ministers and their advisors and officials and half-yearly annual reports are tabled in Parliament, through the office of the Minister. They then become public documents. The annual report contains information on the achievement, or otherwise, of the outcomes projected in the Statement of Corporate Intent. Such reports usually include governance comments and a range of other prescribed items.

2.6. Strategic Management.

One of the board's primary objectives and functions is to appoint the CEO. It could be asked whether the board has sufficient understanding of the objectives, strategy, and expectations of shareholders to enable them to identify a chief executive who will lead the company in creating and implementing the strategic plan. The researcher in an interview with a new chief executive of an Auckland-based utility said he had been recruited to identify the vision and strategy necessary to grow the business and then implement the agreed plans. How can an organisation at the governance level expect the chief executive as a manager to set the strategy in place for their approval, if the board do not know what objectives they need to achieve to meet shareholder requirements? This research also addresses this question.

Many books and articles have been written about company strategic management. Indeed a number have focused on the New Zealand and/or Australian contexts (e.g., Lewis, 1999). However, relatively few

focus on the relationship of the board with the CEO in strategic management. Some examine the behavioural processes in the management-board relationships (Westphal, 1997) whilst others, (Wheelen & Hunger, 2002) underscore three tasks of the board in strategic management: monitoring the organisation's activities, evaluating and influencing the plans and activities of management, and in initiating and determining the strategic options and how they achieve the mission of the organisation (p.27). Wheeler and Hunger describe a continuum of different types of board leadership style. However, their commentary, perhaps unwittingly, is based around the typical American corporate governance structure embracing duality.

2.7. Boards.

Michael Useem (2001) suggests that CEOs need to lead their boards with upwards management or "trickle-up leadership". They should harmonise, and where necessary coordinate, the activities and direction of their boards in order to be truly effective. One of the key factors to successfully achieving these objectives is the CEO's positive working relationship with the Chair. As Shen (2003) points out, although the relationship between the CEO and the board is complicated, it is of central importance in corporate governance. These relationships are examined closely in this research. As Hillman and Dalziel (2003) and many other writers point out this involves monitoring the strategy implementation and the CEO to ensure that management operate in the

interests of the shareholders. There should be no surprises to management, the board, or to the shareholders (particularly major ones) in the running of the business especially relating to any important information.

Overseeing and approving strategic choices are some of the most important functions of a board. Success depends on the ability of the board to define its role, requiring the CEO to initiate the planning, overseeing the process and testing to ensure robustness, approving the strategy and then overseeing its implementation. This requires that board members have the skills, knowledge and experience to be able to direct, interrogate and approve the strategic processes and their outcomes. Westphal (1999) provides an excellent analysis on the implications of the CEO-board social influences on the performance in the boardroom, on the appointment of directors, and on the independence of the board/management rapport.

Michael Porter (1996) comments that the essence of strategy, in fact, lies in deciding what not to do. Because the CEO may well be extrinsically or intrinsically incentivised to establish a particular strategic direction, for example, diversification rather than consolidation, management may well bring to the board recommendations that may not be in the best interests of the company entity, but in the best interests of management. These may, or may not, be aligned with the interests of shareholders. Berle & Means (1932) give special note to the power of a

group of shareholders which is greater than that of other shareholders even to the extent of selecting the board of directors. They apply power as though they have complete ownership of shares, using majority control, legal devices, minority control or management control. The influence of majority shareholders will also be examined in this research.

There are examples in New Zealand of companies where major shareholders appear to have placed their own interests ahead of all shareholders, for instance, Brierley Investments Limited in the case of Air New Zealand. The interests of a major shareholder wishing to exit the company appear to have taken precedence over the longer-term benefits of the company and remaining shareholders. These may be manifest by high annual profit performance at the expense of long term, sustainable revenues and profit, followed by a significant decline in the value of the equity immediately after these majority shareholders exited the company. This suggests self-interest on the part of the directors representing these major shareholder interests and raises the question regarding the degree to which the business processes supported the interests of all shareholders equally and the level of influence and power of both the non-independent and independent directors. The governance mechanisms and influence of the independent directors may have been insufficient to protect the long term interests of all shareholders, or there may be insufficient numbers of independent directors to carry voting weight. One other example of a listed New Zealand company which has shown this sequence of events is Tranz

Rail Holdings Limited, with large, overseas-domiciled shareholders. The remaining shareholders were left with a comparatively undervalued company when the major share blocks were transacted.

Commentary on these subject areas continues to unfold weekly; new articles and research enhance the body of knowledge on some aspect of the strategic relationships and processes between management and the governance of companies.

2.8. Summary

The duality debate has been fueled by the positions of advocates of both agency and stewardship theories. However, the duality of the CEO and Chair is not a variable in this research although it is a characteristic whose effect is being debated by many organisations, particularly those in the USA and United Kingdom as they move to separate out these two leadership roles. These theories lead to the principles and outcomes of corporate governance and the role they play in corporate leadership, both as a control mechanism and as a way of influencing stakeholders to achieve and ascribe increased value for the companies.

The board of a company can be captive to the influences of management and vice-versa. If the governance processes and independence of the board as a monitoring or even controlling entity are

not robust the best interests of the shareholders are not assured. Montgomery and Kaufman (2003) suggest that directors are not individually accountable to investors. Although they have collective responsibility their performance on the board is not measurable nor individually identified to the shareholders. The company's leadership, both board and management, are called to account if the company fails to meet shareholder expectations. It is then that the corporate governance processes are reviewed and amended, that the appointment processes for directors may be evaluated and the strategies and associated planning processes reviewed, usually by the board and management teams. Shareholders are being introduced to new corporate governance codes which serve as a benchmark for them to assess their companies' practices and procedures.

In New Zealand the research undertaken to date has not analysed these procedures, and although there are increasing numbers of workshops and seminars on corporate governance processes the research of what processes are being applied has not provided the foundation to earlier anecdotal comment. This research examines the strategic planning processes being applied in large New Zealand companies and the governance processes and practices in these organisations. In doing so it also studies the relationships and roles of the leaders of the board and management teams.

3 CHAPTER THREE – DATA COLLECTION

3.1 Overview

This research investigates the strategic management processes and procedures and systems of corporate governance applied in major companies in New Zealand, as introduced in Chapter One. Chapter Two presented a perspective that the strategic planning and organisational direction-setting is primarily lead by the CEO and the executive management team rather than, as some Chairs and directors believe, by the board. Because of the access the researcher had to senior executives and experience interviewing senior executives over his 30 years experience as an executive search recruiter, it was decided to investigate these processes and procedures through semi-structured interviews rather than structured surveys. Little previous research has been undertaken in New Zealand on these aspects of the strategic planning and governance relationships. The information from this research was believed to be valuable to the general business community. The results may also suggest that changes in the planning or governance processes are desirable, if not necessary.

The strategic planning and governance processes in small-to-medium sized enterprises which employ 10 or less people and which make up 95% of New Zealand businesses have been observed as unstructured. They are generally lead by the major shareholder who is also the

Managing Director and Chief Executive. The majority of these SMEs have no independent Chair and thus duality prevails. It was, therefore, appropriate that the population of companies for this research was the 200 largest organizations by revenue in New Zealand.

To compare with international research, which is predominantly in US organisations where there is duality of leadership role and function, this research examined the roles of exclusive groups, namely only those companies where there is no common executive between the board and senior management. The expediency of being able to economically, effectively and practically access and interview these officers for about an hour influenced the decision to select only those with company head offices in either Auckland or Wellington.

The list of largest companies was selected from the latest (as at July 2002) published list of companies ranked according to their revenue: 'The Top 200 New Zealand Companies' as listed in *Management Magazine* (December 2001). Some of these companies at the time of sampling had merged or disappeared from the corporate landscape. Notwithstanding these changes all companies were selected by the application of a random number table (Appendix A) (beginning at column one, row one). When a company was reselected, the duplication was recorded. The companies were each then matched with the filter criteria below which excluded:

- Companies with company head offices not in either Auckland or Wellington
- Companies whose Chair was a company executive or not able to be interviewed because of location
- Companies whose CEO was a member of the board.

The Chair and CEO of the first 20 companies so selected were written to, to get their Informed Consent (Appendix B) to participate in the research. Only those companies whose Chairs and CEOs both consented to participate were included in the sample. If acceptance was not received then the officers of additional companies would be approached until the targeted 20 participating companies for the sample would be achieved. If only one of the officers accepted then that person would be interviewed and efforts would be made, without undue pressure, for the other officer to participate.

3.2 Interviews

From the background reading and earlier studies on corporate governance, outlined in Chapter One, the research was developed to understand the actual processes being adopted in the appointment of non-executive directors, the degree to which executives and boards influenced the appointment of directors and the participation of both management and directors in the development of the strategic plan. The writers on corporate governance mechanisms described in Chapter Two suggested that research should also examine the potential for conflicts of

interest to occur in large companies in a small business community like New Zealand, how any conflicts were addressed and other governance issues outlined below.

There are a number of factors that were taken into account in setting up the method of obtaining the information. The interview method was chosen to gain information, in preference to undertaking a survey, because of the experience of the researcher in interviewing and the wish to obtain richer information. Interviewing was also a practical because of the comparatively small number of interviewees (maximum 40) and geographic locations (2). If the interviewer was known to the interviewee through the course of business, the nature of the interpersonal reactions were noted to see if there was any bias or set on the part of either party. Further it was important to have a convenient place for the interview, if possible, and to this end the interviewer made every effort to meet with the officer at his or her place of work thereby creating as little inconvenience and interruption for the interviewee as possible.

A series of semi-structured questions (Appendix D) were drafted centred on the three main themes: strategic planning processes and procedures, the appointment of board directors, and the corporate governance processes. Although originally drafted in a way particularly suited to interviewing CEOs and Chairs of large public companies, they needed modification in their delivery for state-owned companies, as the procedures were prescribed by the Government shareholder for the

appointment of these directors. The questions ensured consistency, focus and a degree of structure more as an interview guide. Supplementary questions were asked, to clarify, expand or delve deeper into issues.

The information sought from interviews, through the questions, translated into the conceptual framework for the analysis of the interviews. It contained ten concepts:

- Strategic planning processes and procedures
- Frequency and nature of CEO/CHM communications
- Order of agenda of board meetings, executive management attendees and influences
- Methods of dealing with conflicts of interest [actual and potential; interest or duty]
- Impact/influence of shareholders on reporting and communications processes [requirements of shareholders]
- Governance understanding and influence
- Board member appointment procedure; specification; due diligence; and induction.
- Other Governance issues.
- Non–Governance material
- Common themes – for example, interactions between individual board members and executive management personnel.

The CEO and Chair of each company was interviewed separately to compare their responses. Each interview commenced with the reiteration of the nature and objectives of the research, and reinforced the details of the Informed Consent (Appendix C) following which the 'taping option' was completed and the Consent signed.

The interview was taped with both an analogue and a digital recorder to minimise the risk that batteries ran out on a machine or the tape which was used for the transcribing accidentally got erased. Notes were also taken during the interview so that in addition to the prepared questions, matters that the interviewer thought should be re-examined could be put again. This also gave a further backup in case the recordings were difficult to hear and thus needed to be edited by reference to the notes and digital recorder.

The transcripts were copied and one copy put into a safe for security. Following transcription of the interviews the audiotapes were wiped. The transcriptions were then edited to ensure anonymity by removing identification of the organisation, the interviewee or anyone referred to in the interview by either the interviewer or interviewee. The transcriptions were then converted into table format so that the initial manual condensation could be undertaken in terms of the original subjects of the questions, and again using NUD*IST 6 software in a series of ten codes/concepts.

By way of an overview the interviews had four levels or layers of information that could readily be extracted:

- The processes and rules applied by the organisation in its strategic planning and governance.
- The type of organisation and the legislation and shareholder requirements, especially in the state-owned companies
- The observations that were correlated to the interviewee's position - CEO or Chair in the dyad - role and attitudes, opinions, and beliefs all of which influenced the processes in the company.
- The particular elements and information about the organisation, its position in its competitive market, its goals and threats, opportunities, strengths and weaknesses. Few of these were discussed as they were considered commercially sensitive.

However, it was decided that the analysis of the interview transcripts would be by way of the ten concepts rather than through the overview concepts as these did not support the purpose of the research though they could produce some interesting information and learning modules for subsequent analysis.

3.3 Ethical Considerations

This interview methodology could give rise to bias, especially if there was a past or present relationship between interviewer and interviewee. Also, the interview could be perceived to give rise to a conflict of interest with future business relationships. The separation between the business of the interviewer and this academic study being undertaken was strictly adhered to by having a personal business card with private address and contact e-mail and phone numbers for all contact with interviewees and by using Massey University Department of Management letterhead for all letters. Further, no contact was made with the interviewees on business matters.

The Massey University Human Ethics Committee granted approval (02/103) noting these possible ethical issues that may arise if the researcher was likely to be known to the interviewees in his capacity as a strategic executive search consultant. The Committee's approval carried the condition that the researcher should not be engaged with any of the participants as candidates or clients of the researcher's business activities. Fortunately, this did not impose a limitation nor influence the sampling for the companies included in the project. The restriction was considered a legitimate requirement to ensure that no conflicts of interest could arise. For example, this research project could have been viewed by participants as a marketing or investigative ploy, or a prelude to a business proposal, or to identify executive candidates who could be appointed into executive search assignments. This separation of the two

roles for at least a year prevented any ambiguity or misinterpretation from occurring.

The researcher has operated over many years under high ethical and professional codes dictated by the Institute of Management Consultants of New Zealand (IMCNZ, 1987) and the Association of Executive Search Consultants (AESC, 2002). Thus, the separation of business activities from this academic research presented no difficulties.

There were no other ethical considerations as the identity of the participants and their companies or anything that could identify them would be excluded from the report. It was not ethically possible to append the edited transcripts to this thesis as to achieve anonymity of the interviewee all identification of the nature of the company and its business environment would need to be removed making the transcript meaningless.

3.4 Selection of Companies for Sample

There are a number of lists of companies in New Zealand. Although there is not a Fortune 500 listing in this country, *The New Zealand Business Who's Who* lists most of the companies in New Zealand. The NZ Stock Exchange Top 50 provides appropriate information only on listed, public companies. State-owned organisations are not included. But they are of a significant size and structure to make them important in research of large companies on strategic management and governance

processes. Rather than creating a list from multiple sources the *Management Magazine's* list of the 200 largest businesses in New Zealand, ranked in terms of revenue became the base population. In commencing this research in March 2002 the latest available list was published in the December 2001 issue (hereafter, referred to as the 'Top 200'). It listed the current and previous ranking (based on annual revenue) name and location of the head office, type of organisation, and revenue.

As the data for the 'Top 200' was obtained during 2001, in the intervening period some companies had merged, some had relocated their head offices and others had ceased trading. Nonetheless, it was chosen as the base information.

A more difficult element was to find information about the officers of the companies. This required referencing other publications such as *The New Zealand Who's Who* to identify the phone contact numbers and if the CEO was referred to as the Managing Director or listed under "Executives" and "Directors", identity of the Chair and an indication of whether or not the Chair and/or the board was located in New Zealand or overseas, a characteristic of an overseas-owned company.

Having gained as much information as possible from these sources, it was then necessary to telephone the head offices and obtain more detailed information from the company, via the switchboard operator or

the CEO's secretary. The names of the CEO and Chair were sought, whether the head office was located in Auckland or Wellington and whether the Chair was an executive of the company and/or the CEO was a member of the board. This latter point usually had to be checked directly with the CEO's secretary. Subsequently, companies with head offices not in these main centres were contacted to get the required information, excluding those where the CEO was already identified (through the Who's Who) as a Director, or the Chair as an executive.

3.5 Sampling

The sampling process was expedited easily, apart from the fact that some of the companies drawn in the initial sample had merged, some had relocated their head offices in or out of the main cities, others had ceased trading, while others had changed the function of their business. The information gained for those companies in Auckland or Wellington was accurate. For the other companies, which were not subsequently included in the sample, accurate information was difficult to obtain and its significance was lower. The result was often incomplete and/or inaccurate information for those companies out of the two main centres. 100% accuracy could only be achieved by talking to both the officers in all the Top 200 companies and identifying their personal position.

Identifying the location of the Chair was sometimes difficult. It was only possible to determine whether they were located in New Zealand (and then in Auckland or Wellington) by getting their address or speaking to

the secretary of the CEO or Chair directly. The information was not readily provided due to the influence of the Privacy Act 1993. Whether the CEO was a director was also very difficult to find out. The Who's Who was the best available reference source for this identification and was more reliable than telephone enquiry. From this analysis the following table was developed:

Table 3.1 Chairs and CEOs by exclusive group and location.

	Chair not an executive	Executive Chair, non-existent or overseas	CEO not a Director	CEO also a Director	Unknown status of CEO
Head office in Auckland/ Wellington	80	13	36	89	
		+49 uncertain			13 + 3 without a CEO
Head office not in Auckland/ Wellington	40	1	19	19	
		+17 uncertain			23
Total known	120	80	55	108	37
	200		200		200

Despite the target of 20 companies for interview from the sample by use of the random number tables, there were only 25 companies in the original sample after the four filters were applied to the population of 200 companies. Two of these changed to just being promotional organisations and on the basis of revenue ceased to be in the Top 200, leaving 23. A further two merged leaving a sample of 22. The CEOs and Chairs of only nine companies that came through the filters agreed to participate. This yielded a very respectable 41% of the targeted sample of companies eligible for the conduct of the research. Thus, there was actually no contribution to validity from the random sampling. New Zealand has few large businesses, a characteristic that has been

accentuated over the last five years with large companies moving their head offices to Australia or to Asia, for example, Lion Nathan Limited and Brierley Investments Limited, whilst others have been broken into smaller units, for example, Fletcher Challenge Limited.

The CEO and Chair of 11 companies both declined to participate. Although during the course of research three Chairs were interviewed with the expectation that their CEOs could be persuaded to participate in the research, when they failed to do so, the transcripts for these Chairs were reviewed but not separately coded and included in the research.

During the research a new listing of the Top 200 Companies was published in *Management Magazine* in November 2002. This listing provided a number of different organisations some of which were introduced because of the merger of some of the Top 200 2001 companies. It was, however, decided not to alter the sample companies during the course of this research.

The sampling process brought a skewing of the sample (refer to Table 3.2) compared to the population of the Top 200 companies from which it was drawn in two aspects: (a) the companies that were selected in the sample, and (b) the companies willing to participate in the research. The result was that there were no overseas companies in the sample and there was a greater proportion of CRIs and state-owned companies than in the population.

Table 3.2: Comparison of Sample with Population

Types of companies	Number of companies in Top 200	% of companies (200)	Number of companies in Sample	% of companies in sample (24)	No. of companies participating	% of companies with both CEO and Chair interviewed
Listed public	64	32	7	29.2	3	33.3
Private	16	8	2	8.3	0	0
CRIs	4	2	2	8.3	1	11.1
SOEs	9	4.5	6	25	4	44.5
LATES	5	2.5	3	12.5	1	11.1
Trusts/ Societies	5	2.5	1	4.2	0	0
Cooperative s	20	10	3	12.5	0	0
Overseas owned	77	38.5	0	0	0	0
	200	100	24	100	9	100

SOEs like CRIs are prevented by law from having an executive director. SOEs were a quarter of the sample but a 25th of the population, and private companies largely due to the size but also to the CEOs being executive directors, were completely absent. Of less significance were the slightly fewer listed companies, and a greater number of LATEs. Thus, public sector companies were 2/3 of the sample, compared to 9% of the population, with the balance of the sample being listed public companies. Overseas companies had their chief executives as directors to represent the interests of the overseas owners within the executive and fulfil statutory obligations as directors. The State Owned Enterprises Act 1986 prevents executive directors being appointed to the main board of their company although they can be members of boards of subsidiary

boards and of other associated entities, for example, joint ventures boards.

Turning to the positivist trinity of generalisability, reliability and validity, it should be noted that a researcher sampling the population of the top 200 companies in New Zealand in terms of their revenue in, say, five years time with the same locational filters and criteria for exclusive groups is highly unlikely to come up with the same companies in the sample. Companies' head offices will have migrated to a different location and the CEOs will have joined the board or alternatively be in another company. Often it is the wish of the CEO, not the organisation, which dictates whether the CEO is a Director.

3.6 Interview outcomes

The interviews were positive discussions that usually kept to the subject. The interviewer and interviewees were experienced executives in business and in most cases in their roles. Those officers, who were not as experienced in their roles, were familiar with the requirements of the positions because they had performed a similar function in another organisation or had close proximity in a previous role to the position. For example, one was previously the Chief Operating Officer, another functional General Manager, before being promoted to the role as CEO.

In a number of cases the interviewer was known to the interviewee as a business person with recruitment and human resources consulting

experience. Although one Chair was also a Chair of the competitor of the interviewer's business and made comment to this, a fully open dialogue occurred in the meeting. There were no negative characteristics or evidence of any set on the part of the interviewer or interviewee. Rather, any foreknowledge of the interviewer appeared to make a positive contribution to the rapport.

In all but two interviews the setting for the interview was the office of the interviewee or the boardroom in the interviewee's company. The two exceptions were the home of a Chair (01C) and the interviewer's office (02C). These were all convenient environments with minimal anticipated distractions (apart from one phone interruption for 01C), and of the interviewees' choice. In one case (06E) there was a time restriction that was identified in setting up the interview which kept it tight and to the point but did not limit the breadth of the discussion. All other interviews were completed within 45 – 75 minutes.

The possible influence on the research of the amount of experience of the interviewees in their roles either in their particular organisations or in the roles was noted. Although tenure questions were not directly asked of the interviewees, two of them (04E and 08C0) had been in their roles less than 12 months which meant they could not confidently comment, from experience, on the full annual strategic management cycle. Neither of these executives had been in a previous CEO or Chair role in a company, let alone an SOE.

For the state-owned companies (01, 04, 07, 11, and 12) the strategic plan approval process and the system for appointing directors were all specified. The rules and regulations are laid down by the shareholder, the New Zealand Government, as per the State Sector Act 1988 and the regulations of its agency, the Crown Company Monitoring and Advisory (CCMAU, Appendix E).

Interviews with officers of crown companies assumed knowledge by both parties of the requirements of the appointment process. These interviews, therefore, included questions to identify the degree, and steps taken, to influence the shareholder's representatives, for example, CCMAU, Ministers of the Crown and the Honours and Appointments Committee of Cabinet, to appoint directors with the skill sets appropriate to the business and technical needs of the organisation, rather than just awaiting the outcome. The standard process, as often as not, resulted in the new director having random skill sets and few business or technical skills. They were primarily a political appointee. Further comments on this are made in paragraph 4.2.8 below.

There were a smaller number of potential interviews conducted than was initially planned. It was considered by those initiating and supervising the research that the outputs from the project, namely 41% of the original sample, would give value.

Using the interview checklist of possible questions as a guide, omitting some questions and combining others as they were unnecessary or inappropriate for certain companies, considerable information was obtained. A knowledge and understanding of the ownership and control exercised by shareholding Ministers of crown-owned companies, the reports required, their level of public visibility, and the formal process for appointing the chair and directors was assumed by both interviewer and interviewee. Further, the interviewer's business experience and knowledge of corporate processes assisted in the interview with the leaders of listed companies with public shareholding accountabilities. This facilitated the opportunity to identify the attitudes and actions of the officers to influence or comment on these structures and processes and their effects on the companies.

The use of recorders did not reflect any impediment to the interviews. The clear identification of the purposes of the research, the support of, and a commitment to, any actions (research included) that may improve governance and the opportunity to converse with the business-knowledgeable interviewer, all contributed positively to an easy release of information in the interviews which were dominated by the interviewees to a level of about 95%. The interviewees believed the confidentiality assured in the Information and Consent documents would be honoured.

Whilst the interviews were designed to provide a deeper knowledge of the strategic management and governance processes in the sampled companies, they also revealed attitudes between the three company groups: board, management and shareholders. The interface between the shareholders and the other two groups was identified but no objective assessment was made of the opinions or satisfaction levels of the shareholders to the actions or communications of the board or management, as they were not interviewed.

Between 90 and 100% of the interview was transcribed. The transcriber was experienced in transcribing for the interviewer (Secretary) and thus did not include extraneous remarks, the "ums" and "aas", or additional comments at the end of the interview. This follows the observation of Tolich & Davidson (1999).

3.7 Implications of filters in Sampling

It was not expected that so many CEOs of public companies were also members of their boards as "CEO and Director", or "Managing Director". Although this study was originally designed to target, through random selection, 20 qualifying companies, namely, some 40 interviews, only 25 companies qualified through the filters to form the sample. Access to both officers in the companies selected, or to the CEO, was declined by a number due mainly to "work commitments" and with relocations and mergers the resultant smaller number of interviews was undertaken.

There are a number of limitations to this research. The primary ones lie in the criteria of having the Chair and CEO as members of exclusive groups. More New Zealand companies have their CEOs on their boards of directors than was anticipated in setting the sampling strategy. The sample included a few listed public companies passing this filter, also a large proportion were State-Owned Enterprises (SOEs), state-owned Crown Research Institutes (CRIs), the trust-owned utilities and Local Authority Trading Enterprises (LATEs), cooperatives, and trusts (Table 3.2). This is particularly so for the CRIs, LATEs, SOEs and overseas-owned companies. Whilst this provided a diverse cross-section of business structures, the ownership and structure of the sample was not representative of the largest companies in New Zealand measured in terms of their revenue.

The geographical limitations imposed by restricting the sample to companies with company offices in Auckland or Wellington also contributed to the skewing of the sample in favour of those companies that are state or public-body owned.

In New Zealand, as compared to the USA, there are comparatively few 40%, Executive Chairs. Whilst it was believed that most of the CEOs of large companies are not directors this was not the case. This board

membership of the CEOs reduced the number of companies qualifying for the sample (refer to Table 3.3).

Table 3.3 Consequence of filters on types of companies.

Companies evaluated from the Top 200 (2001) for inclusion in the research	200
Total known non-Executive Chairs	120
Total known CEOs not directors	55
Companies in Auckland/Wellington with Non-Executive Chair	80
Companies out of Auckland/Wellington with Non-Executive Chair	40
Companies in Auckland/Wellington with CEO on Board	89
Companies not in Auckland/Wellington with CEO on Board*	19
Companies meeting "Chair/CEO" criteria in Auckland/Wellington	25
Companies which would have been included if geographical limitation had not been imposed*	18
Percentage of overseas-owned companies with the CEO not on the board: 6/74	8
Percentage of listed (Public) companies with CEO not on the board: 15/64	23
Percentage of cooperatives with CEO not on the board: 6/19 #	32
Percentage of CRIs and SOEs (both state owned) with CEO not on the board: 15/15 =	100

* Because not all Chair and CEO status with respect to exclusive groups was known for companies not in Auckland or Wellington this is the minimum figure.

This figure is subject to error as the board status of the CEOs of 7 cooperatives could not be ascertained

The summary of statistics of the filters of our sampling is subject to an assessed error of 10% (these statistics are based on what is known to be correct but there are Chairs and CEOs that may qualify to the criteria but the information is not available or cannot be confirmed, hence "10%").

A further influence on the research arose from access to the interviewees. Although the personal and main business addresses of the Chairs in the sample were known, to avoid possible conflicts with business activities or compromises in the approach, information letters, to

both the CEO and Chair, were sent the company address (Appendix B). It would have been easier to establish contact with the Chairs at their usual place of work or their home. Writing to them at the company address increased the possibility that the CEO's secretary would open both letters and discuss them with the CEO, or discard the letter entirely. To minimise interception, all envelopes were stamped "Private & Confidential - to be opened by addressee only".

Whilst many initial responses from officers expressed an interest in being interviewed, a number declined to participate usually on the grounds they were "unable to provide the time". [It was commented that the CEOs often get three or four such requests a month in addition to telephone surveys.] The fact that the researcher's name was probably recognised by many of the addressees supported a more favourable response and thus contributed to easier access. However, it cannot be known what influence this made to the research.

The officers of the company were interviewed separately to ensure corroboration of opinion and to remove the influence of the dominant officer, either by experience, knowledge, position or personality on a joint meeting. Each officer had ample opportunity to fully and freely express opinions. When only one accepted it was decided to interview the 'agreeing' officer and then try and persuade the other officer to participate. This, however, was not achieved as three CEOs did not participate even though the Chairs did. These Chairs' transcripts were

disaggregated manually but not analysed with NUD*IST software concept coding. Their transcripts were reviewed to identify any noteworthy comments on the concepts. Officers who declined when first approached because they did not have the time were told they would be contacted later in the year or early the following year (2003) to see if they would be available for a later interview, unless they did not wish that to occur, because there was sufficient latitude in the timeframe for the research. That option was agreeably received by five officers who did participate when reproached in 2003. If they did not want to participate, the matter was not taken further.

It is appropriate to note that the Government as shareholder of the SOEs and CRIs, has established a process for the selection of directors whereby the Crown Company Monitoring and Advisory Unit (CCMAU) manages the identification and recommendation to the Minister of a slate of candidates which it believes will meet the competencies for any particular vacancy (Appendix E, Clause 8.1). The Minister then decides on the candidate and seeks endorsement of the Appointments and Honours Committee of Cabinet. This will be discussed in detail later, together with the comments on the effectiveness and implications of this process on the crown-owned organisations and their governance processes.

4 CHAPTER FOUR – RESULTS

The interview transcripts containing the questions, answers and comments of both the interviewer and interviewee required analysis to extract the meaningful statements of opinions, attitudes, and other information from each interview. The first stage was to go through each interview to condense the meaning and draw out the main thing the person had to say. It meant extracting the comments from the texts without taking away any of the meaning of the information. The next stage was to link the comments on each subject concept, for example, the different aspects and mechanisms of corporate governance across interviews with all the Chairs and CEOs, and, so identify and examine the significant comments, processes and attitudes in these company officers. The agreements and contradictions or different perspectives of the officers in each dyad would also be identified.

4.1 Methods of Data Analysis

There were two options for the analyses of the transcripts, namely, undertake manual, and possibly more subjective, analysis extracting the salient items from the background of comment and then evaluating the more meaningful aspects, and the application of a computer-based methodology to perform this extraction. The latter procedure could then link the comments in each dyad and enable an easier examination of the common concepts across all interviewees to identify the common and disparate themes or concepts. It was decided to apply both methods; the computer-assisted analysis facilitated grouping of comments on

each concept across all Chairs and CEOs. It also enabled repeatability in any future research that may duplicate this study.

A code-based qualitative analysis programme was sought. NUD*IST was relevant and, compared to ATLAS/ti (Lewis, 1998), had local support from both providers and other users. QSR, the distributors of NUD*IST promoted it in their publicity material as an "efficient management of Non-numerical Unstructured Data with powerful process of Indexing Searching and Theorising". It is a software package which works with textual documents, facilitates the indexing of components of these documents and enabled the researcher to search for words and phrases very quickly. In essence it is designed to be a multi-functional software system for the development, support and management of qualitative data analysis (QDA) projects such as these transcriptions. The concepts are indexed as “free codes”, into which the lines of text of each transcription relevant to that concept are placed. NUD*IST provides a number of statistical reports on the amount of total transcription text and the text in each code. This also recorded the amount of information placed into each coded concept. The major advantage of NUD*IST over the manual condensation process was the grouping of the comments across all interviewees by concept to easily identify similarities and dissimilarities of action and attitude.

The first step to analyse the data was the condensation of the transcripts through the manual condensation. The format and grouping of the questions had already given structure to the interviews and in doing so a framework for the concepts and resulting analysis. The meaningful statements in the

transcriptions were extracted and put alongside the text in a separate column – a manual process that enabled them to be clearly displayed. The manual separation provided clarity of identification. It also facilitated the consequential identification and assignment of the coding categories for NUD*IST, but it did not group together the information on various subject concepts across interviews. The concept codes were then synthesised from the grouping of the questions and from this high-level manual coding condensation.

The NUD*IST software stipulated that the smallest unit of text was a full text line. As with the manual procedure the researcher had to identify what comments were meaningful and this should be extracted into the separate column or code which brought with it a degree of subjectivity as to what was meaningful and what was not. Whilst the manual extraction provided greater clarity for visual inspection of the data, it also enabled the researcher, in examining the extracted comments, to refer back to the nature and subject of the question where necessary. This method of analysis and extraction of information from the transcripts appeared to be the best option of all those suggested by Lofland and Lofland (1995). It also proved an important process before computer application in setting up the coding concepts as the interview transcripts could also be reread to ensure the concepts were not omitting important subjects or issues.

4.2 Coded concepts

The coding categories derived from the questions and manual condensations are:

F1 – **Strategic planning**.

The processes of strategic and annual planning which lead to the annual budget and in the case of crown-owned companies, the Statement of Corporate Intent.

F2 – **CEO/Chair relationship**.

The frequency and nature of the contacts between Chair and CEO.

F3 – **Board meetings**.

The attendees, agenda, and subcommittees of board meetings. [It should be noted that the amount of coded text is the residue following the extraction of F10.]

F4 – **Conflicts of interest**.

The sources and nature of conflicts of interest and the treatment of them when, and if, they arise.

F5 – **Shareholder relationships**.

The nature and influence of the shareholders, identification of any major shareholder groupings

F6 – **Governance processes and procedures**.

Identification of governance mechanisms and influence they may have on the processes and performance of the company.

F7 – **Appointment of directors, due diligence and induction**.

The processes and procedures involved and perceived consequences on the board and company functioning.

F8 – **Other governance matters**.

Miscellaneous governance comments relating to the participating companies or to the interviewees, including relevant governance matters the interviewees wished to comment on.

F9 – **Other non-governance matters**.

Any other comments the interviewees thought may be helpful to comment on.

F10 – **Executives/Directors intersects**.

This was an extraction from F3 above separating out the comments relating to contact

between members of the management team and the board members other than at the board meeting, and excluding that between the CEO and Chair.

The manual condensation contributed to the validity in representing discrete, focused concepts. It was also important to ensure that each concept focused on a single theme. One measure to assess this was the amount of text included under each coded concept. It was revealed from the completion of the NUD*IST analysis that there were two concepts that were significantly larger that the others: that of strategic planning and that relating to the "board, directors as individuals, intersects with the executive management and the board meetings", namely, F3. The latter was fifty percent larger (918 units of coded text) as the average text groupings of the other codings (616 units excluding the size of strategic planning (F1) which was twice as large). From the analysis of the coded text of F3 there appeared to be a considerable level of graininess. The size of this concept also prompted the review of the comments coded into this concept. It was revealed that there were two distinct concepts: that relating to the board meeting and that of the management-director intersects. A sub-code was then established (F10) to separate out of F3 all items relating to "the intersects between the two exclusive groups of management and board excluding that between the CEO and Chair as officers". It was valid and practical to extract it from free code F3, rather than recoding F3 and F10 from the original transcription. There was no loss or duplication of information in applying this method. In the same way the strategic planning coded units were examined both in the manual condensation and in the allocated code F1 from NUD*IST. There was only one concept found and it was confirmed that the

comparatively large volume of coded text was contributed to because officers, especially the CEOs had much to say on this topic. (Refer Table 4.1)

Apart from these two items the amount of text in each conceptual coding was about equal (refer to Tables 4.1 & 4.2) although primarily because of the lack of understanding and knowledge of corporate governance of both Chairs and CEOs, "governance processes and procedures" (F6), elicited the fewest comments. One reason for this was that the CEOs wished to place governance responsibilities in the domain of the Chair, and the Chairs' propensity to closely align good governance processes with control of conflicts of interest, which was a separate code, F4.

It should be noted that the condensation was based on the extraction of the significant comments from the interview transcriptions on each concept not based on key words. The allocation of text to each coded category F1 to F10 was undertaken by the researcher. There was thus a subjective decision which brought a level of possible bias into the coding at this point. It was also possible to code a line of text into two codes where it referred to two concepts. A sample comparison showed that this did not occur, probably because the single unit of text (the line) was only able to accommodate one subject or concept.

The interviewees were coded as 1C to 12E, 'C' representing a Chair and 'E' the CEO and the numbers representing each company. The number sequence is not relevant as it represents the order in which the agreement was received to participate.

Table 4.1 illustrates those interviews from which comments, or no comments ('0'), were made on a concept. Some interviewees spoke faster whilst others were more reflective and deliberate in their remarks. Others included "chatter" that may have had value if the research focused on the methodology and syntax of the interviews but for this research such additional comments were not considered to materially affect the questions.

Table 4.1 Concept codes (F1 – F10) of transcription texts for all participants.

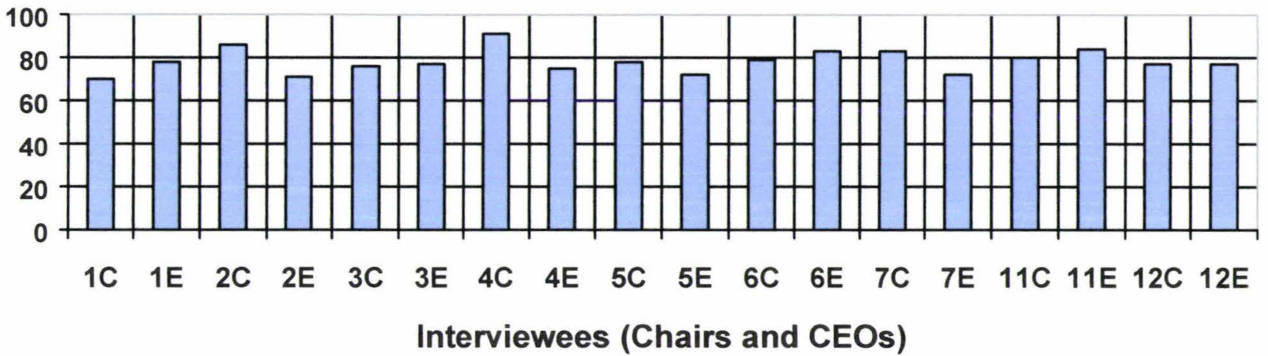
	F1	**F2**	**F3**	**F4**	**F5**	**F6**	**F7**	**F8**	**F9**	**F10**	**Nodes**	**Text units**	**Total units coded**
1C	96	10	62	10	0	0	12	49	25	11	8	336	234
1E	78	108	29	24	38	4	129	0	29	22	9	604	469
2C	38	40	22	44	0	10	26	22	0	8	8	256	220
2E	45	11	29	15	16	18	37	46	40	19	10	388	276
3C	23	7	20	16	4	14	42	6	13	13	10	207	157
3E	100	30	68	0	18	49	57	29	62	12	9	537	415
4C	65	67	78	11	0	17	64	0	33	0	7	369	335
4E	102	25	4	12	0	8	49	18	0	43	8	363	271
5C	22	31	14	15	8	21	28	41	0	23	9	257	201
5E	41	21	22	9	9	17	28	22	33	3	10	286	205
6C	63	7	96	19	48	6	37	46	11	18	10	443	351
6E	95	7	20	10	28	15	33	0	32	11	9	319	264
7C	87	23	7	19	0	0	75	83	0	19	7	398	331
7E	67	33	62	10	46	0	56	24	37	31	9	506	366
8C *												0	0
9C *												0	0
10C *												0	0
11C	36	44	27	44	5	23	56	108	9	15	10	459	367
11E	107	22	16	18	8	8	50	8	45	16	10	360	302
12C	57	31	47	27	2	16	39	8	0	0	8	292	226
12E	146	22	0	5	23	0	31	0	0	39	6	328	254
Total text	1268	539	918	308	253	226	849	510	369	303	5543	6708	5244
Docs	**18**	**18**	**18**	**17**	**13**	**14**	**18**	**14**	**12**	**16**	**Excludes interviewer**	**Includes interviewer**	

* Only Chair interviewed, so not paired sets and therefore excluded from NUD*IST coding. Manual coding only was applied to the transcriptions.

Each of the interviews was different in the speed of speech and provision of answers to specific questions, but they took 50 to 75 minutes and generated

about the same amount of coded text in each of the concepts (Table 4.2). The percentages varied between 71% (2E) and 91% (4C).

Table 4.2: Percentage of Each Transcription Coded



4.3 Concepts[3]

The comments of the interviewees are described in the order in which the concepts were covered in the interview, namely, the order of the questions including that relating to the Executive Management – Board Member intersects (Section 4.3.4) which was the extraction, F10, taken out of F3. They are the opinions and information obtained, some of which, for clarity, is included verbatim. These are the comments and opinions of the interviewees not the researcher. As will have been noted in Table 4.1 above, the subject of strategic planning was the one described in the fullest detail. Those, such as

[3] All but 2 of the interviewees were male. To preserve anonymity, the male personal pronoun is used where a personal pronoun is required to improve readability.

governance were the subject of comparatively few comments, a matter which will be discussed in Chapter Five.

From Table 4.1 it can also be noted that Chair 11C had considerable comments to make on being given the freedom to make 'any other comments' on these subject areas (Refer Corporate Governance question x in Appendix D). Chair 3C had little to say overall. CEOs 3E and 4E both spoke at some length on their strategic planning processes and procedures, while crown-company CEO, 1E, generated a significant amount of meaningful information in his comments on the relationship between the CEO and Chair and on the appointment of directors.

The following is the information from the interviewed officers in each concept.

4.3.1 Strategic Planning

It is reiterated that most (62%) of the comments in this concept were made by the CEOs as they were leading the strategic planning processes. The strategic plan usually started with management identifying at a conceptual level the general direction(s) the business was going in, either by division, domestically, internationally, or as a whole. Three Chairs commented that even a mature business could be stretched to incrementally improve it. Some of the companies involved their middle managers, to lead focus groups, to come up with ideas from younger staff members. Others involved key customers and other stakeholders. The planning process for those companies whose financial year began on 1 July usually started in February. However, one company with this fiscal year started the formative

process in November/December with the commissioning of a number of studies into investment and business options. It held a number of staff workshops with up to 50 middle management personnel. These workshops contributed to the discourse of where the business should be going and how each participant's area of activity contributed to the successful growth of the company measured in terms of shareholder value, community expectations, and environmental management. The February business planning workshop for one company was "mandatory for all board and senior management". As one Chair commented "This has the added benefit of bringing the board in close relationship with management". In the first day and a half, the board and management met for the planning session, canvassed the whole wider area of options, opportunities, strengths and weaknesses and then crystallised the directions the company should pursue. Pre-reading and pre-planning work was expected to be done before the workshop. Then it was for the board to assess the plans management put forward in terms of the fundamental objectives of the company. For example, would the plan enhance shareholder value?

Most of the respondents (86%) stated that the strategic plan development started with a consultation between the board and the CEO. For one listed public company, this was a brief set of objectives identified between the Chair and the CEO which were then developed by the management into a plan for presentation and approval to the board. Another listed public company did not sequester board and management. Management developed the strategy. The CEO held the view that the directors "have

only 50 – 100 hours of detailed exposure to the business in a year and were therefore not in a position to develop a zero-based strategy". The balance of the respondents reported that their boards all met with the CEOs. Most of these companies' boards caucused with management in planning sessions which varied from half a day (usually in conjunction with a board meeting period) to two and a half days, sometimes with an additional meeting held later. These meetings were off-site and in two cases involved a facilitator. One board Chair observed that the board members "did not speak as freely in a planning session when management were there" and thus only the CEO, and Company Secretary (to take notes) attended – a total of 10 in all. Notwithstanding, the board had management come in to the sessions to present their parts of the strategic plan. This same company invited management into their board meetings to speak to their operational reports and the strategic issues arising from them.

One CEO "expected that the board would approve the strategic plan" he put up and that they would not get surprises in the plan. Anything contentious had already been discussed with the board. "If there is not a rubber stamp then there is something I've absolutely missed." He considered that if there was an autocratic and complete separation, where the board meet by themselves and the management were not involved, "they would not rubber stamp the plan and surprises would arise". He affirmed that there must be transparency between the two entities. Another CEO added that the draft of the business plan was considered by his board at their March and April meetings and after approval by the board was submitted to the shareholder

(Government) by 31 May although they would have already been briefed beforehand as to the extent and nature of it, under the "no shocks policy" which is defined by the shareholder (refer Appendix E, Clause 5.1).

One company had three fundamental objectives to achieve through its strategic plan: 5% increase in production, 4% reduction in the expenditure as a percentage of revenue, and a targeted return of the weighted cost of capital plus 1%. They have a large asset base. These objectives were derived by the new CEO undertaking a close analysis of the business environment, determining where the company should be in five years time, applying a "gap analysis", and then a SWOT assessment.

Another company developed their strategic plan around three broad areas: environmental stewardship, customer relationships and leveraging partnerships with their shareholder, other stakeholders, their suppliers and other relationships, many of which are contracted out. This last area involved reducing the pricing levels and adjusting service levels to match the value set by customer expectations. One CEO began the planning process by playing with the numbers to see if "ideas could become a reality" or alternatively result in "collateral damage" and how big it may be if it occurred. He was very experienced in his industry having assumed the role of Company Secretary of his family business at the age of 23, about 40 years ago.

The strategic planning process was described by one Chair as "getting a basic road map" completed, which was followed by the development of management Key Performance Indicators (KPIs). These then lead to the balanced scorecard (an approach being adopted by more companies in this research) and which could then be used by the board to monitor performance against objectives.

In all the interviewed companies, management put the strategic plan together. Some Chairs viewed the strategic planning as the process which lead into the budget round. A Chair pointed out that whilst in theory it was the board's role to set strategy, in practice it was management's task to educate and put boundaries around the strategy moving forward. Nevertheless, all Chairs did not believe, as one Chair put it, that "any board in New Zealand could sit down and coldly develop a strategy". "Moreover, they don't get paid enough....they don't have the intellectual knowledge of the business in depth, to get there". He added that in some of the companies he was involved with, the board did not have a strong industry background so they tended to leave it to management to build the strategic plan from the bottom up. One SOE Chair did not want his board members to get "involved in the bowels of the organisation as it is not the board that is selecting and making appointments", inferring that not all the board members were capable of that level of involvement. He believed that the political process resulted in directors being appointed who have a varying range of skills, abilities, aptitudes and backgrounds, some of which are not

terribly relevant. Notwithstanding, his board played a significant monitoring role in the strategic planning process.

One company had the key objective of adding value to its stakeholders in the community. The CEO had to innovate and develop effective communications systems to ensure that value-based information enabled these stakeholders to understand what was being achieved.

Three Chairs believed their Boards could not accept an "easily achievable plan" put to it by management. In the opinion of one of them there was no point in having a board if at the end of the business planning period there was nothing left to monitor for the rest of the financial year. "If the targets are too low, there isn't a healthy tension, and management can easily match, or even exceed, the targets". They expected stretch targets. They found that their markets or environment could change and usually did, not always for the better, in which case the board and management needed to work together to ensure the best efforts were made to achieve the objectives. One Board reviewed their plan every three months in the light of the practicalities confronting the company and the changes in the environment.

How focused should management be in putting something to the board? One Chair acknowledged that management could "create opportunities for blue sky discussions to get the ideas to come forth and get the board's thoughts and comfort levels on a scenario or idea". But the Chair would not

wish a lot of "possible ideas" coming up to the board without a clear management recommendation, "otherwise our board would be running the company and making all the decisions". A CEO pointed out that his available capital could be spread so thinly that nothing was achieved anywhere if there was not a strategic plan. "The capital utilisation plan needed to be targeted and the capital and labour had to be focused."

Most respondents (70%) commented that their strategic planning processes have continued to be refined over the past five years. They have developed what one CEO referred to as a "fairly standard company-type process". One CEO thought his board "doesn't play a huge role in developing strategy but they play an important role in fine-tuning it and approving it". The strategic plan was reported as being presented to the board in a draft format for their preview, comment, search for alternatives and general testing, before management fine tune it and present it in final form for approval.

What are the problems that companies experience in putting the strategic plan together? For the Chair of one public-owned company it was the "intellect, knowledge and sophistication of the shareholder 95% of the time". For another, it was the board's perception of whether he considered the CEO was a strategic thinker or not. Where he thought the CEO was a competent strategic thinker, as was his view of the respondent CEO, then the strategic plan development was left to the CEO. On the other hand, if

he thought this was not the case (as in other companies he has chaired) his board "drove from the top a lot".

One crown company Chair took up the appointment to find that the board was a "rubber-stamper" with "no strategic input into the company at all". "With two-hour board meetings there was never a strategic work session with management and the board members had little understanding of the strategic context of the company". There was a heavy reliance on management's input to the strategic processes and planning in this company. The Chair believed the company now has a well-based strategic planning process and the CEO agreed and was committed to it as it set a path for the future of the company and enabled the board to monitor its implementation monthly.

One Chair reported that his board identified areas they wanted management to investigate such as the long term financial sustainability of the business, intergenerational equity, etc., at the start of the strategic planning process. Objectives were set around identifying the reasonable outputs that could be expected by an organisation performing in this environment and then the stretch beyond that was added. The plan targeted the "stretch part" – a new development for this company. As one CEO pointed out, the performance assessment needs to be done against what can be expected from somebody fully performing in the role so it depends on the chief executive being serious about it. A protective step is that the board approves the plan. Whilst one Chair believed that having

approved the three or five year strategic plan it should be rigidly adhered to and not cast aside when the environment in which the company operates changes, another believed that the board and management must be adaptable enough to change thinking and direction very quickly especially to adapt to unexpected environmental changes.

One CEO reported that on a couple of occasions they had changed the strategic direction of his company when they found that the planned direction was not sustainable. This arose from embarking on a new area of activity at the request of the shareholder and neither the CEO, the Chair, nor most of the senior management had experience to apply the strategic disciplines to this item.

On the issue of the size of the strategic plan, one Chair thought it could be "the printout from a whiteboard". "It should not be a large document that is put on the shelf and ignored." It needed to be of the value and size that enabled it to be treated as a guide and benchmark for action. One Crown company CEO had 12 critical areas and built the plan around each of them with goals. He plotted these on axes of market differentiation and specialisation so as to guide targeted activities and projects that no-one else was doing in the market, including the international participants in this field. He pointed out that the market differentiation identified whether the company was behind, up to, or ahead of the market, whilst the specialisation addressed the micro components or projects. His ambition to stay ahead of the market was balanced with sustainable and established

revenue streams. He was attempting to stay ahead of the market by pushing out the market's frontiers but also had to ensure he stayed within his funded and revenue-based resourcing.

A CEO commented that despite a five year strategic plan he found that on his appointment the company had not developed a strategic plan with the depth of similar organisations in Australia where they have a 15-year time horizon, especially for addressing long term capital investment and raw material sourcing.

One crown company whilst focusing on a three to five year planning period found it necessary to also include a 10 to 15 year time horizon because major items of technology and equipment had such long life cycles particularly when operating in the competitive international market. In this case the CEO noted that the key customers' requirements had a significant influence on the plan. In respect to technology the company planned 15 years out, but in an environmental sense it covered the next 10 years. It also had a practical business focus for operations for three to five years. It was pointed out that for crown-owned companies the Statement of Corporate Intent for any crown agency was set for three years ahead.

Not all parts of the multi-unit companies had the same timeframe. For one company the domestic business had a 3 – 5 year planning period whilst its international business had to plan for 10 – 15 years because of the global

competition. Further, the various regions of the total international market of this company needed to be addressed differently, both in terms of time frame and also in respect to the nature of the regional plans. The CEO found that the business risks associated with the different areas of the world were only one factor which had to be taken into account.

4.3.2 CEO-Chair Intersects

Intersects between CEO and Chair occurred regularly throughout the monthly cycle between board meetings: in formal meetings, such as presentations and report meetings with shareholders, including Ministers and annual general meetings, and special events, as well as informally in phone conversations and personal discussions. Access to each other is easy with the mobile phone and exchanges of information via e-mail. One of the key themes running through all interviews was the need for the Chair to have "no surprises". Chairs wished to know what was coming up. This was especially evident in crown-owned organisations where the Chair may have needed to advise the shareholding Minister of some pending event or news release on which they may be asked to comment. The Chairs of all these companies said they were aware that their Ministers also liked to release information, usually positive, and thus wished to be consulted before statements were released on behalf of the company.

Noting that many of the larger public companies in New Zealand have their CEOs as a director on the board one respondent Chair of a listed company affirmed that to facilitate CEO performance assessment on an ongoing

basis it was useful not to have the CEO attend all meetings of the board, which if they were a director, he/she could be there as of right. Having the separation between board and management he thought maintaining a certain formality, “friendly but not too close” as he put it.

In three companies the Chairs believed it was the Chair's responsibility to set the board meeting agenda and its contents. Others wished to see the agenda before it was distributed but not necessarily set it, whilst others did not see it ahead of the distribution to the board. All interviewed Chairs caucused with their CEOs before the board meeting. Matters such as the outcomes to be achieved from the meeting and how the meeting would be run were included in such discussions.

The CEOS described their Chairs as “commercially experienced”, “knowledgeable” and as ”sounding boards”. All needed to keep their Chairs up to date with developments on a weekly basis but the Chairs did not interfere with the day-to-day running of the company. Some Chairs exercise a reasonably close influence and contact whilst others took a more background role.

One Chair would defer to the CEO in relation to matters of management but in matters of judgement would not necessarily defer to him. This was the same Chair that had executives in the board meeting to check on what information the CEO was providing to the board. He believed this would precipitate a fairly stratified level of delegation so the CEO was quite clear what he was entitled to do without going to the board.

Another Chair thought it was important for the CEO to strive to have a close enough relationship with his directors to enable him to be able to trust them, as well as to be trusted by them. This Chair remarked that he received a comment from a resigning Chief Executive that the CEO had "realised he had done nothing to develop a close relationship, with the board, including the Chair, and in the end it was purely a business relationship that did not work, because the interaction was not a natural one".

In questioning a CEO as to the balance of power between him and his reasonably assertive and dominant Chair, he responded that the balance of influence between Chair and CEO was important. Having been a director of a health organisation he saw a very evident lack of balance: a dysfunctional board, a Chair who thought he had to do everything and a Chief Executive who was probably quite good, but got dominated by the Chair. The board meetings were described as "meaningless". It was important to have a Chair who understood the boundaries of management and governance and knew when to step back. The CEO looked for an enthusiastic Chair with a lot of abilities, frequently able to toss new ideas into the pot and think about the future, as well as being good at accepting ideas from all quarters. He declined to clarify the relationship with his own Chair.

4.3.3 **Board Meetings**

Attendees. Most of the companies had eleven board meetings a year but, in addition, there were one or two planning sessions. The CEO of a crown company noted that the top Fortune 500 boards met, on average, seven times a year which suggested that his board, meeting 12 times, (most boards met 11 or 12 times) may be leading towards "over-governance" in some ways.

These planning sessions may be attended by none or all of the executives. The CEO was usually present for the entire board meeting unless the board wish to have a directors-only session. One board met for the first 15 to 20 minutes of each meeting without the CEO or any management attending, to "kick things around". Others had the CEO, CFO and Company Secretary, if that position was not also the CFO, in the meetings, to ensure that there was accountability "in case the CEO is saying something that is not totally correct", whilst another company had all the executive management in on what was a full day board meeting. As one Chair commented "This is to make the information available for the executive and presents the opportunity to build a pretty good team". "It also keep the CEO honest" - a reason that was offered to a question about the CEO-Chair relationship. The Chair acknowledged the cost of executive time but felt the practice had benefit. One may ask whether there was a level of mistrust by the Chair and maybe the board towards the CEO and the information that was being fed to them? On the other hand it was suggested by one Chair that it was

more prudent, conservative governance and risk management to have these checks and balances in place.

Agenda. What is the order of a board meeting agenda? One Chair identified three things that drove the board: history, regulatory and governance issues. Most Chairs believed that the bulk of the board meeting should be focused on issues moving forward so the order of the meeting should always be "issues, approvals and history". This meant that strategic and forward thinking items came ahead of the compliance ones. On the other hand one Chair believed that "the board cannot look forward if they do not know where the company has been, or is at". Thus he dealt with the 'history' of the financials before addressing the new initiatives and issues. He considered that new issues would otherwise be "perceived in an undimensioned and undisciplined way", namely, "on an unsound foundation". He believed "very strongly in the context, perspective and dimension of everything", and that the financials were essential to monitoring. His own background was in the financial disciplines.

For this very experienced Chair, the agenda was a standing format:

Chair's welcome

Apologies

Minutes of the previous meeting

Matters arising

CEO report

Finance report

Technical report on one section of the company, Market report, and Company report

Approvals, where they exceed the delegated authority of the CEO

Information including correspondence with shareholders, and

General business.

Other companies moved strategic issues to the fifth item, either as a separate item or as part of the CEO's report.

The Information section of the agenda heralded future initiatives the executive were planning. Four Chairs said that this was very important as it kept the board informed and up to date and that the directors then had the background and could follow management's thinking in developing the scenarios. They were then better able to make decisions when called upon to do so in the future.

One company provided a board report that gave an overview of the highlights of the month and then tabulated the progress against the plan for each area of operation. The board was provided with updates on an investment, project or initiative and as the CEO said, they were "building on a story of facts". It was necessary to link the information into a framework of understanding or "story" rather than just presenting facts in isolation. Thus the board reports were like a "running dialogue on the issues of the day". The board asked questions but they did not have the detailed information to provide answers.

Subcommittees. All of the boards had sub-committees except one, which, as a listed company, with only four directors had the full board perform all the subcommittee functions. The usual subcommittees were:

- The Audit Committee, usually chaired by a director knowledgeable and experienced in compliance matters, and trained in accounting or legal disciplines. One company had a Due Diligence Committee that doubled as the Audit Committee and evaluated new initiatives.

- The Remuneration Committee, chaired by the Chair or Deputy Chair or other experienced director.

The CFO and CEO usually attend all subcommittee meetings.

All Chairs spoke positively of the effectiveness of their subcommittees. Whilst subcommittees have been considered to be a basis for additional directors' fees to be paid, there was no evidence or suggestion that this was a driver or influence on the establishment or membership of these subcommittees. In one case the finance subcommittee was rolled into the board meeting so all directors attending the board meeting were able to participate in "the finance and audit agenda".

In the board meetings the directors would debate at length the various issues. One Chair would then defer to his CEO and ask "where do you wish

to take us on this particular matter?" This board, however, may then tell the CEO to take the matter away and do more work on it or "you may have a problem to solve," or "I trust you to go away and take the appropriate steps", as the Chair commented, rather than introducing the CEO to a person who would solve the problem. For this CEO it reinforced his belief that the board believed the "buck stops with [him]". One Chair said he "deferred to the CEO to lead the company if that executive had the knowledge experience in the industry to give confidence to the board".

4.3.4 Executive Management – Board member intersects

Intersects between the executive management team and the governance group, (concept F10) namely the Board, occurred in three different forums. All Chairs supported greater board-management interactions as a way of facilitating shared understandings and through informal communications between external directors and a range of company executives. One Chair added that the directors were able to gather "soft" information about the firm, rather than just through the formal information flow of papers for the board meetings, an opinion supported by two CEOs. In addition, subcommittees were a basis for increasing that interaction and the understanding that came from them.

At the beginning of the strategic planning cycle the board and executive management (the "management") of all but one company caucused together to identify the targets, objectives or achievements for the

forthcoming year and the future three to five year period. For most it started with the board and management sequestering usually away from the company offices, sometimes with an external facilitator.

The second intersect occurred at the board meetings which for all companies involved some members of management. In some companies the whole management team sat in on the meeting; in others only the CEO and Company Secretary and more often than not the Chief Financial Officer, were in attendance. Other executives came in to speak to their reports or to answer questions. They may attend from 15 minutes or up to the full meeting, if it was a major issue.

The other point of intersect between these two groups occurred more informally. In all companies the communications between board members and management were generated by either party but foreshadowed in all but two through prior contact with the heads of these groups, namely, the CEO or Chair, who gave their permission to speak to the person in their group. One company allowed a rather free exchange of information and contact between management and directors, provided the CEO or Chair was kept informed. Unless a 'special business relationship' existed, directors were not allowed to give any instructions. This 'special business relationship' arose in a LATE. The CEO commented that the director was an executive of the major shareholder and had dealings through the commercial transactions between the companies. The director was thus acting in an executive capacity rather than as a director.

What of the role of board members on subsidiary boards? One issue with potential to be a matter of conflict between the CEO and the Board related to subsidiary companies that were wholly-owned or a joint venture, and the reporting and accountability role directors of the main board would have if they were on the subsidiary company board. In one case of a joint venture there was sometimes a dual accountability for main board members appointed to the subsidiary. The CEO held the opinion that main board members should not be on wholly-owned subsidiaries for which the CEO was accountable. It was however appropriate for executives, including the CEO, to be on subsidiary boards. The degree to which the joint venture was accountable to the main board, as compared to the CEO, should determine whether main board directors are on the joint venture board. It in essence it depends on whether CEO is accountable for the performance of the joint venture. This opinion was supported with full agreement from his Chair.

4.3.5 Conflicts of Interest

Governance processes were largely addressed by both Chairs and CEOs in terms of conflicts of interest and how they were dealt with both procedurally and administratively. [4] Usually a Chair prevented a director from taking part in the discussion or voting and some would request the director with an

-or the context of understanding the common rules these Chairs and CEOs must operate under, it is ıportant to reiterate that the Companies Act 1993 [clauses 139-140] only requires that directors "declare eir conflicts". It does not require that they absent themselves from a meeting, take no part in the voting, main silent in the discussion or apply other behaviours that are, or could be, required in addressing ınflicts.

actual conflict of interest to leave the meeting room. That depended, however, on the subjective stance of the Chair.

One Chair commented that all companies were required to maintain a 'Register of Interests of Directors' and each director was obliged to declare these and keep the information up to date. The Company Secretary usually assumed responsibility for monitoring the activities and interests of a company director and ensured that any issues or matters arising in which the director or board would be involved or had an interest should take into account any identifiable conflicts. Five Chairs commented that at the beginning of each board meeting the directors were asked to declare any potential or existing conflicts with any item on the agenda. Depending on the nature of the conflict, the Chair of one crown company would decide how that director would be expected to deal with the conflict. If it was a matter in which the director had a personal interest or from which he or she could gain material benefit the director would be expected to leave the room for the discussion and be excused from voting on that item. If the conflict was identifiable before the board papers were sent out, the Company Secretary should have prevented the director receiving the papers pertaining to that item.

The Chairs found that conflicts of interest were "easily managed". It was noted that conflicts were only deemed to occur where the matters were dealt with at board level. By way of example, a Chair cited the situation whereby a director was on the board of another company that was trading

with the respondent's each other but the matters were not decided or dealt with at board level no conflicts required to be addressed.

A common conflict revealed by the companies, occurred with the lawyers on their boards and the firms in which these directors were partners were providing professional legal services to the company. One respondent noted that the opinions provided by that director at the meeting could be construed as 'legal opinions' rather than as the application of a legal mind to a governance issue. This potential conflict was rationalised by saying that the partner of the firm managing the provision of legal advice to the company was not the director on the board. Almost all the respondent Chairs were giving this matter increased attention and as a result they were adopting an increasing separation between the professional services being offered to a company and the principals of that firm being on the board. They were wishing to avoid a contestable issue arising with the professional services firm over a transaction that went wrong and the lawyer director was then put in a position of conflict.

In two companies the Chair provided services to the company at the request of management or at the request of the board. One acknowledged that wisdom of doing this was increasingly being questioned by boards in spite of the fact that the Chair, both in terms of knowledge and expertise, brought a unique background to a problem. The belief expressed by some Chairs was that any new director appointed should not be allowed to provide services to the board.

To one Chair the interviewer noted that annual reports of listed companies in New Zealand reveal through the remuneration 'Notes to the Accounts' that directors have been remunerated over and above their director's fees and suggested that this may have remunerated directors for additional services to the company as compensation to directors for their low level of directors' fees and created a potential conflict. To this, the Chair commented, "there is no reason why individual directors cannot do business with the company provided it's on the table and everybody knows about it".

In the opinion of one Chair it was the perception of the board members, that it was the Chair who determined, if a conflict existed, if that conflict was material, and the procedure for dealing with it. It was an issue of judgement for both the individual and the board. "A director places him or herself at the disposal of colleagues on the board to decide how to handle any perceived conflict", as the Chair put it. "It is more an issue of etiquette, not legal duty. A director is entitled to stay in the room and needn't declare his conflict, but the penalty, if caught out to any degree, is that the director is liable for a breach of fiduciary duty."

The CEO of an electricity company noted that legislation prevented cross directorships and therefore reduces the potential for conflicts of interest. [5]

[5] The Electricity Act 1992 prevents cross-directorships between line and generator/retail electricity companies in New Zealand.

One Chair distinguished between actual and potential conflicts of interest and actual or potential conflicts of duty. All the Chairs expected all directors to behave properly.

At least 80% of the Chairs were well aware of the nature and implications of ignoring conflicts of interest. They endeavoured to ensure that they were minimised with current directors and that new directors appointed were scrutinised to ensure that did not have potential conflicts. This was becoming increasingly important for all the Chairs of crown-owned companies because of the risk aversion of shareholding Ministers.

4.3.6 Shareholder relationships

The Chairs of the crown-owned companies all acknowledged they must assume responsibility for the relationship with the shareholding Ministers.

Four of the Chairs commented on the monitoring process for crown companies undertaken by the officers of CCMAU both on the performance of the board, and the financial achievements compared to plan and to other business or political objectives. They noted that this agency and The Treasury also ensure that the dividend objectives were achieved and so needed to receive the financial implications of the business plans before they had been submitted for formal approval. Three Chairs emphasised the fact that the Crown was a very risk-adverse shareholder. One company was adopting and two other crown companies were considering adopting,

triple bottom line reporting which at least one Chair considered "a fad that can take control of you if you're not careful".

Two CEOs of crown companies expressed their surprise and also pleasure at the lack of interference of shareholding Ministers in the day-to-day running of their companies. In setting the business plans, the wishes of the shareholder in respect to financial matters, avoidance of political embarrassment, and other sensitive matters were clearly understood by all the crown-company Chairs and CEOs. One CEO commented that he appreciated that having the crown as a 100% shareholder required just the same behaviours and consultation as having any other 100% shareholder. They needed to be spoken to in setting up the business plan.

In the two listed companies without major shareholders, the CEOs commented that their relationship with their shareholders was quite formal and usually structured around the annual meeting when the company reported. The other companies with a significant shareholder expected the strategic imperatives of the business to be aligned with the requirements and expectations of that shareholder. For one company, according to the CEO, this was necessary to ensure that the dividend distribution policy met the shareholder's requirements whilst still sustaining a viable business. This CEO commented that to fund his major shareholder's needs it was considered necessary to consider a restructuring of the balance sheet so as to facilitate a capital distribution, though whether this was actually implemented was not revealed.

The CEO of a listed company with a major shareholder observed that the difficulty in some companies, public as well as private, where there was a major influence from the executive or director of a majority shareholder, either onshore or offshore, was ambiguity over the autonomy of the governance. He considered that the board endeavoured to add value through monitoring, to minimise shareholder risk, and oversee transactions which required the independent directors to provide input within the strongest ethical framework. However, the degree of influence the whole board had varied compared to the power and influence of the majority shareholder. He believed that, as a general rule, the greater the equity vested in one shareholder, the greater the influence of that shareholder on the governance and direction of the company.

The CEO of the listed company with widely distributed shareholding considered that his board assumed more autonomy and the business and strategic plans were created through discussion between the executive management and the board, and when agreed, were actioned. However, the board and management of this company voluntarily talked to the major funders, particularly the top four or five corporate investment shareholders "as a courtesy" when and if they were planning to establish or modify an employee options plan or take like actions. The Chair thought that "this may tell us something we had missed". The listed companies did little to communicate to shareholders outside of the six-monthly and annual reports. In one company, the CEO stated that, if the equity of the founder,

the Employee Trust, the senior executives and other people associated with the board were added together, nearly 60% of the shares were accounted for. With another 20% of the shares held by overseas interests there was then only about 20% of the shares that the company was publicly reporting to. "This is not enough to regularly consult with, or influence", said the CEO.

As one Chair noted, the regime of continuous disclosure required of New Zealand listed companies must not be breached in telling a major shareholder certain information that is not passed to all shareholders or generally made public. He pointed out that these rules of the New Zealand Stock Exchange and the Securities Markets Amendments Act 2002 require that listed companies keep the stock market and stakeholders constantly informed on matters that may offset the price of their securities (NZX, 2002). The Chair pointed out that the new continuous disclosure rules had changed recent thinking. The information used to be "owned by the company", but now there is a view that the "information about a company is owned by the shareholders" and they have "an absolute entitlement to know on a regular basis, on an event basis, or continuous disclosure basis". He thought this was correct. The Chair went on to add that he believed it was no longer appropriate to continue the practice in public companies of talking to analysts without the presence of the board or a member of the board. The Chair was also rigorously enforcing the separation of audit from other services, particularly in separating audit from tax advice.

4.3.7 Governance processes and procedures

The separation between governance and management was clearly enunciated by all interviewees, to which they appeared to adhere.

All Chairs when asked whether their governance processes and procedures contributed to their company's success interpreted the subject in terms of the mechanisms for dealing with conflicts of interest. All but one Chair had difficulty in understanding the question and six of the chairs were dismissive of the subject of governance. At least two CEOs were somewhat dismissive of its relevance for them and commented that it was the Chair and the board who were responsible for governance and for dealing with the shareholders on such matters. Five of the CEOs believed it was one of the responsibilities of the Audit Committee of the board to monitor governance processes and ensure the business was governed in accordance with best practice. CEOs commended the Chairs for their understanding and application of "good corporate governance practices". One described his Chair as being the "conscience of the company in such matters". "Ethical", "integrity" and "conservative" are three words interviewees associated with good governance and with their Chairs.

One Chair sought to create an environment where board members could openly raise and debate the issues, so if there was to be an issue, it had been fully debated before it became an issue. The same Chair did not believe that annual reports needed to have a Statement of Governance

Processes in them, as he considered "the shareholders do not understand them, even though it would be great if they did".

A number of the companies were improving their governance protocols, two by including a statement on governance in their annual report, one other by developing a directors' manual. One crown-owned company CEO intended adding the governance section in the next annual report. However, both CEOs and Chairs of the crown-owned companies did not see such comment supporting the marketing function which they considered was the primary function of their annual reports. Their reports to the Ministers were formal documents of information but three CEOs considered the "annual report" was an illustrated company profile more for customers and other non-shareholder stakeholders. By contrast the CEOs of the listed companies only wished to meet their minimum statutory requirements for governance reporting. One of these companies had a Due Diligence board sub-committee as its audit committee and that ensured nothing "falls through the cracks" in matters of governance.

4.3.8 Appointment of Directors

Director appointment processes were not an angst for all interviewees, but were for the two thirds of the respondent Chairs who lead crown-owned companies. These expressions of frustration were not made by two Chairs of crown-owned companies as they were rather nonchalant about their right

to have any input into the appointment process[6]. The fact that the Appointments and Honours Committee can inject candidates into the process in additions to those recommended for consideration by CCMAU, and who for political reasons could be considered and appointed, was a frequent complaint of all the Chairs. The fundamental issue for them was the balancing of the political agenda with the business and governance competences of the candidates. Some of the appointees from this process were described as "political lackeys", who, in the opinions of these Chairs, were appointed as a favour for services towards the political activities of the Government with no evident commercial or governance acumen to warrant their appointment. More than one Chair of the crown-owned companies expressed concern about the frequency with which board members were changed by the shareholder.

By comparison, the Chairs of the public companies and LATEs said their directors usually served a long term. They were usually appointed for a period of three years and then, in terms of the company's constitution, retired at the annual general meeting and, being eligible, offered themselves for re-election. Unless a contest for the board seat arose, they were reappointed. The LATE Chair commented that their reappointment depended on the wish of the shareholder.

[6] The process is that the Appointments and Honours Committee [refer Appendix E Section 8 outlining the protocols for the appointments to state-owned companies] receive from CCMAU a recommended slate of candidates who are expected to reflect the Government's expectations for potential director candidates, for example, diversity, commercial competencies, and so on.

In the crown-owned companies with a change of board members annually the Chairs found themselves with a continuing process of developing and educating the new directors. As one Chair pointed out, five of the seven directors had their terms expiring at the one time which he found created a significant succession planning and governance accountability problem for the board especially in appointing chairs of sub-committees. Two Chairs added that when directors were coming to the end of their first three year term, they were usually asked by CCMAU whether the directors should be reappointed for a second, and final, three year term. However, the Chairs appreciated that there was no guarantee their recommendation for a director to remain for another term would be adopted. Too often a contributing and valued director was replaced. A Crown Research Institute Chair thought CRIs were generally used as a training environment by the Government. "Apart from one or two directors, it is often their first board appointment and it becomes a significant learning experience. New directors who do not understand the difference between governance and management want to get involved in the detail and micro-manage."

No matter how strong their advocacy, no Chair was satisfied that the balance between competency and political correctness was achieved in the best interests of the crown-owned organisations. One Chair cited the situation he experienced of two appointees to his board arriving with an agenda of being disruptive and then tried to undermine his authority. He found they had been briefed by Government to adopt this tactic. Another Chair said that over the last 18 months there were five new board members

on his board who had no experience in a state-owned company. He added that it took time and strong leadership to develop the competences of the board to the level where they could deliver responsible governance, pointing out that such companies were "significant organisations in terms of market position, stakeholder responsibilities and human capital". One Chair commented that because of the different industrial sectors spanned by many of these companies, they could not get the expertise on the board that embraced all the activities of the company. He compared it to a property development, or management, company that was more homogeneous and therefore could appoint a board covering all areas of the business.

As a Chair pointed out "the model for the appointment of crown-owned companies is not fundamentally flawed but creates considerable tensions. The companies are Government owned but are required to act as though they aren't".

In the private sector companies, appointments were usually made by the Chair and board identifying possible candidates, sometimes with input from the CEO. The chosen candidate was then appointed by the board between annual meetings, and the shareholders reappointed the director at the annual meeting for a three year term. The Chair of one such board said he adopted this process as they wished to have a director with the required competencies on the board but also one who would work with them in a

harmonious and collegial way, namely, one "who the directors feel comfortable with".

The Chair of a listed company reinforced this opinion in that appointing directors the collegiality of the board was an important factor and as a consequence his board identified a slate of possible candidates who the directors knew and believed they could work with, and decided on one that they thought had the required competencies of expertise and experience.

The comments of the Chairs of public-owned companies suggested they work to achieve a balance between the satisfaction of the board members in working with each other, namely their collegiality, and of ensuring the directors all share equally in the work load of the board. One Chair pointed out that if the company was moving into a new area or planning to do so, or if the organisation needed new functional expertise such as investment banking or marketing they would identify the required expertise and bring it onto the board.

Where a major shareholder existed, as in the LATE and in two public companies it was usually that person or organisation that recommended the new director. The Chairs of these three companies were given the opportunity of interviewing and commenting on prospective candidates.

4.3.9 **Miscellaneous Governance Comments**

During the course of the interviews there were a number of other governance comments proffered, some of which related to companies other than those included in the research but which have relevance in the context of governance and related business issues. They could be considered sub-concepts

Performance Evaluations and development of directors.

The performance evaluation of each director as prescribed by the CCMAU process (Appendix E, clause 8.1.4) "takes hours to do it properly" said one Chair who added that it was "a bit much to do it annually". He had the feeling that "if you eulogise about a board director one year, what can you add that is different to the model in a year's time". One crown company had the whole board assess the director who came up for review at the end of a three year term, following which the director was invited to stand again, or not. This meant that two directors were assessed each year. The Chair found that the widespread location of directors meant it was too much for him to economically travel around the country in order to undertake these performance interviews. Most of the crown company Chairs undertook the assessments in association with board meetings, by phone, or by spreading the contact out over a few months.

Another Chair found the best thing in undertaking performance evaluations was to sit down and talk one-on-one with the director and be quite open. The Chair had been a director of one company where there were 40 questions to be asked and the Chairman, after getting the answers, added them all up and gave each director a total number of points. One of the directors did not understand governance and financials but, at that stage, had understood business and strategic direction. This Australian director did not rate very well. He was a businessman without the specialist compliance and finance expertise and so received a lower mark than anyone else. This evaluation was a contributing factor to his consequent resignation. Such analytical processes, in the opinion of the Chair, could be "very, very dangerous, very destructive". This was particularly so where the board was not appointed by the Chairman, who is not a shareholder and for a director to be told "four of your colleagues think these bad things about you" can be very, very negative.

The Chairs felt an obligation to develop new directors, especially if it was the first directorship undertaken by that board member, as well as monitor their performance. One Chair said he was responsible for developing a strong working relationship with a new appointee to the board, which he usually did within the context of the board meeting.

A CEO of a LATE questioned how directors are developed for their role in governance, as opposed to "accidentally finding themselves" in a governance appointment. Whilst there were commercial courses for

directors, this CEO, as part of the succession planning, encouraged a couple of executives to undertake the Institute of Directors' Company Director Course which gave a particularly valuable insight into a broader view of functional business, including law, finance, etc, especially for an executive with a specialist discipline. This also facilitated the move from general management, or a hands-on operational role, into governance. The CEO noted that he left a previous company because the directors had no experience whatsoever, and irrespective of the induction process provided by management, found himself in a position of significant risk both for himself and the company. He observed that there were differences between experienced and inexperienced board members, but the important issue was to have a blend of experience, not a "totally naive board".

There were varied levels of support for the education of directors. Some Chairs offered their board members the opportunity of attending Institute of Directors courses, or the Chair's Course run by the same organisation. A Chair believed that in offering themselves for a board, directors should have already completed such a course, or be prepared to train themselves for the positions they take up. One crown company provided $3,000 for a director to undertake professional development within the three-year term of office. All Chairs expected directors to be appointed with some sort of life experience and base competencies and that they should not require complete re-education in business matters. Not all directors were well prepared for possible difficulties that may arise. Some director candidates were viewed by one Chair as being fit as a director, but put in a crisis they

did not have the background of experience to exercise very wise judgement. One Chair spoke of another Chair, who had been a CEO, then tried to persuade the major shareholder to make him combined Chairman and CEO, but he was declined. As Chair, he went to significant but inappropriate lengths to gain control, even to the extent of checking the CEO's, and senior management team's, expense accounts. The commentator believed the Chair should be the "most manifest servant as this is the duty of good leadership".

CEO on the Board

All CEOs in this research were not appointees on their boards. However, one Chair believed that it did not matter if the CEO was a Managing Director, namely a board member, or only a member of the management team. If the board was talking about the CEO, he/she would be excluded from the meeting and asked to leave the room. He added that in his view there was no legal basis for ejecting a CEO/Director unless by remaining, he/she may be challenged over fiduciary duties and have conflicts of interest. Another respondent Chair had to remind a Chief Executive of another company who was a Managing Director, that he was "only the Managing Director". In a further case a Chair experienced defensiveness from the CEO towards the dual role of also being a director. That Chair did not favour the CEO being a director. He added also that New Zealand had been quite successful in breaking down the old board structure where

directors had been "there for life". He thought the days of the "old boys club" and the "dictatorial chairman" had gone.

The Chair of a listed company, who considered he might appoint a CEO as Managing Director of a company he was leading, would not do so without a reasonable testing period to see that the "personality was such that it wasn't going to create difficulties in the governance" team. In answer to our question he felt that the role of Executive Chairman "was inappropriate", as was the need for the Chairman to have an office almost adjacent to the Managing Director's. He had turned such an offer down and also the provision of a company credit card, a benefit his predecessor had.

One CEO, given the choice when offered a board seat, elected not to be a member of his listed company board. He gave his reason as, compared to Australia, New Zealand companies did not need to disclose the detailed remuneration components of its executives. Only directors' remunerations were identified under each director's name. New Zealand companies only needed to list in bands of $10,000, the total remuneration of executives who received over $100,000 per annum. He acknowledged that one may assume that the most highly paid executive in the listing of executives was the CEO, but in many companies, particularly those with internationally located executives, that was a fallacy. He pointed out that in Australia current requirements were to nominate the full financial remuneration

details of the top five executives, who they are, what they earn in base, bonus and car, and any other emoluments.

Number of Directorships

How many directorships should a director of a listed company hold, especially if that person is also the Chair? One experienced Chair could "not understand how some directors coped, added significant value and dedicated the time and were accessible to the CEO, if they had a significant number of directorships and/or chairmanships", particularly if the number was in double-digits. The Chair thought there would be commercial casualties, quite significant risk and there might be "some private casualties as well". He was only prepared to hold two Chair appointments and one other director role.

Compensation of Directors

During one interview a CEO passed the new annual report across to the interviewer and it was noted and commented that the Chair was paid double that of the board members and that the Deputy Chair was also getting more, presumably for additional services. The CEO advised that both the Chair and Deputy Chair put in a lot of time on various matters, although he was "not certain that it was all productive". Further, one director in the company received an additional emolument for specialist

work. If the board members for their directors fee spent a day in a board meeting, a day reading board papers, but ended up spending four or five days a month, then "probably they should receive extra compensation". The remuneration of the CEO was not discussed with them although the information was known through the annual reports.

On the matter of compensation one Chair indicated that the responsibilities, the time commitment and the social commitments on a chair were "huge" compared with a director. Whilst he acknowledged that many chairs are paid double that of an ordinary director, he believed "it should be triple", to acknowledge both "the time commitment as well as the responsibility". This Chair said he knew of other Chairs who thought they lead the whole company, and think they were not involved in management, but nevertheless saw the CEO as a direct report rather than as a peer. They created what this Chair considered to be dangerous relationships. He added that if the Chair was carrying the 'public profile' of the company, this was also a very dangerous situation. In his opinion it was unacceptable for a Chief Executive to become the Chair as the transition from being Chief Executive took considerable time and the ex CEO would still be running the company.

The Roles of the Chair

Looking into the future of director appointments and accountabilities a CEO suggested that if directors were in an evolution they were going to have to

be prepared to sacrifice more than one or two days a month for a directorship and would have to be compensated accordingly. He acknowledged that in that framework, SOE directors would probably be remunerated at a lower level. "They serve a purpose in grounding people for ultimate private sector board appointments". On one occasion a CEO sought and needed his Chair's support in a highly fractious and difficult environment, threatened with the risk of political intervention and required a very quick, massive restructuring. As the independent Chair between two shareholders at that time, he said during the interview, that he spent considerable time in the "Chair's office of the company" acting as the independent Chair between two shareholders who were in conflict with each other. The Chair (an interviewee in this research) took on the 'public face' of the organisation believing he was in a better position to manage the political and commercial relationships for which he received a significant compensation, over and above his normal Chairman's fee. He would not repeat this action again. In another part of the interview this Chair had said that the Chair should not be the public face of the organisation. He also commented on the extra remuneration he had received for his services but that the rules now required that if the total compensation of directors of a listed company was above that approved by the shareholders, by 0.5% of shareholders' funds, the board needed to go to the shareholders for approval.

5 CHAPTER FIVE - DISCUSSION

In Chapter Four the comments of the interviewed Chairs and CEOs have been recorded in the framework of the coded concepts. It is important to identify the significant elements of these observations from those that are common to the processes occurring in each of these companies.

It is should be pointed out that with two thirds of the respondent companies being crown-owned many of the issues raised are the particular to the processes applied under the prescription of the crown's agents, CCMAU and The Treasury. A further two companies in this research had local government as major shareholders, and thus, although largely also owned by public bodies could be considered under the same equity structure as a listed company with a major shareholder. Only one company was a publicly listed company without major shareholder influence.

We now turn to the significant findings from this research which in this chapter will be addressed under three main headings: the strategic planning and governance processes that are applied, the relationships between management and the board, and the influences of external parties, namely, shareholders and their representatives.

5.1 Strategic Planning and Governance Processes

Strategic planning processes existed in a similar format in all interviewed companies. For all interviewees they started with the definition of what was to be

achieved in the forthcoming year and how that related to the next three to five year period.

The boards and management are cooperatively responsible for determining the vision and the strategic dimension. The vision was not considered as important to the Chairs or CEOs as the objectives. The Chairs agreed that Boards were responsible for delivering on shareholders expectations whilst management, who understand the business and are best positioned to understand their industry, the opportunities, threats, and so on, and have the greater knowledge, are responsible for running the business day-to-day. The boards in their turn undertook to monitor progress towards the targets.

For many of the companies interviewed, the development of the strategic planning process, and to a certain extent of the plan itself, was a function of the evolution of the company. For those entities that had only been created within the past three years or which had evolved out of another entity, there was greater participation between the board and management on strategic issues. The strategic planning processes in the companies studied appeared well prescribed and yet for more recently established organisations, these processes were still being refined. On the other hand the processes were mature in a long-established SOE or listed company. This also occurred where the CEO had been in the role in the industry and/or the company for a number of years and applied the knowledge, history and record of successfully running the company or like entity. All the respondent companies were transitioning to apply more rigour to the planning process. It was an evolutionary process that for many

companies was becoming more formal. In crown-owned companies, the Government's goal of "growth, innovation and initiative", acted as a shareholder expectation for the development of the strategic plan. The boards participate at an early phase in the strategic planning process. Whereas one previous CEO wished to take his strategic plan to the board as a finished product, his successor, with the agreement of the board, was now involving the board more at the "blank piece of paper" stage.

Some boards expect synergy between the various new initiatives whilst others encourage the securing of opportunities as they arise and do not insist that it is in the plan before it can be pursued. Where a company has a majority shareholder, as in the case of a LATE, or a founder shareholder, the shareholder influence is very strong. Some expect the business plan to be discussed with them.

The time spans for the strategic plan depended on the nature of the company. For example, an electricity utility which is in the long term asset class, undertook actions that affected its performance five and six years hence. Such an organisation could predict with some accuracy, everything else remaining equal, what their financial performance would be five or six years out. Some elements of the planning such as that for the long term asset development necessary in this type of company required it to look 15 years ahead while another in the same sector developed a 20-year asset plan with the attendant 20-year financing plan. As the CEO of such a company pointed out "one needs to have some concept that the strategies being employed will have long term legs". By comparison the

CEO of a retailer said that one "may predict four years out and not be surprised if, at that time, the reality bears little relationship to the plan".

The literature and research on corporate governance increased significantly in 2003, and following the establishment of corporate governance rules but the New Zealand Stock Exchange in 2002, the rules were refined and monitored in the following year. As this research goes to print, the NZ Securities Commission calls for submissions for a Corporate Governance Review. This will bring forward information about risks, rules not being adhered to and new rules that need to be established. They have the propensity to reduce the freedom and autonomy of boards and to tighten the legislative framework under which companies must operate. One Chair hoped that the Enron, Worldcom, etc., series of corporate disasters would not precipitate any "knee jerk reactions" in New Zealand to significantly increase controls which are highly restrictive. But how does the New Zealand corporate governance environment compare to the rest of the world? The evidence from this research compared to the reports referred to in Chapter 2 suggests that the governance mechanisms are no worse, and indeed, may be better, in their application to minimise risk and enhance performance in major companies. The leadership of New Zealand companies is marked by the fact that in New Zealand the duality of the chair and chief executive roles, a characteristic which was excluded as a variable in this research, is rarely found in large, New Zealand companies. Duality could be a variable in future research, but the sample would be small - probably less than 10 major companies. At least five of these would probably be Chairs in title only, with no special functional accountabilities. In these companies, many of them

overseas owned, the CEO represents overseas owners, is also a director, and, as only one of two directors, acts as board leader, namely the Chair.

All the companies in this research applied the three tasks of the board in strategic management described by Wheelan & Hunger (2002), namely, ensuring the strategic objectives implement the mission, working with management in evaluating and influencing, and understanding the plans, and thirdly in applying a sound monitoring process. The crown-owned companies adopted a more rigorous strategic planning process, possibly because of the frequent changes in directors, the wish of the shareholding Minister and his agents to be fully informed, and the comparatively low level of commercial acumen and industry knowledge of a number of these board members. This required the planning process to be as much an educational session for the board to bring them up to speed, as a sequestering with rigorous debate and critical assessment of the strategic options by both groups. It was noted that one Crown company had no strategic planning and management processes in place before the current Chair took over. Along with the CEO, a strategic discipline was put in place over the last two years. The relative stability and longer term appointments of the public companies appear to contribute to the requirement for less discourse in establishing the strategic plan.

In commenting on the issue of governance responsibilities the CEOs deflected these into the domain of the Chairs. Four Chairs, when asked how "the corporate governance elements influenced the company's success" asked what was meant. They could not readily identify the relationship between company

performance and corporate governance. Chairs generally viewed corporate governance as a risk management tool or process, as Hitt (1999) spoke about. They did not reflect any understanding of Rajan & Zingales' (2000) opinion of corporate governance as an incentivisation to human capital. The public company chairs did not relate corporate governance mechanisms to enhancing investor value as described by Newell & Wilson (2002). However, the separation of Audit Services from other advisory services, which has been encouraged as a consequence of the Enron scandal, was increasingly prevalent in companies seeking to adopt the practice of good governance.

Backing up the effectiveness and influence of corporate governance mechanisms on company performance was a strong discipline of strategic planning processes and ongoing strategic management, setting the direction of the company.

5.2 Crown-company Director Appointments

The appointments process for directors was the most contentious aspect of the interviews with both the CEOs and Chairs of crown-owned companies. It created significant frustrations as the Government sought to have diversity as one of its key platforms influencing the selection of director candidates for crown-owned companies.

The nature and outcome of the processes for appointing directors in this sector was an issue of consternation for all the Chairs of these companies. It was also

referenced by the CEOs, although they were more temperate in their remarks, largely because they were not as directly affected as their Chairs. In the opinions of both Chair and CEO, the quality of directors in Crown-owned companies show greater variability of experience and knowledge, both of corporate governance and of the industry and business of the company, compared to that of public companies. The power of the appointment lies with the Crown and the Crown engages in what is fundamentally a political process. CCMAU are in a state of continuous tension with this process as they try to bring more objective commercial and professional competences to upgrade the quality of the directorships. The outcomes are considered to be too often favouring the political agendas of Government and as a result not only is the new director often quite inexperienced in governance, but too often has a narrow perspective or a specialisation. In many cases the new director has a propensity to be involved in the detail of management – an aspect that the Chairs have to keep addressing and reminding the directors about.

Further, effective governance is impaired by the comparatively rapid turnover of crown-owned company directors, many of whom only have one three-year term, although some get a second three-year term. Chairs believe that the decision to appoint the director for a second term should be strongly influenced by the performance report on the director, by the Chair, and other board members. As planning periods for some of these companies is extended out to 15 years, the wisdom of changing all board members at least every six years must be challenged. The corporate memory is therefore dependent on the CEO and management when monitoring the long-term, planning processes. One board,

however, retained a 'monitor' who was effectively an external source and "memory to the board" as, due to the continuing change of directors, there was no ongoing "memory". The Chair found this person needed to be independent because, in the matter of monitoring, the board should not rely on the memory of management. Every six months this external monitor examined the position of the company and advised the board on issues upon which it needed to provide additional focus or audit.

The turnover of directors also means that some directors are only just coming up to speed in contributing to the board debate when they step down. Whilst it is acknowledged that the appointment of inexperienced directors to crown-owned companies is a training appointment in governance, in the view of a number of Chairs it is too often a reward for political favours. By comparison, those companies with the major shareholder a local government authority, are seen to have a uniform high level of quality directors both in respect to experience and knowledge. In the past where the local authority councils have had a propensity to put one or more of their Councillors onto the boards of LATEs, the councillors' industry or commercial knowledge has not been as relevant and resulted in lack of commercial acumen and inadequate corporate governance. Now a more independent process is applied using procedures and advice from independent consultants little or no political agendas or such agendas very subjugated to the commercial acumen of the appointees.

5.3 Relationships between Management and the Board

One of the common elements identified in this research in the processes of both governance and of strategic planning is relationships. Trust, a history of doing the "right thing' as perceived by the other party, and having the organisation held in safe hands, were all repeated phrases. The 'glue' that binds the parties together is the harmonious relationships, with 'no surprises', full, open information flow between management and board, and integrity which ensures responsibility is delivered between the other parties.

The analysis of this research was heavily weighted towards the opinions, actions and attitudes of CEO and Chair in the strategic planning and governance process, but limited detailed analysis was undertaken in examining the discourse, differences and similarities between these leaders of the executive and non-executive groups as dyads. The Chairs and CEOs of each dyad exhibited a high level of regard and respect for each other, with a clear and positive understanding for each other underpinned by open, positive communication. There was no dissonance between them. Any dominance or influence of one officer (CEO or Chair) over the other in a company appeared to depend on the comparative length of time in the role or function of one officer. If they had worked with each other for about two annual cycles they were comfortable and aware of each others strengths and weaknesses. A hierarchy was established. However, this was not directly tested, as the length of time of each officer had been in the appointment was not identified other than through the admission of an interviewee to having been in the position, or the company,

only a comparatively short time. Their roles were being performed to the satisfaction of the other officer.

As one Chair commented "the Chairman and CEO have to be close but they also have to have a good sparring ability on business issues as well." "The board is there to assist management when it can and promote good management ethics of issues", he added. The board needed to make sure the financial position balances and was not a risk to the shareholder. "Hindsight is the only accurate science" said one Chair.

The apparent harmony between the respondent CEOs and the Chairs could lead one to surmise that either the CEO was managing the board as Useem (2001) advocated, or they had learnt the necessary behaviour and protocols to accommodate the style of the Chair. Chairs that were nonchalant, reasonably hands off and laid back, usually had CEOs who were driven, knowledgeable and assertively in control, and visa versa. Some Chairs expressed frustration with the CEOs of other companies on which they held director, or chair positions suggesting that not all large New Zealand companies has positive working relationships between CEO and Chair. There was for one respondent company an underlying current of less than total trust of the CEO, but the researcher believes, from the total comments made by this Chair, that this was more a function of the temperament of the Chair than any lack of integrity or competence of the CEO. It was clear from all the interviews that there was a very restrictive communication between management and directors unless the CEO or, and in most cases also the Chair, had prior knowledge of the matter. The tone was

heavily influenced by the Chair although both Chair and CEO confirmed the rules in this area.

The observation that some Chairs were more detached and aloof in their relationship with the CEO than other Chairs, was more a matter of style than any lack of accountability, knowledge of the business, or commitment to it. The CEO was always assumed to have a much greater knowledge of the business, to have a greater involvement, and to be accountable to the board. There was a balance between the board being fully willing to be guided by the CEO, but quite capable of challenging the recommendations and seeking further investigation or information on a subject before making the decision. Those Chairs, who felt comfortable allowing the CEOs to run the company, stood back and adopted a risk monitoring role when the strategic and business plans had been agreed. It could be questioned as to whether the CEO with such well-based knowledge and/or experience in a particular industry was able to establish and exploit that, and influence the direction of the company.

The Chairs all took a keen interest in the board agenda and discussed the matters arising in it before the board meeting. But they cannot be regarded as the norm in CEO/Chair relationships in respect to the board meetings or in their leadership of the companies. There are exceptions. By comparison the researcher had been told by the CEO of a large, listed rural company that he often does not hear from his Chair from one meeting to the next and the Chair certainly did not wish to have any input into the drafting of the agenda or the papers being presented.

Some Chairs are willing to provide advisory services to the companies; an issue brought up by Baysinger & Hoskisson (1990), and did not see potential conflicts of interest, even if those services were for the management of the company rather than being commissioned by the board. This could be considered compensation for the time provided to the company that is not covered by the low level of directors fees paid which at least half of the Chairs commented on in passing. That the board knew about it was conceded, but because the director was employed for services under a company name, such services and compensation may not be publicly revealed. Or, as one SOE Chair in acknowledging that some of his directors have a conflict of interest remarked, "We're probably quite paranoid about that sort of thing from a governance perspective". One Chair noted that the specialist knowledge and competencies a director brings to a board may have been acquired through working in the same area of business as the company he or she is serving, as a director. In doing so they place themselves in a potential conflict of interest if a dispute arises between the Chair and the company. Such additional services are, in most cases, monitored by and set up by, the board. However, it would be a reasonably brave board that would take a Government-appointed Chair to task over the amount of work they are doing for the company. Less than 25% of the interviewed Chairs were claiming fees for additional services.

5.4 The shareholder influence

The two key aspects of shareholder influence commented on in this research relate to the appointment of directors by the shareholders and the way the companies report both formally and informally to shareholders or their appointed agents.

CCMAU, as the shareholder's agent for crown-owned companies, exercised considerable influence through their prescribed processes and the application of their rules for company reporting to both officials and shareholding Ministers, as well as in the evaluation and appointment processes for directors. The key driver for this appeared to be the minimisation of shareholder risk, but in so saying, the outcome of the appointments process does not appear to have improved since the application of the State Sector Act in 1988 and the risk is not minimised. The commercial competencies required of directors, together with a commitment to governance and the ability to deliver effectively as a board appears impaired by the intrusion of political imperatives into the processes. Whilst the Government, as shareholder, may seek to get a balance between its social platform of diversity for which there has been found to be no correlation with board performance (van der Walt & Ingley, 2003), and commercial and governance competencies, this is not being achieved. One Chair summed up the issue commented on by all Chairs of crown-owned companies, that "it is not the appointment process that is flawed, only the outcomes". If the process has nodes of activity that impede an outcome in the best interests of the organisation, they need to be rectified. Are the boards of Crown organisations pawns in the

Governments process of recognising and rewarding those who have helped it to power? It could be seen that this was the case from the comments of the officers of crown-owned organisations.

Notwithstanding the comments above, the appointment process for the boards of crown-owned companies suggests a degree of independence (note John & Stenbet, 1998). However, but this research also suggests that the Government appoint directors who have relevant industry knowledge. In doing so, they may ignore the actual or potential conflicts of interest that could, or will, arise. Thus the appointments have to balance the input of the commercial acumen, knowledge components, governance competences and experience, with the need to avoid conflicts of interest, make politically acceptable appointments and train and develop new director candidates.

The degree to which the Chairs were able to influence and input to this tricky appointment process particularly in being able to suggest possible suitable candidates was largely dependent on the strength of their relationships with CCMAU and the Ministers as well as the determination of the Chairs, particularly the experienced ones; to not just accept the candidates they were given. The Chair's relationships in turn appear to depend on the time they have been in governance roles within crown entities and their record in making recommendations that include both a commitment both to diversity and to commercial and governance acumen. Some Chairs applied strong advocacy, determined to get the best possible candidates onto the list going forward to the Appointments and Honours Committee, whilst other Chairs shrugged and said

they did not have any real part to play other than in commenting on the skill mix of the required candidate as a reflection of the current board composition. Some Chairs establish a close personal dialogue with the Minister whilst others who claim to "get on well with the Minister" have a greater perceived personal distance and maintain a more formal business relationship.

By comparison in the large public companies there is usually a three-yearly appointment process. Unless the director wishes to step down either voluntarily or at the behest of a shareholder, usually through a change in equity, they would be reappointed at the annual meeting. Even if their seat was contested they have a high probability of being reappointed unless the board is steering the shareholders towards a new board candidate. In this case the Chair and board members have probably canvassed the major shareholders, including the funds and investment managers, to enlist their support in the voting or been able to persuade the sitting director not to seek re-election. There was no evidence that these companies applied a nominating committee as suggested by Gregory (2001) in the appointment process. This is because only one public company in the sample did not have the influence of a major shareholder in the director-appointment process. The more diversified the shareholding the more autonomy is afforded the board in the appointment of directors. There is also more power vested in the board.

This situation can also lead to a stagnant board, unchanging unless new influential shareholders come into the company, or a retirement, usually on the grounds of age, occurs. This points to the need for regular changes of directors,

which most Chairs dislike, through the infusion of new directors, but not as often as occurs in crown-owned companies. One suggestion that has been made is that one new director should come into the board, as a replacement, each year. The debate is whether the replacement is a board decision or based on the longest-serving director stepping down and not being available for re-election. The constitutions of public companies usually require directors to step down after three years though they may seek re-election and be re-appointed of they are still qualified to do so, especially on the grounds of age.

The influence of the shareholders or their agents in the case of Crown companies has been commented on above in respect to the appointment of Directors in respect to the public sector companies and, by comparison, with the listed companies. Crown companies are expected to table an annual business plan for the Ministers' approval by 30 June each year together with their Statements of Corporate Intent which is a three year forecast and a public document. Their business plans contain the financial budget for the forthcoming year. No interviewee commented on the requirement to report monthly to CCMAU (Appendix E, section 4.1.6).

They said they adhere to the requirement to report formally and informally to the Ministers and their officials. All the Chairs and their CEOs meet with their Minister at least annually although most Chairs also presented their quarterly reports in person, some with the CEO in attendance. As part of the planning process they are obliged to advise Treasury officials of their projected revenue, EBIT, profit and dividend distribution in about March to enable the Government's

expected financial position to be determined. All the crown-owned companies interviewed adhered to this procedure.

From this research one can see why agency theory is a strong theoretical framework in corporate governance. Even though most of the participating companies in the research were crown owned, and thus the officers had no equity, there was still the propensity to push out the rules on matters such as conflicts of interest, management exercising a strong, dominant, knowledge-based leadership, and maximising the growth of the company. Although this research provides no evidence, it could be hypothesised that, as remuneration is related to the revenue, asset base and staff accountability of the CEO, the retention of earnings rather than providing the Government shareholder with a large dividend, could be motivated by the wish of the CEOs to increase their own compensation. Given the lack of commercial acumen of some of the Government appointees to the board, one could ask how strong the board's advocacy was for the largely impersonal shareholder, against strong management. Further the influence of CCMAU over crown-owned companies may not be strong enough to outweigh that of the CEO and management, especially if there is also an output from the company which espouses the shareholder's the social policies, or other objectives. Increasing the employment of minority groups, those with disabilities or other diversity, could be one such social outcome.

Whilst New Zealand Directors and Chairs have justified the appointment of the CEO to the board on the grounds that they will have common direction and equal

accountability with the other directors, there is no evidence of a lack of accountability by the CEO not on the board, or being the Chair. In terms of the Companies Act 1993, the CEO as an executive and advisor to the board, is deemed to have director responsibilities and director status.

Crown-owned organisations have a prescription for the performance evaluation of board members (Appendix E, Clause 8.1.4). Whilst that document identifies the need to assess the performance of the Chair and board members annually most of the Chairs saw this as too frequent and preferred to undertake it every three years. These are being revised by CCMAU with feedback from the Chairs.

6. CHAPTER SIX - CONCLUSION

This was designed to contribute to the theory of what is happening in large New Zealand companies and any significant issues that may need to be changed, or at least reviewed. It has revealed the actions and attitudes of Chairs and CEOs of some of New Zealand's large companies through providing insights and comments that describe the processes, procedures and influences in both publicly listed companies and crown-owned companies in strategic management, corporate governance and its mechanisms, the appointment of directors, the interactions between the management and board groups, the interactions with the shareholders and their influence on the companies. What can be learned from this information?

Throughout the interviews the Chairs and CEOs all spoke highly of each other, although negative comments were made about other Chairs and CEOs. The interview process delivered the depth of information that would not have been obtained through a survey methodology from these officers. They would not have given the time to complete a questionnaire of the length necessary to get the information that has come from these interviews.

This research revealed planning processes that set a strong platform for the establishment of business and financial plans, the education of boards, particularly those that have a changing board membership, and that work for the benefit of all stakeholders. It underscores the need for open, positive communication between CEO and Chair and harmonious board and

management relationships, although communications between these two groups, apart from the Chair and CEO, should exist for information flow, not instruction. Board collegiality and harmony should not be at the expense of the opportunity for and encouragement of, rigorous debate and critical analysis of issues.

Of particular significance it has revealed that although the CEOs sidestepped the governance processes by leaving them in the domain of the Chairs and boards, none of the interviewees had a thorough understanding of the governance mechanisms, both internal and external, that needed to be applied, to one degree or another for the best interests of the shareholders and other stakeholders. It was approached more as a risk management process in respect to conflicts of interest and ethical business practices both of which were applied with a high level of subjectivity.

The literature on director appointment processes is light and usually only addresses the election by members or by nomination by a trustee board. It does not embrace political, commercial or other risk aspects associated with governance and planning.

This research has extended the discourse on corporate governance being researched in New Zealand in a number of post-graduate studies which are, as yet, unpublished. Are there any serious shortfalls in this research? It began with a tenet that duality was a dominant characteristic of companies in the USA and UK where much research on strategic planning and corporate governance had

been undertaken. It was therefore decided that it would not be a variable in this research and thus that all companies in the sample would not have dual CEO/Chair appointments. As duality is not a feature of large New Zealand companies it could have been ignored. A more important variable was whether the CEO was on the board or not, and any influence that may have had. Paired companies, namely those with, and those without, the CEO on the board, could have been selected and the difference in the participation, leadership and influence of the CEOs on the strategic planning processes and the degree to which they influenced the application of governance mechanisms assessed. The sampling method for such study would need to accommodate the influence of crown-owned companies to prevent them dominating one of the two groups. They could be excluded, and only listed public companies be included in the sample.

Another limitation of this research lay in the review of the literature. There were comparatively few publications on the definition or influence of corporate governance before the mid-1990s. Since then the research and articles have increased almost exponentially as this topic gained currency and appeal in both practical and academic business research. Although the literature review was undertaken before the research paradigm was set, in many ways it would have been easier to have undertaken the research then examined the previous research and commentary on this subject. It would certainly have been easier to incorporate the latest thinking on this subject.

Notwithstanding the above, this research reveals valuable insights into the strategic activities of large New Zealand companies. It underscores the need for strong competencies in the board as well as in management. It points to the need for harmony in the board but also individual thought, and more importantly, independence in the input to constructive rigorous debate and analysis based on industry knowledge and commercial acumen. It suggests the need for a reasoned analytical and possibly scientific procedure to be applied to ensure the appointment of directors who have these required competencies, and certainly one in which the political agenda of Government or the personal agendas of major shareholders, should be subordinated in their level of influence.

New Zealand business leaders and students of management will learn as much from the anecdotal comments of the experienced Chairs and CEOs of large companies revealed in this research as from the identified flaws in the current processes and changes in governance mechanisms and procedures that may benefit these companies.

6.1 Opportunities for Further Research

The CEO's compensation was not part of this research. It should be aligned with the interests and objectives of shareholders both in terms of the quantum of the performance of the company and in terms of the timescales over which the outcomes have to be achieved. An analysis of the way in which the compensation of CEOs is matched against company performance which meets these shareholder objectives is an opportunity for further study.

So few public companies in the two, New Zealand main centres, namely Auckland and Wellington, have CEOs who are not also directors, that the question could be asked, is this a positive or a negative situation. Whilst very few large companies in New Zealand have duality with an executive CEO/Chair, and a few have a Chair whose previous appointment was the CEO of the same organisation, for example, Telecom New Zealand, it would be interesting to identify how many CEO appointments were made with a seat on the board at the behest of the incumbent CEO, rather than at the instigation of the board, or major shareholder of an organisation, and their ramifications. This could be the subject of further research: examining the attitudes and appointment processes for CEOs onto the board. Of course the decision could be a historical one in that a Managing Director is replaced by an appointee as Managing Director.

Another area of research could be to extend this research into an examination of the same exclusive groups for the CEO and Chair but without the geographical limitations imposed. Those companies not in Auckland or Wellington could be examined and compared to those in these main urban centres.

The appointment processes have been the subject of significant comment in this research. It is understood that this is subject has been the subject of current masters degree research through Massey. This research suggests this is a relevant area of study.

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Appendix A

Random Number Table

2500 Random Digits

	1 12345	11111 67890	11111 12345	11112 67890	22222 12345	22223 67890	33333 12345	33334 67890	44444 12345	44445 67890
1	87257	58162	24097	35344	71626	30564	72241	92705	43468	85727
2	23930	38657	85479	73153	90003	52325	96113	67925	65441	50915
3	92791	40302	93701	04585	93430	21549	97164	21275	91216	00585
4	75686	79266	04769	21084	35890	06619	03696	67240	91886	74197
5	40199	50062	91876	91565	01998	47852	03455	61002	80048	33381
6	11267	63450	13644	54478	02530	64490	02883	46430	54683	48599
7	35623	41628	63210	66891	40550	90775	22745	24950	72072	89228
8	52029	38996	69032	01409	31408	97587	40417	72628	90887	59824
9	95190	12433	30130	31596	99671	71903	19495	15438	69008	24687
10	74831	05055	91767	42803	60805	97605	75727	32498	88952	94746
11	71040	47243	96527	66414	63056	73455	59433	18585	62441	61265
12	60281	54305	12636	83732	98625	90932	64648	08514	47683	93300
13	88669	29834	26736	17793	26858	85543	56186	99893	16039	18685
14	68998	56624	37193	05329	29925	01241	82687	70456	31668	54400
15	48285	63229	56404	28879	38439	64156	59480	28451	93021	65411
16	61387	10153	59211	11072	96949	56306	20348	58202	52362	84538
17	16115	11805	41374	45102	66458	67047	87425	09086	59172	29872
18	43663	73853	38391	97827	85155	84876	83313	86045	46940	47402
19	58226	43366	17829	72784	28003	02672	85970	29998	41759	00559
20	98108	89500	90446	15027	73873	79219	65322	47684	40929	15673
21	53754	49023	89136	20169	69468	14502	93969	65780	13777	08944
22	30951	69526	41046	77016	24201	14855	17539	95244	22501	07907
23	47862	09955	23599	61139	76971	76741	62988	05712	96249	49756
24	96359	94606	22147	26009	31398	07457	44234	84385	03193	11505
25	48593	18097	15984	35826	24686	61644	67613	59837	72218	83392
26	33854	14137	08726	52815	38834	89693	91897	94085	45209	99757
27	92388	44184	42628	13739	52971	55516	74033	42291	61096	94121
28	22350	02173	26205	85588	01796	09214	81296	86521	73745	59600
29	66258	76414	87652	33169	42890	65613	33365	68175	94288	25747
30	33200	06281	53955	82981	42513	72384	29830	25185	54986	97036
31	39414	58257	84087	74040	00612	42758	42876	59035	47149	88573
32	84362	25796	15027	79001	83443	78103	43149	62272	33734	81190
33	68552	98552	12411	69688	73576	73677	63618	06327	41485	54162
34	93294	75281	32508	62840	24880	59056	81681	60982	88073	62311
35	15638	93026	73177	80626	77155	92184	04143	08049	79627	02882
36	03865	68501	80374	64415	11442	69004	89207	86604	13056	58391
37	80368	21508	74216	53702	30230	05715	37345	08169	63913	84512
38	44512	99825	69751	31220	41539	24309	00754	22808	84007	06853
39	96312	66661	81352	72329	89927	92914	66529	45452	19004	19540
40	88229	09501	98234	47822	46481	22289	70428	36873	36229	97964
41	16103	13417	36836	50919	93579	30210	11490	80318	66671	80749
42	27680	02234	30580	52441	80978	31407	28228	57827	69319	81827
43	56870	28352	28891	25711	39475	71555	87792	34645	49595	51786
44	90870	85656	56503	74990	44909	29780	93207	11213	03336	94993
45	35666	39202	26638	11811	52177	19146	90185	77810	60588	71201
46	92772	77979	64169	19061	96708	81629	03937	85957	08459	59300
47	34894	50742	20356	70952	32751	05468	97786	99222	48140	93592
48	51343	14368	21136	83905	24470	27863	86417	66868	91850	13629
49	59161	68137	11603	36229	93579	49108	22834	18534	33358	33999
50	93157	66185	70112	74556	98520	11380	88700	40738	19218	40839

Appendix B

Information Letter

Department of Management
Private Bag 11222
Palmerston North
New Zealand
Tel: ++64 6 350 5799 extn 2777
Fax: ++64 6 350 5661

Dear .....

My name is Maurice Ellett and I am undertaking research as part of my Masters Degree in Business Studies being undertaken at Massey University, under the supervision of Dr James Lockhart and Dr Astrid Baker of the Department of Management. I am examining how strategic management processes are conducted in New Zealand companies where, unlike the prevalent structures in the United States, the management (CEO) and governance (Board) are usually exclusive groups. I am intending to identify the division of labour between the CEO and the Board relating to those factors that may influence the autonomy of these two groups in delivering strategic management with integrity and accountability for the benefit of the shareholders. This is a new area of research for the New Zealand context.

I am wishing to interview the Chief Executives and Chairpersons of up to 20 listed New Zealand companies to gain their comments and thoughts on these matters. I anticipate that each interview will take up to an hour. I will take notes during the interview and, with the participants' permission, record the interview on audio tape. This information will then be analysed and the results will form the basis of my report. The only people with access to this information during the research process will be myself, my supervisors and a person who I will use to undertake the transcription and who sign a confidentiality agreement. The report will be completely anonymous from any identification of the contributing organisations or their executives and the confidentiality of participants will be preserved.

Participants will be selected randomly from a list of the top 200 listed companies in New Zealand. Potential participants are invited to take part but will have full right to decline to do so. Participants will have the right to withdraw at any time, to refuse to answer any particular questions, or to make comments that will not be recorded. They will have the opportunity to ask questions about the study at any time during their participation and will be given access to a summary of the findings of the study when it is concluded.
Contact details for me and my supervisors are listed below:

Dr James Lockhart
Senior Lecturer
Department of Management
Massey University
Private Bag 11222
Palmerston North
Ph: 06 350 5799 ext 2809
E-mail:
J.C.Lockhart@massey.ac.nz

Professor R.E. Stablein
Department of Management
Massey University
Private Bag 11222
Palmerston North
Ph: 06 350 5799 ext 2795
E-mail:
R.Stablein@massey.ac.nz

Yours sincerely

Maurice C Ellett

Appendix C

Consent Letter

Department of Management
Private Bag 11222
Palmerston North
New Zealand
Tel: ++64 6 350 5799 extn 2777
Fax: ++64 6 350 5661

The Role of the CEO and Board Chairperson in Strategic Management in New Zealand

CONSENT FORM

I have read the Information Sheet and have had the details of the study explained to me. My questions have been answered to my satisfaction, and I understand that I may ask further questions at any time.

I understand I have the right to withdraw from the study at any time during the interview and to decline to answer any particular questions.

I agree to provide information to the researcher on the understanding that my name will not be used without my permission.

(The information will be used only for this research and publications arising from this research project).

I agree/do not agree to the interview being audio taped.

I also understand that I have the right to ask for the audio tape to be turned off at any time during the interview.

I agree to participate in this study under the conditions set out in the Information Sheet.

Signed:...

Name:...

Date:..............................

Appendix D

1) QUESTIONS FOR THE INTERVIEW

a) STRATEGIC MANAGEMENT/PLANNING

i) What does the board/management see as its role in strategic management? How is the plan developed? Approved? and what input is there to the creation of the strategic plan?

ii) Does the board and CEO/management sequester together to set the directions and guidelines for the company strategies? If so, for how long?

iii) Is there an expectation that the board will endorse the strategic plan and consequential business plan recommended by the CEO?

iv) To what extent does the board influence the CEO in terms of strategic vision?

v) To what extent does the CEO influence the board's thinking on the strategic vision, direction and management?

vi) For how long is the strategic plan set?

vii) Could you please provide a chronological description of the typical monthly/annual cycle of CEO/Board interaction?

viii) Could you also provide a description of a typical board meeting? What drives the agenda?

ix) What interactions do the board members have with the executive management team?

b) SELECTION OF BOARD MEMBERS

i) How are new Board members selected and appointed?

ii) Does the CEO/Chair become involved in the selection of new Board members? If so what does the CEO do?

iii) Does the CEO/Chair meet the prospective board candidates only to ensure compatibility? or identify possible candidates?

iv) As part of due diligence does the CEO/Chair assess candidates he/she could work with as Board members?

v) Does the CEO/Chair approach possible board candidates and convert them to a shortlist for the Board to decide/endorse?

vi) What actions does the Chair/CEO take in influencing the appointment of directors with the shareholder's agents? [For crown-owned companies]

vii) In appointing new Board members is a Board subcommittee (Nominations Committee) tasked with shortlisting and recommending a slate of the required number of Board members?

viii) What due diligence support is the prospective/ newly appointed member given?

ix) What other aspects are important in appointing new Board members (How identified? How selected? What criteria are set? etc)

x) What percentage of your directors have no connection with the company other than a seat on the board? (Excludes full-time employees, family members of employees, and the company's lawyers, bankers, accountants, consultants.)

xi) How many other boards are your directors on?

xii) What sort of induction/training is done when bringing a new member onto the board?

xiii) What provision or action is taken for ongoing board education?

c) GOVERNANCE PROCESSES

i) What does the board Chair/CEO understand Governance to be and how is its importance assessed?

ii) What potential conflicts of interest exist and how are they handled?

iii) What, if any, Governance elements contribute to your company's success? What elements impair the company's performance?

iv) What actions or decisions does the board undertake to ensure they deliver on their governance accountabilities (given they understand what it is)?

v) What direct and indirect interrelationships exist between the board as the governance body and the rest of the company entity?

vi) If it is the task of the Board to hire and fire the chief executive what criteria should exist in performing this action?

vii) What are the differences in power/influence between CEO and board in your organisation?

viii) What, if anything, should the board tell the shareholders of their position on governance and whether they are applying/delivering effective governance processes?

ix) What contact does the Chair/CEO have with the shareholders both formal and informal?

x) Is there anything else you would like to tell me about the planning processes or governance procedures that may be of interest to this subject or comments you wish to make?

OWNER'S EXPECTATIONS MANUAL

Content

The Manual covers the following:

1	Introduction
2	Background - Crown Company Policy Framework
3	Roles and Responsibilities of Stakeholders
4	Reporting Requirements of Crown Companies
5	The Monitoring Function
6	Financial Governance
7	Process for Dealing with Strategic Issues
8	The Board Appointment Process

1 Introduction
2 Background - Crown Company Policy Framework
3 Roles and Responsibilities of Stakeholders
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1 INTRODUCTION

1.1 Purpose of the Expectations Manual

This Manual outlines shareholding Ministers' expectations of Crown company boards. It also clarifies the environment within which shareholding Ministers expect boards to meet their responsibilities and the Ministers' expectations.

The Manual describes the relationship between shareholding Ministers and boards, and explains the role of both the Crown Company Monitoring Advisory Unit (CCMAU) and the Treasury in monitoring Crown companies' performance. This information is set out in relevant legislation, including the Companies Act 1993, State-Owned Enterprises Act 1986 (the SOE Act), the Public Finance Act 1989 (the PFA) and specific Crown company legislation.

In the past, shareholding Ministers' expectations of and ownership policies for Crown companies have been communicated to boards at different times in different ways, namely:

- letters dating back to 1987
- statements of shareholding Ministers' expectations of Crown companies' business processes
- annual outlook letters to Crown companies
- speeches by shareholding Ministers to Crown company chairs; and
- discussions at business plan meetings and subsequent correspondence.

Although these policies and procedures still apply, some aspects may have been overlooked owing to the fragmented nature of the documents and changes in boards and management over time. It is timely for existing arrangements to be communicated in a more structured way.

This Manual is designed to provide Crown company boards with:

- a comprehensive policy and process framework; and
- generic shareholding Ministers' expectations, to be used by all Crown company boards as an overarching "evergreen" document.

The Manual will be updated regularly depending on changes in expectations, processes and policies. It is designed to help shareholding Ministers, advisors and boards operate efficiently in their roles so that they are able to assist Crown companies to become successful businesses, while observing their social and other obligations to society and the Crown as a whole.

The Manual is **not** intended to replace the "outlook letter" sent by CCMAU and the Treasury at the outset of the annual Business Planning cycle, which covers specific issues of individual Crown companies.

2 BACKGROUND - CROWN COMPANY POLICY FRAMEWORK

2.1 Crown Company Policy
2.1.1 Crown Company/SOE Structure

2.2 Crown Company Attributes
2.2.1 Statutory Obligations
2.2.2 Processes Specified in the SOE Act, CRI Act and Other Crown Company Specific Legislation
2.2.3 The Companies Act

The policy framework is designed to ensure that Crown companies:

- operate at "arm's length" from the Government. Unlike departments, they are not part of the Crown, but are instead owned by the Crown
- have independent boards that are accountable for companies' performance
- are separate legal entities (this means company directors are legally responsible for the companies' activities); and
- are subject to the financial reporting and other requirements applying to all companies, unless they are supplemented or changed by the Public Finance Act 1989 and/or any relevant sector-specific or company-specific statute.

1 | Introduction
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2 BACKGROUND - CROWN COMPANY POLICY FRAMEWORK

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- **have independent boards that are accountable for the performance**
- **are separate legal entities (this means company directors are legally responsible for the companies' activities); and**
- **are subject to the financial reporting and other requirements applying to all companies, unless they are supplemented or changed by the Public Finance Act 1989 and/or any relevant sector-specific or company-specific statute.**

2.1 Crown Company Policy

During the 1980s, the Government began using the company model as part of its broader state sector reforms. Until then government departments as trading operations generally undertook the activities now carried out by these companies.

Crown companies are limited liability companies established under and subject to the Companies Act 1993. Each Crown company also operates under a statute, which is either specific to a sector – as in the case of State-Owned Enterprises (SOEs) and Crown Research Institutes (CRIs) – or specific to a certain company, as in the case of Radio New Zealand. This statute typically addresses ownership, governance and public accountability arrangements for the company.

A key principle under the Crown company model is the separation and maintenance of a clear division between the Government's different interests as they relate to a company, ie, ownership, purchasing and regulatory. This separation enables Ministers to make decisions on the mix and relative priority of policy goals.

Under the Crown company model:

- each company has the principal objective of acting as a successful business
- compensation is paid to each Crown company for social objectives that the Crown requires to pursue
- each company takes managerial responsibility for all operating decisions
- competitive neutrality is maintained between Crown companies and the private sector; and
- each company is a separate legal identity, established as a limited liability company.

2.1.1 Crown Company/SOE Structure

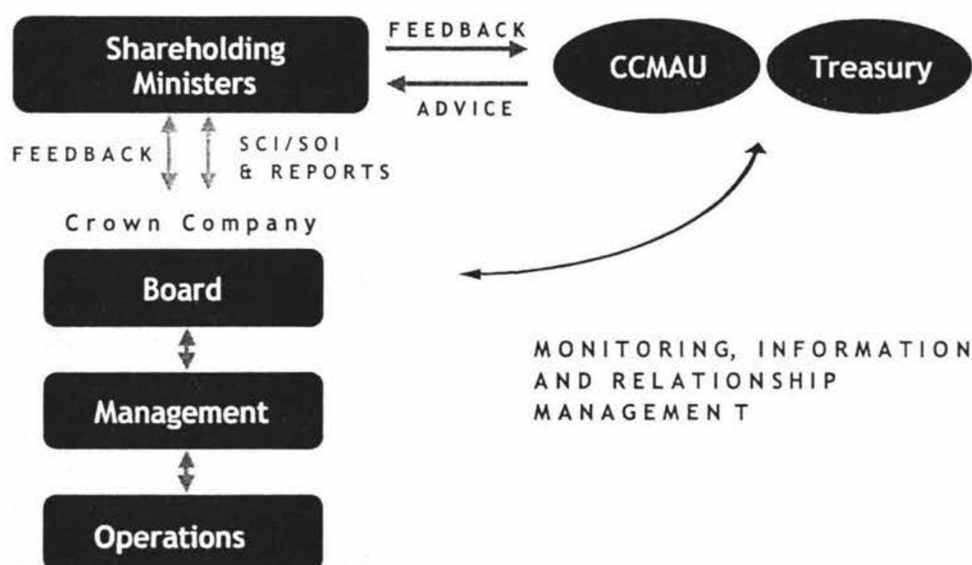
Every Crown company has two shareholding Ministers, each of whom holds 50% of the company's shares. One of these, the Responsible Minister, has specific responsibility for an individual company or group of companies (eg, SOEs or CRIs). The Responsible Minister generally takes the lead-shareholder role, particularly in their capacity as the formal point of contact with boards.

The Minister of Finance has always been the second shareholding Minister because of the importance of the sector or company to the Crown's economic and financial objectives. From time to time, the Minister of Finance may delegate some of their responsibilities to an associate or deputy Minister of Finance.

The Crown, through the two shareholding Ministers, is normally the company's sole shareholder. The Crown acts as a steward, protecting the investment in these companies on behalf of the ultimate beneficiaries, the people of New Zealand.

Shareholding Ministers appoint a board of directors to run each company. Directors oversee the company's management and are legally bound to act in the company's best interest. The chief executive, who is appointed by and is an agent of the board, has the power to control the company within the limits of their delegations. The company's management and employees are agents of the chief executive.

Figure 1 The Crown Company Framework



2.2 Crown Company Attributes

The "company form", as described at the beginning of this section, gives all Crown companies certain attributes that differentiate them from other corporate forms such as government departments, statutory bodies and charitable trusts.

2.2.1 Statutory Obligations

The Companies Act 1993 provides the overarching framework of accountability and governance for all Crown companies. This framework is augmented by specific statutes such as the SOE Act 1986, the Health and Disability Services Act 1993, the Crown Research Institutes Act 1992 (CRI Act), the PFA 1989 and other enabling legislation.

Crown company boards are accountable to shareholding Ministers for their performance. Shareholding Ministers are, in turn, accountable to Parliament for the performance of Crown companies. Select committees review performance according to the requirements of the relevant Acts. Members of Crown company boards may be asked to appear before select committees to help in this assessment.

Crown company performance is measured against a set of parameters and targets contained in a Statement of Corporate Intent (SCI) for CRIs and SOEs or Statement of Intent (SOI) for other Crown companies. The requirement for SCIs and SOIs is set out in the SOE, PFA and CRI Acts. The company boards are responsible for ensuring that the company targets are met.

The SCI or SOI, financial statements and annual reports provide a framework for Parliamentary and public accountability of Crown companies. SCIs and SOIs are explained in more detail on the CCMAU web site: www.ccmau.govt.nz

2.2.2 Processes Specified in the SOE Act, CRI Act and Other Crown Company Specific Legislation

These Acts require each board to:

- *SCIs/SOIs:* deliver to shareholding Ministers a draft SCI/SOI no later than 1 month before the start of each financial year, to consider any comments made by shareholding Ministers on the draft SCI/SOI, and to deliver a completed SCI/SOI to shareholding Ministers on or before the start of the financial year, or at a later date set by the shareholding Ministers

  Section 14(2)(g) of the SOE Act and the relevant section of the CRI Act and other Crown company Acts (where applicable) require Crown companies to detail the kind of information to be provided to shareholding Ministers during the financial year, including an undertaking to deliver quarterly reports to shareholding Ministers within one month after the end of each quarter, and business plans before the start of each financial year
- *Half-yearly Reports:* produce a half-yearly report within two months after the end of the first half of each financial year, containing the information and targets required by the SCI/SOI
- *Annual Reports*: produce annual reports within three months after the end of each financial year; and
- *Other Information*: according to section 18 of the SOE Act and the relevant section of the CRI Act and other Crown company Acts (where applicable), provide any more information that either shareholding Minister requests after consultation with the board. Boards are obliged to respond to official information requests and provide information on outcomes for the Government's routine financial publications and parliamentary questions, as well as respond to other demands for information.

2.2.3 The Companies Act

All Crown companies have been reregistered in terms of the Companies Reregistration Act 1993. This means the Companies Act 1993 applies to all Crown companies in the same way as it applies to other companies. While Crown companies are subject to both their own specific legislation and the Companies Act, these Acts do not conflict with one another.

The Companies Act requires each board, among other things, to:

- prepare annual accounts and submit them to annual shareholders' meetings
- comply with the solvency requirements
- comply with the directors' duties

- hold annual general meetings
- present special resolutions to shareholders when necessary (for example, a resolution for the approval of "major transactions" – as this term is defined in section 129 of the Companies Act 1993); and
- manage the company's business affairs.

3 ROLES AND RESPONSIBILITIES OF STAKEHOLDERS

3.1 Shareholding Ministers' Role
3.1.1 The Relationship between Shareholding Ministers and Other Portfolio Ministers
3.2 Crown Company Boards' Role
3.3 The Role of Advisors
3.3.1 Advice Flows and Advisor Relationships
3.3.2 CCMAU's Perspective
3.3.3 The Treasury's Perspective

Generally shareholding Ministers have statutory powers to:

- exercise all rights as a shareholder as set out in the Companies Act and the company's constitution
- direct the board to alter the company's SCI or SOI subject to the respective legislation
- determine the level of distributions payable by the company (after consultation with the board); and
- require additional information from the company.

A Crown company board is typically responsible for:

- appointing, managing and monitoring the chief executive's performance
- providing leadership and vision to the company in a way that will enhance shareholder value and ensure the company's long-term organisational health
- developing and reviewing organisational strategy
- monitoring the performance of senior management
- reviewing and approving the company's capital investments and distributions
- ensuring compliance with statutory requirements
- providing leadership in its relationships with key stakeholders
- negotiating the SCI or SOI with the shareholder, developing the business plan so that it will receive shareholder support, and holding management responsible for meeting the performance measures/milestones in the SCI or SOI and business plan; and
- establishing appropriate governance structures (such as board committees and clear lines of responsibility and accountability between the board and management) to ensure the smooth, efficient and prudent stewardship of the company.

Advisors focus on:

- Crown companies' commercial opportunities and risks
- the operating environment and Crown company performance
- protecting and enhancing of shareholders' value
- performance against objectives; and
- ownership objectives for individual Crown companies.

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3 ROLES AND RESPONSIBILITIES OF STAKEHOLDERS

3.1 Shareholding Ministers' Role

Shareholding Ministers' statutory powers, as set out in the Companies Act 1993, may be modified according to the sector or company specific legislation.

Generally shareholding Ministers have statutory powers to:

- **exercise all rights as a shareholder as set out in the Companies Act and the company's constitution**
- **direct the board to alter the company's SCI or SOI subject to the respective legislation**
- **determine the level of distributions payable by the company (after consultation with the board); and**
- **require additional information from the company.**

If the Minister uses their power to direct boards, they are generally required to table notice of this in Parliament within 12 sitting days of giving the direction. This ensures that shareholding Ministers are accountable to Parliament for the exercise of their statutory powers.

Table 1 Shareholding Ministers' Main Activities

Shareholding Ministers responsibilities include:

- approving Crown companies' medium- to long-term strategic direction
- appointing and removing directors
- consulting with boards on the content of draft SCIs (most notably this includes meeting with boards to discuss business plans) and commenting on these, including any aspects that may be inconsistent with statutory requirements
- approving SCIs or SOIs and tabling them
- developing and articulating policies on the Government's ownership intentions
- monitoring board performance and taking necessary remedial steps should boards be failing to meet the targets in their SCI or SOI and business plans
- consulting with boards as issues arise
- tabling annual and interim financial reports in accordance with statutory requirements
- taking decisions within the shareholders' area of prerogative (for example, approving the sale or purchase of a company, capital distribution or major transaction where such approval is required under a company's SCI or SOI, or the Companies Act 1993); and
- passing resolutions at annual general meetings (or special general meetings).

3.1.1 The Relationship between Shareholding Ministers and Other Portfolio Ministers

Most Crown companies operate in sectors for which there are other Ministerial portfolios (eg, broadcasting, where the Minister of Communications as well as the Minister for State-Owned Enterprises are responsible for Television New Zealand).

3.2 Crown Company Boards' Role

Best-practice corporate governance recognises that there are quite legitimate "boundary" disputes in the interaction between the three legs of the governance tripod - the shareholder, board and management. However, by adhering to proper processes and procedures, these boundary disputes can be minimised.

The board's main role is the governance of the company. It exercises stewardship on behalf of the shareholder to ensure the company's ongoing health and financial viability. Under all circumstances, the board's first duty is to the company and this has been enshrined in the Companies Act. (There is some academic debate about what constitutes the "company" as distinct from the "shareholder", but nevertheless in a company that is wholly owned, the interests of the "company" will generally accord with those of shareholders.)

Crown company constitutions are different from typical private-sector counterparts in that shareholding Ministers, as opposed to the board, directly appoint the chair and deputy chair.

Crown company boards are also responsible for preparing, finalising and implementing SCIs or SOIs. The SCI/SOI is a central part of the accountability system and ensures clear organisational objectives are set.

Table 2 Crown Company Board Duties

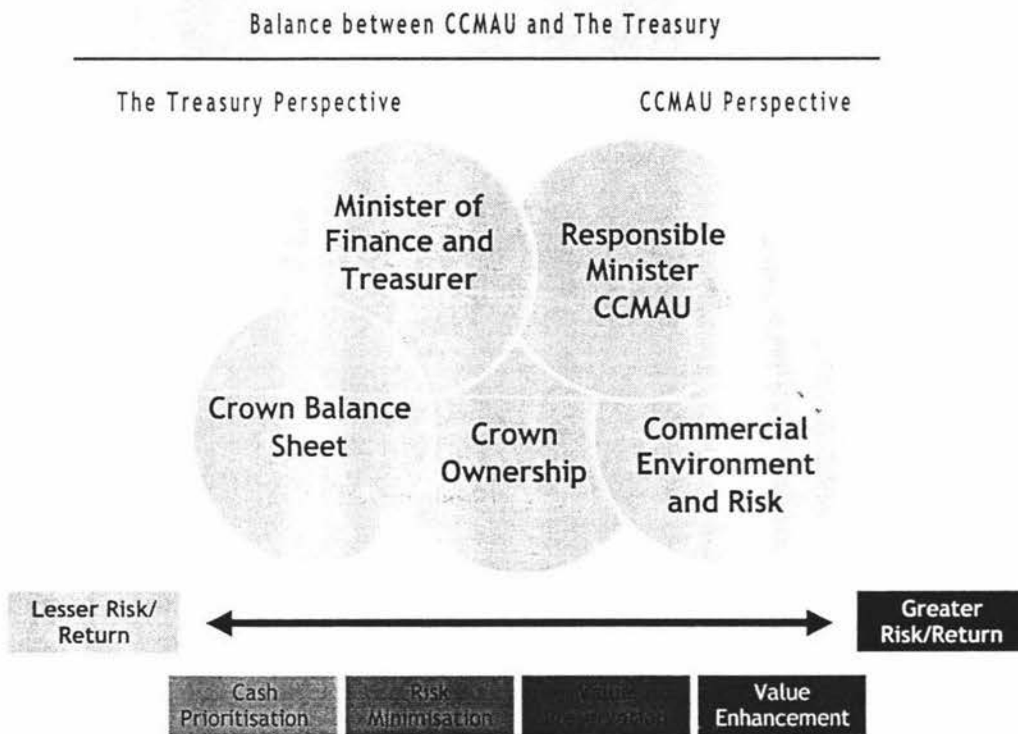
A Crown company board is typically responsible for:

- **appointing, managing and monitoring the chief executive's performance**
- **providing leadership and vision to the company in a way that will enhance shareholder value and ensure the company's long-term organisational health**
- **developing and reviewing organisational strategy**
- **monitoring the performance of senior management**
- **reviewing and approving the company's capital investments and distributions**
- **ensuring compliance with statutory requirements**
- **providing leadership in its relationships with key stakeholders**

- dividends
- diversification and expansion
- company divestments; and
- other issues, as appropriate.

Advisors also contribute to general policy advice on Crown companies in consultation with other departments, as appropriate. However, final decisions on all Crown company issues remain with shareholding Ministers.

While the two agencies share the monitoring of the Crown companies they are responsible for considering issues from different aspects of the Crown's ownership objectives. Their complementary roles are described below:



3.3.2 CCMAU's Perspective

CCMAU has lead agency responsibility in:

- routinely monitoring Crown company performance and providing advice related to that performance; and
- issues management.

CCMAU has sole responsibility for board composition and performance.

CCMAU advises and is accountable to the Minister responsible for a specific Crown company. While CCMAU's purchase agreement of services is with the Minister for State-Owned Enterprises, it is also assigned to monitor Crown

companies that fall under the jurisdiction of other Ministers, such as TVNZ (Minister of Broadcasting), Animal Control Products (Minister of Agriculture) and Learning Media Limited (Minister of Education), to name just a few.

CCMAU adopts a commercially oriented perspective in its role as advisor, with primary emphasis on ensuring individual Crown companies are successful businesses. CCMAU also advises shareholding Ministers on specific issues affecting Crown companies as and when they arise.

3.3.3 The Treasury's Perspective

The Treasury has lead agency responsibility for:

- the regulatory/policy interface; and
- asset sales.

The Treasury reports to, and is accountable to, the Treasurer and the Minister of Finance.

The Treasury manages the Crown's finances and is the Government's principal advisor on economic and financial issues. Therefore it focuses on both economic efficiency and the fiscal impact of Crown company performance (ie, the impact on the Crown's balance sheet).

The Treasury provides policy advice on the Crown's ownership interest from a broad perspective, with particular emphasis on implications for economic efficiency and welfare. This advice may result in shareholding Ministers constraining the bounds within which Crown companies operate.

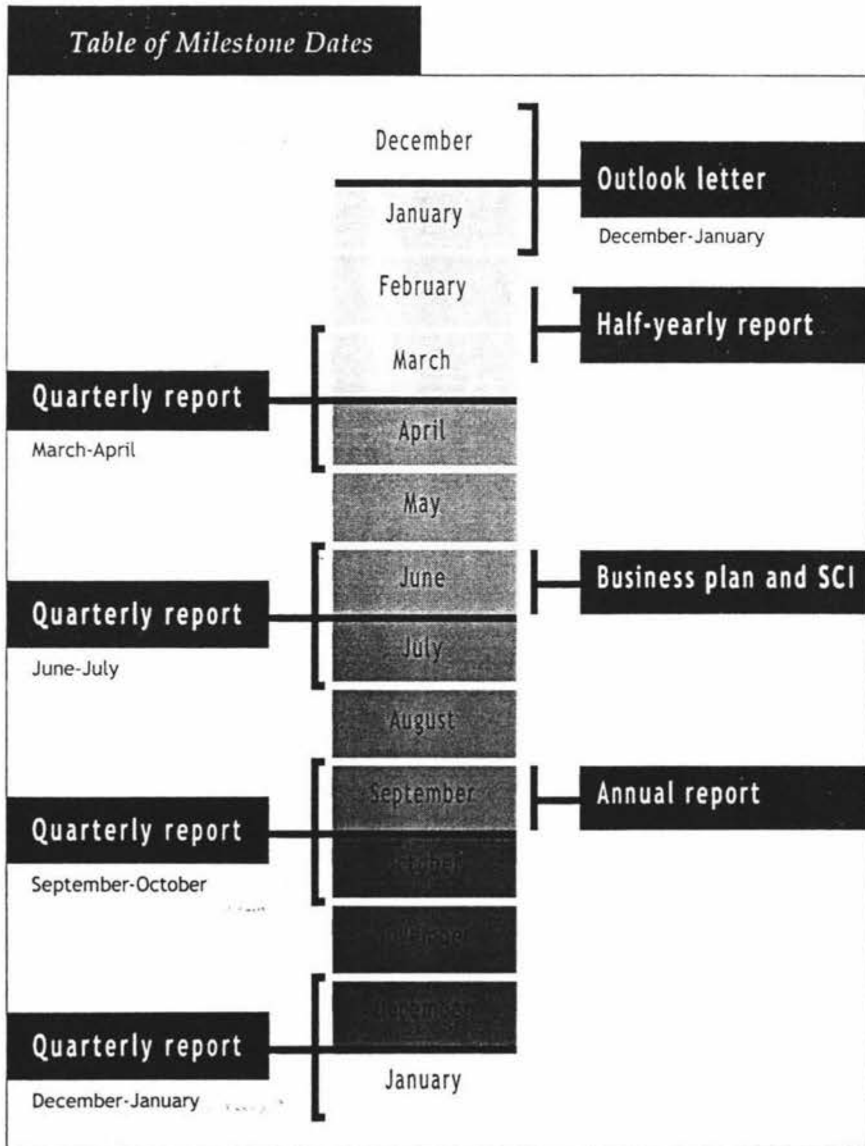
Where a Crown company proposes action that is likely to have a significant impact on the Crown's balance sheet or the economy, the Treasury provides advice on the financial or economic implications.

For example, the Treasury's focus may include issues relating to a Crown company's capital structure, dividend policy, the scope of Crown company businesses or major divestments or acquisitions. In cases where shareholding Ministers oversee divestment of Crown company assets or their shareholding in a Crown company, the Treasury manages the divestment process.

4 REPORTING REQUIREMENTS OF CROWN COMPANIES

4.1 The Business Planning Cycle

- 4.1.1 The SCI/SOI
- 4.1.2 Scope and Core Business
- 4.1.3 Capital Expenditure Statement
- 4.1.4 Reporting on Financial and Non-Financial Performance Indicators
- 4.1.5 Treaty of Waitangi
- 4.1.6 Table of Milestone Dates



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4 REPORTING REQUIREMENTS OF CROWN COMPANIES

Shareholding Ministers expect their relationships with each Crown company board to be maintained in a specific way. One of the most significant periods during each year is the annual business planning cycle, where boards and management formulate the anticipated strategic and financial future of their companies for the three years ahead. The process is outlined below:

4.1 The Business Planning Cycle

The main steps in the business planning cycle are:

- **shareholding Ministers write to each Crown company board before the beginning of each planning round to detail the information requirements, the timing (milestone dates) and any special issues the company is to address during the planning round**
- **boards are then required to: assess their business environment; reassess their strategic direction; provide a detailed plan for the immediate year; and provide financial projections for the following 2 to 4 years**
- **following the delivery of the boards' outlook and business plans to the shareholding Ministers, advisors then prepare a report on these documents for shareholding Ministers' consideration. Draft SCIs/SOIs are delivered together with the business plans. The SOE Act, the CRI Act and other relevant company-specific legislation require boards to deliver their draft SCIs to shareholding Ministers at least one month before the end of each financial year**
- **shareholding Ministers may then, through their advisors, seek further information**

- shareholding Ministers then consult with boards on any issues or concerns they have with the business plans and draft SCIs/SOIs. This occurs either by letter or, more often, meeting between shareholding Ministers, advisors and the board (referred to as the business planning meeting)
- following the business planning meeting (if held) shareholding Ministers write to boards outlining their understanding of the main outcomes and issues discussed
- boards then consider the outcomes from business planning meetings and the shareholding Ministers' written comments, and if necessary, revise their business plans and SCIs/SOIs·boards then deliver to shareholding Ministers finalised business plans and SCIs/SOIs; and·
- shareholding Ministers table the finalised SCIs/SOIs in the House.

4.1.1 The SCI/SOI

The SCI/SOI sets out the nature and scope of the activities to be undertaken by Crown companies, and is the document against which boards are held accountable. It also specifies the key targets arising out of the business planning process. Boards are required to report against their SCI/SOI targets in the Crown companies' annual reports.

If a board wishes to change its business strategy, including developing new business, it must let shareholding Ministers know so they can comment accordingly. Shareholding Ministers would expect proposed amendments to be discussed in the context of the business planning round before implementation. The draft SCI is the appropriate time to document such changes. The SOE Act, the CRI Act and other company specific-legislation allow changes to a completed SCI during the year. However, this is done sparingly.

The board determines targets in the SCI/SOI. Boards must, however, consult with shareholding Ministers and take into account their expectations and preferences. Shareholding Ministers expect the targets to be meaningful and related to the drivers of each Crown company's performance as specified in the business plan.

4.1.2 Scope and Core Business

Shareholding Minister's expect companies to define clearly their scope of business and core business in the SCIs/SOIs.

4.1.3 Capital Expenditure Statement

SCIs/SOIs should include an estimate of intended aggregate capital expenditure for the relevant period while the Strategic Plan should include a more detailed analysis of intended capital expenditure.

Ministers expect this expenditure to meet an internal rate of return that is at least commensurate with the company's required return on equity.

4.1.4 Reporting on Financial and Non-Financial Performance Indicators

Performance indicators (financial or non-financial) must:

- be meaningful to the Crown company's business and the relevant Acts
- involve reasonable transaction costs
- be measurable without ambiguity
- be capable of auditing, where appropriate
- be within the Crown company's responsibility or power to control
- influence the Crown company's purpose and principles of operation or business, without unprofitably interfering or causing dysfunctional behaviour
- respect commercial sensitivity, where appropriate
- encourage "best practice"; and
- ensure employee participation in, and ownership of, these indicators.

All key generic non-financial performance indicators must be reliably reported and supported by a robust process for recording and reporting the data. The board must verify that such a process is in place in its Statement of Responsibility in the annual report.

4.1.5 Treaty of Waitangi

Section 9 of the SOE Act includes the requirement that Crown actions and decisions taken under the Act are not to be inconsistent with the Treaty of Waitangi. Boards will be aware that the nature and extent of this requirement have been the subject of extensive litigation, judicial scrutiny and Government activity.

Boards should consider including a statement in their SCIs that recognises both the Crown's Treaty of Waitangi obligations, and that the Crown's Treaty settlement process may affect their business operations.

4.1.6 Table of Milestone Dates

The table below shows the milestone dates for the business planning round and regular reporting. [Please note it relates to Crown companies with 30 June balance dates.]

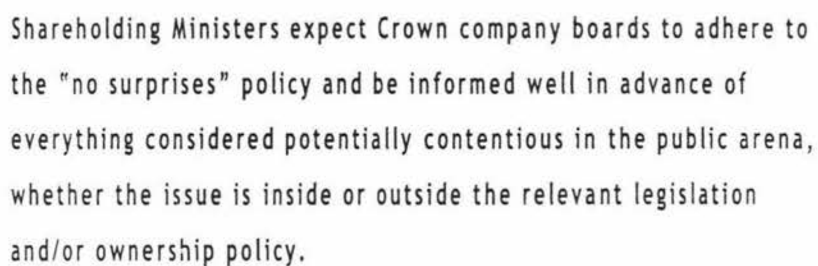
Type of Report	Date	Comments
Table of Milestone Dates		
Business planning rounds	**For Crown companies with 30 June balance dates**	
Shareholding Ministers Send Outlook letter to boards	December/January	The Outlook letter details the information requirements for the planning round
Board Submit outlook report, draft business plan and draft SCI to shareholding Ministers	Before 31 May (s14(1)-SCI)	Boards should endeavour to deliver these documents as early as possible (before 31 May)
Shareholding Ministers Comment on draft documentation	By 16 June (s14(4))	This usually takes the form of a meeting with shareholding Ministers and advisors, followed by a letter with shareholding Ministers' comments
Board Deliver final business plan and SCI	By 30 June (s14(4))	The completed SCI must be delivered before the start of the financial year, or by a later date set by shareholding Ministers
Shareholding Ministers Table SCI	Within 12 sitting days of receipt (s17(2)(a))	
Annual reports		
Board Deliver report of board, audited financial statements and auditor's report to shareholding Ministers	Within 3 months after the end of each financial year (ie, by 30 September) (s15(1))	
Shareholding Ministers Table annual report	Within 12 sitting days of receipt (s17(2)(b))	

Table of Milestone Dates

Type of Report	Date	Comments
Annual general meetings		
Board		
Call an AGM	At least once in each calendar year (s120 of the Companies Act 1993)	Each Crown company is to hold an AGM at least once in each calendar year and no more than 15 months may elapse between the date of one AGM and the next, nor may the Crown company hold an AGM later than 6 months after its balance date.
Half-yearly reports		
Board		
Deliver half-yearly report to shareholding Ministers	Within two months after the end of the first half of each financial year (by 31 August) (s16 (1))	
Shareholding Ministers		
Table half-yearly report	Within 12 sitting days of receipt (s17(4))	Each report must include the information specified in the SCI
Quarterly reports		
Board		
Deliver quarterly reports to shareholding Ministers. The requirement to deliver quarterly reports is usually set out in the SCI	Within one month after the end of the quarter	CCMAU prepares a report for Cabinet once it receives the quarterly reports. Those not received in time are omitted from this report with a note on the reason for omission. Feedback is given to Crown companies where appropriate
Monthly indicators of trends		
Board		
Advise CCMAU of the Crown company's monthly revenue, net profit after tax and operating cash flow performance measured against its monthly budget. The board is simply required to advise CCMAU whether the Crown company is ahead of budget, in line with budget, or below budget (given a 5% variance)	Within 15 days after the end of each month	Shareholding Ministers request each Crown company to supply the information requested, to allow CCMAU to track performance trends on a monthly basis. Where a Crown company is below budget, CCMAU will ask for an explanation

5 THE MONITORING FUNCTION

5.1 No Surprises Policy



Shareholding Ministers expect Crown company boards to adhere to the "no surprises" policy and be informed well in advance of everything considered potentially contentious in the public arena, whether the issue is inside or outside the relevant legislation and/or ownership policy.

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5 THE MONITORING FUNCTION

The Government, as the owner of over 60 Crown companies, has an obligation to manage its investments in the best interests of New Zealanders. The monitoring function is central to ensuring that relevant legislation, ownership policies and shareholding Ministers' expectations are clearly communicated to, and adhered to by, Crown company boards.

When Crown companies were first established in 1987, the Treasury reviewed the monitoring regimes operated by a number of larger private sector businesses and developed a model designed to replicate their key features. This model was extended to the Health and CRI companies as they were established in the early 1990s.

The shareholding Ministers' monitoring function is similar to that of equity markets in the case of private sector companies. However, shareholding Ministers face certain constraints not faced by private sector equity holders:

- shareholding Ministers, as owners, do not have a share price to enable them to monitor their boards' performance
- boards of Crown companies do not face the direct threat of takeovers in the event of poor performance; and
- should shareholding Ministers become dissatisfied with a Crown company's performance, they cannot readily divest themselves of ownership of that company without empowering legislation.

This is why it is important to monitor Crown companies and receive timely and relevant information from them. In light of these considerations, legislation such as the SOE Act gives shareholding Ministers certain powers over and above those of ordinary shareholders, eg, the power to determine the level of dividends payable.

The success of this monitoring regime relies on:

- a common and clearly understood framework of accountability and governance for all companies. This is provided by the Companies Act and supplemented by individual company- and sector-specific statutes such as the SOE Act, the CRI Act, the Health and Disability Services Act, the PFA and other relevant legislation
- independent advisors being familiar with and understanding the companies they monitor so that shareholding Ministers receive expert advice
- the implementation of best-practice corporate governance policies and procedures; and
- a mechanism to develop and maintain clear and focused board accountability.

5.1 No Surprises Policy

Under the "no surprises" policy boards are expected to communicate with shareholding Ministers, as appropriate, on specific issues. Shareholding Ministers expect boards to:

- understand the wider Government policy issues as part of their decision-making
- be aware that the Crown has interests wider than those of ordinary shareholders in private companies
- be aware of the potential implications of company-specific issues on the Crown and/or its balance sheet; and
- be sensitive to the demand for accountability placed on shareholding Ministers from both Parliament and the many taxpayers who hold shareholding Ministers directly accountable for Crown company operations.

Shareholding Ministers have a considerable interest in remaining aware of issues affecting Crown companies, and in the performance of Crown companies. Boards should therefore advise shareholding Ministers of issues that are controversial or likely to be discussed in the public arena.

Boards are not expected to make political decisions or to compromise either shareholding Ministers' political decision-making, or boards' legal responsibilities to their companies.

Shareholding Ministers expect Crown company boards to adhere to the "no surprises" policy and be informed well in advance of everything considered potentially contentious in the public arena, whether the issue is inside or outside the relevant legislation and/or ownership policy.

6 FINANCIAL GOVERNANCE

6.1 Capital Structure and Dividend Policy

6.2 Managing Risks

6.2.1 Foreign Exchange Risk Management

6.3 Financial Targets for Crown Companies

6.4 Crown Company Borrowing Considerations

6.4.1 Explicit Disclaimer of Crown Guarantees and Loan Covenants

6.4.2 Ownership Review Clauses

6.5 Tax Planning

6.6 Value-Based Reporting (VBR)

The level of estimated dividends is driven by the desired capital structure, the company's profitability and the level of future capital expenditure as outlined in the business plan and SCI/SOI.

The proposed dividend payout ratio and estimated dividend payment should be included in the business plan for each year covered by the plan.

Increases in shareholder value are achieved when the return on equity is increased, regardless of whether the target is reached. However, if a Crown company achieves a return that is less than its financial target it is expected to adopt strategies aimed at achieving the target.

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6 FINANCIAL GOVERNANCE

6.1 Capital Structure and Dividend Policy

Each Crown company should have a target optimal capital structure (ie, the combination of financial liabilities and equity used to fund its assets) that is considered as part of the business plan consultation process. An optimal capital structure is one that, in light of economic, industry and company-specific factors would provide for a credit rating, while at the same time imposing a discipline on the Crown company to optimise efficiency. While having an optimal capital structure is a key objective for the company, the applicable target ratio may change over time.

The level of estimated dividends (and forecast payout ratio) is agreed annually between the board and shareholding Ministers through the SCI/SOI and business plan consultation process. It should aim to maintain, or progress toward, the company's optimal capital structure.

The level of estimated dividends is driven by the desired capital structure, the company's profitability and the level of future capital expenditure as outlined in the business plan and SCI/SOI.

The proposed dividend payout ratio and estimated dividend payment should be included in the business plan for each year covered by the plan.

In providing for a Crown company to expand its capital base through retained earnings, any proposed future capital expenditure should add shareholder value. That is, capital expenditure plans must at least meet a hurdle rate of return that is consistent with the company's principal financial target (see "Financial Targets for Crown companies").

Dividends are paid in two instalments: an interim dividend and a final dividend.

Interim dividends are paid as soon as possible after the half-yearly report and the final dividends as soon as possible after the annual accounts. The Treasury requires at least a week's notice of the actual date and amount before payment, which should be accompanied by a shareholder dividend payment statement. The shareholding Ministers may agree on variations to those dates, after consultation with the board.

The capital structure of a Crown company is reviewed if its application of dividend policy has not led to, or is unlikely to lead to, an optimal capital structure within the timeframe forecast in the business plan.

6.2 Managing Risks

Boards are responsible for managing risks and should therefore establish processes and practices within the Crown company to manage all risks associated with its operations.

Boards should also keep the shareholding Ministers informed of risk management strategies through business plans and progress reports, and other reports when necessary. In addition, and unless otherwise qualified because of circumstances applying to a particular Crown company, business plans and progress reports should contain:

- a statement from the board that it has appropriate risk management policies
- an outline of the practices in place
- an assurance that adequate systems are used; and
- an assurance that expertise is available to achieve compliance with those policies and procedures.

6.2.1 Foreign Exchange Risk Management

Crown companies involved in foreign exchange risk management should provide shareholding Ministers with their policy and monitoring procedures.

6.3 Financial Targets for Crown Companies

All Crown companies are required to add to shareholder value in their operations with a view to at least meeting financial targets agreed by the shareholding Ministers.

> Increases in shareholder value are achieved when the return on equity is increased, regardless of whether the target is reached. However, if a Crown company achieves a return that is less than its financial target it is expected to adopt strategies aimed at achieving the target.

By setting appropriate financial targets Crown companies:

- replicate the discipline that the threat of takeover would exert over the directors and managers of a company owned by the private sector; and
- provide an environment that is competitively neutral with the private sector.

The target for Crown companies is the weighted average cost of capital (WACC). This target requires companies to earn returns sufficient to cover the "cost of debt", and the "required return on equity". WACC is used to estimate the required rate of return on total assets, taking into account the required rates of return attached to the different components of the company's capital structure.

The cost of debt is the expected long-term rate at which the Crown company is able to borrow.

The required return on equity is the risk-free rate plus the proportion of market risk premium appropriate to the Crown company.

Crown companies should include in their annual reports a glossary of the terms used for financial performance indicators.

6.4 Crown Company Borrowing Considerations

6.4.1 Explicit Disclaimer of Crown Guarantees and Loan Covenants

For all Crown company financing not provided by the Crown, there must be a disclaimer associated with the contract that the Crown does not guarantee or financially support any Crown company borrowings. The disclaimer aims to give a clear signal to third parties of the nature of the relationship between the Crown and Crown companies.

6.4.2 Ownership Review Clauses

Some loan documents link the loan terms to the shareholder's identity, so that if the control of the company changes the lender reserves for itself the right to call up the loan. For Crown companies, this would connect the terms of borrowing with the Crown, and could incorrectly give the appearance of an implicit Crown guarantee.

The policy on such clauses is as follows:

- it is acceptable to have loan provisions that require lenders to be informed whenever a Crown company becomes aware that its ownership will change
- shareholding Ministers prefer Crown companies not to enter loan agreements that provide for a review of the loan at the lender's discretion, in the event of an ownership change; and
- it is not acceptable to have loan provisions that involve a technical default at the lender's discretion in the event of an ownership change.

There are alternative mechanisms that can provide lenders with the comfort they desire without the drawbacks typically inherent in ownership change clauses. These range from covenants concerning debt/equity ratio and interest coverage to lenders taking security over specific company assets. However, these mechanisms can place constraints on the company and must be designed to minimise the extent to which they frustrate any future restructuring of a Crown company. Boards should bear this in mind when considering such mechanisms.

6.5 Tax Planning

Crown companies are expected to conduct their businesses on the same basis as comparable businesses not owned by the Crown, including normal prudent planning of their tax affairs. Crown companies are also required to act as good corporate citizens by being good employers and by exhibiting a sense of social responsibility where able to do so.

These objectives are not served by tax planning that is outside the spirit of the law. And, while shareholding Ministers are comfortable with Crown companies engaging in normal tax planning they would be most uncomfortable with companies leading the market in developing aggressive tax planning strategies.

When assessing performance, the Government views dividend payments as if it were a domestic resident taxpayer. This means imputation credits are treated as if they have value in the hands of shareholders, and should be reserved for attachment to dividends.

6.6 Value-Based Reporting (VBR)

In addition to reporting under the requirements of generally accepted accounting practice (GAAP), Ministers support the use of VBR. VBR represents a useful tool to assist both Ministers and boards advance the objectives of Crown companies. Using economic methodologies, VBR focuses on the changes in a company's economic value from a shareholder perspective. While GAAP is generic in use and performance measurement, VBR is concerned with organisational performance from a shareholder's point of view, while at the same time supplementing the information provided by GAAP.

While each Crown company is required to be as profitable and efficient as comparable companies not owned by the Crown, a number of Crown companies have no companies with which to compare their performance. VBR is a useful benchmarking tool in such cases.

By providing decision-makers with better quality information, and focusing on shareholder value, VBR should be able to contribute to improving overall performance over time. A number of Crown companies have already implemented VBR for internal purposes, for example Airways Corporation, New Zealand Post and Transpower.

7 PROCESS FOR DEALING WITH STRATEGIC ISSUES

7.1 Expansions (including Overseas Expansions)

7.1.1 Key issues when Assessing Expansions

7.1.2 Preferences for Overseas Expansions

7.2 Subsidiaries

Boards are expected to allow sufficient time for shareholding Ministers to comment before implementing strategic initiatives such as:

- major new investments
- material changes in the capital structure; and
- a significant restructure in response to a major change in the business environment.

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7 PROCESS FOR DEALING WITH STRATEGIC ISSUES

Boards are expected to allow enough time for shareholding Ministers to comment before implementing strategic initiatives such as:

- **major new investments**
- **material changes in the capital structure; and**
- **a significant restructure in response to a major change in the business environment.**

Companies are expected to follow certain procedural issues related to setting Crown companies' strategic direction, that relate to their SCI requirements. These are dealt with briefly below.

If a Crown company fails to meet its stated performance target, shareholding Ministers expect the board to advise them in detail of the reasons for the shortfall. Shareholding Ministers also expect the board to take any appropriate remedial action and to keep them aware of progress. In this instance, the board could expect closer monitoring by advisors, with the extent depending on the circumstances at the time.

In cases of under performance or financial distress by a Crown company, shareholding Ministers have the right to:

- seek more detailed information
- work with the board to restructure the Crown company with a view to reducing its costs and/or increasing its revenue
- take legal action if there is a reasonable allegation that there has been fraud

- issue a section 13 notice of direction, directing the Crown company to alter the nature and scope of its activities
- review membership of the board; and
- liquidate, or subject to approval from Parliament, re-capitalise the Crown company.

Shareholding Ministers would consult the board before taking these steps and take proper account of any relevant Government policy.

7.1 Expansions (including Overseas Expansions)

7.1.1 Key issues when Assessing Expansions

Key issues for Ministers when considering company acquisition proposals include:

- the business case for the proposal, including expected financial returns and risks, and the sensitivity and volatility of returns to various alternative scenarios
- the size of the proposal and fit with core business
- the company's track record of success in associated activities
- the synergies with the company's existing core business
- the proposal's strategic fit with the Government's policy framework, including the benefits to the economy as a whole from synergies that cannot be extracted by the private sector
- whether the acquisition is consistent with the Government's competition and industry policy, especially where company has significant market share, and any Commerce Act implications; and
- whether the proposal can be funded from the company's balance sheet without recourse to new equity finance from the Crown.

7.1.2 Preferences for Overseas Expansions

Overall, shareholding Ministers have signalled the following preferences for overseas expansions (and expansions generally):

- the company's primary focus must be on core business
- expansion should not significantly increase the risk profile of the company and/or the Crown
- expansion strategies should tend to develop from domestic activities rather than developing entirely new products and services for international markets
- overseas expansion should not put at risk the company's New Zealand operations or assets

- the company should have some level of non-Crown private sector debt for expansion and should not seek total funding by the Crown, eg, through withholding dividends
- overseas activity should be driven by sound commercial reasons and must make financial sense
- overseas expansion should not expand the scope of the business (other than in a geographic sense); and
- overseas expansion should not create a risk that the New Zealand Government may be associated with and held accountable for the company's overseas actions and behaviour.

7.2 Subsidiaries

In relation to subsidiaries, shareholding Ministers expect that:

- the parent company will comply with the restrictions on subsidiaries set out in its current SCI/SCI
- the powers and functions of the proposed subsidiary will be treated in practice as if it is subject to the same statutory limitations as the parent company
- the parent company will be accountable to the Minister for State-Owned Enterprises (or the relevant responsible Minister) for the subsidiary's activities and performance and will have appropriate business planning and monitoring procedures in place; and
- public accountability documents for the parent company (SCIs/SOIs, financial statements, annual reports and any future output agreements) will include information on the subsidiary's activities and performance.

8 THE BOARD APPOINTMENT PROCESS

8.1 Board Membership Selection

8.1.1 Candidate Identification, Selection and Appointment
8.1.2 Director Database
8.1.3 Terms of Appointment
8.1.4 Board Evaluation
8.1.5 Board Fees
8.1.6 Director Development

Non-executive directors are required to have:

- an ability to add value
- an ability to clearly communicate orally and in writing
- a wide perspective on issues
- integrity and a strong sense of ethics
- common-sense
- organisational and strategic awareness
- an appreciation of the role of the Crown as shareholder
- an ability to distinguish corporate governance from management
- financial literacy
- a well developed critical faculty
- the ability to be information oriented
- a knowledge of the responsibilities of a director; and
- an ability to work in a team and collaborate.

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8 THE BOARD APPOINTMENT PROCESS

8.1 Board Membership Selection

Director selection aims to ensure that a Crown company's board contains the skills necessary to enhance the company's sound performance and the board's effective interaction and operation. It is important that the board comprises a balance of skills and experience that matches the company's strategic direction and needs. The emphasis is on appointing the "best-qualified" person for each position.

A "best-qualified" Crown company director is generally defined as the candidate whose skills and experience best meet the Responsible Minister's assessment of the skills profile for the director vacancy. Skills profiles are developed on the basis of the Government's strategic overview of the company in consultation with the chair and upon the advice of CCMAU.

Preference is given to director nominees who:

- have demonstrated experience in governance in significant organisations with a commercial focus
- have experience at chief executive or senior management level in organisations that have commercial attributes
- hold senior positions in relevant professional areas, including, but not limited to, science, technology, finance, law, health, agriculture and social policy; and
- have relevant governance or management experience in community or professional organisations.

Key competencies required for non-executive directors are shown in the Table below.

Crown Company Board Directors' Key Competencies

Non-executive directors are required to have:

- an ability to add value
- an ability to clearly communicate orally and in writing
- a wide perspective on issues
- integrity and a strong sense of ethics
- common-sense
- organisational and strategic awareness
- an appreciation of the role of the Crown as shareholder
- an ability to distinguish corporate governance from management
- financial literacy
- a well developed critical faculty
- the ability to be information oriented
- a knowledge of the responsibilities of a director; and
- an ability to work in a team and collaborate.

Irrespective of a director's specialist expertise, all members of the board are collectively responsible for the company's performance.

8.1.1 Candidate Identification, Selection and Appointment

CCMAU has placed considerable emphasis on Crown company governance issues in the past two years. In September, Cabinet reviewed and approved a best-practice, codified director appointment process to formalise shareholding Ministers' expectations for board competencies and skills. This skills-based process reinforces the role of shareholding Ministers in identifying the required skills for a particular position on a Crown company board, appointing a suitable candidate to that position, and reviewing the performance of the directors and boards.

8.1.2 Director Database

CCMAU has developed a computer database of the essential features of over 3,000 individual resumes. This database allows CCMAU to search for candidates on the basis of work experience, academic qualifications, other directorships, gender, residence, ethnicity and preferred areas of appointment. Its existence has

resulted in a number of Crown organisations seeking informal advice on possible candidates for other Crown appointments. The fact that the Unit screens all suitable candidates has given these other organisations confidence in the quality of the candidates.

8.1.3 Terms of Appointment

Directors are generally appointed for terms of up to three years. Subject to the director's performance and their skills continuing to be relevant to the business, they may be reappointed for a second term of three years. In exceptional cases, a director may be appointed for a third term. A director who is appointed to the position of chair in the course of their term may also be appointed for a further period.

Directors' terms end on a specific date. This ensures Responsible Ministers and boards stay focused on director performance and continued skills relevance.

8.1.4 Board Evaluation

The annual review of board and director performance underpins the appointment process. This is a growing practice in the private sector and has been operating, with periodic refinement, in the Crown sector since Crown companies were formed. Formal performance appraisals are now sought for every director as they help Responsible Ministers in their deliberations on appointing or replacing directors.

CCMAU also monitors and advises shareholding Ministers on board performance according to measures such as their:

- **achievement of SOI or SCI objectives, meeting financial and non-financial targets**
- **consistency of business plans with Ministers' expectations**
- **positive community relations**
- **constructive relationships with purchasing agencies**
- **value-added focus (not simply meeting easy targets); and**
- **development of robust business cases for specific capital projects.**

8.1.5 Board Fees

The constitutions of all Crown companies state that the shareholders must approve board fees.

Because the Crown is effectively competing with the private sector for directors and needs to retain the services of well performing directors, board fees are a global amount calculated on a per director rate. The Crown company's rate is set by comparing Crown companies with each other and with comparable private sector companies.

8.1.6 Director Development

New directors are provided with an appropriate induction to familiarise them with their role. This takes two forms:

- CCMAU conducts brief, sector-specific induction programmes for all new directors; and
- the chair provides the new director with a formal induction into all aspects of the company.

If a new director is unfamiliar with their role and obligations, CCMAU encourages them to participate in the Institute of Directors' development programmes.

The chair is responsible for director development and must provide an annual written evaluation of each director's performance, contribution and skill relevance. This evaluation is used to:

- contribute to the director reappointment process
- provide feedback to directors
- provide counselling to new and under-performing directors; and
- contribute to each chair's succession plan, taking into account the future needs of the organisation as assessed against the skills, expertise and aspirations of the current directors.

Director Appointment Process

◆ = Decision
■ = Action

1. Minister agrees board skills profile at time of business plan annual review
1. CCMAU monitors for prospective vacancies, and conducts ongoing candidate identification programmes
2. Requirement for appointment to a board position
3. Skills requirements confirmed by CCMAU, Chair and Responsible Minister
4. Responsible Minister consults Caucus colleagues for nominees. CCMAU searches database and consults agencies
5. Potential candidates discussed with Responsible Minister
6. Minister identifies shortlist? — NO: Go to step 4; YES: (to step 7)
7. CCMAU advises company chair
8. Arrange due diligence with candidates and Chair
9. Candidate suitable? — NO: Go to step 4; YES: (to step 10)
10. Responsible Ministers approve candidate — NO: Go to step 4; YES: (to step 11)
11. CCMAU prepares appointment documentation
12. Candidate confirmed by Cabinet Appointments and Honours Committee, Cabinet and Caucus? — NO: Go to step 4; YES: (to step 13)
13. Appointment letter & terms of reference issued, new director induction planned, Company advised.
14. Chair, Board, & Director performance evaluated annually