DPE UNDP Conference

SOE Governance and Realistic Performance Target Setting: *Issues and Challenges*

A K Rath

15 Jan 2015

Background

- The SOEs have to fulfil the **twin objectives** of commercial efficiency and social responsibility.
- The challenge to ensure a reasonable return on investment, while discharging their constitutional and social obligations.
- As **wings of the welfare state**, the enterprises have the mandate to act as model employers, and conduct their business in an ethical manner.
- The environment of **competition** and **globalisation** makes the tasks all the more challenging.

- Liberalization of the Indian economy in **1991** resulted in a **paradigm shift** in the policy of GOI towards SOEs
- The enterprises lost the monopoly assured by the government.
- The regime of commanding heights for the public sector gave way to the open economy & market forces.
- The public sector has to face competition instead of protection by the government.

PHASE : ECONOMIC LIBERALISATION (1991)

- Strategic, high-tech and essential infrastructure area to be opened up to the private sector.
- Sick PSEs be referred to BIFR.
- Social security mechanism to protect workers.
- A part of the government's share-holding in the public sector would be offered.
- ***Autonomy to Public Sector***
- ***Professionalisation of public sector Boards***
- ***MOU between Enterprise and Ministry.***

Phase Resurgence (2004)

- ***Strong & effective public sector.***
- Social objectives to be met by commercial functioning.
- ***Full managerial , commercial autonomy to profit making PSUs***
- Generally, no privatisation of profit making companies.
- Existing *Navratnas* will be retained in the public sector.
- To modernise & restructure sick CPSEs.
- PSEs be encouraged to enter capital market.
- Chronically sick CPSEs to be sold off/closed.
- Economic reforms with human face.

Accountability of PEs

Three main issues:

(i) Accountability for what?

(ii) To whom?

(iii) How?

Accountability of PE's (Top Management) to

(a) Parliament

(b) Audit

(c) Vigilance

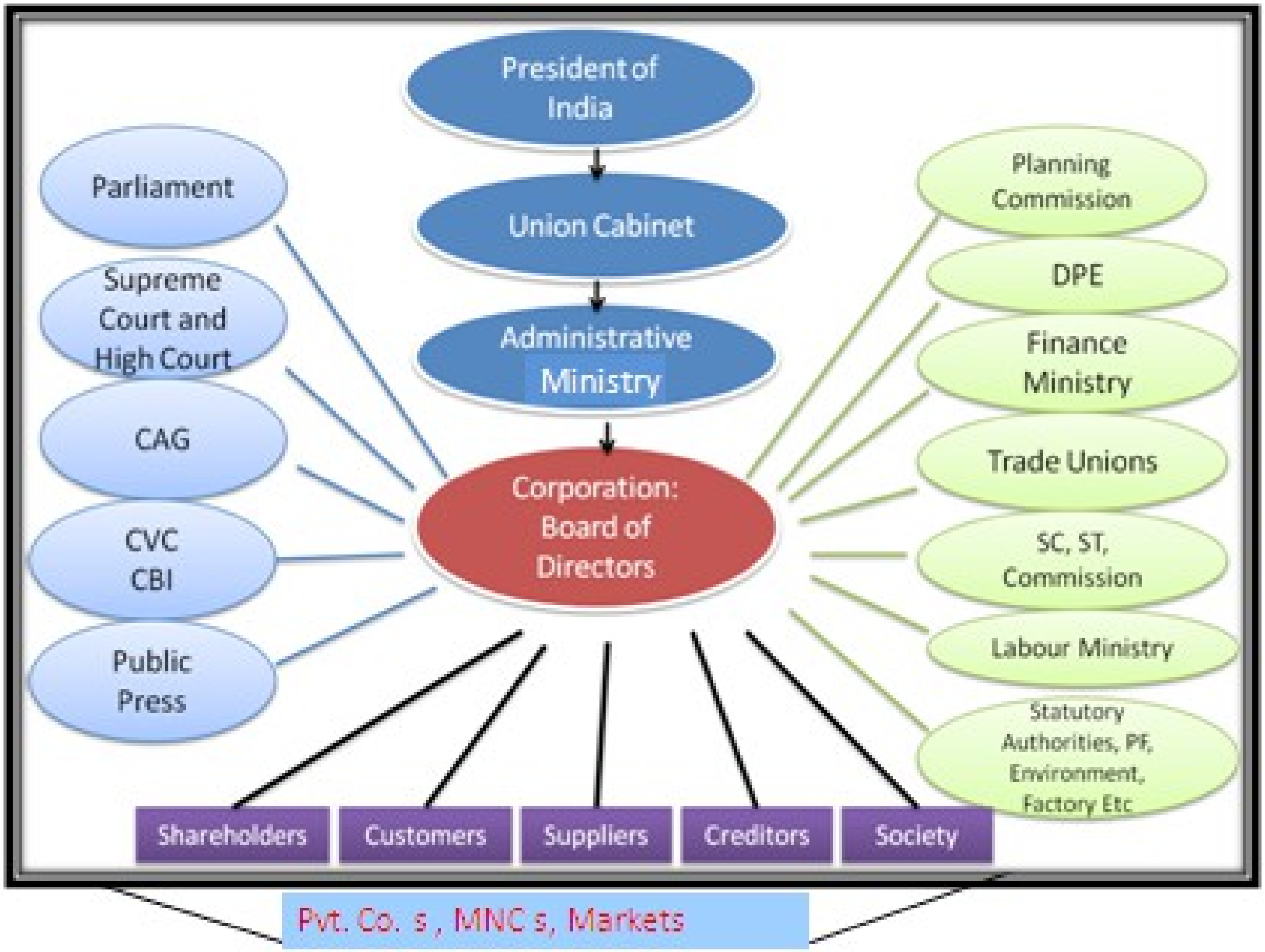
(d) Courts

(e) Shareholders

(f) Society

(g) Others

Constituents of the External Environment



Public Enterprises : " Distinct Governance Challenges"

"Corporate governance of state-owned enterprises is a ***major challenge*** in many economies. But, until now, there has not been any **international benchmark to help governments** assess and improve the way they exercise ownership of these enterprises which often constitute a ***significant share of the economy***." (OECD, Paris, 2005)

OECD Guidelines for State-Owned Enterprises

- The government should not be involved in the day-to-day management of SOEs.
- The state should respect the independence of SOE Boards.
- Empower and improve the quality of SOE board
- SOEs boards should monitor management without undue political interference.
- ***SOE boards should have the same responsibilities and liabilities as per company law.***

Code of Conduct for Govt. as Owner

- Departments- **custodians** of public enterprises on behalf of Government and public at large.
- **Arms-length-distance** by the Ministries.
- Not more than two Govt. nominees on the Board.
- In extraordinary situations, Govt. may give instructions to the Company only through **directives as per due procedure.**
- There should be a **negative list** of areas which must be kept away from the intervention of the Government due to their commercial, operational or administrative nature.

- Arjun Sengupta Committee Report

MoU System

- The Industrial Policy of GOI as part of the Economic Liberalization announced in 1991 mandated that autonomy be granted to Public Sector Enterprises, their boards be professionalized and Annual MOU between Enterprise and Ministry be drawn .
- The Policy of GOI was further reformed in 2004 to build a strong & effective public sector whose social objectives are to be met by commercial functioning, and that full managerial and commercial autonomy be given to profit making PSUs.

- (MoU) is a negotiated agreement between the Government and the management of the CPSE.
- ***MOU system is regarded as an instrument to grant further autonomy to the public enterprises.***
- It is intended to fix targets of the CPSE at the beginning of the year and evaluate their performance at the end of the year vis-à-vis the targets fixed .
- Draft MOU is submitted by company to DPE after approval by Board and the administrative Ministry.
- ***Autonomy and empowerment of the public enterprise are necessary conditions for effective MOU***

Recommendations

- Government as the owner must take the initiative to empower the SOEs with **full managerial and commercial autonomy.**
- **Board of Directors** should be given full powers in commercial and administrative matters.
- The **complex web of ownership structures** must be simplified fixing clear responsibility and authority
- **Ownership Policy of the government** must be spelt out without any ambiguity in respect of the functionaries who would exercise the ownership functions.
- **Self regulation** by authority exercising ownership functions

- **Board of Directors should govern and decide .**
- **Interface** between SOEs and government ministries and agencies in respect of **decision making** process must be **eliminated .**
- Ownership role be given to **one ministry**, say the DPE or Economic Affairs, instead of to numerous authorities as at present.

- **One year MOU** suffers from limitations regarding outcomes in a year's time.
- Generally **projects take more than one year** to be completed. The non-financial parameters having projects need 3-5 year time frame for implementation.
- As such there should a flexibility of **3/5 year parallel MOU** (to be chosen by particular public enterprises) .The targets may be divided on yearly basis for annual targets setting and performance measurement in the annual MOU document.

- **Commitments / assistance** from government as per MOU document should be reviewed and complied with
- **RFD** of the Department should reflect such commitments for review and assessment of the Department's achievement.
- Role of **government Director** who represents the Ministry /Government need to be assessed to ascertain his contribution in achieving the targets and assistance provided by him through his Ministry.
- There should be midterm review of the MOU targets.
- Annual MOU review by Task Force should be more realistic and must **adjust targets due to slippages** based upon **recorded realistic factors**.

- Board of the SoE must **exercise the delegated powers** ,otherwise the SOE’s performance will not be significant.
- PSEs holding huge funds parked in Banks !
- Economy needs these funds for investment
- Boards cant spend !
- **WHY ?**
- **Can the enabling conditions be created ?**

- Human Resource Management must go beyond mere **training**.
- Some of the targets (on CSR & Sustainability , R/D, projects) need be assessed by **third party** external agencies by selecting high value projects.
- Expert agencies may be engaged as **Resource Groups** to assist Task Force.
- Such agencies should be able to present better forecasts and provide global benchmarks for comparison and better target fixing .

- **BoD of SoE should have more power in the MOU**.
- An **empowered Committee** of Directors and Independent Directors constituted by the Board should draft and monitor the MOU document.
- Commitments/assistance expected from the Government should be relevant and related to the fulfilment of the agreed performance targets.
- These obligations should have a direct bearing on the performance of the enterprise, and their effect on the performance should be quantified.

- Regarding commitment / assistance from the government / administrative ministry, it is suggested that the **government nominee Director** in the Board of the CPSE should be designated as the Nodal Officer of the ministry and be entrusted with the responsibility of facilitating the required support and assistance from the ministry / government in implementation of the MoU.
- The contribution of the Nodal Officer (Government Nominee Director) should be recognized by making entry in his annual confidential remark by his reporting authority with a report from the Chairman of the enterprise.

- The rating of CPSEs from Excellent to Poor has to be done on a realistic basis.
- It is recommended that a **Moderation Committee** (MC) under the chairmanship of Secretary, DPE with representatives from Task Force (at the level of chairman of Task Force), Ministry of Finance, Ministry of Corporate affairs etc. may be constituted to go into this critical issue and recommend final moderated ratings for CPSEs on a realistic basis.

- Realistic performance target setting depends on autonomy and empowerment of the enterprise to avoid **one sided exercise** in the MOU process .
- It is being realised that many public enterprises have vast **unexploited potential**, which need to be fully developed for higher return on investment.

- The state-owned enterprises suffer from district **governance challenges**.
- There is limitation on **autonomy** of the Boards of public enterprises.
- The **Independent Directors** are not always selected on grounds of professional experience and expertise.
- Many Director **vacancies** are not filled up in time.
- **Interference** from sources of power outside the Board restricts exercise of authority by the Board.
- Corporate governance cannot be meaningful in developing the full potential of the public enterprises to participate effectively in the MOU process .

- **The MOU system can be a tool of empowerment of SOEs**
- The **Board** of Directors should be empowered to play their **strategic** role
- With renewed stress on improved profit, sound management principles and good corporate governance practices, the public enterprises are capable of becoming **world-class companies.**

thank you !

Target Setting Process: Looking back and looking forward

R K Mishra
Director & Senior Professor
Institute of Public Enterprise, Hyderabad – 500 007
E-mail: rkmishra@ipeindia.org

Backdrop

- State Owned Enterprises were established to fulfill social objective as well as to achieve developmental goals.

- The first wave of SOE reforms was initiated in 1970s and 1980s, when a major effort was made to improve SOE performance while maintaining public ownership.

- The second wave of reforms focused on privatization, sale of enterprises to private investors with a belief that under the government vigil the private sector could achieve social goals.

- The third wave of SOE reforms shifted back to the improvement of SOEs while maintaining public ownership. With the experiences of market failures the public sector can only achieve the social and developmental objectives.

Performance of SOEs

- **Performance Issue:** Capacity of SOEs to achieve their fullest potential has been an issue, reasons being
  - Lack of autonomy (bureaucracy)
  - Multiple control points (dispersed accountability)
  - Conflicting roles

- Performance Contract System was adopted as a tool to improve performance of SOEs through streamlining accountability and reducing government control

- India adopted a system of Memorandum of Understanding
  - Initially French system
  - Later converted to signaling system
  - Evolved into a comprehensive score card tool taking a holistic view and including all the critical performance areas of an enterprise

Components of MoU

Components of Indian MoU System:

- Mission
- Objectives
- Criteria
- Target Setting
- Scoring/Evaluation
- Grading
- Incentivizing

Performance Criteria

- Performance criteria defined by Government through Govt. Guidelines
- MoU system in India includes Financial and Non-financial criteria
  - 50% financial criteria like gross margin, net profit, EVA, PBDIT etc
  - 50% Non-financial criteria like Capital expenditure (expansion, technology up-gradation, Project implementation, HRD, Sustainable Development, CSR etc
- Key Determinants:
  - Currently, the performance targets of enterprise are fixed based on their performance for last 5 years. In the case of enterprises performing badly, the targets are fixed based on the average performance of the last three years
  - Alternatively there are other mechanisms for deciding targets such as inter-firm comparisons and trend analysis for assessing performance improvement.
  - Yardstick competition is applied by a target-setter based on the unit costs in similar enterprises, Work study and management audit is also used to set up targets, which represent reasonably efficient performance, though this method is slow and costly.

Determinants of Target Setting

- Capacity utilization and expansion are also considered for determining targets
- Nature of enterprise (social sector enterprises, sick and loss making enterprises could have lower weightage for financial criteria)
- Presence of private players in area of operation could also lessen the emphasis on financial criteria
- Group Targets
- Negative marking for non-compliance
- ***<u>Negotiations conducted for finalizing the targets</u>***

Negotiation

The CPSEs enter into a process of negotiation with government for finalising the performance targets. The steps involved:

- At draft stage of MoU development
- During finalisation
- Agreement on performance targets
- Mid review of progress
- Determining timelines for achievement of targets
- Negotiations due to gaming have constrained evolving realistic targets which could be seen from the fact that the real growth of targets in financial terms is less than 5% as most of it is neutralized by inflation

Issues in Target setting

- **Long list of performance criteria**
  - Currently the MoU signed by the enterprises has more than 20 financial targets and around 10-15 non-financial which is a big number. Ideally the targets should be between 6-8 in No.
- **Discrepancy between MoU Targets and Targets for other business plans submitted to the ministry**
  - CPSEs have a tendency to fix separate targets for MoU and for other planning documents
- **Flow of Information**
  - There is no proper flow of information between the enterprise manager and the ministry leading to poor target setting
  - This also effects the process of negotiation
- **Lack of Research:**
  - Lack of research base and Information asymmetry between SOE and ministry. Soft targets leading to over achievement which is rewarded

Issues in Target setting

- **Process limitation:**
  - MoU a negotiated/Agreed/written document and has been used more for gaming than accepting challenges of improving upon the performance targets
  - Does not follow the bottom-up approach
- **Corporate governance issue:**
  - Lack of accountability at the top level
  - Fixing Boards responsibility for targets
- **Monopoly/government control**
  - Does not give benchmarks to set with other players

Strengthening Target Setting

- **Improve data flow:**
  - A robust Management Information System to developed and implemented
  - Industry/sectoral data to be collected and shared with Ministry, Task force and other evaluating agencies and stakeholders from time to time
- **R&D/Innovation Cell:**
  - Target setting process to be backed up by strong research evidence on industry/sector on a continuous basis
  - Innovation cells to be established
- **Benchmarking (Outputs/Process)**
  - Benchmarking exercise to be continuously done with similar sectors global including private sector
  - Benchmarking of processes across industries in public and private sector vital
- **Group Targets**
  - Targets which need more than one organization to contribute for its achievement are identified
  - Helps in sorting out cross cutting issues for better achievement of results
- **Incentives and Disincentives**
  - PRP is being implemented since 2010 integrated with MoU system. PRP is low when benchmarked with Korean SOEs
  - MoU guidelines (2015-16) provides for negative marking in case of non-compliance to corporate governance and other issues

Comprehensive Tools Used

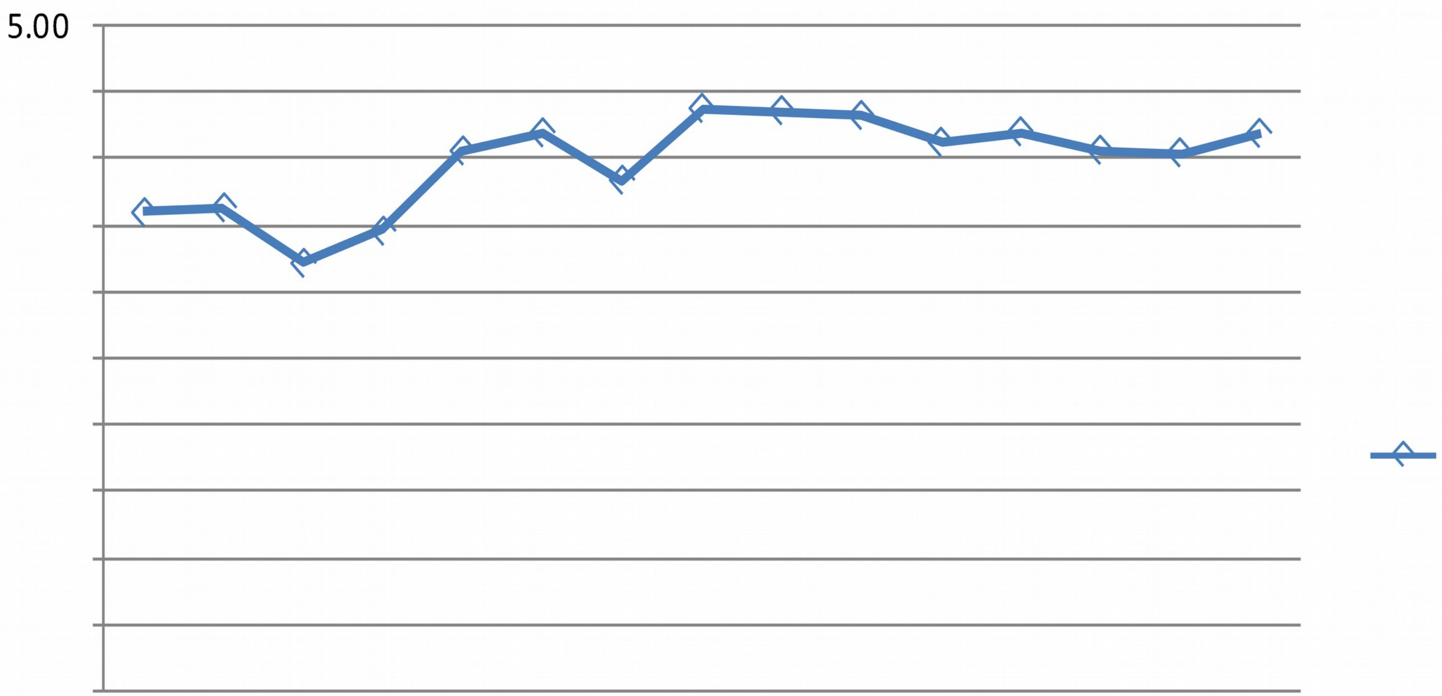
- **Balanced Score Card:** used for SOEs to improve enterprise profitability, provide required guidance to enterprise managers, build consensus and improve communication among stakeholders. Jinshan Telecom a unit of China Telecom (an SOE) implementing BSC with considerable success. The present system does not take the full view of the balance scorecard
- **Economic Value Added:** tool designed to give managers of SOEs better information to make decisions. Introduced by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), for 129 Chinese SOEs under direct administration of central government since 2010. EVA is RoI – Cost of Capital. Many Maharatnas and Navaratnas have cut into the EVA (to be explained through financial ratios).
- **Total Factor Productivity:** TFP is a composite measure of technological change and changes in the efficiency with which known technology is applied to production. The translog index of technology changes is based on a translog production function, characterization by constant returns to scale. There are enough number of cases where enterprises have been found doing well on the financial front but their TFP is either stagnant or declining or is not rising in proportion to the growth of the financial parameters (to be explained Algebraically)

Factor Productivity (average partial and total) of CPSEs in India

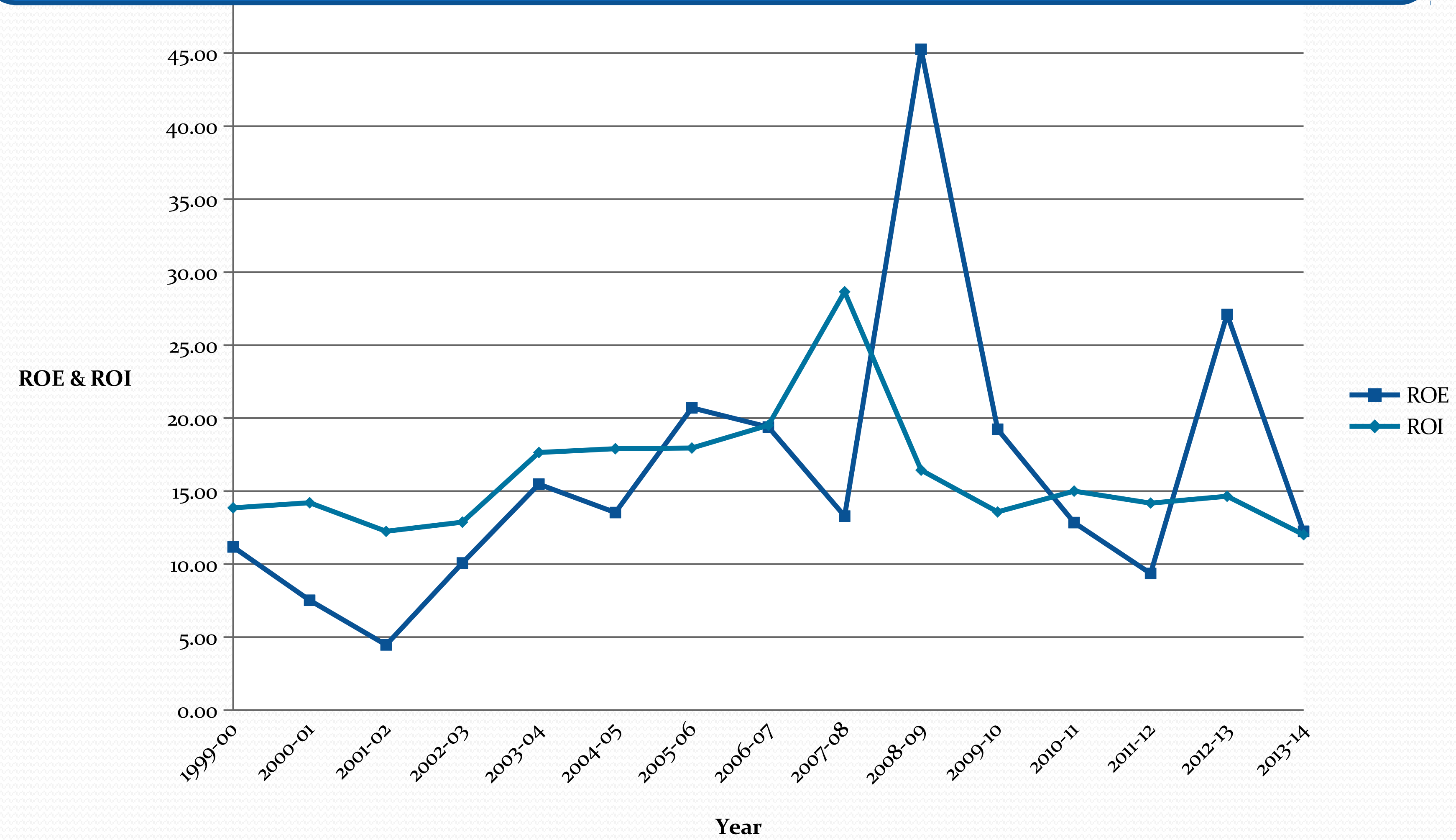
Year	Average			
	Partial Raw Material Productivity	Partial Labour Productivity	Partial Capital Productivity	Total Factor Productivity
1999-00	8.60	23.13	2.31	3.60
2000-01	3.11	18.07	2.31	3.64
2001-02	3.23	16.58	2.27	3.22
2002-03	3.50	20.32	2.40	3.46
2003-04	4.16	25.83	2.63	4.06
2004-05	4.60	28.25	3.10	4.20
2005-06	5.84	34.77	3.32	3.84
2006-07	5.25	32.75	3.62	4.38
2007-08	5.89	30.03	3.60	4.37
2008-09	6.61	31.17	3.60	4.33
2009-10	6.12	24.25	3.21	4.13
2010-11	8.39	20.33	3.33	4.21
2011-12	7.49	27.21	3.52	4.07
2012-13	6.72	24.60	3.68	4.05
2013-14	8.61	24.54	3.77	4.20

Source: Calculated from the CMIE Prowess Database

Total Factor Productivity in CPSEs



Return on Investment and Equity of CPSEs



Calculation of Economic Value Added (EVA) of PSUs Equity Shares for the period 1998-99 to 2008-09 *(Contd…)*

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
OIL & GAS											
BPCL	-1973	-2160	-1241	453	-334	289	-696	-5066	22035	-20246	366
BRPL	-1787	-1500	-1514	-1840	-890	-632	-594	19726	52081	-35799	-50
CPCL	-1059	-1174	-913	-1270	-570	-486	-248	1372	6218	-17819	8706
GAIL	-6373	-992	28598	-5569	-3644	-1021	-1676	-78476	35048	-103443	17574
HPCL	-2470	-3315	-2848	-2166	-2002	-147	-312	81	20451	-4113	600
I B P Co. Ltd.	667	849	927	598	1413	1802	1784	-83	1471	-	-
IOC	16713	-3983	21460	-1010	-4735	-5810	-1171	-20163	94960	-31235	2764
KRL	956	1276	1717	1793	5284	6255	49	-2089	-	-	-
MRPL	-6784	-7682	-6937	-7360	-10498	-6422	-7049	-105466	112494	-31754	26341
ONGC	-7958	-8141	-7808	-8531	-6447	-5892	6320	89831	339475	-1515109	64999
AVERAGE	-1820	-2314	713	-2692	-2246	-1366	-477	-1020	67175	-110871	13913
Aban Loyd	-33	-49	-81	5	19	-2	43	202	-706	-297	570
MIN & METALS											
GMDC	-177	-183	-25	-69	78	317	-74	-1250	-63	3464	-1072
NALCO	154	-833	-912	-2292	-506	825	-4804	-108616	44862	-97688	17190
NLCL	-5944	-5932	-5848	-832	-2447	-3353	-3377	-67592	412153	-1174706	4247
SAIL	-1149	-1182	-1663	-215	-1072	-405	-762	-793412	-957732	-1132083	35802
HIND COPP	-15899	-15473	-13551	-16793	-9543	-7388	-5451	67076	-106267	-138059	53565
NMDC	4943	-38230	-19544	-3355	-24235	-15995	-23543	-5402	2242	-12986	915821
AVERAGE	-7327	-9748	-8913	-5889	-5914	-4041	-6295	-81847	-11637	-238749	84818
TISCO	-3191	-2827	-2480	-970	-434	177	-101	-6075	37600	-74863	25094

Calculation of EVA of PSUs Equity Shares for the period 1998-99 to 2008-09 *(Contd…)*

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
ENGINEERING											
BEML	-298	-332	-274	-317	-156	-170	10	-10203	2159	711	1191
BEL	-745	-659	-435	-336	-208	-158	64	-7908	-1725	4186	717
BHEL	-1770	-1109	-1773	-1455	-818	-471	-334	-42691	1790	7460	4636
EIL	-442	-190	-370	-393	-286	-247	-155	-7159	7901	-4085	498
H M T Ltd.	-1088	-4488	-3797	-719	-1768	-2200	-2105	-183023	-22775	-7697	13536
AY	-438	-455	-394	-425	-344	-391	-352	-3400	792	-7137	316
SIL	-479	-296	-303	-267	-268	-390	-269	-15928	2768	-6441	391
AVERAGE	-763	-1025	-1014	-828	-639	-618	-394	-30445	4585	-8629	2510
SIEMENS	-111	-305	-142	-93	-13	-37	55	-3587	17510	7922	1182
LOGISTICS											
CCI	-410	-394	-251	-172	-170	22	118	-610	-1098	995	-1108
SCI	-5927	-1475	-1820	-386	-514	-1287	-1146	-5250	-2299	-18056	-9080
B L	-126	-134	-124	-187	-86	-85	-52	-4701	1227	381	328
IMFC	-17	-16	-17	-17	-17	-17	-17	-	-	-	-
AVERAGE	-1608	-902	-934	-3246	-536	-458	-376	-9526	1525	-842	-932
G.E. SHIP	-120	-188	-256	-247	58	-638	-107	-19545	-5460	-27909	1887

Calculation of EVA of PSUs Equity Shares for the period 1998-99 to 2008-09

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
TELECOM											
I T I Ltd.	-812	-790	-493	-477	-490	-190	-1085	-168093	141233	7714	5997
MTNL	-4981	-5073	-4442	-4333	-3162	-2401	-2909	-88586	59000	104584	4170
TTL	-254	-209	-174	-186	-125	-120	-137	1080	244	-2628	-8258
AVERAGE	-3067	-2868	-2265	-2399	-1681	-1264	-1597	-70617	62291	8166	-35124
VSNL	-2539	-1507	-119	-468	45	-1511	-883				
FERT & CHEM											
FACT	-3167	-720	-845	-2594	-2231	-1670	-1457	-23371	90470	-23821	-4564
HOCL	-614	-880	-418	-568	-421	-333	-154	-28416	1611	-9010	-25
NFL	-4064	-8453	-2516	-3477	-1995	-1562	-2240	-18382	106623	-119603	4650
RACFL	-2503	-1114	1232	5472	7127	6085	5632	-14918	3723	-134301	13054
AVERAGE	-2536	-2476	-596	-646	620	1400	-1650	-50459	46044	-62975	2470
TCL	-83	-1279	-989	-1397	-338	-842	-631	-23048	13180	-16238	5864
MISCELLANEOUS											
DCIL	-271	-193	-67	-143	6	32	-36	-236	951	-2232	5
L I C	-493	-553	-235	147	-166	205	-312	3910	8174	-26704	671
NTPC	14	16	76	36	52	53	5807	-971677	-272876	-984987	4223
STC	-69	-188	-129	-158	8	-4	-76	-5652	1741	-2505	1557
TNPL	2736	2948	3155	3412	3301	4902	-257	-19862	7801	-4021	841
AVERAGE	269	302	488	493	580	998	987	-190739	87027	-225677	13651
REL	-1271	-991	62	93	-1037	-316	-717	-5580	10805	-75032	7105

Source: Concerned CPSE annual reports and Prowess data base

Thank you

WORLD BANK GROUP
Energy & Extractives

Corporate Governance and Performance at the State level: The case of Indian Power Utilities

Sheoli Pargal
Lead Economist

January 2015

Key Questions

- What is the extent to which Corporate Governance good practices are followed at the state level?
- Does governance in fact impact performance of these utilities?
- Is there an empirical basis for focusing on it?
- What can be learnt from the experience of well-performing state/central PSUs?

Background: Study of Power Utilities at the State Level

- Electricity Act of 2003: Focus on Sector Governance
- Unbundling and Corporatization: Fundamental Changes in Electricity Sector Structure
- Analytic Framework and Data

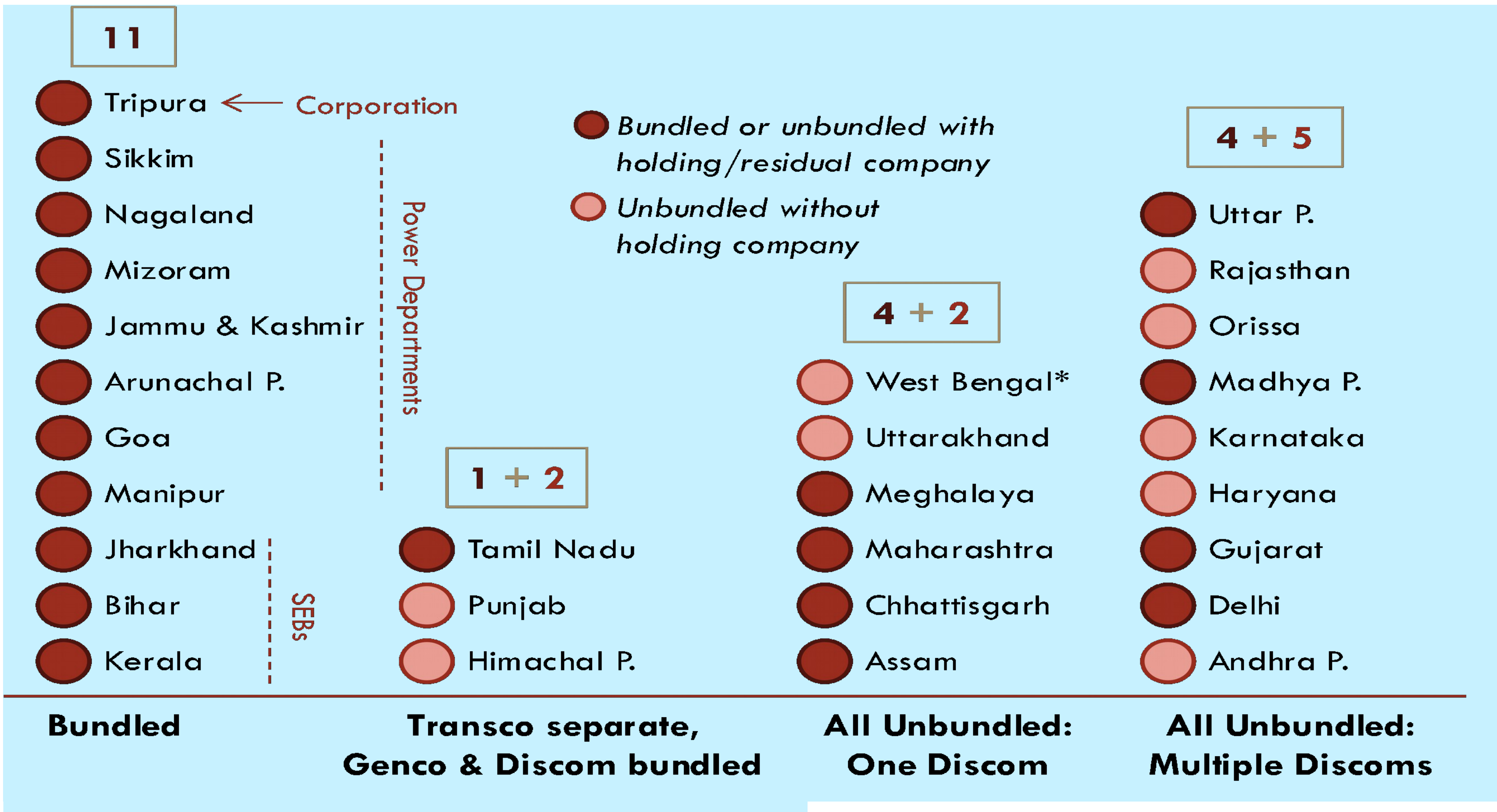
Electricity Act 2003: Spotlight on Governance…

Aim at improved sector operation, better service delivery

Action	Objective
Unbundling	Bring Accountability and Transparency to Power Sector Operations
Corporatization	Insulate Utilities from State Develop a Commercial Orientation
Independent Regulation	Limit Role of State in Sector Introduce Competition Balance consumer and investor interests

WORLD BANK GROUP
Energy & Extractives

The Structure of the Power Sector has been Altered – From SEBs to Multiple Companies



Study Approach, Data and Coverage

- Review
  - Utility compliance with corporate governance requirements
- Statistical analysis of relationship with utility performance
- Data
  - From Power Finance Commission on all utilities
  - Basic quantitative corporate governance data on **69 utilities** (desk study)
  - Detailed qualitative data from interviews (Board, mgt., SERCs, government), websites and annual reports on **21 utilities**
  - Experience of Gujarat, West Bengal and Delhi

Corporate Governance

- Requirements for State Utilities in India
- External Accountability
- Internal Accountability
- Overall Quality of Corporate Governance

Companies Act applies: State Corporatized Utilities DPE, SEBI Clause 49 are only Guidelines

Companies Act (mandatory)

- Minimum 3-member Board,
- Audit committee: min 3 members, 2/3 of which non -executive
- Minimum frequency of meetings

DPE Guidelines (recommended); also SEBI

Board Composition:

- Executive or "full-time" directors" $\leq$50% of the Board.
- Government representatives $\leq$ 2 ($\leq$ 1/6 of the Board)
- Independent directors $\geq$1/3 of Board (if the chairman is a non-executive); else 50%

Board Functioning:

- Meet $\geq$ 4 times per year, with max 3-4 months between meetings.
- Peer evaluations of non-executive Board members

Audit committee:

- Required
- >= 3 members, two-thirds of which, including the chairman, must be independent directors.
- Able to understand basic financial statements

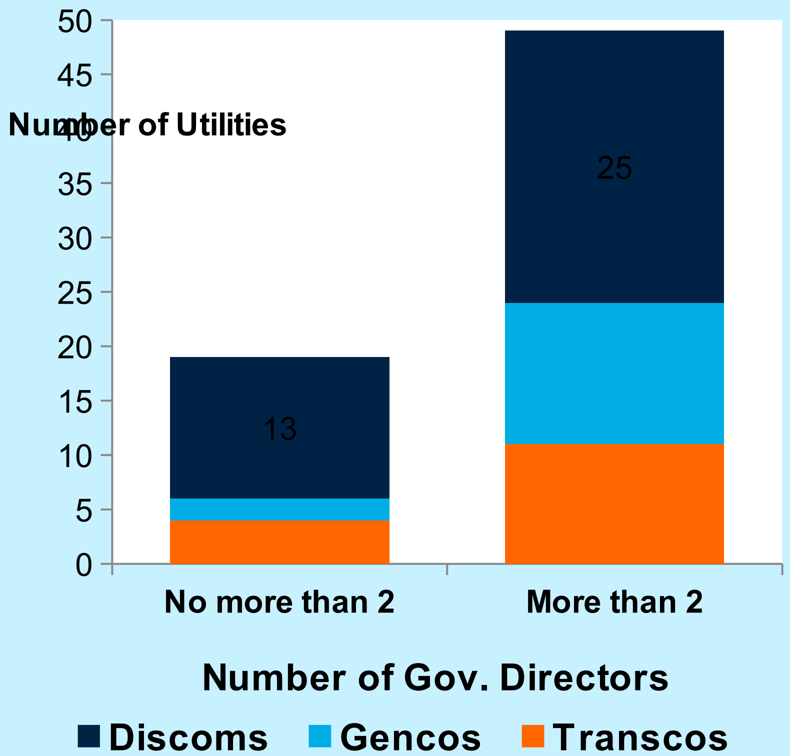
Government-Board Relationship

- Clarity about where the Board has decision-making powers and where the Board must seek government approval.

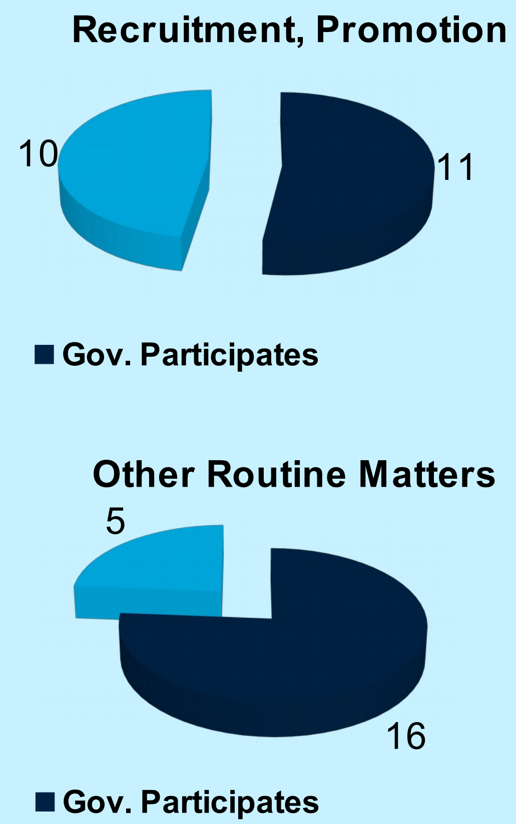
WORLD BANK GROUP
Energy & Extractives

External Accountability: Government- Board Relationship needs to be Arms Length but isn't always!

Government Directors

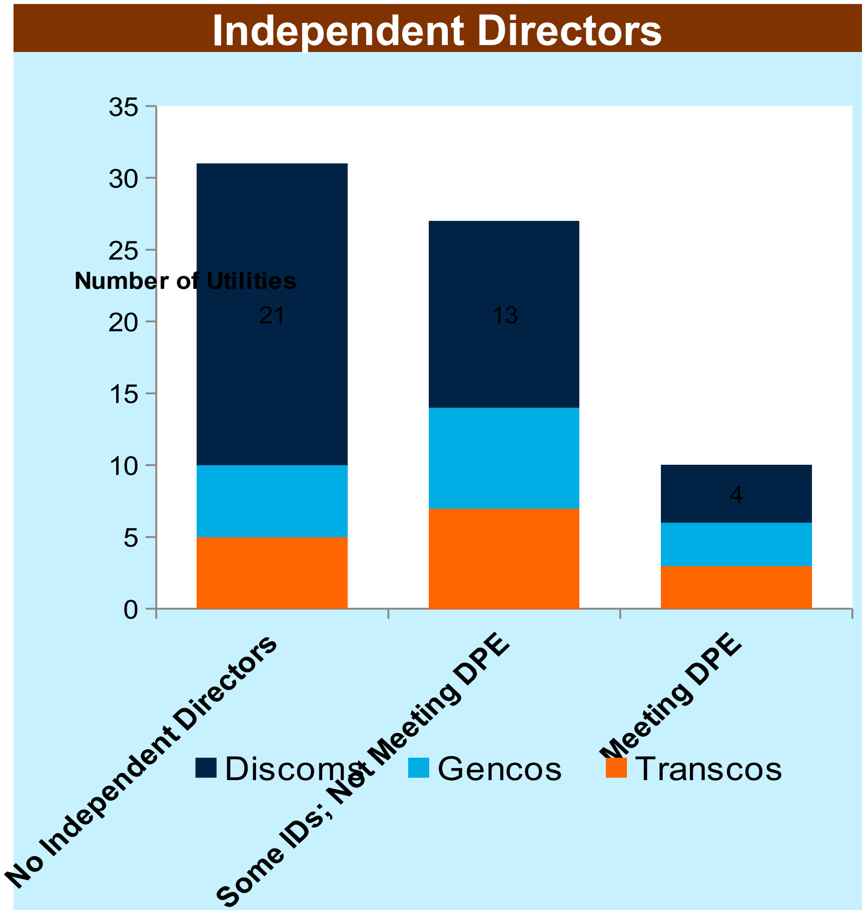


Government Involvement



WORLD BANK GROUP
Energy & Extractives

Board Independence limited: Too few Independent Directors

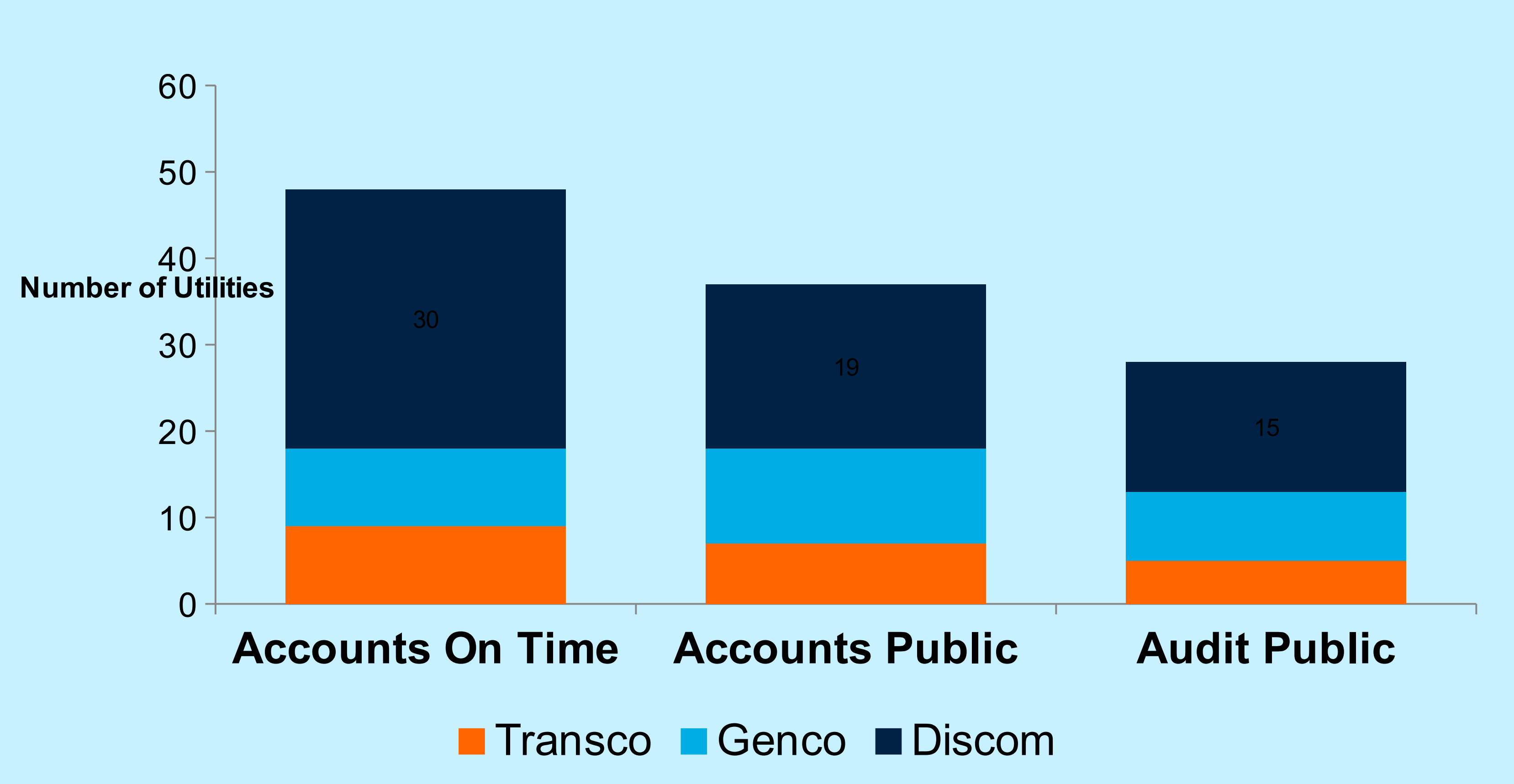


About 40% of sampled utilities have at least two independent Board members

15% of utilities comply with DPE guidelines – including utilities in Assam, Gujarat, Haryana, Madhya Pradesh, Orissa, and Uttarakhand

31 utilities **(46% of the sample) have no independent directors on their Boards** - including utilities in AP, Chhattisgarh, Gujarat, Haryana, Karnataka, Maharashtra, Orissa, Punjab, Rajasthan, Tripura, and UP

Progress in Public Accountability -- but More is Needed



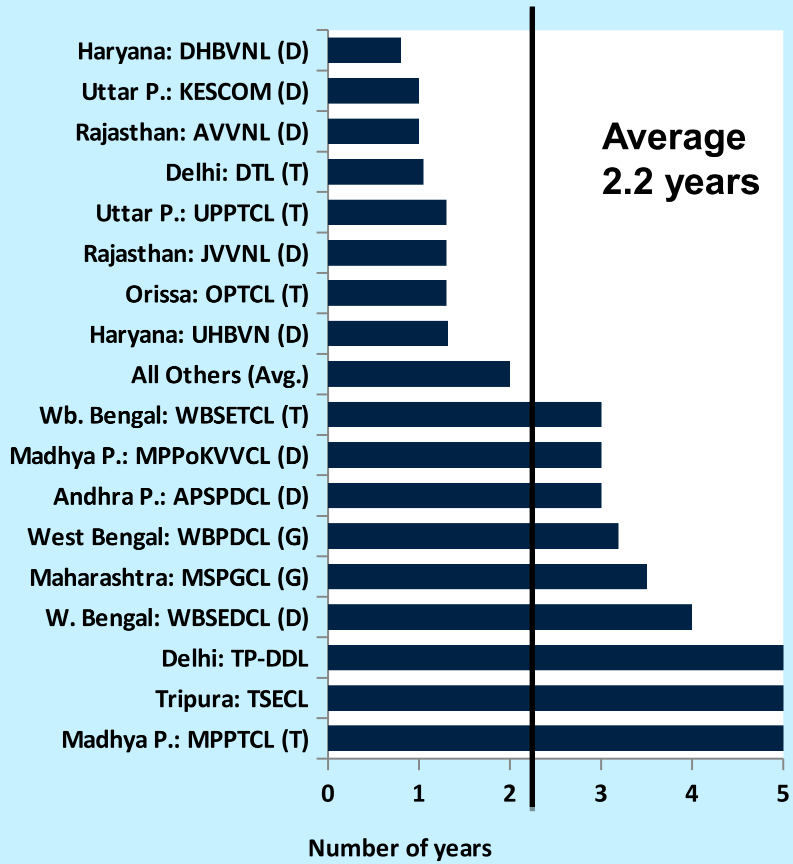
40% publish audit reports on their websites
86% file their accounts on time

WORLD BANK GROUP
Energy & Extractives

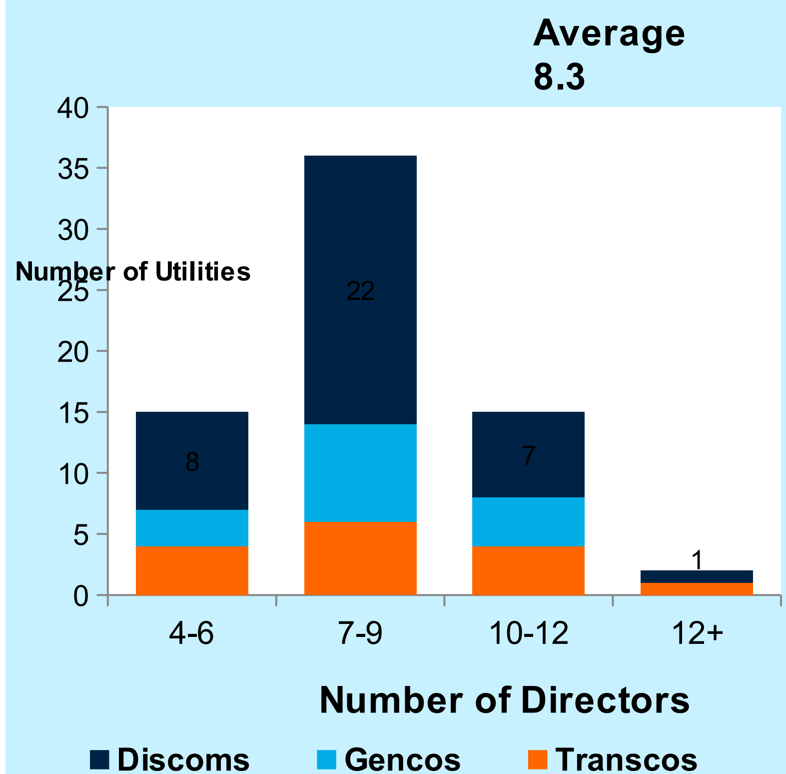
Internal Accountability: Monitoring Management, Strategic Oversight

Board Effectiveness in Monitoring depends on Independence, Size and Stability

Average Chairman/CMD Tenure

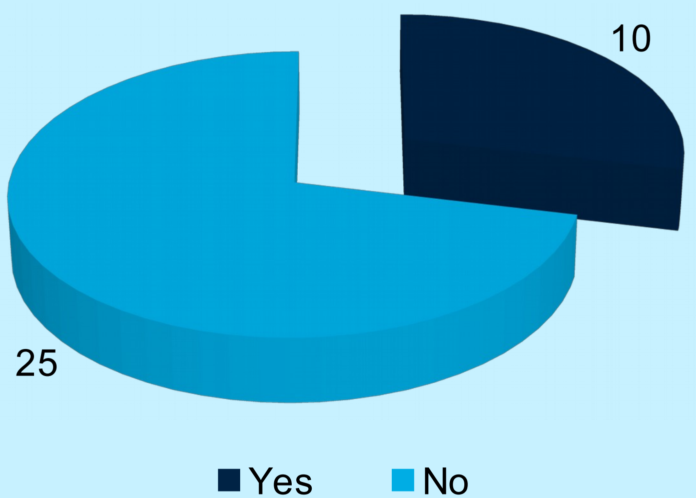


Board Size

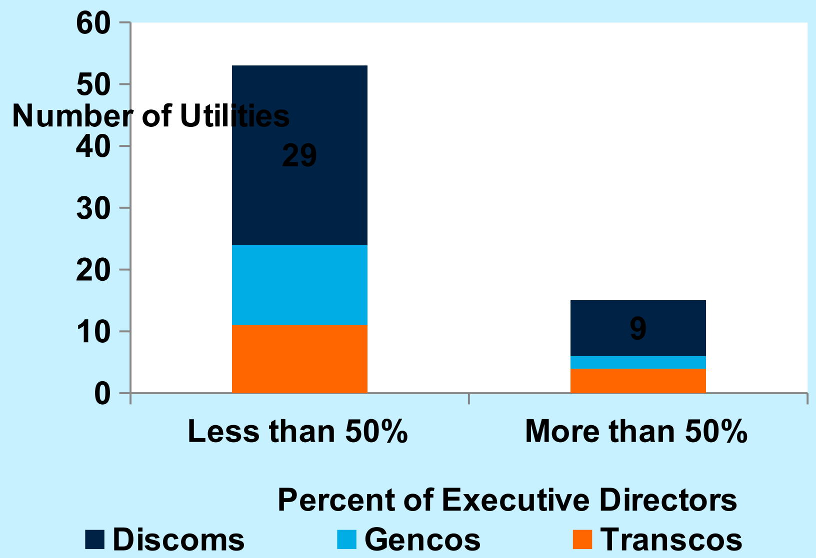


Ability to Monitor and Incentivize Management Requires Distance – and tools!

Audit Committee Headed by Independent Director



Executive Directors



Limited use of Specialized Committees for Monitoring
MIS/ERP in only 1/3 utilities; limited use of Merit-based Performance Mgt.

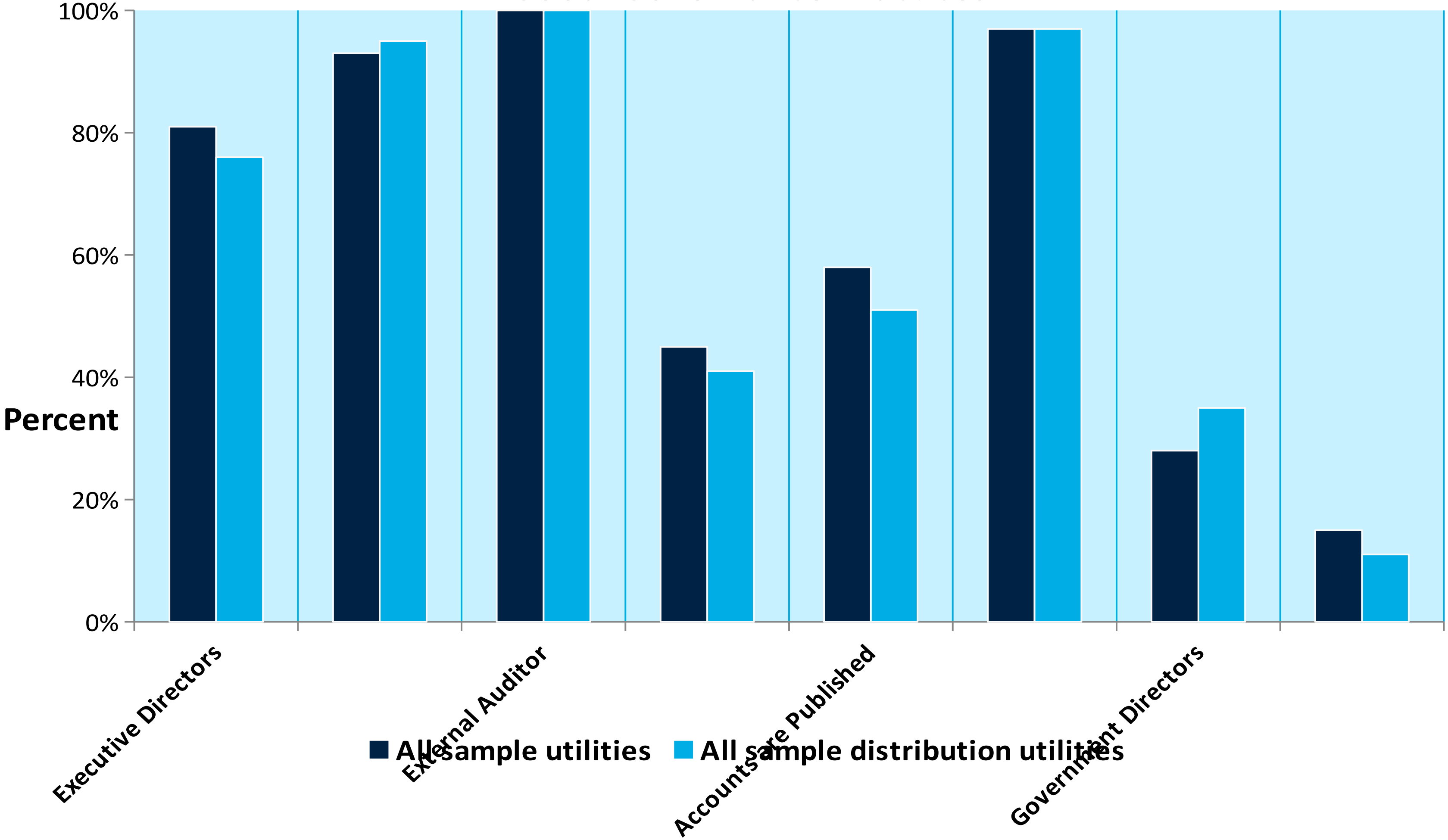
WORLD BANK GROUP
Energy & Extractives

Index of Compliance with Basic Guidelines

Indicator	Utility Receives a 1 if…	Share of sample (%) meeting this	Sample size	Number of utilities complying
External Accountability				
Independent Directors	>= 33% or >=50% if chairman is executive	15	67	10
Govt. Directors	<=2	28	67	19
Audit made Public	Yes	45	67	30
Publish Accounts	Yes	58	67	39
Use External Auditor	Yes	100	67	67
Internal Accountability				
Executive Directors	<=50%	81	67	55
Board Size	<=12	97	67	65
Audit Committee	Yes	93	67	62
Overall		**61**	67	

Utility Boards Dominated by State Government

Share of Utilities in Compliance with Basic Good Governance Practices



Internal Processes and Accountability (Detailed study of 21 utilities; avg. compliance 46%)

Board Management Relationship

- % Executive Directors
- Audit Committee
- Other Committees *
- Indep. Dir. Heads Audit Comm*
- Audit On Time *

External Accountability

- # of Government Directors
- % Independent Directors
- Gov. Influences Routine Matters*
- Gov. Influences Recruitment *
- External Audit

West Bengal, Gujarat and Delhi do well

Board Effectiveness

- # of Directors
- Average CMD Tenure*

Public Accountability

- Audits made Public
- Accounts made Public

Management Practices

- ERP/MIS *
- Performance-Linked Incentives*
- Employee Training Policy *
- Merit-based Promotions*

Governance and Performance

- Expected Relationships
- Correlations
- Exploratory Regression Analysis

Expected Relationships

A higher share of **independent directors** will be associated with stronger performance.

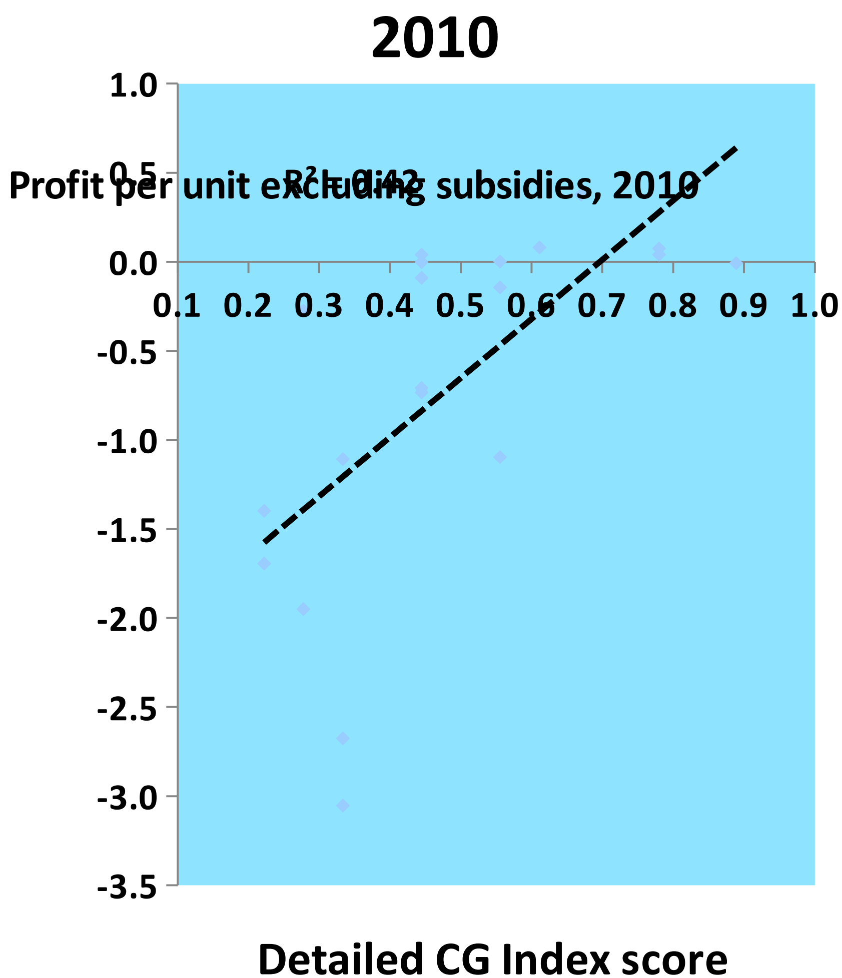
Agnostic on the relationship between share of **executive directors** and performance, though the fact that DPE restrict the share would indicate a negative expected relationship.

CMD tenure is expected to be positively related to firm performance

Board size is expected to be negatively related to performance or might have an inverted U-shaped relationship with performance, with a "mid-size" Board being optimal.

Basic corporate governance index is expected to be positively related to performance.

Correlation observed: Corporate Governance and Performance



Profit/Unit:

(+) CMD Tenure

(+) % Independent Directors

(-) % Executive Directors

(+) Detailed Index

WORLD BANK GROUP
Energy & Extractives

Regression Results: Exploratory Analysis

Dependent Variable: Profit per Unit excluding Subsidies (2010) - All Utilities		
State-Level Controls incl. Regulatory Indexes		
GDP per capita	Index of Regulatory Institutional Design	Index of Implementation of Regulatory Mandates
Utility-Level Controls		
Discom Dummy	Net Financial Assets	2007 Profit/Unit
Corporate Governance Variables		
Basic CG Index		
% Executive	(-)	
% Independent	(+)	
# Directors		
N	61	

Bringing it all together

- Conclusions
- Recommendations

Conclusions

- **Corporate Boards are undermined by State Govt.**
  - Too few independent directors
  - Short CMD tenures
  - State involvement in procurement, recruitment, etc.
- **Implementing DPE guidelines can lead to higher profits**
  - Independent directors
  - Executive directors
- **Need external source of scrutiny, pressure to perform**
  - SERCs? Regulating/sanctioning SOEs is hard, the revolving door
  - Market listing?
  - MoUs? … but state interference? Data?

Recommendations

Professionalize and empower the Board

- DPE guidelines
- Independent directors appointed by committee including CEA/CERC
- Lenders to appoint an independent director

Institutionalize arms length relationship with state government

- Articles of Association (WBengal)
- MoU (as in CPSEs) but adapted for situation of state utilities
- "Shadow Listing" (WBengal)
- Divest some equity to CPSUs such as NTPC or PGCIL?

Greater accountability through "full" unbundling (staff, accounts)

- Operational and financial independence of each unit

Invest in data

- For Board to manage and monitor performance
- For external stakeholders (government, public, regulator) to monitor Board