Context Matters

BOARD PRACTICE AND LEADERSHIP

State Capitalism

A Transformational Tale From the Heart of Europe

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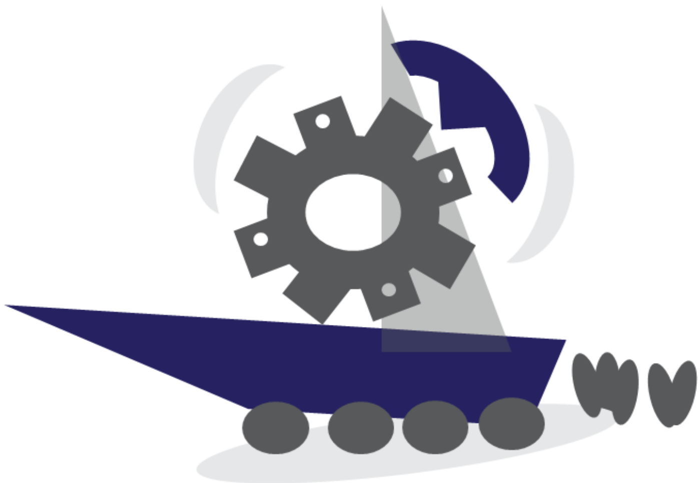
"So, Stefan, here is the role. The position on the table is that of CEO of a major natural resources organization with the state as a major shareholder. The mission is to modernize the structure and ramp up operational excellence within the next 24 months. You will be dealing with uncertain tenure, below-market compensation, intense public scrutiny and strong unions. Interested?"

Nestling at the intersection of seven European countries, Poland made its transition to post-communism in 1989. It is the only European economy to have posted consistent growth throughout Europe's recent recessional drought.

This is not just a local tale from the heart of Europe. For in the Polish story lie vital clues to a global story – one which finds its most powerful expression in today's big emerging markets. It concerns the transformation of a group of state-owned behemoths in the hands of a generation of superlative leaders – people motivated not by money, but by the chance to make deep change.

It leads to an important question: could such organizations be the gardens from which some of tomorrow's most exceptional global leadership talent may spring? Could the paradox of 'state capitalism' be anything but a contradiction in terms?



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Firing Up the Engines

Privatization in Poland took off in the 1990's with the intention that the state would eventually bow out of its interests in corporate shareholding. Thousands of companies were privatized, although a number of the largest in the land were retained by the state - due to union resistance and the belief that state ownership would ultimately preserve the country's major industries. These flagship companies were mainly to be found in strategic infrastructure, natural resources, utilities, banking and financial services.

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The economic crisis of 2008 sounded a wake-up call for politicians and the business elite the world over - and Poland was no exception. Here, the locally-owned, homegrown companies underpinned the economy and it was vital now more than ever to safeguard their presence in key strategic sectors. As such, the idea began to form that, whilst private or publicly-owned companies tend (in theory) to operate more efficiently, the government should remain the single largest stakeholder in these and other critical entities.

The economic policy team, led by LSE-trained Finance Minister Jan Vincent-Rostowski, (viewed by many as the chief architect of Poland's relatively resilient economic policy), designed the model for partial state ownership. This needed to answer the tricky question of how a state-owned company could achieve the agility of a privately-owned organism. First, internal capital was raised via a series of IPOs. In some cases, the state divested itself of shareholdings to levels below 50%, retaining between 25% and 30% interest. For others, it retained 100% ownership, nevertheless resolving to manage these organizations as if they were publicly or privately-owned.

Whatever their new structure, all faced a series of challenges as they strove to modernize. Firstly, it was difficult for the Government to escape accusations of nepotism; political cronies, it was suspected, were still roaming corporate corridors. Secondly, labor unions sought to bypass the management of the transforming organizations, reverting straight to the Ministry of the Treasury to present their case.

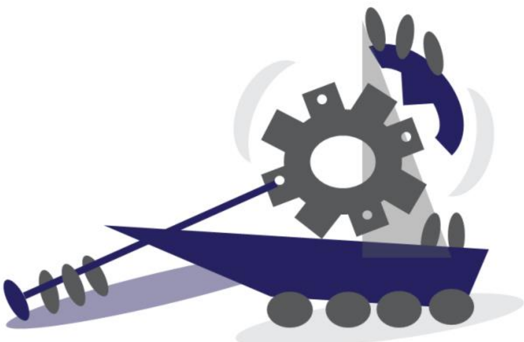
Finally, the compensation of top management was far below the market rate for such positions. Where the Government held more than 50% of the shares in a company, regulation stipulated that its CEO or Board Members could earn salaries no greater than six times the national average. This meant that at one point, a CEO of a 10bn EUR organization might be earning only 50.000 EUR per annum. While such restrictive compensation levels are becoming a thing of the past (and might bring a wry grin to the face of many a shareholder activist), this fiscal ceiling risked leaving businesses starved of the highly-skilled top executive talent so vital for their transformation.

Some CEO's retained their chairs in the C-suite for just twelve months in the face of relentless resistance to change, their actions disregarded by stakeholders who 'waited out' in the knowledge that their new leader would likely depart after only a year in the job.

Compensation remains a conundrum. Even if legal regulations could be bypassed, executive pay is still subject to the keen scrutiny of the general public, the parliamentary opposition and labor unions. However it approaches the problem, the Government, it seems, can do no right.

Motivating a potential CEO to operate in such conditions means reaching out to a distinctive group of intrinsically motivated individuals who are able and willing to board ship for the sheer love of the content of the job and the appeal of re-orienting the course of their heavy vessel. Helping matters is the fact that overall political influence has incrementally decreased since the mid 2000's – and it is the Ministries themselves who have consciously and proactively stepped back from the bridge. Perhaps it is in their best interests to do so. Limiting state interference in the governance, strategy and operations of a nationally crucial organization may be counter-intuitive, but it can yield exciting results. As a politician, presiding over the renaissance of a once-moribund company can surely be no bad thing. Indeed, being over-involved can be risky given the scrutiny such organizations attract. And being over-involved to the extent of nepotism can sink a political career. Still, it is accepted that the state maintains a 'golden share' of its flagship organizations – able to exercise a final power of veto over potential take-overs, hostile or otherwise.

Many incoming CEOs have faced another thorny problem – communicating effectively with the Executive Board as well as a host of other important shareholders, structuring compensation in a way acceptable to all, and exercising ownership rights in a manner that is transparent and clear and holds any residual political interference at bay. This can only mean one thing – the installation of a professional management corpus around the CEO or Executive Board and ensuring that the system begins to resemble a well-run blue chip outfit. This, in turn, implies four conditions: the right person at the helm, with the right team, within the right ownership structure, working in an environment that provides the right levels of stability.



Easier said than done

In revitalizing a major organization, the quality and shelf-life of the Executive Board are paramount. This includes sufficient CEO tenure to sustain rigorous strategic implementation. In less successful cases, CEO's have stayed in the C-suite for on average only twelve months in the face of relentless resistance to change, their actions disregarded by stakeholders who 'waited out' in the knowledge that their new leader would likely survive only a year in the job.

Pessimistic though this may sound, several role models have broken through the fog. Those organizations in which state ownership was lower than 50% have typically stood a better chance of success. For no matter how well-intentioned and self-regulating the state might be, the leadership of organizations where state control is limited can more easily and rapidly make changes in both structure and management culture. In these instances, we note that the tenure of the CEO has also exceeded the five year mark. As such, these companies are rapidly beginning to resemble some of their western competitors.

In conclusion, three success factors are capturing the attention of stakeholders: CEO tenure, executive management quality, and a level of state ownership below 50%.

Several role models have broken through the fog; in the oil, insurance and banking sectors.

Organizations in which state ownership was lower than 50% have typically stood a better chance of success.

In Search of Unusual Excellence

The transformation of formerly state-owned supertankers into the corporate speedboats of the future reveals a stark reality: getting the right leadership on board is an unusually difficult challenge and a pivotal success factor. According to Government regulation, C-suite roles in some companies must be openly advertised, and still the Government demands recourse to objective, external expertise in the hunt for talent. This partially explains why the executive search industry in Poland has been so fundamental in helping engineer the paradigm shifts that are changing the face of some of its most prominent businesses. Amrop, no exception to the rule, has worked intensively assisting Supervisory Boards in top candidate selection. We have found four factors are critical in ensuringthat the best are attracted to, and retained by, the big industry players:

1. All stakeholders must be convinced by the need for stability of CEO tenure
2. Executive Boards must be designed to function as true teams and as such, the CEO needs a say in team composition and appointments
3. In a public recruitment process, desire for transparency and full public disclosure, must be carefully balanced with the discretion candidates need and deserve.
4. When thinking of suitable candidates, 'out of the box thinking' can prove invaluable. As such, outliers should be invited to the interview table.

> CEOs that have succeeded often say that this was the most fascinating business journey of their life

Yet it takes a certain skill - and stamina – for an executive search firm to perform the role of trusted advisor in these cases. Some hiring organizations prefer to adopt a 'wait and see' attitude – trusting that the systemic problems they face will dissolve over time. Some, until recently, were unaware of what an executive search firm does. And search firms themselves need to be prepared to accept the same scrutiny to which their clients may be subject. Furthermore, they face a difficult task. It takes exceptional talent to lead the transformation of an organization with a weighty inheritance into its desired new state of agility, proactivity, collaboration and innovation. This talent must not be dissuaded by perceptions of low organizational justice, the reality of low salaries and the lingering risk of short and painful tenure.

This makes for a small candidate pool. Yet Poland has a new generation of bright-eyed executives – people who have never experienced a socialist economy. They are attracted by challenge of being the independent CEO or Non-Executive Director of a major organization ripe for revitalization. And those that have succeeded often say that this was the most fascinating business journey of their lives. Why? What arguments could attract their peers to take up the challenge? Here are just two:

1 The prestige of size. Relative to the national economy, the sheer amplitude of these organizations makes them the equivalent of IBM in the US – together with millions of consumers
2 The chance to be a game-changer. Piloting these big-hitters provides an opportunity to re-shape not only internal culture and management methods, but society as a whole.

Spotting the special breed of people who are not only enticed by such a promise, but who will be able to step up to the (rather slippery) plate, demands a certain amount of gut feeling. Still, Amrop's experience in the specialism has led us to formulate a clear skillset:

- These are individuals with robust C-suite level abilities
- Their helicopter view enables them to distinguish what is truly important from white noise.
- They are fearless and self-assured - pioneers rather than followers
- They are fundamentally motivated by the unique set of problems in these companies
- They are able to identify key stakeholders and understand the complexity of the network
- They relish ambiguity

It is too early to say whether these new CEOs will experience the churn endured by their predecessors. Still, the risk may be worth it. For these companies are slowly transforming themselves into employers of choice, members of a market that is the most profitable the country has ever seen. Their leaders – if successful – become part of a highly prestigious peer group. But is it a relevant one?

Fertile Ground

Could the skills and experiences associated with this particular type of leadership be transferable between growing and emerging markets - or between different forms of enterprise? To what extent is transforming such an organization dependent upon the specificities (and eccentricities) of national systems? On the other hand, to what extent are the leadership challenges it raises really so unique?

'State capitalism' is not 'just' a Polish issue. It applies to some of the world's most important economies. And the notion of organizational revitalization – no matter what the ownership structure - is a widespread concern.

A new global talent pool is emerging from the particular blend of challenges caused by the transition from fully to partially state-owned enterprise. Those who rise above all the odds to succeed in their mission have proven their unrivalled ability to manage change in a wide spectrum of environments. They deserve serious consideration.

"This is an immensely difficult and frustrating job." one CEO told us. "But in terms of sheer exhilaration, it compares to none of the challenges I have faced before."

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About Amrop

With 84 offices in 56 countries, Amrop provides services in Executive Search, Leadership Assessment and Board Consulting. It is the largest partnership of its kind.

Amrop works with existing Boards as well as helping start-up organizations ensure that their Boards of Directors are appropriate to the aims and core business of the company and compliant with Governance rules and regulations. Amrop's Context Driven approach to executive search helps our clients find Leaders For What's Next - top talent, adept at working across borders in markets around the world.

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