

To whom it may concern,

Please find enclosed the McKell Institute's submission to the *Construction Industry Training Fund Act (1993) Review*.

The McKell Institute is a non-profit research organisation dedicated to identifying practical policy solutions to contemporary challenges.

In this submission, the Institute draws attention to the deficits with the current appointment process of the CITB board.

It respectfully notes that the 2019 reforms that changed the way in which board members were appointed defied best practice, and led to an imbalanced board, where employee representative voices have been minimised.

This submission contends that, in order to strengthen the long term performance of the CITB, as well as improve public confidence in the organisation, the Act should be amended to enshrine balance between employee, employer, and impartial expert board members.

This submission also draws on established research into the influence that employee representation has on board performance. Much of this research is focused on the performance of corporate boards, which have metrics such as profits and share prices which can be observed to quantify board performance.

Statutory, government bodies have much more specific mandates.

However, lessons can be drawn from the literature on worker influence on board performance in the private sector to assuage any industry concerns about the impacts increased worker representation on a board such as the CITB may have.

Please find the McKell Institute's submission below.

Sincerely,

A handwritten signature in black ink, appearing to read 'Edward Cavanough', with a long horizontal line extending to the right.

Edward Cavanough
Director of Policy, McKell Institute
1 February 2023



T H E M C K E L L I N S T I T U T E

McKell Institute Submission

Into the South Australian Parliament's Review of the Construction Industry Training Fund Act 1993

Edward Cavanough

February 2023

About the McKell Institute

The McKell Institute is an independent, not-for-profit research institute dedicated to identifying practical policy solutions to contemporary challenges.

The Institute regularly contributes to key parliamentary and government inquiries, including in South Australia.

A complete list of McKell Institute research can be found at its website:

www.mckellinstitute.org.au

About the Authors

Edward Cavanough is Director of Policy at the McKell Institute. He is based in South Australia.

About this Submission

This document has been prepared by the McKell Institute for the consideration of the Government of South Australia.

It has been authored on Kurna Land in January 2023.

Table of Contents

<i>Introduction.....</i>	<i>4</i>
<i>1 Summary of 2019 changes to CITB board appointments</i>	<i>5</i>
<i>2. Evidence supports enhanced worker representation on boards</i>	<i>7</i>
<i>3. Improving public perceptions of government bodies</i>	<i>13</i>
<i>4. The CITB board needs rebalancing.....</i>	<i>14</i>
<i>References.....</i>	<i>16</i>

Introduction

This submission presents McKell Institute research on the effectiveness of varying types of board composition on board performance in relation to the *Construction Industry Training Fund (CITF) Act 1993* Review process currently underway by the Government of South Australia.

The *Construction Industry Training Board (CITB)* is the entity responsible for administering the CITF. The CITB is a “whole of industry led organisation that provides support to attract, train and retain South Australian building and construction workers by providing leadership in training and skills development”.ⁱ The organisation is funded by a levy of 0.25% on construction projects with a value of over \$40,000. In 2021/22, the CITB received a total of \$21.97 million.ⁱⁱ

In 2019, the former Government of South Australia amended the *Construction Industry Training Fund Act 1993* to adjust the way in which its board appointees were selected. The adjustments significantly altered the method of director appointment in a major departure from the original method of appointment that had previously been in place.

The CITF Act Review considers various amendments to the Act. This submission focuses on *Terms of Reference A: CITB composition, administration and operation*. In doing so, it cites relevant research into board governance and composition, and leverages McKell Institute’s research expertise in this space to provide an analysis of the status quo, and to recommend a pathway forward.

It acknowledges a growing consensus by stakeholders, as cited in the *Investigation and Review of the Construction Training Fund Act 1993 Issues Paper* released by the Government of South Australia, of the need to reform the way in which board directors of the CITB are appointed.

1. Summary of 2019 changes to CITB board appointments

In 2019, the Government of South Australia passed the *Construction Industry Training Fund (Board) Amendment Act 2019*. The Act significantly changed the way in which board members were appointed, granting considerably more power to the responsible Minister with regards to board appointments.

Prior to 2019, the CITB board's composition included:

- A presiding member
- Two people nominated by the Minister with experience in VET/provision of training
- Five people nominated by employer associations
- Three people nominated by employee associations.

After the 2019 Act, the CITB board's composition included:

- A presiding member
- Between 4 and 8 people nominated by the Minister with industry knowledge, experience or expertise. This cohort included one member to represent both the "interests of employers" and "interests of employees".
- 2 people nominated by the Minister who, *in the Minister's opinion*, are independent of the building and construction industry who, together have the knowledge, skills and experience necessary to enable the board to carry out its functions.

The Act also removed any formal requirement for the minister to consult with employer and employee associations when appointing the Presiding Member, and restricted the capacity for individuals to self-nominate for the board. These changes clearly skewed the board, with more of its members coming from industry or employer backgrounds at the expense of employee representatives.

Both employer groups and employee representatives require a place on a board of the CITB's nature, given the organisation's unique remit to ensure the long term sustainability of the South Australian construction industry's skills base.

Following the 2019 changes to the Act, the board composition evolved. Currently there are 10 members of the board.

The current board has just one employee representative from a trade union, with six board members representing peak industry organisations or employers. The remaining three members consist of two lawyers with subject matter expertise, with the presiding member being the former Small Business Commissioner.

Irrespective of the merits of any individual on the board, this outcome clearly represents an imbalance between stakeholder voices on the board. For the board to be delivering better outcomes for South Australia's construction sector, and to the advantage of the South Australian economy, a more balanced board is recommended.

2. Evidence supports enhanced worker representation on boards

There is a broad literature on the efficacy of governing boards of various compositions. Much of this literature is focused on corporate boards — the boards governing private sector firms, the performance of which can be measured by metrics common to all private firms, such as profits or share prices. Given the specific mandates of boards governing statutory authorities, meta analyses of board performance in these statutory entities is challenging to conduct. However, lessons can be drawn from the literature examining the composition of private sector boards to inform best practice in the appointment of boards governing statutory authorities, such as the CITB board. The existing literature typically finds no adverse impacts to organisational performance resulting from employee representation on boards, whether this be in private sector boards or other decision making bodies.

Literature suggesting negative effects of worker representation on boards is thin

Opponents and proponents of workers' representation on boards both cite individual papers to justify claims that their preferred governance model has the best outcomes in terms of organisational performance. The reality is, however, that it is challenging to accurately quantify the direct correlation between the composition of a board and the performance of the organisation it governs.

Studies attempting to quantify the specific impact on productivity or shareholder returns resulting from employee representation on corporate boards are typically inconclusive. Several studies have noted modest gains in overall productivity and performance in firms with employee representation, but often cite various caveats.

Jones (1987), using British retail cooperatives as his case study, identified that co-ops with workers on their boards 'modestly increase(ed) productivity'ⁱⁱⁱ. Other attempts to determine the efficacy of various board structures throughout the 1970s and 80s, however, typically proved inconclusive due the myriad determinants that effect organisational performance being hard to isolate from board composition as a variable.

More recently, Boneberg (2010)^{iv} attempted to quantify the impacts on productivity and profitability of the German co-determination model of board governance. Boneberg found that, while ‘great uncertainty remains about the economic consequences of co-determination in supervisory boards’, ‘the existence of a co-determined supervisory board seems to positively affect productivity, but not profitability’.

Another study on the German model, published by the Hans Bockler Foundation in 2019,^v found that companies with codetermination had less unemployment and more reinvestment during and after the financial crisis. The study also finds between 2006 and 2011, the change in share prices of companies with codetermination was accumulatively 28 percentage points higher than the share prices of companies without codetermination.

Wheeler (2002)^{vi}, using six major Swedish corporations as case studies, found that ‘with regard to local decision and conditions, both corporations and unions studied have benefited greatly from codetermination’. While Wheeler found that employee representation on corporate boards did not limit board majorities from making occasional decisions that impacted workers, including plant closures, it did advance conditions in individual circumstances, and likely helped increase productivity.

Ultimately, however, there is little consensus that any one form of board governance is the key determinant to productivity gains or an increase in productivity within a corporate setting. The literature typically qualifies its findings one way or the other, stressing key business performance indicators, like profitability, are often driven by other independent variables.

Claims workers’ representation undermines organisational performance are ultimately speculative and not proven in literature

Opponents of employee representation on corporate boards typically argue that, because workers’ are involved in decision making, corporations are unable to navigate economic headwinds in ways which might be to the detriment of their employees. As Gorton & Schmid note,

“By impeding the ability of shareholders to respond to negative shocks in the economy, employees make holding shares riskier, but protect themselves”.^{vii}

The challenge with this position is that it exaggerates the influence of minority influence on the decision making of boards. In no legislated regime do employee representatives constitute a majority on corporate boards, and there is no suggestion in this submission that the CITB board should be composed of a majority of worker representatives. Should the employee representatives on a board voice dissenting views, the board majority are still in a position to shape the ultimate decision, albeit from an informed position regarding the employees’ perspectives an issue at hand.

Other opponents to employee representation on boards cite anecdotal evidence that boards are unable to enter meaningful deliberations with employee representatives at the table. Such reasoning was put forward by Sam Bowman of the UK’s Adam Smith Institute, who – after Prime Minister Theresa May suggested allowing workers to sit on boards – cited an individual account of a poorly functional board at Volkswagen, which senior executives had blamed on worker representation. Such individual examples fail to demonstrate any correlation between poor company performance and the composition of a company board.

“Some research shows that co-determination has a positive effect, especially through work councils, and some shows no effect. Co-determination doesn’t guarantee corporate growth and profits, but it certainly doesn’t undermine them.” – Susan Holmberg^{viii}

Worker representation can increase trust between workers & employers

There are other benefits to worker representation on boards. One advantage of European models of corporate governance, for example, are their impacts on relationships between employees and corporate management. As Garner (2018) notes:

“Employee participation on company or supervisory boards can strengthen workers’ voice but, critically, it can also improve cooperation with management.”^{ix}

Research has demonstrated that the worse relationships between management and labour are within OECD countries, the more susceptible those countries are to spikes in unemployment.^x Blachard & Philippon (2006) identified an ‘apparently causal relationship’ in Europe between and the quality of labour-management relations and unemployment. Their thesis argues that the less adversarial relationships are between labour and management, the less vulnerable an economy is to spikes in unemployment.

The authors theorise that an asymmetry in information can lead to bargaining failures and inefficiencies within the firm – but that these challenges can be offset by increasing trust between labour and management. In the context of a statutory board, this could suggest that more collaborative decision making between employer and employee representatives would likely improve the quality of decisions made by the board.

The collaborative culture within the German economy, which is institutionalised in the form of employee representation, has also seen Germany emerge as the economy with the lowest occurrences of industrial action and disputes between workers and employers broadly. Between 2009-13, Germany lost 12 days of work per 1000 employees due to industrial action – half that of the UK, at 24 days^{xi}.

This evidence has a simple and consistent message: while there is no discernible downside to employee representation on important decision making bodies, there are numerous examples of enhanced worker representation strengthening decision making in corporate settings, and ultimately leading to a more harmonious, informed and collaborative relationship between employees and employers. This is a lesson that should be carried over into statutory board practices in South Australia.

Overcoming information asymmetries between workers and employers a benefit to all

A common argument against workers on boards is that the presence of labour during board decision making could skew the board from making important decisions that may be of a net benefit to the firm, while coming at the expense of employees. There is some evidence, however, that the opposite can be true. Furbotn & Wiggins argue that overcoming the asymmetry of information between employees and management is a pre-requisite to informed decision making and bargaining between both management and employees. The authors argue:

“If appropriate decisions are to be taken, corporate employees must not only have access to certain types of strategic information but have the confidence that the information received is reliable. Under (ideal) structures...labour directors will possess exactly the same information as other directors and have access to business data possessed by management”.

Furbotn & Wiggins argue that in this circumstance, mutually detrimental bargaining tactics by both labour and management can be avoided, and management can better to avoid closures of businesses because employees have visibility over business data just as management does:

“Inefficient plant closure may occur precisely because imperfect information (and consequent labour suspicions) rule out a wage cut beneficial to both labour suppliers and capital owners. Presumably, labour participation on boards of directors can help overcome this type of problem”.

In the context of the CITB, these lessons would suggest that a more equal balance between employer and employee representatives on the board would lead to more equal flow of information regarding the CITB's activities among employees and employers in the construction sector. This would be advantageous to all parties.

The SA Government has accepted the benefits of improved worker representation in other contexts

The notion of expanding worker representation in important decision making bodies in South Australia is not new. In his recent review of another key South Australian institution, SafeWork SA, John Merritt recommended that the organisation consider the appointment of additional worker representatives in its decision making and oversight processes.^{xii}

Recommendation 4 of the Merritt Review proposed the establishment of a SafeWork SA Oversight and Advisory Council, or SWOAC. The composition of that council, Merritt suggested, should be balanced, with worker representatives and employer representatives being given equal representation on the newly proposed entity. It should be noted that the Government has accepted this recommendation.

Merritt proposed that the SWOAC be composed of five employer representatives and five employee representatives, as well as other key stakeholders in workplace safety in the state. The rationale behind this equal employer and employee representation on the proposed body is that more balanced representation can lead to better decision making outcomes, and enhance the legitimacy of the proposed SWOAC. Similar principles apply to the composition of the CITB board.

3. Improving public perceptions of government bodies

Beyond the practical, performance management issues related to the over concentration of certain types of directors on a government board, there are also broader questions surrounding public confidence that should be considered in any reform to the Act.

In recent years, Australians' trust in government, and in government institutions has been waning. There are myriad determinants of this decline in trust in government institutions. Misinformation about politics and public administration abounds; genuine corruption and malpractice at certain levels of government outside of South Australia; and perceived disinterest by governments to adequately tackle these issues have fuelled an increase scepticism in government. The growing number of political appointees and close acquaintances of Ministers or members of other governments onto government boards, particularly at a Federal level,^{xiii} has also added to this unsavoury public sentiment.

Beyond the day-to-day administration of state, the Government of South Australia also has a responsibility to govern, and overseeing governing entities that improve the public's trust in government. Statutory boards, which oversee numerous impactful institutions established through legislation in South Australia, must be seen to be arms-length from the government of the day, whatever its ideological persuasion. Only by achieving this can true public confidence in the governance of these important statutory authorities be achieved.

It is clear that the 2019 reform to the Act concentrated increased appointment powers to the minister, which risks the CITB board being filled, at some point in the future, with potentially unmeritorious appointees that have curried favour with government, or are perceived to be pliable to government interests. Only through the reform of the Act can this risk be mitigated, and the confidence of the public in the appointment process, and therefore the institution itself, be safeguarded.

4. The CITB board needs rebalancing

The status quo ante 2019 reforms to the Act regarding the composition of the board was more desirable in terms of balance than what has followed.

However, this review process creates an opportunity to strengthen the CITB board composition to ensure it is meeting best practice, is impartial, and is balanced moving forward.

Prior to the 2019 changes, the board was composed of five members nominated by employers and three nominated by employee representatives. The remaining three members were appointed by the Minister, with the appointment of the Presiding Member requiring consultation with employer and employee representatives prior to their appointment.

This represented a structural imbalance that saw employer voices granted more influence over the CITB board than employee representatives.

Ideally, balance should be enshrined in the board. This can be achieved by reforming the appointment process to ensure that there is balance, and that decision making is governed by consensus and compromise, without the risk of 'allied' members representing similar constituencies dominated board decision making.

Enshrining Impartiality into the Board Appointment Process

A potential model is the 3 + 3 + 3 + 1 model — a structure that would enshrine balance in the board, while maintaining the position of independent, impartial expert voices and an independent Presiding Member.

The 3 + 3 + 3 + 1 model would see:

- 3 members nominated by employee representatives.
- 3 members nominated by employer representatives.

- 3 impartial members nominated by the Minister, meeting a reformed criteria of impartiality.
- 1 Presiding Member nominated by the Minister, whose appointment would be conditional to support from a majority of the board.

Resorting to the pre-2019 board composition requires increased checks and balances

Were the Act amended to re-establish the appointment mechanism seen prior to the 2019 changes, checks and balances should be formalised that enshrine consensus into the decision making process. Given the pre-2019 appointment model was still imbalanced between worker representatives and employer representatives, any return of this structural imbalance must be accompanied by considered mechanism to ensure that this imbalance doesn't lead to skewed outcomes that receive no support from either worker or employer representatives.

References

ⁱ <https://citb.org.au/about>

ⁱⁱ CITB Annual Report 2021-22. Accessed online:

https://citb.org.au/assets/docs/general/CI0001_Annual_Report-V11-24112022.pdf

ⁱⁱⁱ Jones, Derek C. 1987. "The Productivity Effects of Worker Directors and Financial Participation by Employees in the Firm: The Case of British Retail Cooperatives." *Industrial and Labor Relations Review* 41 (1): 79. <https://doi.org/10.2307/2523866>.

^{iv} Boneberg, F. 2010. 'The economic consequences of one-third co-determination in German Supervisory Boards'. University of Luneberg Working Paper Series in Economics, no 177. Accessed online: https://www.leuphana.de/fileadmin/user_upload/Forschungseinrichtungen/ifvwl/WorkingPapers/lue/pdf/wp_177_Upload.pdf

^v Hans Bockler Foundation, 2019. 'Why Codetermination? A collection of good arguments for strong workers' voice'. Accessed online:

https://www.boeckler.de/pdf/mbf_praes_arguments_co_determination.pdf

^{vi} Wheeler, Jeff. 2002. 'Employee Involvement in Action; Reviewing Swedish Codetermination'. *Labour Studies Journal*. 26:4, 71-97.

^{vii} Gorton, G., & Schmid, F. 2000. 'Class Struggle Inside the Firm: A Study of German Codetermination'. Wharton School of Finance.

^{viii} <https://www.nytimes.com/2019/01/06/opinion/warren-workers-boards.html>

^{ix} <https://hbr.org/2018/09/what-we-do-and-dont-know-about-worker-representation-on-boards>

^x Blanchard, O., & Philippon, T. 2006. 'The Quality of Labor Relations and Unemployment'. Accessed online: <https://pdfs.semanticscholar.org/b310/9e2a96f0aeac9d7189a3fa4999e9160b5666.pdf>

^{xi} <https://www.independent.co.uk/news/world/europe/the-european-countries-that-strike-the-most-french-strikes-industrial-action-map-a7063926.html>

^{xii} Meritt, J. 2022. 'Independent Review of SafeWork SA'.

^{xiii} <https://www.thesaturdaypaper.com.au/post/max-opray/2022/04/05/liberals-stack-boards-before-election>