

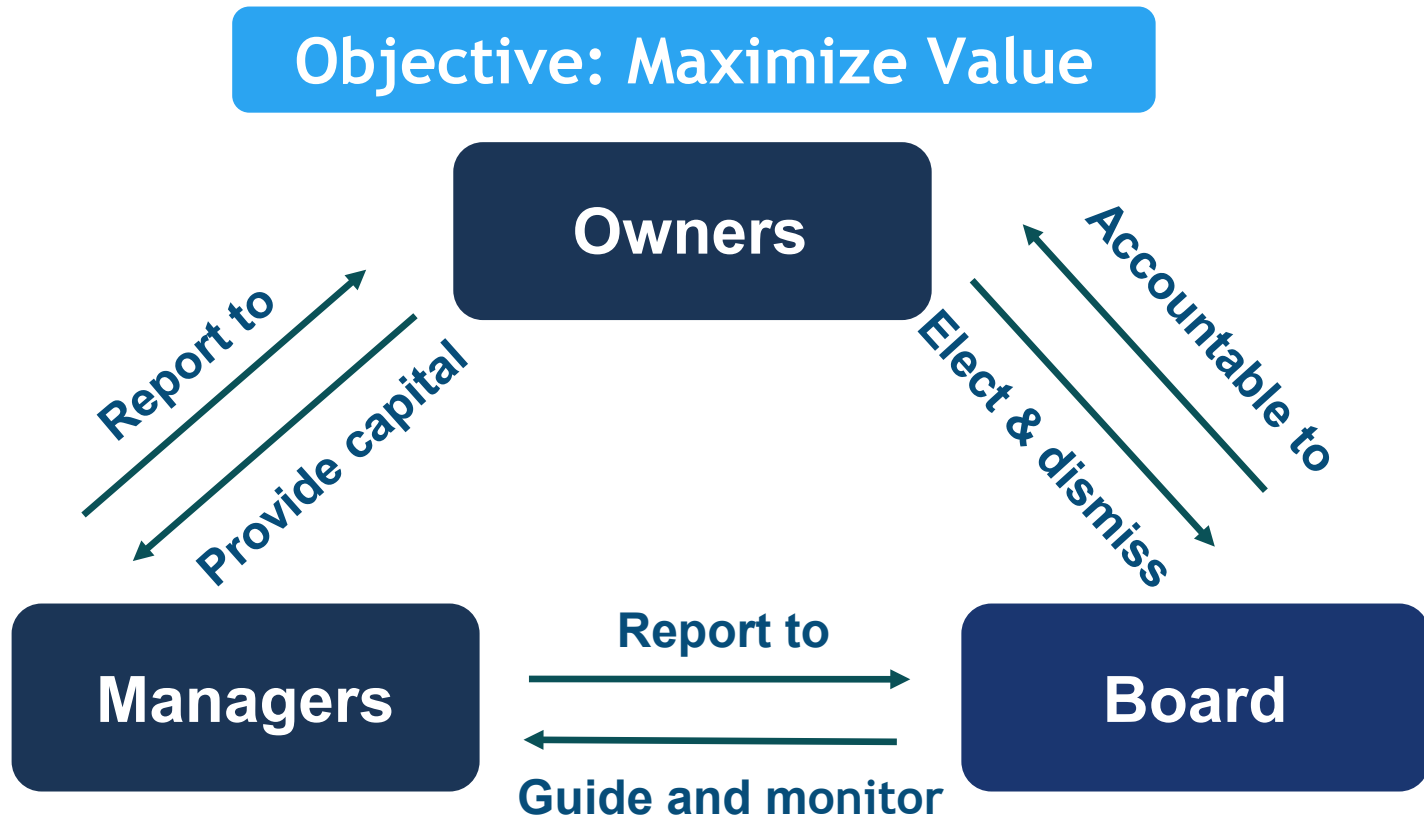
# **Governance of State-Owned Enterprises**

## **Good Practices and International Trends**

Irina Gordeladze  
Consultant World Bank, IFC

**21 November 2019**  
**Baku, Azerbaijan**

# CORPORATE GOVERNANCE: THE LOGIC



# SOE CORPORATE GOVERNANCE: KEY ASPECTS

Legal and Ownership  
Framework

The State as Owner

Supervisory Board

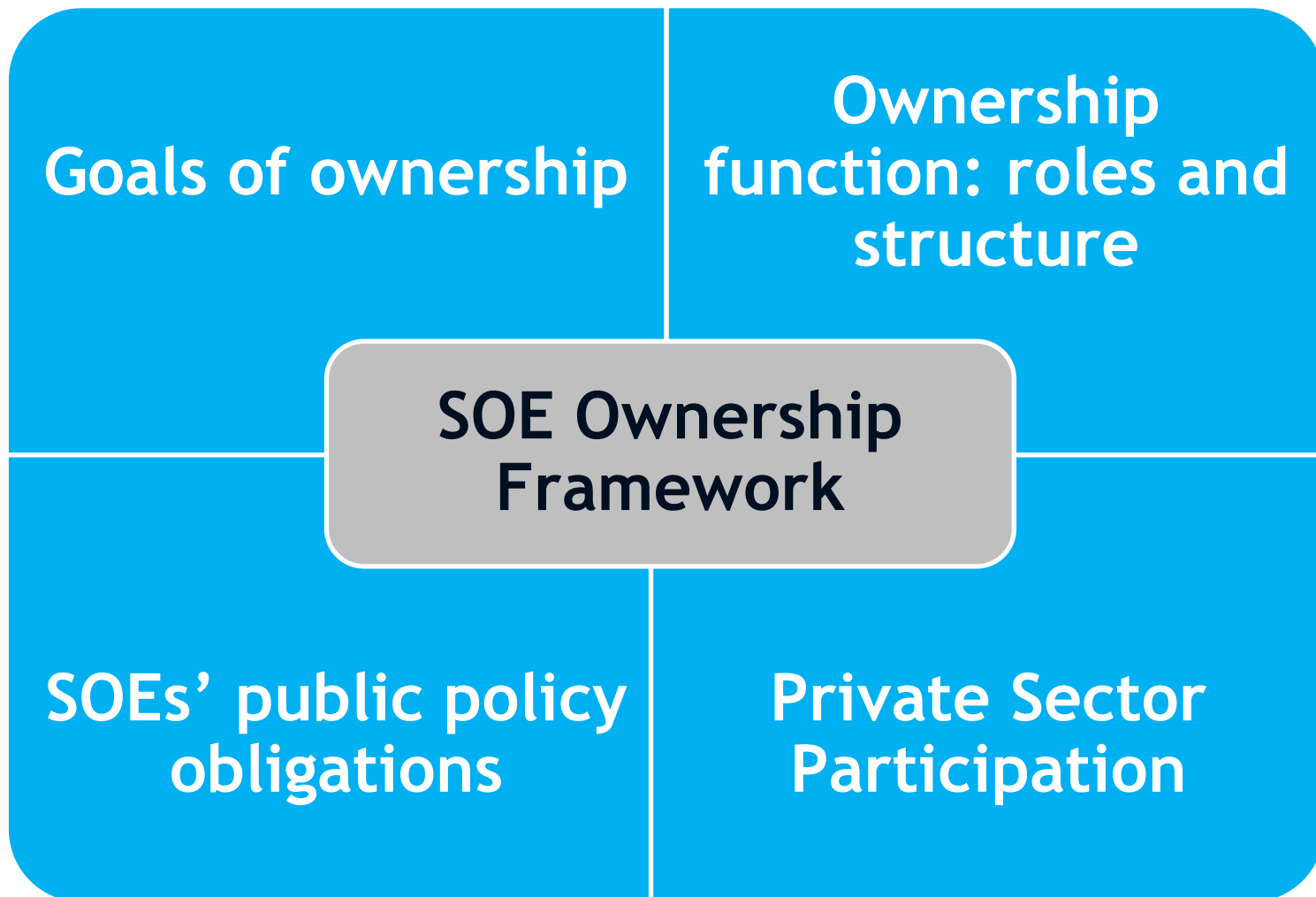
SOE

Performance Management

Financial discipline

Transparency and Controls

Equal  
Treatment of  
Shareholders  
Relations with  
Stakeholders



## SOE OWNERSHIP: KEY FUNCTIONS

### Appoint

Board members

External Auditor

### Direct and Guide

Strategic Objectives

Remuneration Policies

Return Targets

### Monitor

Financial Performance

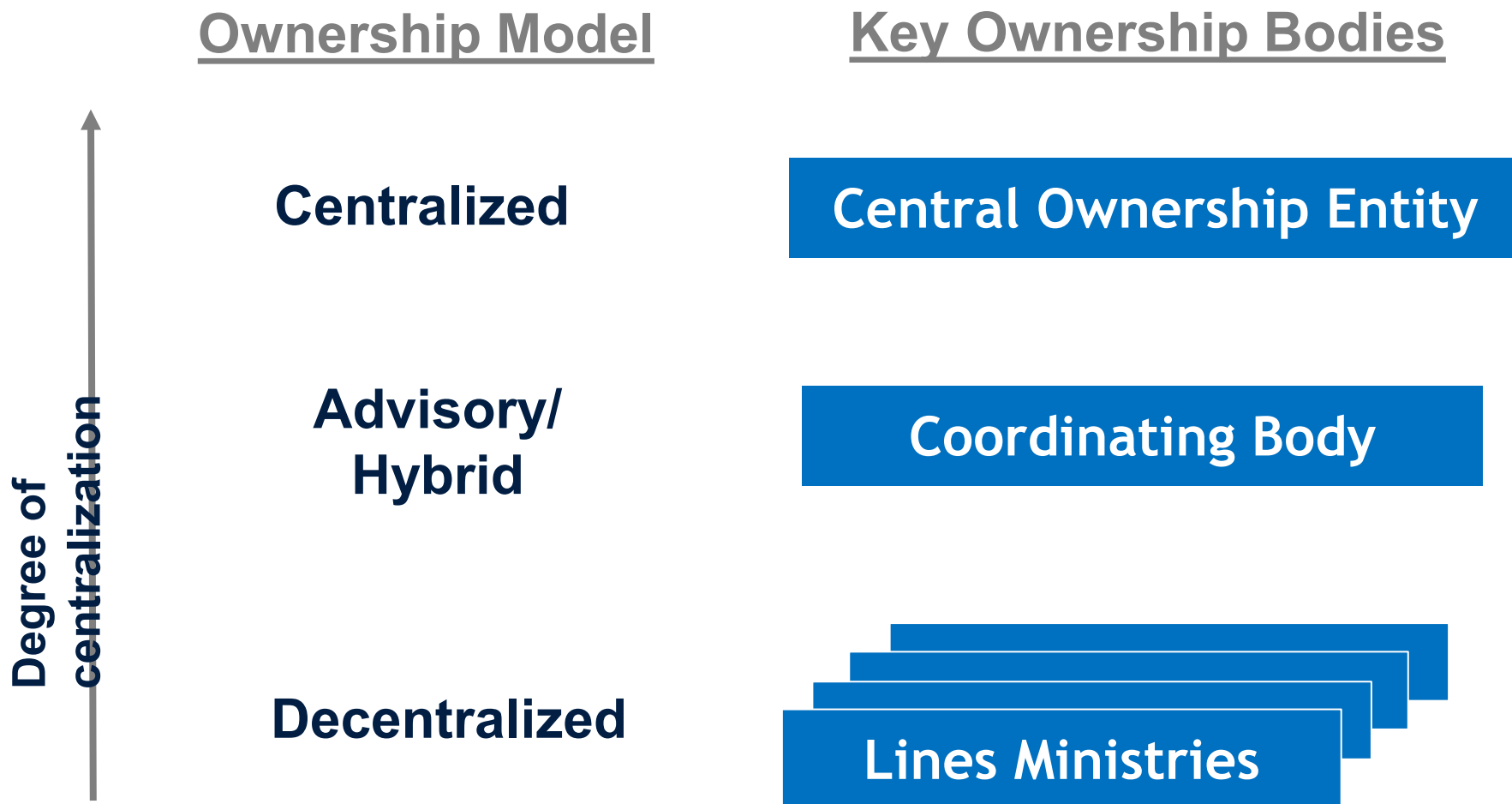
Financial Risks

E.S.G.\* Aspects

**Report** on SOE Sector and Ownership Activities

\* Environmental, social and governance

# INSTITUTIONAL ARRANGEMENTS FOR SOE OWNERSHIP



# OVERVIEW OF OWNERSHIP ARRANGEMENTS

- » The *decentralized model*, where ownership responsibilities are dispersed among different line ministries.
- » The *dual model*, a variation of the decentralized model, where in addition to line ministries a second ministry, such as the ministry of finance, may also have certain responsibilities.
- » *The advisory model*, where ownership remains dispersed but an advisory or coordinating body is created to advise ministries on ownership matters.
- » The *centralized model*, where ownership responsibilities are centralized in an entity or entities that may be independent or may fall within government.

# DIFFERENT MODELS OF STATE OWNERSHIP – NO ONE SIZE FITS ALL SOLUTION

Decentralized model	Dual model	Centralized model
<p><b>Line ministries responsible</b> (e.g. <b>Pakistan</b>) Most common in past, still in many countries today</p> <p><b>Benefits:</b></p> <ul style="list-style-type: none"> <li>Line ministries have historical experience, sector/company knowledge</li> </ul> <p><b>But many limitations</b></p> <ul style="list-style-type: none"> <li>Conflicts between ownership, policy-making and regulatory functions</li> <li>Fragmentation of ownership</li> <li>Insufficient “ownership” capacity</li> <li>Lack of adequate oversight and accountability of sector as a whole</li> <li>Scope for day-to-day involvement</li> </ul>	<p><b>Line ministries &amp; another ministry</b>, usually MOF (e.g. <b>Turkey, Mexico</b>) Hybrid between decentralized and centralized model</p> <p><b>Benefits:</b></p> <ul style="list-style-type: none"> <li>Provides checks and balances</li> <li>Promotes technical and financial oversight</li> </ul> <p><b>Limitations:</b></p> <ul style="list-style-type: none"> <li>MOF focused more on financial and budgetary matters</li> <li>Lack of capacity to be advocate for reform</li> <li>Numerous other bodies continue to be involved</li> </ul>	<p><b>Three broad types:</b></p> <ul style="list-style-type: none"> <li>Advisory bodies (e.g. <b>Norway, Sweden, New Zealand, India, South Africa</b>)</li> <li>Ownership agencies within the government structure (e.g. <b>France, Indonesia, China</b>)</li> <li>Holding companies (e.g. <b>Malaysia, Singapore, Hungary, Gulf countries</b>)</li> </ul> <p><b>Benefits:</b> Helps drive reform</p> <ul style="list-style-type: none"> <li>Separates and strengthens the ownership function</li> <li>Ensures consistent implementation</li> <li>Concentrates scarce skills and resources <b>fail solution</b></li> </ul>



# THE STATE'S ROLE AS AN OWNER

- » The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.

*Source: OECD, 2015a*



## ADVANTAGES OF CENTRALIZED MODEL

- Clearer **separation between ownership and policy** formulation at sector level
- More **consistent and coherent ownership** practices
- **Pooling** of specialized resources and expertise
- Central point for **data collection** on SOEs and **monitoring** of SOE performance
- More efficient **management of financial/fiscal risks** associated with SOEs
- State's increased ability to **report on ownership role**

# Recent Trends in SOE Corporate Governance



# TRENDS IN SOE CORPORATE GOVERNANCE

## Ownership Function

- Centralization and professionalization
- Modern performance monitoring
- Aggregate reporting
- Development of rationale for ownership of economic activities

# TRENDS IN SOE CORPORATE GOVERNANCE

## Supervisory Boards

- Appointment of independent board members
- Systematic evaluation of board members
- Specialized committees

# TRENDS IN SOE CORPORATE GOVERNANCE

## Other

- Regulation of procurement practices
- “Integrated dashboard”
- Sustainability reporting

# KEY CONCEPTS AND DEFINITIONS

- » *Ownership arrangement* - the way in which the state organizes itself to exercise its ownership rights over SOEs.
  - » It refers not just to the legally recognized owner of the assets but also to the body or entity that has the authority to exercise the state's ownership rights.
- » *Ownership function* - the fundamental rights and normal functions exercised by shareholders when they own shares in a company or when they own a company outright.

# КРУПНЕЙШИЕ ФОНДЫ БЛАГОСОСТОЯНИЯ (СЕНТЯБРЬ 2017)

## Norway's Sovereign Wealth Fund Hits \$1 Trillion

Largest sovereign wealth funds by assets under management in 2017\*

Fund	Country	Origin	Assets
Government Pension Fund - Global	Norway 	Oil	\$1t
Abu Dhabi Investment Authority	UAE 	Oil	\$828b
China Investment Corporation	China 	Non-Commodity	\$814b
Kuwait Investment Authority	Kuwait 	Oil	\$524b
SAMA Foreign Holdings	Saudi Arabia 	Oil	\$514b
Hong Kong Monetary Authority Investment Portfolio	Hong Kong 	Non-Commodity	\$457b
SAFE Investment Company	China 	Non-Commodity	\$441b
Government of Singapore Investment Corporation	Singapore 	Non-Commodity	\$359b
Qatar Investment Authority	Qatar 	Oil & Gas	\$320b
National Social Security Fund	China 	Non-Commodity	\$295b



\* As of September 19, 2017

Source: The Sovereign Wealth Fund Institute



# SOES SUCCESS FACTORS

---

- » SOEs success depends upon the quality of the management including the incentives to achieve good performance coupled with penalties for poor performance.
- » The quality of the management depends upon the corporate governance arrangements that exist including clarity of responsibility for the operational management of the enterprise.

# STATE OWNERSHIP OBJECTIVES (EXAMPLE 1)

» **Sweden:** The State Ownership Policy, approved by the Government in 2015, pronounces that “The Government’s overall objective is creating value for the owners” and, where applicable, to ensure that specially commissioned public policy assignments are well performed. The Government believes in principle that the state should not own companies that are active in competitive commercial markets unless the company has a specific public service assignment that would be difficult to fulfill in any other way

*Source: OECD, 2015b*

# STATE OWNERSHIP OBJECTIVES (EXAMPLE 2)

» **New Zealand:** The State-Owned Enterprises Act 1986 specifies that “the principal objective of every State enterprise shall be to operate as a successful business and, to this end, to be (a) as profitable and efficient as comparable businesses that are not owned by the Crown; (b) a good employer; and (c) an organization that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavoring to accommodate or encourage these when able to do so...”



# LITHUANIA: MAKING STATE OWNERSHIP SUCCESSFUL



## Ownership policy

- Adoption of Ownership policy
- Establishment of the Governance Coordination Centre

## Governance professionalisation

- Improved Board autonomy (independence)
- Introduction of letters of expectations

## Portfolio optimisation

- SOE portfolio optimisation
- Corporatisation of SOEs

2010

2012

2015

2017

2018

Now

## Transparency and disclosure

- Adoption of Transparency Guidelines
- Introduction of aggregated SOE portfolio reporting

## Board nomination principles

- Adoption of Board Nomination Guidelines
- Opened OECD accession discussions

## Accession to





# STRENGTHEN THE OWNERSHIP FUNCTION



- ✓ Strengthened SOEs coordinating institution – the Governance Coordination Centre
  - ✓ Strengthened independency
  - ✓ Increased budget and staff

## GOVERNANCE COORDINATION CENTRE

The analytical centre, founded by the Government, seeks to ensure the consistent and professional governance of state-owned enterprises

### Transparency

Analytic reports and publication of SOEs performance

### Boards

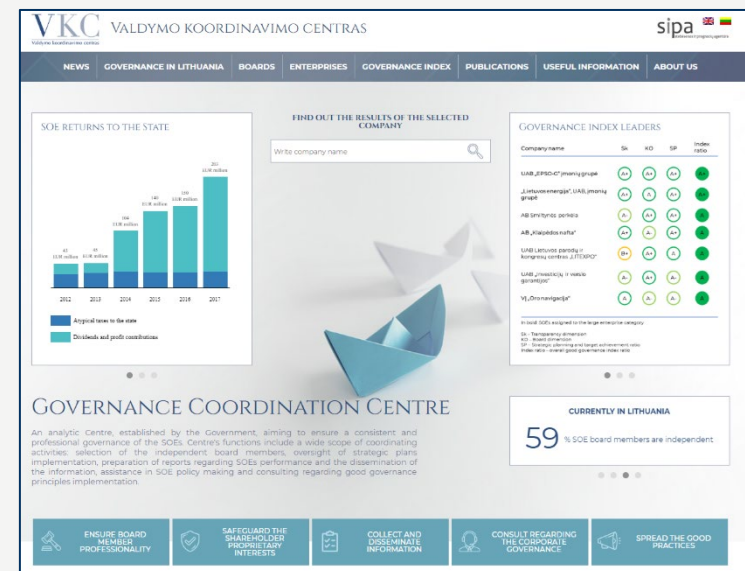
Selection procedures of independent board members

### Clear targets

Review of SOEs strategies, letters of expectation and monitoring of the achievement of targets

### Consulting

Assistance in SOE policy setting, consulting on good governance practices



<https://vkc.sipa.lt/en>

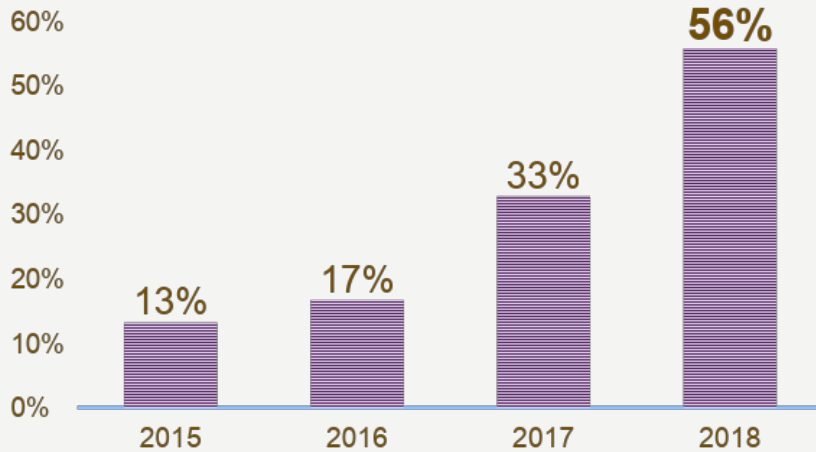


# INCREASED OPERATIONAL INDEPENDENCE OF SOE BOARDS

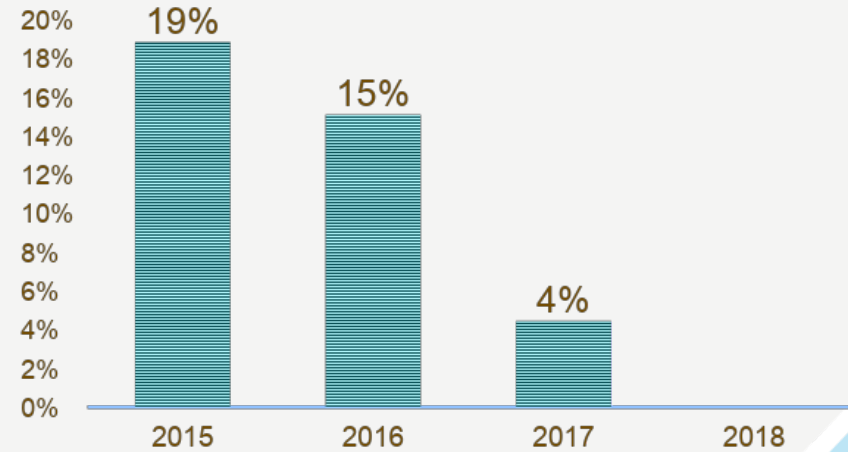


- ✓ At least ½ of Independent Board members
- ✓ Boards without political appointees
- ✓ Standardised board nomination procedures for all SOEs

The percentage of Independent Board members



The percentage of Political appointees in Boards

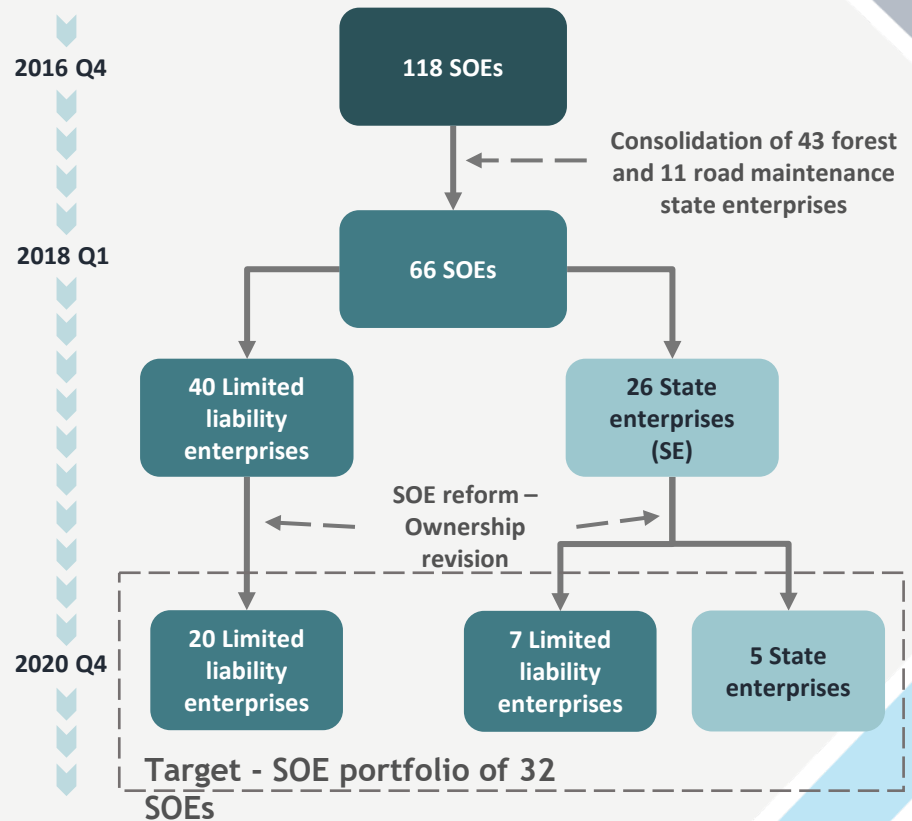
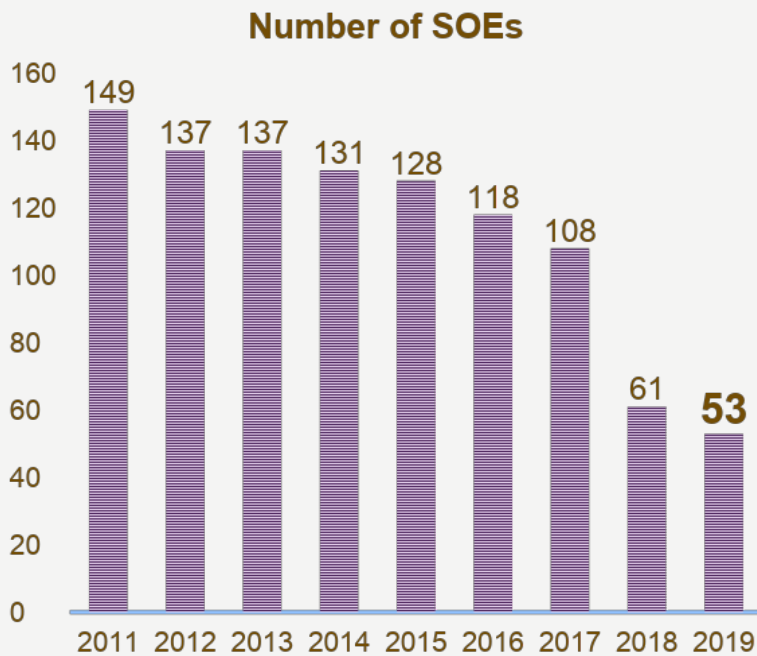




# STREAMLINING SOEs' LEGAL AND CORPORATE FORMS



- ✓ Optimisation of SOE portfolio
- ✓ Review of the legal form of state enterprise



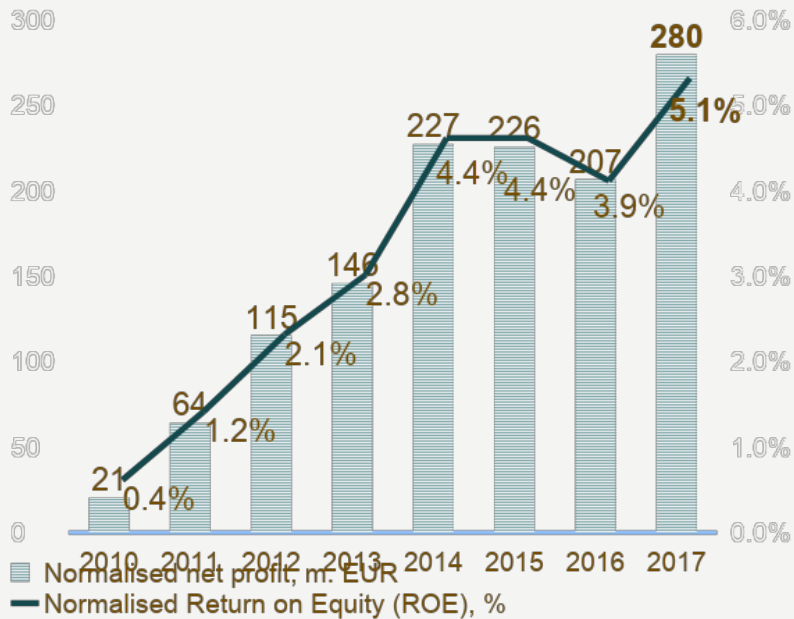


# RESULTS

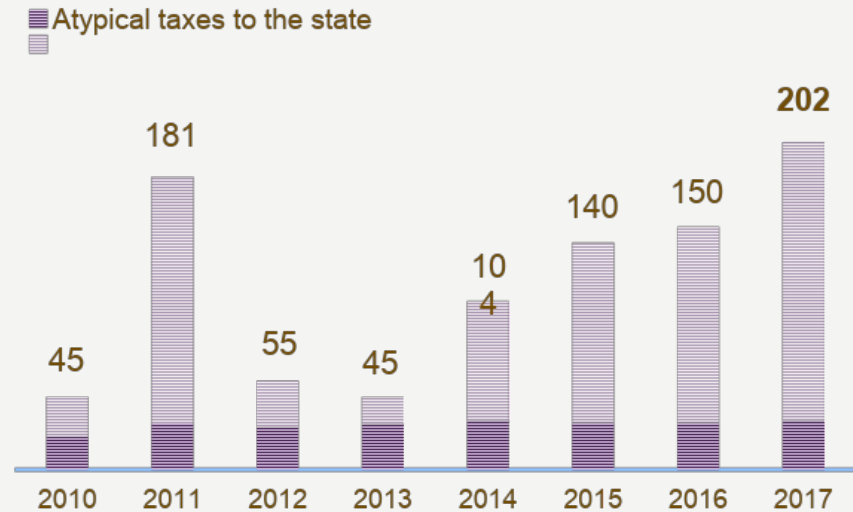


✓ Improved SOEs' governance leads to higher return to the state

### Profitability of SOEs



### Return to the State (EUR million)







# Questions and Discussion