



**THE WORLD BANK**  
Corporate Governance

# Held by the Visible Hand

*The Challenge of SOE Corporate  
Governance for Emerging Markets*



MAY 2006

# Held by the Visible Hand

*The Challenge of State-Owned  
Enterprise Corporate Governance  
for Emerging Markets*



MAY 2006



**THE WORLD BANK**  
Corporate Governance

Prepared by David Robinett of the World Bank Corporate Governance Department with the support of the Global Corporate Governance Forum and in cooperation with the Corporate Affairs Division of the Organisation for Economic Co-Operation and Development (OECD). Olivier Fremond, Mathilde Mesnard, Daniel Blume, Alexander Berg, William Mako, Tatiana Nenova, and Catherine Hickey provided useful advice and comments.



# Contents

<b>Introduction</b>	<b>1</b>
State Ownership in Emerging Market Economies	1
The Challenge of Corporate Governance in State-Owned Enterprise	3
Overview	4
<b>SOE Status and Objectives</b>	<b>7</b>
Status	7
Objectives	8
Improving the Status and Objectives of SOEs	9
<b>Ownership Function</b>	<b>11</b>
Ownership Form	11
Exercising the State's Ownership Rights	13
Dividend and Investment Policy	14
Oversight and Performance of the Ownership Function	15
Monitoring and Motivating Performance	16
Performance agreements	16
Evaluation of SOE performance	17
Improving the Performance of the Ownership Function	18
Overseeing the SOE and exercising the SOE's ownership rights	18
Dividends and major transactions	18
Efficiency and accountability of the ownership function	18
<b>Transparency and Disclosure</b>	<b>19</b>
Disclosure Requirements	19
Enterprise reporting	19
Aggregate reporting	20
Disclosure Oversight	20
Improving the Transparency of SOEs	20

---

<b>SOE Boards</b>	<b>23</b>
State Ownership and Board Member Duties	23
The Limited Authority of the Board	24
Reform to increase board responsibility	25
The Challenge of Building an Effective Board	25
Nominating and selecting board members	25
Board composition	26
Board professionalism	26
Improving the Boards of SOEs	27
<b>Relations with Other Shareholders and Stakeholders</b>	<b>29</b>
Relations with Other Shareholders	29
State and minority shareholders	29
When the state is a minority shareholder	30
Relations with Stakeholders	30
Relations with employees	30
Relations with creditors	32
Relations with other stakeholders	33
Improving Relations with Other Shareholders and Stakeholders	33
Shareholders	33
Stakeholders	34
<b>Notes</b>	<b>35</b>
<b>References</b>	<b>37</b>
<b>Boxes</b>	
1 Examples of State Ownership in Emerging Market Economies	2
2 SOE Form in India	8
3 Other State Owners	12
4 The Ownership Function in Indonesia and India: Centralized versus Dual	13
5 Temasek and the Oversight of Ownership in Singapore	15
6 Checklist for a Shareholder Compact	17
7 The Directors Report: An Example from South Africa	21
8 Key Functions of Boards	24
9 Employees as Shareholders: The Experience from the Regional Corporate Governance Roundtables	31

# Introduction

The critical role that corporate governance plays in financial development and enterprise reform has been confirmed by financial crises, corporate scandals, and the long and difficult transition from plan to market. In state-owned enterprises (SOEs), state ownership and government control present inherent governance challenges that contribute to poor performance. However, efforts to improve corporate governance in SOEs have lagged those of the private sector, where changes have been extensive over the last decade (OECD 2004b; 2004d).

The focus of SOE reform has been on privatization, which remains the most direct solution to the problems of state ownership. However, it has become clear that, for both political and economic reasons, the state will remain a major owner of productive assets in a number of economies for years to come. Extensive experience with privatization has also confirmed the important role that corporate governance can play before, during, and after the state divests its assets.

Current SOE corporate governance reform incorporates lessons on how to improve corporate governance in the private sector, and the international consensus that has developed regarding corporate governance reform. It also builds on reforms to SOE administration and management in the 1970s and 1980s and later efforts to prepare SOEs for privatization. Overall, corporate governance provides a coherent and tested framework for addressing key weaknesses of SOEs that is consistent with indefinite state ownership or continuing privatization. The

recently issued *OECD Guidelines on the Corporate Governance of State-Owned Enterprises* (2005b) outlines this framework and what SOEs and governments need to do to ensure good corporate governance.

## State Ownership in Emerging Market Economies

State ownership remains significant in middle- and lower-income countries despite extensive privatization over the last two decades. State-owned enterprises—sometimes also referred to as government corporations, government-linked companies, parastatals, public enterprises, or public sector enterprises—are a diverse mix ranging from internationally competitive listed companies, large-scale public service providers, wholly owned manufacturing and financial firms, to small and medium enterprises. They remain prominent in air and rail transport, electricity, gas, and water supply, broadcasting, natural resource extraction, telecommunications, and banking and insurance. Publicly owned banks and other state-owned financial institutions still serve the majority of individuals in developing countries (Caprio et al. 2004). Companies with at least some state ownership can also be found in such industries as aerospace, automobile manufacturing, shipbuilding, shoes, textiles, steel, and tourism and leisure. Globally SOEs account for 20 percent of investment and 5 percent of employment. In Africa SOEs produce around 15 percent of GDP, in Asia 8 percent, and in Latin America 6 percent. In Central and Eastern

Europe, the state sector remains significant, accounting for 20 to 40 percent of output. Overall, SOEs play an important role in a number of major economies (Box 1) (Chong and Lopez-de-Silanes 2003; European Bank for Reconstruction and Development [EBRD] 2001–2003).

Traditionally, state ownership has been advocated as an alternative to regulation, especially for natural monopolies or oligopolies, including network industries such as telephony.<sup>1</sup> It was believed that in these industries direct government ownership would allow for greater economies of scale, more efficient pricing, and higher levels of investment and innovation. Reinforced by the perceived failures of industrial regulation in western economies in the 1930s, state ownership became a popular policy prescription for

a wide range of market failures in the decades following World War II (Lange 1937; Shleifer 1998).

Modern theories of ownership generally take a restrictive view of both regulatory failure and the role of the state as owner. The focus of this work is on the residual control rights held by the owner of an enterprise. If the state can achieve its goals through regulation (including appropriate taxes and subsidies), then residual control rights, and hence, ownership are unnecessary. However, there may be cases where arms-length regulation is not able to meet the state's policy goals. If the scope and quality of the SOE's output or service delivery is hard to verify, and hence, contract on or regulate explicitly, then in theory, it might be best for the state to retain residual control rights to ensure adequate delivery. For example, if a

### Box 1 Examples of State Ownership in Emerging Market Economies

In **China**, the central government is responsible for 17,000 SOEs, the number of SOEs under local governments exceed 150,000. On the Shanghai and Shenzhen stock exchanges almost all listed companies are directly or indirectly state owned; in the Hong Kong Stock Exchange Chinese, SOEs make up 35 percent of market capitalization. The 1,200 listed SOEs produce 18 percent of GDP, and their total market capitalization is around 40 percent of GDP.

In **India**, there are 240 Public Sector Enterprises outside the financial sector. These enterprises produce 95 percent of India's coal, 66 percent of its refined oil, 83 percent of its natural gas, 32 percent of its finished steel, 35 percent of its aluminum, and 27 percent of its nitrogenous fertilizer. Indian Railways alone employs 1.6 million people, making it the world's largest commercial employer. Financial sector SOEs account for 75 percent of India's banking assets.

In **Indonesia**, the Ministry of State-Owned Enterprises controls 161 SOEs and has minority stakes in another 21. With \$86 billion in assets and an estimated 1.4 million employees, over 70 percent of SOEs operate in competitive sectors, including pharmaceuticals; agriculture, fisheries and forestry; printing and publishing; and over 20 other industries.

In **Poland**, approximately 1,800 SOEs account for about 28 percent of GDP and 30 percent of employment.

In **Russia**, companies controlled by the federal government produce 20 percent of the country's industrial output, the regional governments another 5 percent. As measured by assets, the federal government controls 20 percent of the banking sector, the regional governments 6 percent.

In **Singapore**, Temasek—the national holding company—has a \$90 billion portfolio with shares in over 20 major SOEs, including such well-known multinationals as SingTel, Singapore Airlines, and Raffles. The 12 Government Linked Companies listed on the Singapore Stock Exchange represent about 20 percent of market capitalization and produce 12 percent of GDP.

In **South Africa**, there are 270 SOEs with a total turnover in excess of \$15 billion a year.

In **Vietnam**, 5,000 SOEs produce 38 percent of GDP, contributing 22 percent of total government revenue through earnings and taxes.

*Sources:* OECD; China: Qiang (2003), Mako and Zhang (2004), *The Economist* (2003); Indonesia: Babcock (2002) and Ministry of State-Owned Enterprises (2002); Poland: Prus (2003); Singapore: Mako and Zhang (2004), [www.temasekholdings.com.sg](http://www.temasekholdings.com.sg)

constant and reliable supply of electricity could not be guaranteed via regulation, then the government could attempt to ensure it by retaining direct control of electricity production and distribution. As in the traditional case, this could be relevant for natural monopolies where competition could not ensure adequate quality (Hart, Shelifer, and Vishney 1997).

However, these residual control rights must be weighed against the downsides of continuing state control. To continue the previous example on electricity, state ownership could be counterproductive if it led to lower investment and higher costs for power generation. The regulatory power of the state itself is not fixed and may develop through time. Hence, according to these theories, temporary state ownership in certain industries may be desirable as regulatory capacity develops, but permanent state ownership would only be best for very particular activities. Again, it is in noncompetitive industries where regulation may need to develop through time, and where a lack of competitive pressures may limit the relative benefits of private ownership (Perotti 2003; Shleifer 1998).

In practice, state ownership in many countries went well beyond natural monopolies. Enterprises were nationalized as a means to better labor relations, as part of programs to bring all productive activity into state hands, and to limit private and foreign control. SOEs were also created to encourage economic development and industrialization. In the traditional debate over state ownership, the focus was on existing industries that should or should not be nationalized. In many developing economies, however, the goal for the state was to *create* new industries by channeling national savings and foreign aid directly into SOEs large enough to achieve economies of scale. These projects were often designed to encourage wider industrialization, usually by creating demand for potential domestic industrial producers (backward linkages) or to supply critical inputs (forward linkages) (Easterly 2002; Gerschenkron 1952; Sachs 1996). Industrial decline has also been a source of new SOEs, with the state receiving ownership stakes as part of enterprise restructuring (Ayub and Hegstad 1986).

At its peak, state ownership accounted for 20 percent of output in Africa, 12 percent in Asia, and

10 percent in Latin America. In some sectors, such as banking, the share was over 50 percent. Despite their popularity and seeming early success in some countries, the overall performance of SOEs has been disappointing. SOEs have tended to be less productive than their private sector counterparts and have been used by politicians to create patronage and reward their supporters. In the process, SOEs have diverted resources from both the private sector and other state priorities. The need to find resources to prop up failing SOEs has also distorted financial systems and monetary policy, at times contributing to wider macroeconomic crisis.<sup>2</sup>

Starting in the 1970s, many countries began reforms aimed at enhancing SOE performance, and by the 1980s and early 1990s, extensive restructuring had become the norm for the state sector. These initiatives have been wide reaching with a number of elements, including downsizing; new capital infusions; performance incentives for top management; changes in administration, organization, and legal form; and privatization. These decades of reform have made clear that fundamental problems in the governance of SOEs explain much of the poor performance of SOEs (Baygan-Robinett 2004; Chong and Lopez-de-Silanes 2003). Although these problems are inherent to state ownership, an effective ownership policy that addresses the key challenges of SOE corporate governance may limit their adverse impact and facilitate wider restructuring and privatization.

### **The Challenge of Corporate Governance in State-Owned Enterprises**

The emergence of large, shareholder-owned corporations in the first half of the 20th century seemed to provide evidence that “publicly owned” enterprises could be successful, including state-owned ones. However, it has become clear that companies with dispersed shareholders presents significant challenges in terms of governance and require a developed institutional framework. SOEs have the same core problem in terms of separation of control and ownership—the owners in this case being the citizens of a country—but they also face additional challenges that can severely undermine their efficiency.<sup>3</sup>

Unlike a widely held corporation in the private sector, an SOE generally cannot have its board changed via a takeover or proxy contest, and most cannot go bankrupt. The absence of potential takeovers and proxy contests reduces the incentives of board members and managers to maximize the value of the company, and the lack of bankruptcy can introduce a *soft budget constraint*, which reduces pressure to contain costs. Hence, two of the most important checks on underperformance are absent (Baygan-Robinett 2004; Estrin 1998).

Although an SOE has very diffused owners, it generally has a higher body or bodies that oversee it. This can be one or more ministries, an ownership entity specifically created to oversee SOEs, the Parliament, or frequently some sort of combination. At the worst, these various authorities may use SOEs to achieve short-term political goals at the cost of both efficiency and longer-term policy objectives. Even without flagrant abuse, this *complex agency chain* through and across various levels of the government may present difficulties not present in the more straightforward relationship between a company's board and managers on the one hand and its shareholders on the other (Estrin 1998; OECD 2005a).

SOEs also have the related problem of *common agency*. Given that each relevant part of the government has somewhat different objectives, each could attempt to influence the SOE accordingly. Even if the various objectives are perfectly legitimate, the overall impact of this competition for influence reduces accountability and weakens the incentives for managers and board members (Dixit 1997). Managing multiple and potentially conflicting objectives is one of the central challenges in the governance of SOEs.

In recent years, improving the corporate governance of SOEs has become a major policy objective in countries around the world. India proposed Principle of Corporate Governance for Public Enterprises in 2001, and South Africa released its first Protocol on Corporate Governance in the Public Sector in 1997 and a revised version in 2002. In Indonesia, the newly formed Ministry of State-Owned Enterprises (MSOE) has a core mission to reform SOEs based on "Good Corporate Governance Principles." In China, as part of its campaign to "Grasp the large and let-go the small," corporate governance reform, especially

for listed SOEs, has become a policy priority (Mako and Zhang 2004; Ministry of State-Owned Enterprises 2002; Reddy 2001; South African Department of Public Enterprises [DPE] 2002; Taskforce on Corporate Governance [TCG] 2004). A recently issued corporate governance code for Bangladesh contains a section specifically for SOEs.

Improving the governance of SOEs can bring substantial benefits. By increasing profitability, corporate governance reform can contribute to the government's financial position and allow greater reinvestment. Better corporate governance can increase productivity and contribute to overall economic performance both directly and by reallocating resources within the state sector and across the economy as a whole. In addition improved governance in the state sector can create a model for and increase pressure on the private sector to improve its own governance.

Even when privatization is planned for SOEs, corporate governance remains crucial. An inattention to governance in the privatization process has caused sometimes spectacular failures and widespread abuse (Chong and Lopez-de-Silanes 2003; Coffee 1999). It may take time to develop the institutional infrastructure needed to ensure adequate governance for privatized firms, and the privatization process itself may take substantial time, especially when difficult restructuring and liquidation are necessary. By improving the governance of SOEs, the state can better protect its assets, enhance performance, and ensure higher valuations and revenue from privatization. Finally, state ownership remains an element of many countries' economic strategies. Major companies around the world will retain state ownership for years, if not decades, to come.

## Overview

This study provides an initial assessment of SOE corporate governance in emerging market economies. The focus is on practice and experiences based on a range of sources, including background meetings and materials prepared for the *OECD Guidelines on the Corporate Governance of State-Owned Assets* (2005b). Most examples come from middle-income countries for which data are more readily available. However, many of the

study's observations and recommendations will also be relevant for lower-income economies.

Each chapter discusses a key element of the corporate governance framework for SOEs:

- The **status** of SOEs in terms of their legal form—joint stock company, departmental undertaking, autonomous body, etc—and place within the administration;
- The framework for setting the **objectives** of SOEs, communicating those objectives, and updating them when necessary;
- The organization of the **ownership function** of the state, including how the state exercises its rights as a shareholder, SOE dividend and investment policy, and how to monitor and motivate SOEs to achieve their objectives;
- **Disclosure and transparency** of individual SOEs and the state sector as a whole, including requirements for enterprise and aggregate reporting, and the system of external and internal controls to ensure that disclosure is effective;
- The authority and responsibilities of **SOE boards**, and the role of the state in nominating board members, ensuring professionalism, and determining board composition; and
- Relations with other **shareholders** and **stakeholders**, including if the SOE acts in an ethical manner, and whether SOEs deal with one another on an arms-length basis.

Each chapter concludes with recommendations for economies looking to further improve the corporate governance of their SOEs.



# SOE Status and Objectives

## Status

The form and status of SOEs are closely linked to the wider ownership policy of the government. For example, in China in the late 1970s, 5-year plans specified SOEs' investments, prices, and quantities of key products. The economic commission in collaboration with line ministries was responsible for day-to-day management. The financial department and state-owned banks provide funds, while the profits from SOEs went to the central budget, where they contributed a sizeable portion of national revenue (Mako and Zhang 2004).

Economic reform in China required significant change in enterprise status: the “separation of government from management” to form a modern company system. Following the end of central planning in the late 1980s, many companies were converted into joint stock companies, with the state's ownership represented by its shareholdings. By the 1990s, SOEs had a legal personality and property distinct from that of the state, and fell under company law and laws for bankruptcy and mergers. Hundreds of large SOEs are now publicly listed (Mako and Zhang 2004). Overall, both the legal form and the de facto relationship of SOEs with the government changed radically, with far more decisions made at the enterprise level. This fundamental change in SOE status was a critical part of the reform effort and the move to a more market-oriented economy.

Countries as diverse as Bulgaria, Chile, Peru, and Singapore all have a relatively uniform system for the

legal status of SOEs. In these countries, practically all SOEs have the standard form of a shareholder-owned company, even when the state is the only shareholder. Legally, the state's powers as owner come from its status as a shareholder, and hence, through shareholder powers vested in the general meeting of shareholders, including the ability to choose board members. Such a uniform system clarifies and simplifies the relationship between the state as an owner and SOEs, and may allow it to be a more effective shareholder. In many countries, the state sector is opaque: a more uniform system could contribute to overall transparency, facilitating the compilation of information and comparisons across SOEs. Finally, it has been noted that the standard corporate form could provide greater political insulation for SOEs and transfer greater autonomy to their boards (Wong 2004).

However, many countries have a wider range of legal forms for SOEs. Legal form may vary depending on what level of government owns the enterprise, how the enterprise was founded, where it falls in public administration, the purpose of the SOE, and whether or not the enterprise is in the process of being privatized. Box 2 describes the various forms of SOEs wholly owned by federal government in India, which includes departmental undertakings, statutory corporations established by official act, and the governmental limited liability. Similar forms are found in a number of other countries, along with the shareholder owned company. Although a wider range of forms gives the government greater flexibility, it could also complicate ownership policy and insulate

SOEs from the legal framework for other companies, including bankruptcy or securities law.

Legal form is only one difference across SOEs. The state may wholly own some SOEs, have majority ownership in others, and in some companies will be a minority shareholder. The SOE may or may not be listed on a stock exchange—in many countries, the state has retained significant ownership in some of the largest listed companies—and in transition economies may have many minority shareholders even when not listed. SOEs will also have joint ventures with private companies, and some companies may be “government linked” because of shares owned by government pension funds, asset management, or restructuring corporations, development lenders, or some other part of the government.

The potential variety of SOEs, their legal form and other distinctions form an important element in the government’s ownership policy, and can have implications for the broad objectives of state ownership, and the state’s rights and effectiveness as an owner. Unfortunately, SOE status is often developed in an ad hoc manner, with little consideration for its wider

implications. This can lead to confusion and opacity with respect to the governance of SOEs, the role of the ownership entity, and the relationship of the SOE to other parts of the government and the law.

## Objectives

A typical SOE is mandated to produce an output of reasonable quality to be sold at an affordable price. It may be required to offer a comprehensive service (e.g., rail, telephony, mail). It has such financial targets as returns on capital, profitability, taxes and dividends paid to the treasury, and other performance indicators. It may very well have additional goals in terms of employment, community development, correcting past social injustices, and providing social services for its workers and their families. Many of these objectives may be explicit, others may be implicit but no less important in practice. Typically, the enterprise is not reimbursed for its various social mandates; there is usually no clear link between any subsidy it may receive and its various objectives. Finally, besides the state, a major SOE may have additional stakeholders,

### Box 2 SOE Form in India

In India, Public Enterprises “currently in commercial activities or pursuing potentially commercial objectives include...[local] state level public enterprises, state controlled co-operatives, organizations created by special statutes, joint ventures of state and central governments, departmental undertakings, and companies promoted by developmental financial institutions of the government.” Focusing on nonfinancial SOEs owned by the central government, there are three main types in India:

Departmental enterprises (or undertakings), as their name implies, are integrated into their controlling ministry and follow many of the same procedures as other government departments.

Statutory corporations are established by an official act of the legislature, wholly owned by the state but organized to have greater operational autonomy. Statutory corporations are empowered to acquire property and enter contracts, have a certain degree of financial independence and discretion in allocating

revenues, and are generally exempt from the rules and regulations applicable to government departments and departmental enterprises. This exemption normally extends to their employees, who do not have civil service status.

The third form, the government limited company, is the most flexible of the three, not requiring an official act to be established and more easily adopted to changing circumstances. This has led the government limited company to be the preferred company form of the Indian government for entities set up primarily with commercial objectives. Organized like companies in the private sector, with the state as the main shareholder, these SOEs can more easily co-operate in private sector ventures and do not have the same reporting requirements to Parliament that other Indian SOEs have.

Sources: OECD sources, Reddy (2001)

such as minority shareholders, creditors, and nonstate business partners that must also be considered.

When the objectives of the firm are ambiguous or conflicting, managers have substantial discretion to run the firm effectively in their *own* interest (Jensen 2000). Governments themselves may also abuse the discretion that comes with weakly defined objectives, meddling in the affairs of SOEs for short- and longer-term political gain under the cover of its various policy mandates. Explicitly defining the objectives of the SOE can allow for greater political autonomy and clarify what management is supposed to achieve, allowing for improved monitoring and thus increased performance in the process.

The importance of spelling out the objectives for SOEs is now widely acknowledged. Many countries set out objectives for the SOE in performance agreements between the government and the enterprise or its board and chief executive. The objectives may be set by the broad ownership policy of the government, or by the entity or entities that exercise the state's ownership function. In South Africa, for example:

The directors of a wholly owned public entity and the Executive Authority must agree on a Corporate Objectives Statement (“COS”), which shall be a public document. The COS is a brief, high level, plain English document expressed in terms of outputs and containing . . . objectives and broad expectations on financial and non-financial performance. (DPE 2002)

In developing their policy, the government generally needs to consider both the economic performance of the SOE—productivity, return on capital, and so forth—but also other policy objectives of state ownership. For example, SOEs in Indonesia have both explicit commercial and public sector obligations, and are required to maintain a clear separation between the two (Babcock 2002). It has been recommended that governments also budget for the noncommercial obligations of SOEs and offset the cost of these obligations. This could facilitate the pursuit of economic value creation while still allowing the enterprise to meet its noncommercial obligations. In practice, however, these sorts of proposals remain controversial.

An SOE may have a well-understood mission to provide certain goods or services to low-income households, but formally accounting for the cost could be difficult. Highlighting the cost of policy objectives may also act as a deterrent to a SOE carrying out certain social functions. In addition, in some countries formal budgeting may open the door to additional abuses. For example, it has been suggested that funds allocated for only certain contingencies may always end up being spent, independent of actual events. Formal budgeting may also involve the legislature more deeply into the workings of SOEs, undermining a common reform goal of depoliticizing SOEs.

## Improving the Status and Objectives of SOEs

When possible, SOEs should have the same legal form and be subject to the same laws as other commercial enterprises. The variety of different legal forms for SOEs should be limited. When SOEs do have a special status, an explicit rationale should be provided as to why. Accordingly, the government should develop an explicit policy regarding that companies it retains special control rights in (golden shares) and under what circumstances state ownership may be increased.

The objectives of SOEs should be as explicit as possible. To ensure efficient use of state assets, maximizing enterprise value should be considered as a primary commercial objective. Returns to capital and accurate measures of cash flow can also be useful indicators of commercial performance.

Policy objectives should be clear and realistic. Guidance should be provided on trade-offs, and management should have limited discretion in balancing different objectives. Efforts should be made to estimate their costs, which should be transparent. The national budget should provide for required subsidies in a transparent manner. When possible, regulation, restructuring, and/or competitive procurement should be used to achieve relevant policy goals, allowing the ownership entity and board to focus on commercial objectives.



# Ownership Function

Although the state and its citizens own SOEs, in between them are the part, or perhaps many parts, of the government that performs the ownership function for the state. What performs this function and how it is performed varies widely across countries. Regardless of the form of ownership, exercising the ownership function involves protecting the state's interest as an owner of valuable assets, while ensuring that SOEs carry out their policy objectives. Achieving these twin goals demand competence and accountability that can be undermined by an ownership form that is opaque, complex, or contains inherent conflicts of interest.

## Ownership Form

The ownership form for SOEs can generally be put in one of three categories: centralized, decentralized, or dual. In the centralized form, there is one government body—an *ownership entity*—such as a ministry or holding company, responsible for the government's stake in all SOEs. In the decentralized model, different enterprises are overseen by different ministries, and SOEs may also have widely varying requirements and relationships with other parts of the administration. In the dual form, one single ministry such as the ministry of finance, or a specialized body, performs certain ownership functions for all companies, but other functions are performed by different ministries for different SOEs. In this latter case, the power of the central ministry or body can range from being close to that of the centralized case, with other ministries

playing a fairly limited governance role, to being much more circumscribed, with the entity serving as a consulting and advisory unit for the rest of the government, and having no direct control over SOEs. In addition to specialized ownership entities and ministries, the state may hold its shares through pension funds, privatization funds, or asset management entities established to hold the assets of bankrupt companies (Box 3).

Globally there is a trend of less reliance on a purely decentralized system, with many countries establishing a single ownership entity or coordinating body. Chile, Indonesia, Jordan, Peru, Poland, and Singapore all have what are essentially **centralized systems**:

- In Singapore, SOEs are owned by Temasek, the national holding company, which in turn is 100 percent owned by the Ministry of Finance. As a holding company, Temasek has substantial authority in its subsidiary companies.
- The Chilean State Owned Enterprise System is not considered the direct owner of SOEs, but carries out the ownership function for the state in all of them.
- In Poland, the bulk of SOEs are under the Ministry of the Treasury, which has special units for privatization and SOE governance.
- In Indonesia, the Ministry of State-Owned Enterprises exercises the states ownership rights in SOEs.
- In Jordan, the ownership function is carried out by the Jordan Investment Corporation.

### Box 3 Other State Owners

**Pension funds** may be limited in their holdings, and not in a position to act as an ownership entity. They may also hold small stakes in non-state controlled companies. The ownership entity or coordinating body may issue guidance to pension funds on exercising their ownership rights. **Privatization funds**, which can have stakes in hundreds or even thousands of companies, may have a status similar to pension funds, especially at the later stages of privatization where primarily minority stakes remain, or they may be charged with preprivatization restructuring and have extensive power over their portfolio companies. By its very nature this power is transitory, and in transition economies privatization funds today generally play a secondary ownership role. **Asset management or restructuring companies** may also have transitory power over their holdings. In practice, these special entities are generally most successful when they hold relatively homogenous portfolios and can sale their assets quickly. In each case, these entities may have formal autonomy, but be subject to political interference that can compromise their effectiveness.

SOEs often own each other, with some having many subsidiaries, and large **state controlled conglomerates** having a rich mix of private and state ownership. The parent companies in these enterprise groups may or may not be the ultimate “ownership entity,” but can have similar, or greater, powers in companies they control. There is limited evidence that a parent company, as the ultimate recipient of the returns from their subsidiary companies, may have greater incentives to maximize value than a government agency that remits all returns to the national budget. On the other hand, concern has been raised by the complex and opaque nature of some of these groups, and they are certainly capable of the abuses made familiar by their nonstate counterparts.

*Sources:* Berkman, Cole, and Fu (2002), Chen and Wang (2004), Lange (2002), Mako and Zhang (2004), OECD sources

- Brazil, Bulgaria, India, Kenya, Mexico, South Africa, Turkey, and Vietnam all have variations on the **dual system**:
  - In Brazil, Mexico, and Vietnam, although different line ministries oversee different SOEs, the Ministry of Finance is responsible for the financial performance and asset management of each.
  - In Kenya, the Ministry of Finance also sets other guidelines for SOEs.
  - In Turkey, the Treasury and the Privatization Administration are the legal owners of SOEs and share responsibility for the SOE with the relevant sector ministry.
  - In India, SOEs are overseen by specific ministries. The Department of Public Enterprises issues guidelines and a number of government bodies have an oversight or advisory role.
  - In South Africa, the Department of Public Enterprises develops policies and processes for the governance of SOEs and directly oversees six major enterprises, while line ministries are responsible for the rest. The South African National Treasury also has an oversight role in SOEs.

Some countries still have a **decentralized system**. In China, ownership rights are typically exercised by a designated state shareholder at the relevant level of government. The central State-Owned Assets Supervision and Administration Commission (SASAC) oversees about 165 large state-owned enterprise groups, with about 19,000 business units. At the end of 2003, local SASACs (e.g., at the city or provincial level) oversaw another 127,000 nonfinancial SOEs. Other state entities—for example, other SOEs or the national pension fund—may also be important shareholders. For banks or financial institutions, the Ministry of Finance or a local finance bureau acts as the designated shareholder (Mako and Zhang 2004).

Although the usefulness of a coordinating body in standardizing certain guidelines and procedures for SOEs is widely accepted, centralized control of SOEs is more controversial. Centralization promises better corporate governance of SOEs by creating one highly competent body responsible for the state’s commercial assets. A single body may be able to develop specialized capabilities more easily, and should have clearer accountability for the performance of SOEs,

than several different ministries. In addition, when different parts of the government compete for influence in the SOE, they can create conflicting incentives that can undermine its performance, something a single ownership entity should mitigate.<sup>4</sup>

On the other hand, critics have expressed deep skepticism in having a single, “monolithic” ownership entity, especially for countries with larger and more complex state sectors. Such an entity is seen as a potential bureaucratic monster, wasting resources and acting as a magnate for corruption. There is also concern about how SOEs meet what are perhaps diverse objectives when controlled by a single body focused on financial returns. Advocates of centralization emphasize that policy can still be set by the relevant parts of the government and that the SOE can maintain good relations with ministries.

## Exercising the State’s Ownership Rights

The “ownership function” for the state may involve a number of responsibilities (Box 4 provides examples

from Indonesia and India). Some of these come from the state’s right as a *shareholder* and include participating in the general meeting of the SOE, nominating board members, and exercising other powers held by shareholders. Under the right circumstances, the state’s ownership function can be exercised using primarily their rights as a shareholder. For example, state-owned conglomerates in Brazil, such as CVRD and Petrobras, have used normal shareholding meetings, director appointments, and board procedures to exercise effective governance over large numbers of subsidiaries (Mako and Zhang 2004).

However, many ownership entities and coordinating bodies also act as “ownership policy makers,” setting guidelines and policy for the state sector. Although both centralized and dual systems have bodies that perform this function, it is particularly significant in a dual system where ownership rights may be exercised by a wide range of government agencies. Typical governance related guidelines include procedures for the general meeting and nominating board members. In South Africa, the Depart-

### Box 4 The Ownership Function in Indonesia and India

#### Centralized versus Dual

The **Indonesian** Ministry of State-Owned Enterprises was established under presidential decree in 2001. As the ownership entity in a centralized system, it has wide-ranging functions. It acts as the representative of the government in SOEs, coordinates SOE management, and assists the president in formulating policies:

Formulate government policy in managing SOE, including supervision, improving efficiency, restructuring, and privatizing SOEs; Coordinate and enhance synergy of plans and programs, monitoring, analysis and evaluation in managing SOEs; forward outcome reports, suggestions, and ideas for consideration in relation to their duties and functions to the President.

In addition to representing the state as an owner and helping to set policy toward SOEs, the ministry is very much an active manager of its portfolio:

[the Ministry] will accelerate the process of value creation through business, financial organizational/human resource restructuring, mergers/acquisitions/consolidations, liquidations/divestments, spinning off non-core competence business units and non-performing business units [with] privatization.

In **India**, with its complex dual ownership form, a number of bodies oversee SOEs. The Department of Public Enterprises issues guidelines on governance related issues, including board appointments, appointments of other personal, wages and salaries. The Central Vigilance Commissioner issues guidelines on conduct, disciplinary cases, investigations and related issues. Departmental enterprises are subject to a special additional audit by the comptroller and auditor general. The Central Bureau of Investigation, an autonomous police organization of the government, assumes jurisdiction over the employees and board members. The Planning Commission has a role in planning and project proposals. The Public Enterprise Selection Board recommends and selects potential SOE board members. Finally, it is the various ministries that exercise ownership rights and set policy objectives (sometimes together with the legislature). The ministries make the final choice for certain board members and the chief executive—through which they exert substantial influence—and can also issue directives to and veto major decisions of SOE boards.

Sources: OECD sources, MSOE (2002), Reddy (2001)

ment of Public Enterprises has issued Protocols on Corporate Governance in the Public Sector that apply to the six SOEs it oversees, but other SOEs as well. These protocols provide detailed guidance on the board and financial oversight of SOEs as well as their obligations to stakeholders and social objectives. It should be noted that even in a centralized system, guidelines on these issues may still be important for companies with outside shareholders or where employees or other stakeholders have a governance role.

### Dividend and Investment Policy

Governments have to address key financial issues for SOEs. Who determines dividend pay out, and who receives it? What sort of discretion does the board and chief executive of the enterprise have in terms of making major investment decisions? What role does the ownership entity or equivalent have in overseeing financial decisions of SOEs? How much discretion do they have to allocate funds across SOEs or otherwise manage a portfolio of state assets? Some countries approach these issues using a legal framework very similar to that for nonstate companies, other countries have much more specialized, and restrictive, regimes.

In practice, many SOEs do not pay dividends. This can reflect chronic losses, the need to use earnings to meet social objectives, or good investment opportunities that dictate the reinvestment of excess earnings. However, a lack of dividends may also reflect a lack of financial discipline on the part of the enterprise. If SOEs retain too much discretion over their earnings, this could soften their budget constraint: reducing incentives to manage cost, allowing for wasteful investments, and harming performance over time.

The government may simply dictate to the SOE what it should pay in dividends, either as part of a common policy or at the discretion of the ownership entity; or the board of the SOE may have the power to decide dividends, as the board of a non-state enterprise might. It has been recommended that a dividend policy be developed for SOEs that allows the board some discretion, but takes into account the nature of the enterprise and its growth opportunities. A basic element would be justification from the SOE board

for any funds retained, and agreement between the shareholders, including the state, and the SOE board on the dividend to be paid (Mako and Zhang 2004; also see Kuijs, Mako, and Zhang 2005 for a discussion of dividend policy). For example, in South Africa, SOEs are called upon to weigh the gains from reinvested earnings and maintenance of an optimal capital structure against the government's preference for dividends over capital gains (DPE 2002). In a similar vein, a policy for exceptional sources of income—for example, a sale of major assets—could also be developed.

As with dividends, an SOE may have a fair amount of discretion in terms of investment, or may face very strict controls, requiring approval for almost any sort of capital project or acquisition. If the goal of SOE reform is to increase operational autonomy for the SOE while preserving accountability, then some middle course may be warranted. As with other shareholders, the ownership entity or equivalent may have approval over certain major transactions, especially those that have an impact on the capital structure. In Singapore Temasek, the national holding company, must approve any diversification away from the core functions of the company (DPE 2002). The government's ownership policy may also dictate when assets may be brought into state hands, and hence, certain acquisitions on the part of SOEs, as well as other elements of SOE investment. In any case, a successful strategy will require the SOE to report its investments and financial performance accurately. Linking long-run performance to the compensation and retention of board members and executives may be a good way to encourage prudent investments by the SOE.

Beyond the investments of particular SOEs is the investments of the ownership entity itself. Again, these may be heavily restricted, with all surplus funds reverting to the treasury and the entity having little authority to reallocate or drastically restructure assets. Or the entity may have great discretion to reinvest funds, reallocate capital and restructure SOEs, including the power to sale off certain SOEs or their components, including liquidation and sale of assets.

In theory, the freedom to allocate funds across firms could be highly effective in maximizing the return on the state's assets, by channeling resources to the best performing firms. This could be particu-

larly effective when financial markets are underdeveloped. However, such discretion would transfer substantial power to the ownership entity. Empire building, the abuse of minority shareholders in listed SOEs, even de facto expropriation from the state are possible when the ownership entity can move resources between firms.

In practice, most ministries and other bodies that oversee SOEs cannot freely move funds between them. One exception is state holding companies; that is, SOEs that own other SOEs. In Brazil—until privatized in the late 1990s—these enterprise groups have been successful in managing dozens of companies and billions of U.S. dollars in assets; overseeing acquisitions, mergers, capital spending, and disinvestment, using powers as established under normal company law (Chen and Wang 2004; Mako and Zhang 2004). Again, the state, as the ultimate shareholder, may still retain approval over certain major transactions and changes in capital structure involving these groups.

## Oversight and Performance of the Ownership Function

The resources used in exercising the ownership function, and mechanism used to ensure accountability on the part of an ownership entity, vary widely across countries. Singapore, with its single ownership entity and streamlined and unified ownership structure, has a reputation for efficiency and limited political interference (Box 5). It is the exception, not the rule. The state's ownership function is not always carried out effectively. Political meddling and undue legislative interference are widespread. Possibilities for abuse of the ownership function, such as trading in listed SOEs with inside information, are all too real, and those carrying out these functions are not always accountable for their performance and the performance of the enterprises they oversee.

In a dual or decentralized system where ministries exercise the ownership function, these ministries are responsible for particular SOEs in the same way they are for other government functions. Within each ministry there may be a special unit or fund overseeing SOEs. These units are a normal part of the administration, report to the minister, and are subject to audit

### Box 5 Temasek and the Oversight of Ownership in Singapore

In Singapore, Temasek, the main holding company for SOEs, manages its \$55 billion portfolio of government-linked companies at an estimated annual operating cost of \$30 million, a 0.05 percent expense ratio. Temasek is managed with a core staff of just over 50 and is able to do so by focusing on board appointments and ensuring its portfolio companies have high-quality boards.

Temasek is subject to standard company law, is expected to earn a reasonable rate of return on its investments, and is governed by a commercially oriented board of directors. The Ministry of Finance (MoF) owns 100 percent of Temasek. Despite the high profile nature of many of Singapore's government linked companies, MoF plays a small role in the holding company. It appoints the chairmen and members of Temasek's board. Every year, Temasek submits audited financial statements to the MoF for review. The MoF may ask for meetings with Temasek or its portfolio companies to discuss performance and plans. Otherwise the MoF is only involved when an issue affects Temasek's shareholdings in a portfolio company.

*Source:* Mako and Zhang (2004)

and investigation as are other parts of the government. The ministry, in turn, may have reporting requirements to government and the legislature regarding its SOEs. The particular status of SOEs may vary widely, and the overall number of people involved in overseeing the state sector may be substantial.

Under the centralized approach, the ownership entity can be given substantial autonomy, and can in turn shield SOEs from interference from other parts of the government. At the same time, as a single body charged with overseeing the state's commercial assets, it can be held accountable for their performance, with little room for "spreading the blame." Under a dual or decentralized system, each ministry or other body must be held accountable. Maintaining the focus on asset ownership versus policy may very well be more difficult. It demands useful guidance from the coordi-

nating body, and that the government's methods of oversight are effective.

## Monitoring and Motivating Performance

The state has a clear interest in monitoring the performance of its enterprises, ensuring that arrangements are in place to motivate SOEs to high performance and measure SOEs achievement with respect to their nonfinancial, policy objectives. Better monitoring and motivating performance have long been one of the main goals of SOE reform. Although earlier initiatives have shown limited results, current efforts, as part of more comprehensive than in the past, offer promise.

### Performance agreements

Performance agreements between the SOE board and management and the government have long been used in an attempt to enhance performance. The World Bank played a significant role in supporting the implementation of performance agreements. Some examples include:

- In India, the Memorandum of Understanding (MoU) is negotiated between the Government of India and a specific Public Sector Enterprise. The intentions, obligations, and mutual responsibilities of both parties are to be clearly specified under the MoU.
- In South Africa, the shareholder compact is agreed between the SOE and its shareholders. It is a joint responsibility of the SOE board and the government (and other shareholders) to ensure that the shareholder compact is developed (DPE 2002).
- In Bulgaria, the state has management contracts with the CEO and board members of SOEs. As part of these contracts, business plans must be developed that include both performance measures but also social obligations including employment.
- In Indonesia, the agreement is a Statement of Corporate Intent and includes financial and operational benchmarks (Babcock 2002).
- In Turkey, SOEs develop program proposals with the Treasury and State Planning Organization that

must be approved by the Council of Ministers and published in the Official Gazette (OECD 2005a).

- In Bangladesh, a new corporate governance code also recommends SOEs have Statements of Corporate Intent to be negotiated between the board, shareholders and a "relevant government entity". The Statement should also include "social, policy, or non-economic arrangements" (TGC 2004).

These agreements are effectively a kind of contract between the government (or more specifically the ownership entity) and the SOE board and CEO, defining the goals and requirements for the SOE and giving the board a certain authority to achieve them. They may also specify the incentives for the board and management in relation to these goals. They often include a mix of financial performance targets, as well as the broader policy objectives of the SOE. These can be quite specific, or expressed as a more general statement of the SOEs mission.

Historically, performance agreements have had limited success. One problem was the objectives in the agreement. Certain targets, such as revenue growth, could create perverse incentives, leading, for example, to overinvestment in unprofitable businesses.

The limited success of performance agreements also reflects their introduction in isolation, without wider reforms of SOE governance (Baygan-Robinett 2004; Shirley 1998). Without improved transparency, greater clarity in the ownership form, tighter budget constraints, or other steps to improve SOE boards, performance contracts in and of themselves will have a limited impact. These reforms were not forthcoming in large part because the political will to make hard choices was absent. A lack of credibility on the part of the government saps a performance agreement of any potential effectiveness.

Recent comprehensive reforms offer hope that these agreements will be more effective. Governments have shown that at least in some cases they are willing to downsize, liquidate, and privatize SOEs. Budget constraints have tightened in many countries, albeit often when crisis made continuing support of SOEs untenable. Governance-related reforms have also advanced. Under these circumstances, performance agreements might work better than in the past.

### Box 6 Checklist for a Shareholder Compact

- Is it enforceable? How can it be structured to be enforceable?
- Is it consistent with existing legislation?
- How does it relate to other governance documents and legislative provisions?
- What is the appropriate form?
- Does it provide for the following:
  - the overarching purpose/ objective of the shareholder;
  - the mandate of the SOE;
  - key performance objectives, criteria and measures, which should be set out in a clear, concise, and simple manner;
  - a definition of the role of the shareholder and the SOE;
  - instances where consultation with or approval of the shareholder is needed;
  - powers reserved for the shareholder;
  - the process for the appointment of board members;
  - reporting requirements;
  - the nature and extent of the organisations social obligations, if any.

Source : Mohamed Adam, Company Secretary and Corporate Counsel for Eskom

## Evaluation of SOE performance

The performance of commercially oriented SOEs may be evaluated like that of a nonstate company. In Singapore:

Temasek expects those “government linked corporations” (GLCs) in which it holds shares to (i) be world class and compete internationally, in order to attract talent (ii) have a high-quality board (iii) focus on core competencies (iv) pay competitive wages; and (v) maximise financial performance in terms of EVA [economic value added], return on assets (ROA) and return on equity (ROE). GLC performance may be benchmarked to international standards. (Mako and Zhang 2004)

Although Temasek’s portfolio may be exceptional, developing and evaluating commercial objectives are important for any SOE:

Careful development of strategic business plans, cash flow forecasts, and regular reporting are needed for the

shareholder’s representatives to exercise effective governance and to link management/employee performance and incentive compensation...The best SOEs in the world focus on financial performance, especially returns on capital. (Mako and Zhang 2004)

To get the most out of its assets through time, economic performance objectives, including returns to capital, are key. A credible focus on returns to capital can prevent wasteful investments that may increase revenue or nominal earnings but do not reflect the SOEs cost of capital. In the process, it can enhance earnings and provide resources for reinvestment and the national budget.

Other measures of commercial performance include indicators of cash flow and dividends paid. For SOEs that issue stock or bonds to the public, stock prices, and credit ratings can also be useful as performance measures. Related indicators include measures of risk and risk management. Performance with respect to policy objectives must also be reported; and both board members and the ownership entity or equivalent must know and understand the objectives of the SOE.

Unfortunately, the very range of objectives that a SOE is required to consider may also undermine performance. Without clear guidance on how to weight or trade-off particular objectives, undue discretion may be transferred to management, who may follow their own interest under the cover of vague or conflicting objectives (Aharoni 1981; Jensen 2000)). Opaque targets will also hamper even well-meaning management.

Whether through performance agreements or some other mechanism, clearer objectives with parameters or “metrics” that facilitate decision making by SOE board and management could help clarify trade-offs and make it easier to hold managers and boards accountable for enterprise performance. This could include requirements similar to regulation in terms of minimum standards or targets, or “shadow values” or “shadow costs” that place the social gain or loss to certain actions by the SOE onto the balance sheet, allowing for a clearer focus on a single bottom line. These reforms would make it easier to incorporate these costs in the national budget, and provide appropriate compensation. Clearer accounting for policy objectives will also facilitate the comparison—

benchmarking—of SOEs against each other and private sector firms.

## Improving the Performance of the Ownership Function

The exercise of the states ownership rights should be separated from regulation and other policy functions. A direct way to do this is to establish a single dedicated ownership entity, such as a specialized ministry, agency, or holding company, for all SOEs, or one for financial SOE and one for nonfinancial SOE. An alternative approach is to create a coordinating body that works with ownership entities, who, in turn, exercise the ownership function independently of other activities. A combination is also possible, with the central entity directly overseeing many but not all SOEs, and/or with SOEs migrating from ministry to central control it over time.

### Overseeing the SOE and exercising the state's ownership rights

The mechanisms through which the ownership entity monitors and motivates the performance of SOEs and exercises the state ownership rights should be clearly defined, transparent, and not discriminate against other shareholders. This includes the nomination of board members, the oversight of both commercial and policy objectivity,<sup>5</sup> and the participation of the ownership entity in the general shareholders' meeting. If performance agreements—memoranda of understanding, shareholder compacts, management contracts, and so forth—are used, they should be developed in consultation with other shareholders, who should have full knowledge of the their content.

### Dividends and major transactions

Policies should be developed for SOE dividends, major investments, and other major transactions, including mergers, acquisitions, divestures, and changes in the capital structure. These policies should address basic procedures and the respective roles of the SOE board, the ownership entity, and other shareholders. These policies should not allow the ownership entity to bypass the board or other shareholders.

A key issue is the discretion retained by the board and what sort of rationales they must provide to justify dividend retention or payment, major investments, and other major transactions. Another is the special powers of the ownership entity—if any—in overseeing dividends and major transactions, and the extent to which these powers are compatible with equitable treatment of shareholders. In some cases it may be enough to give the ownership entity the same power as other shareholders under company law in terms of being informed on and approving dividends and major transactions.

Special consideration must be given to the extent to which the ownership entity can retain dividends and exceptional income, approve investments between SOEs, and generally allocate resources across the SOEs it oversees. State-owned holding companies may have these powers, other ownership entities generally do not, and dividends and exceptional income flow directly to the national budget. Special consideration must also be given to the treatment of transactions that contract the scope of the state by involving greater private sector ownership or participation, or expand the state's role by acquiring ownership in private sector companies or through other means. In many cases, these sorts of transactions may require parliamentary approval.

### Efficiency and accountability of the ownership function

The government should strive to ensure that the ownership function is exercised in an efficient and accountable manner. In conjunction with reforms, including improved transparency at the enterprise level and greater professionalism and accountability for SOE boards, substantial authority can be transferred to the enterprise. This allows the ownership function to be exercised without an excessive staff empowered to micromanage SOEs. In turn, broad governance reform, including accurate and timely aggregate reporting, can allow the government to devolve authority to the ownership entity. This requires a careful consideration of its competencies, clear channels for reporting and accountability, and clarity and transparency in the overall ownership policy.

# Transparency and Disclosure

Although truly “publicly owned,” many SOEs report little to the public. Not only do SOEs rarely have public reporting requirements, they may, in fact, be prevented from doing so, with SOE accounts and other information treated as classified. Normally, SOEs report to the part of the government that oversees it and that may, in practice, be deeply involved in its management. Although necessary, reporting only to a government department directly involved in running the SOE does little to ensure transparency. SOEs may also be subject to auditing by governmental authorities and oversight by a finance ministry or similar body, however, the focus is generally on expenditures, with little accounting for financial performance, possible liabilities, or the success of the SOE in meeting its potentially wide-ranging objectives.

A lack of transparency is one of the most common, and unfortunate, shortcomings of SOEs. Opacity undermines performance monitoring, limits accountability at all levels, and can conceal liabilities that can have an impact on national budgets and even financial stability. This opacity reflects not only limited disclosure at the enterprise level and inadequate auditing of this disclosure, but insufficient reporting on the performance of the state-owned sector as a whole.

## Disclosure Requirements

SOEs, at least larger and listed SOEs, have standard financial reporting requirements to the government and sometimes the legislature or public at large. Glo-

bally, there is an increasing emphasis on nonfinancial disclosure by major companies. This is especially relevant for SOEs, which normally have policy objectives in addition to their commercial and financial goals. In addition to enterprise level reporting, some countries also use *aggregate reporting* to give a clearer picture of the state sector as a whole.

## Enterprise reporting

Disclosure by SOEs can be broken down into ex ante and ex post reporting. Ex ante reporting by SOEs includes disclosure of company objectives, ownership structure, the board members and high-level executives of the enterprise, perceived risk factors, and future plans. Importantly, ex ante reporting also includes assistance from the state and commitments to costly policy objectives. The ownership entity or equivalent generally has access to this sort of information, at least to the extent that it exists. However, public disclosure of this sort of information at both the enterprise and aggregate level is neither common nor comprehensive.

Ex post reporting includes reporting of financial and other accounting information. Listed SOEs normally use International Financial Reporting Standards (IFRS, also known as International Accounting Standards, IAS). Some nonlisted SOEs also publish public accounts, using IFRS or similar standards. Many disclose basic accounting information to (a part of) the government, not the public. Using IFRS may be difficult for wholly owned or smaller SOEs. Inter-

national accounting standards for both smaller companies and public sector companies are being developed that may prove useful in this regard. In practice, the basic reporting of cash flow and liabilities by many SOEs is poor, including the (non)reporting of accrued interest on unpaid loans and pension liabilities. However, the most significant deficiency is a lack of public reporting.

SOEs can also disclose ex post nonfinancial information such as related party transactions (including with other SOEs), changes in board membership and high-level executives, and changes in ownership structure. Performance indicators related to the SOEs objectives, where used, could also be reported. Listed SOEs, as with other listed companies, may also be required to report material events in a timely manner. In each case, such reporting would provide important information to the public increase accountability of board members and management and make other governance reforms more effective.

### Aggregate reporting

Only a few countries—generally with a single ownership entity—have aggregate reporting, which provides combined financial and nonfinancial information for all SOEs. This sort of reporting is done for the state and the public to provide an overarching view of the entire state-owned sector and is distinct from the reporting of particular SOEs. Some countries have “semi-aggregate reporting,” which covers SOEs under a certain ministry or holding company, and some have no combined reporting of any kind.

At a bare minimum, state holding companies and investment funds can produce properly consolidated accounts for their holdings, and ministries that oversee SOEs or a coordinating body, when present, should provide summary information on SOEs. When there is a single ownership entity, then reporting can include information specific to the entity, as well as combined information on SOEs. The government can also report its ownership policy for SOEs and how the ownership function is organized. Aggregate reports may be presented in the context of reporting to parliament or another authority, or may be stand-alone annual reports. Some ownership entities, such as Temasek in Singapore and the Indonesian

Ministry of State-Owned Enterprises, have established websites that provide substantial information on the state sector.

### Disclosure Oversight

In many SOEs, the responsibility for ensuring adequate disclosure falls on the management of the enterprise and the part of the government that oversees the enterprise. The board plays a limited role. Nominally, many SOEs have systems for internal audit and are subject to external audit, either by a government auditor or the ownership entity. For listed SOEs, standards for external audits may be to the same standards as for other listed companies. This includes the independence of the external auditor. Listed SOEs may also be subject to auditing by a government auditor. In Turkey, the High Audit Committee, under the Prime Minister, periodically audits SOEs; SOE annual financial statements are audited and approved by the National Assembly (OECD 2005a).

Through their oversight, the ownership entity and government auditors can prevent certain abuses on the part of enterprise management. However, if the goals of reform are to increase enterprise autonomy and accountability, then board needs to be given a greater role in the disclosure process. In South Africa, SOE directors are given responsibility over disclosure and are required to supplement standard enterprise disclosure with a wide ranging “directors report,” that must be submitted to the SOE’s auditors (see Box 7); SOEs must also have Audit Committees chaired by an “independent non-executive director” (DPE 2002).

In addition to greater board involvement, ensuring high levels of transparency will require SOEs to have external auditors independent of the enterprise and the ownership entity or equivalent. This can include governmental auditors, or the statutory auditors of an “audit board,” if the company has one. To be fully effective, these auditors need to have the capability to evaluate the potentially broad range of material disclosed by the SOE.

### Improving the Transparency of SOEs

Transparency is key in addressing the specific governance challenges faced by SOEs. To allow transparent

## Box 7 The Directors Report

### An Example from South Africa

The “Protocol on Corporate Governance in the Public Sector” issued by the South African Department of Public Enterprises requires all SOE boards to issue Directors Reports with the following elements:

- An outline of the organizational structure, and comparison with the prior period if any significant changes have been made.
- A review of the financial performance of the past year.
- Information related to internal and external factors influencing SOE performance, stressing risks and opportunities and strategies to manage them.
- Significant events notified to the Executive Authority during the year.
- Any judicial proceedings filed during the year or likely to be filed during the coming year.
- Any significant postbalance sheet events that will have a material effect on performance in the coming year.
- Discussion of relations with stakeholders, with specific reference to any significant changes.
- Financial and other effects of directions from the Executive Authority or other political body.
- Description of social service obligations, with an assessment of their cost and likely impact on the SOE and beneficiaries.

Source: DPE (2002)

and efficient exercise of the ownership function, each ownership entity should use aggregate reporting to present an accurate picture of its SOE portfolio, and, where relevant, the coordinating body or principle entity should report on the state sector as a whole. This should include reporting to the public as well as to parliament or other parts of the government. This disclosure should be subject to appropriate governmental audit and oversight. The government should also report its ownership policy for SOEs and how the ownership function is organized.

At the enterprise level, SOEs should provide ex ante information to the public, including commercial and policy objectives, estimates of the latter’s cost, and financial assistance from the state. Financial reporting for listed and large nonlisted SOEs should comply with international standards, and all but the smallest SOEs should produce accurate financial reports available to the public. SOEs should also report nonfinancial information including related party transactions (especially with other SOEs), changes in board membership and high-level executives, and changes in ownership structure. Performance indicators related to SOE objectives could also be reported to the public. Listed SOEs must comply with the standards for other listed companies regarding timely reporting of material events.

All SOEs should have internal controls overseen by the board and be subject to external audit. This can include audit by governmental and/or statutory auditors. For listed SOEs, external audits should be conducted by independent auditors to the same standards as for other listed companies. Similar standards should be used for large, nonlisted SOEs. This does not exclude additional oversight by governmental or statutory auditors.



# SOE Boards

Boards play a central role in the governance of the enterprise. A strong board participates effectively in company strategy and provides proper incentives for management, maximizing value, while taking into consideration the policy objectives of the enterprise. However, boards in SOEs often do not play this role. At best, they may act as a kind of parliament that represents the interests of employees, various ministries, and in some cases, nonstate shareholders, leaving control of the company to management and various parts of the government.

As with companies in the private sector, SOE board structure varies across countries. They include unitary or one-tier boards or a two-tier structure with both a management and supervisory board. SOEs sometimes have a distinct board of statutory auditors—which goes by different names in different countries—to oversee the reporting and compliance of the company. While these “audit boards” have been phased out in private sector companies in many countries as they have adopted audit committees and external auditors, they remain more common in SOEs.

The ownership entity that oversees the SOE, may often bypass the board of the companies it controls. Top managers work directly with the relevant ministry or body, while the board serves to represent various stakeholders, providing them with a nominal voice in the company’s affairs. Improving the governance of SOEs requires more effective and powerful boards that take due account of the wider objectives of the enterprise.

## State Ownership and Board Member Duties

The legal duties and responsibilities of board members provide guidance on what board members are expected to do and in whose interest they should act. In private sector companies, board members normally have duties to the company and all shareholders, although the exact nature of these duties varies across countries (OECD 2004b, 2004d). SOE board members often have similar duties. However, with the state as the main shareholder and the company having special objectives or purpose, the “interest” of the shareholders and the company may be different in SOEs than in private sector companies.

This difference in duties can be reflected in the objectives of the SOE, which can be defined in the charter or founding statutes of the company, in the performance agreement between the board and the government, or in explicit regulation. In this sense, the basic duties of SOE board members and private sector ones—who must also account for legal requirements and legitimate stakeholder concerns—are not fundamentally different. Given their policy objectives, SOE board members are responsible to the company and all its shareholders. In practice, SOE board member duties may not be so clear. This could be attributable to the legal status of the SOE, ambiguity regarding policy objectives, or legislative shortcomings.

## The Limited Authority of the Board

A key difference between private sector and SOE boards is the relationship between the board and its controlling shareholder and the relative authority of the two. The *OECD Principles of Corporate Governance* (2004c) list a number of key functions that should be the responsibility of the board (Box 8). In practice, a major shareholder and the board may both perform some of these functions or share them, for example, monitoring corporate performance or overseeing the nomination process for the board. When the company has a controlling shareholder, the board may be bypassed altogether.

However, the shifting of authority from the board to the state as represented by the government tends to go further in SOEs than in many private sector companies. The legal framework itself frequently gives the state special powers. For example, the Protocols on Corporate Governance in the Public Sector, issued by the South African Department of Public Enterprises, list a number of areas of responsibility for the board, and notes that it is the board that has “absolute responsibility for the performance of the SOE.” However, it is the Executive Authority charged with the oversight of the SOE that chooses the chief executive, albeit in consultation with the board. Normally, choosing top management is one of the principal responsibilities of a company board.

In practice, *almost all* of the “key functions” for a SOE board may be performed, or at least heavily influenced, by the ownership entity or equivalent. “The power of [SOE] boards to take basic policy decisions is more theoretical than real.”<sup>6</sup> Legally, financial and investment decisions may be restricted, with any significant capital project or one time expenditure, the raising of outside funds, or the distribution of profits requiring government approval. Decisions on employment and employees may also be severely constrained, both from policy objectives and the status of SOE employees. Accordingly, the government would have as big or bigger say in the strategy and purpose of the SOE than its board. The ownership entity or equivalent also has formal oversight, and guidelines may be issued on a whole range of matters. Given that the day-to-day management of the company is delegated to its managers, the role of the board would be limited.

### Box 8 Key Functions of Boards

The OECD Principles of Corporate Governance list these key functions that a board should carry out:

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets, budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions, and divestitures.
2. Monitoring the effectiveness of the company's governance practices and making changes as needed.
3. Selecting, compensating, monitoring, and, when necessary, replacing key executives, and overseeing succession planning.
4. Aligning key executive and board remuneration with the long-term interest of the company and its shareholders.
5. Ensuring a formal and transparent board nomination and election process.
6. Monitoring and managing potential conflicts of interest of management, board members, and shareholders, including misuse of corporate assets and abuse in related party transactions.
7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
8. Overseeing the process of disclosure and communication

Source : OECD (2004c)

These restrictions and requirements not only reflect an inherent reluctance of the government to delegate authority to the board, but practical difficulties that have arisen when insiders have taken over SOEs. SOE management with little accountability and lacking ownership and a long-term interest in the performance of the company has engaged in asset stripping and other serious abuses (Mako and Zhang 2004). On the other hand, limiting the power of the

board does not necessarily enhance its ability to police and prevent abuses by management.

The role played by the government in the SOE may be even greater than implied by formal controls. Both through the influence of its board nominees and the objectives and directives given to the SOE, the ownership entity may run the company directly, bypassing the board all together. Even when the SOE is wholly owned by the state, this degree of direct control can be problematic. It undermines the common reform objective of reducing political interference and increasing SOE autonomy. It makes board accountability essentially meaningless because there may be little to be accountable for. This direct control may also reduce transparency, as direction of the enterprise bypasses formal mechanisms of control.

### Reform to increase board responsibility

As SOE reforms have continued to advance, the need to strengthen the role of boards in SOEs is being more widely acknowledged. The Indonesian Ministry of State-Owned Enterprises in its 2002 Master Plan for SOEs, the South African Department of Public Enterprises in its Corporate Governance Protocols, and proposed corporate governance codes for SOEs in India and Bangladesh all emphasize the need to give real and substantial authority to the board (DPR 2002; MSOE 2002; Reddy 2001; TCG 2004).

These reforms seek to transfer authority to boards to act in the interest of the company and shareholders, while still taking into account relevant policy objectives. For these reforms to be effective, special requirements and restrictions for SOEs and their boards should be straightforward and transparent. Objectives should be clear and explicit, as should the relationship with the parts of the government setting those objectives. With the right framework in place, and the right board members, substantial authority could be transferred to boards, allowing a nontrivial role in such major decisions as new capital projects or the hiring and firing of the CEO.

The issue of board responsibility becomes all the more critical in an enterprise where the state is sharing ownership with private parties. Here, law and good practice generally indicate that boards have real

authority and the sort of independence of judgment outlined in the *OECD Principles of Corporate Governance* (2004c). In enterprises with shared ownership, it becomes even more important to define clearly the nature of special requirements and state interventions, including policy objectives unusual restrictions and the role of governmental employees on the board. If the role of the state remains ambiguous and is not well defined, governance will suffer, and nonstate investors will be wary of investing in the enterprise.

### The Challenge of Building an Effective Board

Establishing an effective board capable of independent judgment can be more difficult for an SOE than a private sector company. SOE boards can include elected officials and political appointees, civil servants, and employee representatives, all of whom may have agendas that conflict with the interest of the company. The nomination and appointment of board members tends to be nontransparent, and may exclude nonstate shareholders. Programs and institutions to train and develop the professionalism of SOE board members are generally lacking, or less developed than in the private sector, and remuneration is generally minimal.

### Nominating and selecting board members

The government generally nominates or directly appoints most or all SOE board members. This may be the case even in publicly traded companies. In China, state entities appoint 76 percent of the board members in listed companies (Qiang 2003). Nominations may come directly from the ownership entity or another source. In South Africa, SOEs have nominating committees that provide a list of suitable candidates to the Executive Authority that oversees the SOE, which has the final power of appointment. In India, Public Enterprise board members are recommended and recruited by the Public Enterprise Selection Board, an autonomous government body. The final decision, however, lies with the ministers in the Appointment Committee of the Cabinet. All appointments are subject to due diligence and clearance by the Central Vigilance commissioner (DPE 2002; Reddy 2001).

In many countries, when board members are being nominated, the skills and “fit” of the candidate are rarely the main considerations, and the board and chairman are not always involved in the process. Board positions tend to be considered as a reward for a political supporter or current or former company executive. A structured nomination process that includes appraisals of board members can avoid complex, opaque, multiround negotiations between various parts of the government and allow for greater transparency, and merit and fit playing a larger role in the selection process.

For listed SOEs, the nomination process generally must also comply with the rules for other listed companies. If nonstate shareholders are to be able to exercise their rights, it is important the board members nominated by the government are announced in advance and that nonstate shareholders have some options in terms of nominating board members directly.

### Board composition

SOE boards normally contain state representatives, such as from a ministry and are more likely to contain employee representatives than private sector companies. They may have outside members with certain areas of expertise, and they may also have minority shareholder representatives. In a unitary board system they will have executive members as well, in a two-tier board former executives. Overall, they tend to be large in number, in many cases to the point of being unwieldy. However, this reflects the tendency to see the board as a kind of “parliament” where a range of groups are represented, rather than as a body to direct the company. Under these circumstances, true direction of the company may instead come from the ownership entity or another part of government.

In India, SOE boards have three kinds of board members: “functional directors,” essentially executive board members who should make up no more than 50 percent of the board; “government directors” who represent the Administrative Ministry for the SOE (each SOE should have only one or two) and “non-functional directors,” the part-time members of the board who should make up at least one third of its

strength. In Mexico, 50 percent of the board are state representatives, including the chairman; in Turkey all SOE board members are state representatives (OECD 2005a). In other countries, company law may set the requirements for board members, with either a mix of nonexecutive and executive directors on a unitary board or a supervisory board with nonexecutives and a management board of executive directors. A few countries also mandate employee representatives, and nonstate shareholders may also be represented, if present.

The particular “government director” or equivalent varies by country, but they are common on SOE boards. In a high-profile company, these may be of the ministerial rank or consist of (other) elected officials. There have been cases where the nonexecutive or “independent” board members in an SOE have been political officials. In other countries, elected officials cannot serve on SOE boards: a straightforward way to limit political interference. In many cases, the government is represented on the board by civil servants from the relevant ministry or other part of the government. These board members are sometimes called “super directors” because of the influence they generally wield.

### Board professionalism

Developing focused boards capable of greater responsibility remains an important challenge in many countries for the foreseeable future. Finding the right board members, providing the proper incentives, and ensuring that the board maintains high ethical standards for themselves and the enterprise as a whole are all critical challenges. In Poland, civil servants have to go through specific examinations to be able to apply for a board position (OECD 2005a). In many countries, it is the job of the chairperson, a nonexecutive board member, to set the tone for professionalism for the rest of the SOE board.

Nonexecutive board members independent of the government are a potentially important source of both expertise and oversight for an SOE. However, for both private and public sector enterprises in many emerging market economies, the market for nonexec-

utive directors tends to be a thin one. When the state sector is large, thousands of qualified nonexecutive directors may be needed. To ensure that boards have their full complement of these board members a specialized agency, the ownership entity, or an equivalent could develop a database of potential nonexecutive board members and engage in regular recruiting. Training and certification for board members, possibly developed with an independent Institute of Directors (IoD), may also be useful in increasing the competence and effective pool of nonexecutive board members.

Executive board members, ministerial appointees, and employee representatives when present, generally receive no compensation for serving on the board of the enterprise, except perhaps for a nominal fee. Nonexecutive board members may also only receive a nominal fee, even though such board service may not be directly related to their job. Recruiting qualified nonexecutive board members requires more than a nominal fee. The ownership entity or equivalent may wish to issue guidelines on remuneration and performance of board members. For example, in South Africa, it is recommended that:

... board remuneration should first be based on the individual director's level of skill, experience and expertise and secondly on his contribution to the performance and success of the SOE over the director's term of office ... any scheme employed in remunerating directors should take into account the need to attract, incentives and retain high quality skill, experience and expertise, as well as loyalty and commitment to the SOE. (DPE 2002)

For civil servants on boards, remuneration and promotion depend on the assessment of their superiors in the administration, which may be weakly correlated with their performance as board members (For the case of China, see Qiang 2003). Here, guidelines could help civil servants on boards maintain a certain degree of independent judgment with respect to the SOE. Independence is also an issue for employee representatives, who are also required to consider the interest of the company in their decision making. For all board members, systems for both self evaluation and evaluation by the ownership entity or equivalent can also encourage professionalism. In Turkey, the

body in charge of auditing SOEs also evaluates their boards (OECD 2005a).

Although large private sector companies in developed capital markets make extensive use of specialized committees, they are rare in both public and state sector companies in emerging markets. Specialized committees can increase the board's competence and, by having all or mostly independent board members on key committees, the board's independent judgment in areas where conflicts of interest and/or specialized knowledge are critical. They may also help offset the large size the "representative" boards that SOEs have by allowing meetings of smaller subgroups. However, these committees are not widely used.

## Improving the Boards of SOEs

To be effective, boards must be in a position to act in the interest of the company and shareholders, while still taking into account relevant policy objectives. They must have the power to exercise their own judgment. In contrast to current practice in many emerging economies, SOE boards should be given responsibility for strategic decisions including major investments and the choice of senior management as well as overseeing the ongoing performance of the SOE and its disclosure. The board should not be bypassed by the ownership entity. When the state is sharing ownership with private parties the board must have the authority and the independence of judgment outlined in the *OECD Principles of Corporate Governance* (2004c).

Ensuring compliance with policy objectives may not require any exceptional obligations or duties for the board: the standard duties of board members to act in the interest of the company and shareholders, while ensuring compliance with the law and legitimate commitments to stakeholders, may be sufficient. If board members do have special duties or requirements beyond their private sector counterparts, these should be transparent and clearly defined. In any case, ownership policy should not give the ownership entity influence over board members disproportionate to the state's ownership stake

To ensure an effective board, a structured and transparent nomination process should be developed that includes appraisals of board members, avoids complex negotiations between various parts of the government, and has a role for nonstate owners when appropriate. Boards should include qualified nonexecutives independent of the state and management,

and this should be facilitated with adequate remuneration. Relevant training for board members should be encouraged. Guidelines should be provided to help civil servants and employee representatives on boards maintain independent judgment with respect to the SOE.

# Relations with Other Shareholders and Stakeholders

## Relations with Other Shareholders

In parallel with SOE reform, the state has increasingly shared asset ownership with the private sector. Hundreds of listed companies around the world have the state as a controlling shareholder. The state also remains a significant minority shareholder, especially in transition economies. Joint ventures between SOEs and private firms are another source of mixed ownership and are not unusual in emerging economies.

When the state and private investors are owners of an enterprise, their relationship is normally governed by the same company and commercial law and securities regulation that govern relations between private investors. In most cases, this legal framework is sufficient. However, the state has powers that private investors generally do not. The parts of the state that exercise ownership rights also have distinct political constraints and incentives. Both of these factors can complicate the states' relations with other shareholders. Nonetheless, the state can use its ownership to set an example of good corporate governance, to the benefit of the entire economy.

## State and minority shareholders

In most countries, publicly traded companies have a controlling shareholder, usually a family or sometimes a financial institution. The state is also significant controlling shareholder and in most economies, holds a controlling stake in at least some large listed companies.<sup>7</sup> In Argentina, 20 percent of listed com-

panies have the state as a controlling shareholder, in Indonesia 10.2 percent, in Malaysia 18.2 percent, in Singapore 23.5 percent, in Thailand 8 percent (La Porta et al. 1999; Claessens, Djankov, and Lang 2000). In China, the fraction approaches 100 percent. In Russia, 14 of the 50 largest publicly traded companies, including Aeroflot, Gazprom, RAO UES, Rostelcom, and Sberbank, have state control or large state stakes (S&P 2004).

Controlling shareholders all too often use their power to abuse the rights of other shareholders. The controlling shareholder, and her friends and relatives, may have management positions for which they are overcompensated. The investment decisions of the company may reflect personal interests, not the best opportunities for the company. Most problematically, the controlling shareholder may engage in *tunneling*, diverting resources to themselves using abusive transactions (OECD 2004b). This abuse comes at a cost to the economy as well as the minority shareholder: reduced investor participation in equity markets. Valuations and the ability of firms to issue equity will suffer accordingly (Claessens et al. 2002; La Porta et al. 1997, 2002; OECD 2004d).

As with other controlling shareholders, the state may abuse the rights of minority shareholders that have invested in SOEs. This can include transactions that benefit management or other SOEs at the expense of outside shareholders. The general problems of under performance that afflict SOEs also reduce returns to minority shareholders. In turn, fear of abuse and underperformance depresses demand

for the shares of SOEs, thus creating an adverse impact on government finances and complicating privatization.

When an SOE sells shares to the public, it takes on the obligations of other listed companies. Minority shareholders in state-controlled companies have the same legal rights that shareholders in other companies do; law and good practice indicate that they should be treated equally. Not only does this imply that the state avoid using its power to abuse minority shareholders, but that it exercise policy objectives in a way that preserves the legal rights of other shareholders and is consistent with board members serving in the interest of all shareholders.

To ensure the confidence of outside investors, special measures may be warranted to ensure equal treatment of shareholders. For example in Turkey, if private shareholders control 20 percent of the shares, they may appoint one board member (at 40 percent they can appoint two). In Vietnam, minority shareholders are represented on the board through cumulative voting. They are encouraged to participate in the general shareholder's meeting and have certain guarantees to share in the profits of the SOE.

It has been argued that to exercise the ownership function effectively, the ownership entity will need superior information vis-à-vis minority shareholders. In practice, however, while the ownership entity may need to expand extra efforts in monitoring the firm, little prevents it from sharing this information from other shareholders. When the ownership entity or another part of the government does have superior information, then the possibility of trading on this privileged information also must be considered.

### When the state is a minority shareholder

Despite the recent wave of privatization, governments continue to have controlling minority stakes in numerous public companies. Sometimes, however, "golden shares," states seek to maintain control rights disproportionate to their remaining ownership. That is, they sell shares, while retaining "residual control rights." In theory, this may allow reorientation of the company in a commercial direction, while preserving enough influence to ensure that additional policy objectives can still be met.

In practice, those exercising the states ownership rights through the golden share may have less interest in the firm's performance, which is now the concern of its new owners. But they might still have incentives to engage in politically motivated interventions that transfer many of the problems of SOEs to the privatized firm. Golden shares have a mixed record, and the government should always strive to achieve policy goals through regulation in privatized firms.

Although the possibility of the state misusing its power in companies in which it owns shares is very real, there is also the possibility of the state becoming a passive, perhaps even abused, owner. Those overseeing the government's share portfolio may have little incentive to be an active and effective owner. They may still be politically influenced, and this can include the influence of powerful businessmen who may have much to gain at the state's expense. The objectives, incentives, and accountability of those exercising the state's ownership rights are critical, whether a control stake or a minority stake is involved.

### Relations with Stakeholders

As with other companies, SOEs have a number of stakeholders. Moreover, as with other companies, they must take account of their relations with stakeholders as part of good business practice to ensure that their legal and contractual rights are respected. SOEs may also have special obligations to certain stakeholders because of relevant policy objectives or the SOEs' place in the public administration. For example, a state-owned utility may have a special obligation to ensure that heating oil is supplied to households without interruption during the winter. Employees may also have special rights or a different status. In addition, SOEs may have special conflicts of interest involving stakeholders, including state-owned creditors or other SOEs.

### Relations with employees

Because of their place in the public sector, SOEs' employee rights and status are often distinct from those of workers in the private sector. SOE employees may have a greater say in the governance of the

company, for example, through board representation. They may have the status of civil servants and corresponding benefits such as special job protection and pensions. In some countries, employees in both private sector and state companies have at least a limited governance role, through such mechanisms as worker councils. Some countries even give workers a constitutional right to participate in the governance of the company (Botero et al. 2003).

For example in Vietnam, SOE employees have a range of consultation rights and are represented on the board, as are their counterparts in Taiwan (China), Croatia, and Poland. In India, employees in Departmental Enterprises have the status of government employees, as do employees in government companies where the state has 51 percent or greater ownership (Reddy 2001). In privatized companies, including in a number of Central and Eastern Euro-

### Box 9 Employees as Shareholders

#### The Experience from the Regional Corporate Governance Roundtables

Privatization in Russia, Southeast Europe and Eurasia have made millions of employees shareholders in the companies for which they work. In some companies in other regions, employees are also significant shareholders. [Regional Corporate Governance] Roundtable participants pointed out that employee owners are in a strong position to improve the governance of their company. They have particular knowledge about the company that other shareholders might not have. Because the company is the source of their livelihood, they have strong incentives to ensure that it is successful. Being owners may also motivate employees to advocate corporate governance reform more generally.

Dominant controlling shareholders and weak boards diminish the potential advantages of having employees as shareholders. In many cases employees sell their shares as soon as possible. When they have held onto their shares, employee owners have faced barriers to full participation in corporate governance. Employees may be prevented from voting their shares and may even have their shares voted by management. In Macedonia, employees were pressured into formally transferring voting rights to management, a practice that was legal at the time. Employees, as shareholders, may not have the necessary information to exercise their vote effectively. They also may not have access to independent advice, but may be heavily influenced by management or other corporate insiders.

These problems are similar to those faced by other shareholders. In addition, employees also face the threat of retribution by management if they choose to vote in an independent manner, demotion, being

fired, and so forth. Roundtable participants noted that these problems can be addressed by bringing employee owners into the general meeting as normal participants, and ensuring that the meeting itself meets adequate standards: voting should be secure, and results confirmed by an independent party; management should not be able to vote employee shares, or any shares they do not have; confidential voting should be encouraged and is highly relevant for proxies acting on behalf of employees; and relevant information should be distributed to all shareholders in a timely manner before the meeting. Kazakhstan now forbids employers to act as proxies for their employees. Some countries have also introduced cumulative voting, which would allow employees and minority shareholders to choose some board members, even when the controlling shareholder and their allies have a majority of votes in the general shareholder meeting. A different kind of concern expressed in the Roundtables has been that when employees do use their votes, they tend to focus purely on “employee issues” and do not take into account the wider interests of the company. Cases were raised where employees focused on increasing compensation and blocked needed restructuring—an issue of great importance in transition economies, and reminiscent of some worker-owned companies in the former Yugoslavia. There was a feeling that, in some cases, employees may not see themselves as owners and do not act as such. Bringing employee owners into the shareholder meeting, and giving them the same treatment as other shareholders, could help to alter this mindset. However, the best way to make employee shareholders feel like owners is broader based corporate governance reform that makes being a shareholder worthwhile.

Source: OECD (2004b)

pean countries, employees may have significant shareholdings, along with the state, and hence, will have the rights of other shareholders.

There is a long-standing and widespread perception that employees in SOE have *too many* rights. It has also been argued that SOEs are seen primarily as a means to create employment, and that this politicized focus on job creation is one of the main symptoms of poor SOE governance (Shleifer and Vishny 1994). In fact, over the last decade, downsizing has emerged as one of the main elements of public sector, including SOE, reform. Supported by the World Bank and International Monetary Fund (IMF), dozens of countries have undergone extensive downsizing exercises, some involving hundreds of thousands of employees. These programs generally feature severance pay or benefits, such as retraining for laid off employees, in part to overcome political resistance, as well as ensuring that those affected are treated equitably. However, one of the lessons of these reform programs is that the wider context is essential. If the relation between the SOE and the government is not changed, then the enterprise may re-emerge as a vehicle for patronage. In this sense, governance reforms that increase the autonomy of the SOE from undue political influence, while maintaining accountability, can help to sustain the gains from downsizing (Baygan-Robinett 2004; Rama 1999).

The consultation rights that certain SOEs have, whether through the board, a workers' council, or some other mechanism, can give voice to worker concerns, including during periods of difficult restructuring. In addition, such consultation rights can be an important source of information for the board, especially independent board members, and for shareholders, including the state. Employee representatives can provide the point of view from the "shop floor," which may differ substantially from the view presented by other corporate insiders.

To stay competitive with the private sector, SOEs may need greater flexibility in their workforce, including greater freedom over compensation, than the government administration. However, it is also important to remember that many of the restrictions put in place in the public sector are there to prevent political abuse and patronage. Freedom from civil service requirements does not prevent those that con-

trol the SOE from using it as *their* patronage machine, does not guarantee that employees act with high ethical standards, and does not ensure that they are motivated to achieve the objectives of the SOE. As is often said, "a fish rots from its head," and ultimately it is the board and management that must set a good example and use the workforce of the SOE effectively.

## Relations with creditors

SOE relations with creditors vary substantially across countries. Lending to a SOE may be seen the same as lending to the government, and the SOE may be able to borrow on the same terms.<sup>8</sup> On the other hand, an SOE may be perceived as the worst kind of borrower, beyond legal redress and in a position to default at will. Finally, some SOEs, usually large listed ones, are able to borrow on the strength of their own credit.

When the state provides an implicit or explicit guarantee to the creditors of an SOE, it can soften the budget constraint for the enterprise, leading to greater borrowing and reducing discipline in containing costs. A strong perception of such a guarantee can be self-fulfilling because the heavy borrowing of an SOE may lead to a situation where the government feels it has no choice but to intervene and absorb some of its liabilities. In some economies, these sorts of liabilities have been the root of major financial crises. If the government does credibly establish that an SOE will not be rescued from its debts, then it may, in fact, succeed in locking the enterprise out of credit markets. In either case, the national budget may become the only mechanism to supply outside finance.

The reason for this borrowing dichotomy is that creditors have little confidence in loans to SOEs being repaid unless the government stands behind them. Nominally, bankruptcy legislation applies to SOEs in many countries. However in emerging market economies bankruptcy procedures are rarely used, and creditors often receive little formal protection, even with regards to private sector firms (Claessens and Clapper 2002).

In fact, it is possible to subject SOEs to re-organization or liquidation, increasing accountability, financial discipline, and credit worthiness in the process. Nonetheless, cases of SOE restructuring and liquidation remain relatively rare, and effectively implement-

ing bankruptcy will require improving the capacity of the judicial authorities, greater efforts to tailor bankruptcy law—often transplanted—to local circumstances, and in some cases the sort of severance arrangements discussed above (Baygan-Robinett 2004; OECD 2004b).

One sort of credit that SOEs may have access to is “soft lending.” Often, for loans from a state-owned bank or other state-owned financial institution, repayment is optional. It is the state that will ultimately pick up the bill.<sup>9</sup> Related lending between connected companies, that is, companies with the same ultimate owner, is a pervasive problem in emerging market economies (La Porta, Lopez-de-Silanes, and Zamarripa 2002a), and the state remains a major player in the banking industry, with state ownership exacerbating the corporate governance difficulties banks have (Caprio and Levine 2002; La Porta et al. 2002b). Hence, the abuse of related lending between SOEs should be no great surprise. Measures to control such lending include disentangling nonfinancial and financial SOEs, for example, putting them under separate ownership entities (Mako and Zhang 2004), and improving the governance of state banks themselves. If successful, these reforms can harden budget constraints, reduce the state’s potential liabilities, and improve the performance of SOEs and the financial sector.

## Relations with other stakeholders

As with banking, SOEs have a tendency to favor trading with other SOEs, at the expense of other companies and possibly minority shareholders and taxpayers. Many have called for the establishment of a level playing field between SOEs and private sector firms. Although some SOE reform includes increased synergies across the state sector as a goal, some jurisdictions seek to prevent abusive transactions and encourage efficiency by requiring SOEs trade with each other on a commercial, arms-length basis. Success in enforcing these requirements has been mixed. One way to reduce a favorable bias toward other SOEs is to prohibit interlocking directorships: limit the ability of board members, especially executive board members, to serve on each others’ boards. When an ownership entity controls many SOEs, it must also be careful to avoid conflict of interest.

Because of their special nature, SOEs may have a particularly large list of potential stakeholders beyond employees, creditors and other SOEs. Mandates to particular consumers or communities, to encourage environmental protection, or to address social injustice are very much the norm. However, SOEs don’t necessarily do a better job in meeting these commitments. For example, there are a number of reported cases where SOEs polluted more heavily than comparable private sector enterprises (World Bank 1995). To be effective, SOE obligations should be made as explicit as possible, understood by all parties, and implemented in such a way to allow the board adequate autonomy in directing the enterprise. They should also be realistic: a SOE that is asked to do everything may find it difficult to accomplish anything.

## Improving Relations with Other Shareholders and Stakeholders

### Shareholders

Minority shareholders in state controlled companies should have the same legal rights that shareholders in other companies do, and should be treated equally. The state must avoid using its power to abuse minority shareholders, and should exercise policy objectives in a way that preserves their legal rights and is consistent with board members serving in the interest of all shareholders. Special measures to ensure equitable treatment of shareholders, such as proportional or cumulative voting for the board, should also be considered, and the ownership entity should seek to consult and share information with other owners on a regular basis.

When the state is a minority shareholder, the ownership entity should avoid both passivity on the one hand and exerting disproportionate influence on the other. Accordingly, minimal use should be made of golden shares, and the government should always strive to achieve policy goals through regulation in privatized firms. At the same time, the ownership entity should participate on an informed basis in the general meeting of shareholders, in choosing board members, and should seek to stay informed on the performance of the company, its board, and its management.

## Stakeholders

As with other companies, SOEs must take account of their relations with stakeholders as part of good business practice and to ensure that their legal and contractual rights are respected. Because of their special nature, SOEs may have a particularly large list of potential stakeholders. Special obligations to stakeholders should be made as explicit as possible, understood by all parties, and implemented in such a way to allow the board adequate autonomy in directing the enterprise. They should also be realistic: an SOE that is asked to do everything may find it difficult to accomplish anything.

Special rights and obligations often extend to SOE employees. When possible, SOE employees should have the same legal status as their private sector counterparts. To allow flexibility in hiring and firing, restructuring of the enterprise to limit redundant employment should be considered. To encourage ethical behavior by employees, SOEs should have codes of conduct, “whistle blowers” should be protected

from retaliation, and the board and management—who set the tone for the enterprise—should be held to high standards.

To prevent abusive transactions and encourage efficiency, SOEs should trade with each other on a commercial, arms-length basis, and not reduce opportunities for other companies or the financial performance of the SOE. When an ownership entity controls many SOEs, it must be careful to avoid conflict of interest that could harm other shareholders or the state’s objectives.

Avoiding conflicts of interest is critical for state-owned lenders, which should only lend on an arms length basis. Prohibiting such entities from lending to other SOEs should also be considered. To encourage alternate sources of finance and harden budget constraints, SOEs should become subject to the same insolvency law as other enterprises, and creditors to SOEs given the same protection. The state should minimize the use of implicit or explicit guarantees for SOE borrowing.

# Notes

1. State ownership is widely accepted for the provision of public goods such national defense.
2. There is a wide-ranging literature on the poor performance of and problems associated with SOEs; see, for example, Ayub and Hegstad (1986); Boardman and Vining (1989); Chong and Lopez-de-Silanes (2003); Gomez-Ibáñez (2006); La Porta, Lopez-de-Salinas, and Shleifer (2002b); and World Bank (1995).
3. For the separation of ownership and control, see Berle and Means (1932) and Jensen and Meckling (1976); for the analogy between the two kinds of “public” ownership, see Lange (1937), Schumpeter (1942), and Stiglitz (1994).
4. This is the *common agency* problem discussed in the Introduction.
5. The separation of policy functions from ownership implies that the ownership entity should not set policy objectives. However, it may still have a role in overseeing compliance with these objectives.
6. Quoted from a questionnaire prepared for the OECD.
7. With regard to large listed companies, known exceptions are Canada, Ireland, Mexico, the United Kingdom, and the United States. Practically all other OECD economies and many nonmember economies have at least some major listed SOEs.
8. Being able to borrow at the same terms—but no better—as the government may be a liability when lenders are concerned about sovereign default.
9. For example, in China 51.2 percent of enterprises fail to repay bank debt. The fraction of nonperforming loans in the state banking system, which are to other SOEs, is estimated to be 25 to 30 percent (Qiang 2003).



# References

- Aharoni, Yair. 1981. "Managerial Discretion in State-Owned Enterprises." In *State-Owned Enterprises in the Western Economies*, ed. Raymond Vanir and Yair Aharoni. New York: St Martin's Press.
- . 1986. *The Evolution and Management of State-Owned Enterprises*. Cambridge: Ballinger.
- Ayub, Mahmood Ali, and Sven Olaf Hegstad. 1986. "Public Industrial Enterprises: Determinants of Performance." Industry and Finance Series, v. 17. Washington, DC: World Bank.
- Babcock, Lee H. 2002. "A Survey of Issues Relevant to an Organisational Change and Its Strategy at the Indonesian Ministry of State-Owned Enterprises." Jakarta. Unpublished paper.
- Baygan-Robinett, Günseli H. 2004. "Government-Led Industrial Restructuring in Transition Economies: The Role of Information, Incentives and Legal Setting." Ph.D. dissertation, The George Washington University.
- Berle, Adolf, and Gardiner Means. 1932. *The Modern Corporate and Private Property*. New York: Macmillan.
- Berkman, Henk, Rebel Cole, and Jiang Fu. 2002. "From State to State: Improving Corporate Governance Where the Government is the Controlling Block Holder." Paper presented at the 2nd Asian Corporate Governance Conference, Seoul, Korea, May.
- Boardman, Anthony, and Aidan R. Vining. 1989. "Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed and State-Owned Enterprises." *Journal of Law and Economics* 32: 1–33.
- Botero, Juan, Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer. 2003. "The Regulation of Labor." Unpublished paper.
- Brumby, Jim, and Michael Hyndman. 1998. "State-Owned Enterprise Governance: Focus on Economic Efficiency." *Corporate Governance, State-Owned Enterprises, and Privatisation*. Paris: OECD Proceedings.
- Caprio, Gerard, Jonathan L. Fiechter, Robert E. Litan, and Micheal Pomerleano. 2004. *The Future of State-Owned Financial Institutions*. Washington, DC: The Brookings Institute.
- Caprio, Gerard, and Ross Levine. 2002. "Corporate Governance of Banks: Concepts and International Observations." Paper presented at the Global Corporate Governance Forum Research Network Meeting, Washington, DC, April.
- Chen, Kevin C. W., and Jiwei Wang. 2004. "A Comparison of Shareholder Identity and Governance Mechanisms in the Monitoring of Listed Companies in China." Hong Kong. Unpublished paper.
- Chong, Alberto, and Florencio Lopez-de-Silanes. 2003. "The Truth About Privatisation in Latin America." Inter-American Development Bank, Washington, DC, October.
- Claessens, Stijn, and Leora Clapper. 2002. "Bankruptcy Around the World: Explanations and Its Relative Uses." Unpublished paper.
- Claessens, Stijn, Simeon Djankov, Joseph P. H. Fan, and Larry H..P. Lang. 2002. "Disentangling the Incentive and Entrenchment Effects of Large Shareholdings." *Journal of Finance* 6: 2741–71.
- Claessens, Stijn, Simeon Djankov, and Larry H. P. Lang. 2000. "The Separation of Ownership and Control in East Asian Corporations." *Journal of Financial Economics* 58: 81–112.
- Coffee, John C. 1999. "Privatisation and Corporate Governance: The Lessons from Securities Market Failure." Working Paper 158, Columbia Law School Center for Law and Economic Studies, New York.
- Dewan, S. M., ed. 2006. *Corporate Governance in Public Sector Enterprises*. Delhi: Pearson's.
- Dixit, Avinash. 1997. "Power of Incentives in Private versus Public Organizations." *The American Economic Review* 87 (May): 378–82.
- Djankov, Simeon, and Peter Murrell. 2002. "Enterprise Restructuring in Transition: A Quantitative Survey." Discussion Paper No. 3319, Centre for Economic Policy Research.

- DPE (Department of Public Enterprises). 2002. "Protocol on Corporate Governance in the Public Sector." South African Department of Public Enterprises, September.
- Easterly, William. 2002. *The Elusive Quest for Growth: Economist Adventures and Misadventures in the Tropics*. Cambridge, MA: MIT Press.
- EBRD (European Bank for Reconstruction and Development). 2001–2003. *Transition Report*. London: EBRD.
- The Economist* (London). February 6, 2003. "A Survey of Asian Finance."
- Estrin, Saul (1998) "State Ownership, Corporate Governance and Privatisation." *Corporate Governance, State-Owned Enterprises, and Privatisation*. Paris: OECD Proceedings.
- Frémond, Olivier. 2000. "The Role of Stakeholders." Paper presented at the First Meeting of the Eurasian Roundtable for Corporate Governance, Kiev, October.
- Gerschenkron, Alexander. 1952. *Economic Backwardness in Historical Perspective: A Book of Essays*. Cambridge MA: Harvard University Press.
- Gómez-Ibáñez, José A. 2006. "Alternatives to Privatization Revisited: The Options for Infrastructure." Washington, DC: World Bank.
- Hart, Oliver, Andrei Shleifer, and Robert W. Vishny. 1997. "The Proper Scope of Government: Theory and an Application to Prisons." *The Quarterly Journal of Economics* 112 (4): 1127–61.
- Hodges, Ron, Mike Wright, and Kevin Keasey. 1996. "Corporate Governance in the Public Services: Concepts and Issues." *Public Money and Management*, April–June.
- Huchet, Jean-Francois, and Xavier Richet. 1999. "China in Search of an Efficient Corporate Governance System: International Comparisons and Lessons." CERT Discussion Paper No. 99/01.
- Jensen, Michael C., and William H. Meckling. 1976. "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure." *Journal of Financial Economics*. 3: 305–60.
- Jensen, Michael C. 2000. "Value Maximisation and the Corporate Objective Function." Working Paper 00-058, Harvard Business School, Cambridge, MA.
- Kuijs, Louis, William Mako, and Chunlin Zhang, 2005. "SOE Dividends: How Much and to Whom?" World Bank, Beijing Office, October 17.
- Lang, Larry. 2002. "Corporate Ownership on the Mainland." Paper presented at the Global Corporate Governance Forum Research Network Meeting, April.
- Lange, Oskar. 1937. (Feb.) "On the Economic Theory of Socialism, Part II." *The Review of Economic Studies* 4 (2): 123–42.
- La Porta, Rafael, Florencio Lopez-de-Silanes, and Guillermo Zamarripa. 2002a. "Related Lending." Unpublished paper.
- La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer. 2002b. "Government Ownership of Banks." *The Journal of Finance* 57: 265–302.
- \_\_\_\_\_. 1999. "Corporate Ownership Around the World." *The Journal of Finance* 54: 471–517.
- La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny. 1997. "Legal Determinants of External Finance." *The Journal of Finance* 52: 1131–50.
- \_\_\_\_\_. 2002. "Investor Protection and Corporate Valuation." *The Journal of Finance* 77: 1147–69.
- Mako, William P., and Chunlin Zhang. 2004. "State Equity Ownership and Management in China: Issues and Lessons from International Experience." Paper presented at the Policy Dialogue on Corporate Governance in China, Shanghai.
- Ministry of State-Owned Enterprises (MSOE), Indonesia. 2002. "Master Plan: State-Owned Enterprises." Jakarta, Indonesia.
- OECD (Organisation for Economics Co-operation and Development). 2004a. *Corporate Governance in Eurasia, A Comparative Overview*. Paris: OECD.
- \_\_\_\_\_. 2004b. *Experiences from the Regional Corporate Governance Roundtables*. Paris: OECD.
- \_\_\_\_\_. 2004c. *OECD Principles of Corporate Governance*. Paris: OECD.
- \_\_\_\_\_. 2004d. *Survey of Corporate Governance Developments in OECD Countries*. Paris: OECD.
- \_\_\_\_\_. 2005a. *Comparative Report on Governance of State-Owned Assets*. Paris: OECD.
- \_\_\_\_\_. 2005b. *Guidelines for the Corporate Governance of State-Owned Assets*. Paris: OECD.
- Okeahalam, Charles. 2002. "Corporate Governance, State Ownership, and Finance in Africa." Paper presented at the Global Corporate Governance Forum Research Network Meeting, Washington, DC, April.
- Prus, Marta. 2003. "Corporate Governance in Treasury Companies." Paper presented at the 3rd meeting of the OECD Working Group on Privatisation and Corporate Governance of State-Owned Assets, OECD, Paris.
- Perotti, Enrico. 2003. "State Ownership: A Residual Role?" *Global Corporate Governance Forum Discussion Paper 2*.
- Pistor, Katherina, Martin Raiser, and Stanislaw Gefler. 2000. "Law and Finance in Transition Economies." *Economics of Transition* 8: 325–68.
- Qiang, Qu. 2003. "Corporate Governance and State-Owned Shares in China Listed Companies." *Journal of Asian Economics* 14: 771–83.
- Rama, Martin. 1999. "Public Sector Downsizing: An Introduction." *The World Bank Economic Review* 13: 1–22.
- Reddy, Y. R. K. 2001. "The First Principles of Corporate Governance in Public Enterprises in India: The Yaga Report." Standing Conference on Public Enterprises and Yaga Consulting.
- Sachs, Jeffrey D. 1996. "Notes on the Life Cycle of State-Led Industrialisation." *Japan and the World Economy* 8: 153–74.

- Schumpeter, Joseph. 1942. *Capitalism, Socialism, and Democracy*. New York: Harper and Row.
- Shirley, Mary. 1998. "Why Performance Contracts for State-Owned Enterprises Haven't Worked." *Public Policy for the Private Sector* 150, World Bank.
- Shleifer, Andre. 1998. "State versus Private Ownership." *The Journal of Economic Perspectives* 12: 133-50.
- Shleifer, Andre, and Robert W. Vishny. 1994. "Politicians and Firms." *The Quarterly Journal of Economics* 109: 995-1025.
- S&P (Standard & Poor's). 2004. "Russian Transparency and Disclosure Survey 2004." Standard & Poor's Governance Services, supported by the Moscow Interbank Currency Exchange.
- Stiglitz, Joseph. 1994. *Whither Socialism?* Cambridge, MA: MIT Press.
- TGC. 2004. *The Code of Corporate Governance for Bangladesh: Principles and Guidelines for Best Practices in the Private Sector, Financial Institutions, State-Owned Enterprises & Non-Governmental Organisations*. Taskforce on Corporate Governance and the Bangladesh Enterprise Institute.
- Vittal, N. 2002. "Corporate Governance and Marketing Ethics." Paper presented at the 29th World Marketing Congress, Delhi, March.
- Watanabe, Mariko. 2002. "Holding Company Risk: A Final Step of State-Owned Enterprise Reform and an Emerging Problem of Corporate Governance." *China Economic Review* 13: 373-81.
- Wong, Simon C. Y. 2004. "Improving Corporate Governance in SOEs: An Integrated Approach." *Corporate Governance International* 7 (June): 5-15.
- World Bank. 1995. *Bureaucrats in Business: The Economics and Politics of Government Ownership*. New York: Oxford University Press.
- Yeyati, Eduardo Levy, Alejandro Micco, and Ugo Panizza. 2004. "Should the Government Be in the Banking Business?" Inter-American Development Bank.



The World Bank Corporate Governance Policy Practice helps client countries assess their corporate governance policy frameworks. The assessments serve to increase transparency in international financial markets and assist country-level and global reform initiatives, underpin policy dialogue, strategic work and programmatic operations, and provide input to technical assistance and capacity building efforts.

The activities of the joint IFC-World Bank Corporate Governance Department are aimed at helping companies and countries improve standards of governance for corporations, focusing on shareholder and stakeholder rights, board member duties, disclosure, and effective enforcement. The department promotes the spirit of enterprise and accountability, encouraging fairness, transparency and responsibility through its work. The measures taken to improve corporate governance present opportunities to manage risks, add value to companies, and contribute more broadly to promoting sustainable private sector investment in developing countries.

For more information, please see:

<http://rru.worldbank.org/Themes/CorporateGovernance/>

Or contact us at:

[CGROSC@worldbank.org](mailto:CGROSC@worldbank.org)