Expert Consultation

OECD Guidelines on Corporate Governance of State-Owned Enterprises

Paris, 8 September 2014

BIAC appreciates the opportunity to participate in the consultation on the revision of the OECD Guidelines of State-Owned Enterprises (SOEs) and is pleased to provide the following comments on the draft which has been issued for public consultation. These comments should be read in conjunction with the BIAC comments for the 14 February consultation. We appreciate that several of our comments have been taken into consideration. Others should be further reinforced and are highlighted again below, in addition to further comments on the latest draft. We look forward to remaining involved in the discussions as the revision process proceeds.

General comments

- As an internationally agreed standard of how governments should exercise their ownership of SOEs, and of how SOEs should be governed, the OECD Guidelines have made an important contribution to improving corporate governance of SOEs in OECD member and non-member countries and as such have played a major role in fostering a level playing field for competition among SOEs and private firms and in ensuring that SOEs achieve their intended corporate outcomes while acting in the public interest at all times. At the same time, they give concrete advice to countries on how to manage their ownership rights.

- Having been developed in 2005, the Guidelines are in need of updating. Therefore, the revision process presents an important opportunity to ensure that the Guidelines remain up-to-date and are strengthened as a global benchmark for SOE governance and that state ownership does not distort the marketplace to the detriment of private enterprises. As such, dual objectives should be kept in mind, i.e. on the one hand ensuring that the state exercises its ownership functions responsibly and wisely and on the other avoiding distortions of competition and fostering open trade and investment. The Guidelines should help ensure that states, as well as the SOEs themselves, do not abuse their power and that they use their power wisely.

- In view of the increasing importance of SOEs, in part due to their rapid growth in non-OECD countries, it is crucial that non-member countries are closely involved in the discussions and that the revision process includes a plan for outreach and capacity building once they have been finalized. Due attention should be given to encouraging implementation and appropriate application of the principles of the Guidelines.

- The OECD is involved in a range of different activities regarding SOEs, including in the areas of trade and investment. For overall consistency and to ensure that trade and investment implications of SOEs, including in the context of bilateral agreements, are given
due attention in the review of the Guidelines, we recommend involving relevant experts from other parts of the OECD in the review process, including among others investment, trade, and competition. Careful attention should be paid to the broader implications of language on SOEs if used in other policy settings.

- The Guidelines not only focus on the SOE itself, but also on the role of the state as an owner. One could therefore consider referring to this set of recommendations as “Guidelines on the enablement of Corporate Governance of State-Owned Enterprises”.

- We welcome the transparent commenting process that has been put in place for the revision of the SOE Guidelines. However, since the SOE Guidelines were developed as a complement to the OECD Principles of Corporate Governance on which they are based, the review process of the Principles should closely inform the update process of the Guidelines to ensure continued compatibility. We are concerned that the two processes have not taken place exactly in parallel and that the SOE Guidelines might “get ahead” of the review process of the Corporate Governance Principles, for which the public consultation has not yet started.

Preamble

The preamble correctly underlines the economic weight of SOEs in a number of countries and the importance of supporting governments in improving the performance of SOEs. As the Guidelines have several objectives, the preamble should also more fully reflect the need for SOEs to achieve their intended outcomes while acting in the public interest at all times as well as the need to avoid distortions of competition and foster open trade and investment.

We suggest underlining in para 1 that the governance of SOEs is critical to ensure that they can make a positive contribution to economic, social and environmental efficiency and competitiveness. Para 1 should also underline that SOEs are to the extent possible engaged in the provision of public services and not in commercial competition with private enterprises.

Additional specific comments

- Para 2: “natural monopolies” would require proper explanation.
- Para 6: “takeover” should not necessarily be portrayed as a “threat”
- Para 8: As mentioned in our comments on the Principles, we recommend moving the chapter on the Board further to the front as good governance starts at the top.

Applicability and definitions

As mentioned in this section, the Guidelines are an “OECD Recommendation”, i.e. a set of non-binding guidelines and best practices to which the OECD members and associate countries have expressed their commitment. For OECD Recommendations, the OECD often has a well-established process in place to report on their practical implementation. It would be appropriate to already refer at this stage to the intention to put such a process in place with regard to the SOE Guidelines, both for member and non-member economies.
Additional specific comments:

- In paragraph 10, the sentence “corporate assets held indirectly via asset managers operating independently of the government would normally not be considered as SOEs” should be further clarified in the context of this paper.

- In paragraph 15, the sentence reading “Enterprises held at subnational levels of government would, according to the national context and legislation, normally not be qualified as SOEs” is problematic. From a trade and investment perspective, sub-central SOEs, which can in fact be quite large, are important, and can in some cases pose serious challenges.

- Para 17: replace “company” by “entity” as part of an SOE.

The rationale of state ownership

BIAC appreciates that several of its earlier comments have been taken into consideration, including the need for governments to review at regular intervals their ownership policy and to define the rationales for owning individual SOEs. It is important for governments to consider both when state ownership is desirable and when it is not, what the various implications and challenges are, and when future privatization should be aimed for.

There should be clear distinctions drawn between any inherently public policy functions an SOE may be performing and commercial activities where it would compete with current or potential private sector companies. The state should avoid the creation of SOEs that engage in commercial competition activities and should limit SOE activities where commercial competition exists or may exist. The state should undertake a review of the laws, decrees, circulars and other regulations affecting the activities of commercial SOEs to ensure the absence of conflicting rules and negative implications for private companies as well as to ensure the accountability of the board of SOEs and for the performance of the SOE.

We recommend mentioning in the section that public policy objectives and ownership policies should be developed and reviewed in consultation and communication with the general public.

The State’s role as owner

Striking the right balance between the state’s responsibilities for exercising its ownership functions and ensuring that SOEs serve the public interest should remain a fundamental objective of policy in this area. Governments should refrain from political interference in the management of the company, and should ensure that there is a level playing field so that private companies, whether domestic or foreign, can compete with SOEs in a competitively neutral manner. The manner in which the state balances the various objectives and interests should be publicly disclosed. The SOE Guidelines should highlight concerns about advantages SOEs might have in certain segments of the economy and should provide guidance for the privatization of certain SOEs.
We welcome the introduction of a disclosure policy and clearer language on the setting and monitoring of the implementation of broad mandates. BIAC’s recommendation regarding public disclosure of SOE objectives have been taken into account.

Regarding the remuneration of SOE boards and senior management, we have noted that the wording in the annotations has been strengthened. As many SOEs are or have been supported by tax payers’ money, wider stakeholder interests should be taken into account. BIAC’s earlier comments on the related commercial experience of board members of SOEs still remain to be reflected.

Additional specific comments:

- In point F, “acting as an informed and active owner” is not sufficient, in our view. It should also be underlined that the state should act with integrity and in the public interest.

- Point F does not necessarily relate to the intent or purpose of an SOE, but signals control (see also section in the annotations). The Guidelines should avoid giving the impression that an SOE in compliance with OECD corporate governance best practices can be exempt from trade and investment commitments.

- “Governance in a transparent and accountable manner” – Transparency and accountability are indeed attributes of good governance, but there are many others.

- F: According to the legal structure of each company – suggest (state owned) entity

- F 3, 4, 5, 6: There is a fine line between the responsibilities of the state as the owner and those of the board of the SOE themselves. Many of these responsibilities would be attributed to the board of a (private) company and not to the (individual) stakeholder.

- Para 66: “In the case of partially owned SOEs, the state may not be in a position to formally ‘mandate’ the fulfilment of specific objectives…” We recommend redrafting the sentence as this is rarely the case.

State-owned enterprises in the marketplace

BIAC welcomes the Working Party’s analysis on SOEs in the marketplace, which underlines the need to avoid market distortions. As a general principle, whatever rules are applied to the private sector should also be applied to SOEs at the national but also sub-national level of ownership. For example, governments and SOEs themselves should pay due attention to, among other things, conditions surrounding the issuance of equity, debt financing, and other sources of funding of SOEs, including how these compare with private competitors; explicit or implicit advantages (including in financing, regulatory treatment, enforcement, etc.) over private sector entities operating in similar industries; limitations to competition by SOEs benefiting from state subsidies / guarantees or from significant revenues from non-competitive markets, etc.

In this respect, the amendments in C and E2 with regard to the possible benefits of SOEs are welcomed. When SOEs engage in competitive economic activities, it is understood that those
activities must be carried out without undue advantages relative to the private sector. The same change is needed in para 84.

We welcome clarifications in annotations 84 and 88, including the reference to the OECD flagship publication on competitive neutrality as requested by BIAC.

Additional specific comments:

- We recommend deleting the sentence in D “SOEs should not face uncompensated or operational obligations that could put them at a material disadvantage vis-à-vis private companies” as it only refers to material disadvantages of SOEs. The focus should be on ensuring a truly level playing field, not just that governments might create SOEs that are unable to compete because of that burden (this also applies to para 94 in the annotations).

- We recommend adding “oversight” to points D, i.e. “SOEs should not be exempt from the application of general laws, tax codes, regulations and oversight”

- E3: Why should this only relate to financial rate of return? SOEs should be required to achieve similar (or better) economic, social and environmental performance.

- Para 105: “… discourage cross-subsidisation…” We recommend replacing “discourage” by “eliminate”.

- When an SOE is acting as an agent of government engaging in the purchase of goods or services for the use of government, it should be subject to public procurement rules. When it is acting as a commercial entity, it should buy and sell on a non-discriminatory basis in accordance with commercial considerations.

- Regulatory authority should be exercised by independent government entities, not SOEs. The following addition should be made to draft guideline III.A: “No ministry or agency of government that is responsible for the commercial success of an SOE should also be the regulator.”

- The last sentence of para 92 should either be deleted or modified as follows: “On the other hand, under compensation for public policy activities can jeopardize the commercial viability of an SOE’s competitive activities, putting them at an undue commercial disadvantage to the enterprise.

Equitable treatment of shareholders

As mentioned in our earlier comments, we believe that some revision is required in the Guidelines or annotations to indicate that when an SOE is partially privatized, the state should have no greater participation or involvement in the company or access to information that would not be available to a minority shareholder, other than the role its shareholding provides as a right. In addition, safeguards should be established for the fair treatment of minority shareholders. Minority shareholders also deserve adequate representation in the board and nominating committee of the SOE.
We welcome the addition of a new point C underlining the importance of SOEs informing shareholders about the public policy objectives. We also welcome the clarification in the annotations that non-state shareholders are protected against abusive action and have means of redress.

Additional specific comments:

- The first sentence in point A does not fully recognize that the OECD Principles are also directed to states and exchanges, enabling good corporate governance, rather than just companies themselves.

- B: “National corporate governance codes should be adhered to by all listed and, where feasible, unlisted SOEs”. We are concerned about the qualifier “where feasible”. Who determines what is feasible?

**Stakeholder relations and corporate ethics**

As underlined in our earlier comments, SOEs need to consider the economic, social and environmental impacts of their policies, plans and decisions and need to ensure that appropriate trade-offs are made, balancing the various stakeholder interests.

Additional guidance on balancing stakeholder interests and encouragement for communication and consultation with various stakeholder groups would be helpful, recognizing that stakeholders should be encouraged to express legitimate interests and concerns and that there are long-term benefits to balancing stakeholder interests.

We welcome the fact that annotation 149 calls for monitoring and periodically testing the compliance with codes of ethics as recommended in our earlier comments. It is important that the board of an SOE keeps the enterprises values at the forefront of its own behaviour, uses them to guide its actions and promotes an ethical culture and collaboration throughout the enterprise through a number of mechanisms as appropriate (e.g., codes of conduct, staff consultation, training and performance, whistleblowing processes).

We welcome the addition in annotations 155/156 that SOEs should under no circumstances be used directly as sources of capital to finance political campaigns or activities, but recommend deleting “directly”.

**Transparency and disclosure**

As underlined in our earlier comments, it is important to consider developments in the areas of disclosure and transparency with regard to corporate reporting to provide a sound basis for decision-making by the various stakeholders. Reporting requirements should be equal or similar to private-sector competitors.

SOE boards should be transparent about their decisions, actions and outputs and the outcomes they have achieved. To demonstrate that they have delivered their stated commitments and have used
public resources effectively in doing so, they should report their financial and non-financial performance in a timely manner. SOEs should assess the extent to which they are applying the principles of corporate governance as set out, for example, in the SOE Guidelines, report publicly on this assessment and develop action plans for continuous improvement.

We welcome the clarification in B that SOEs should be subject to an annual independent external audit based on internationally recognized standards as well as consistent reporting on SOEs and annual publication of aggregated reports in principle D. Several annotations provide additional details, such as n° 168 which correctly clarifies that SOEs should face at least the same or similar disclosure requirements as listed companies, n° 193 giving more detailed information on the content of the aggregate report.

Additional specific comments:

- Para A and B: We recommend some clarification of what should be the subject of these internal and external audit procedures.
- The order of the paragraphs should be changed to make the sequence more logical (starting with first accounting, then auditing).
- C5: There should be a reference to reporting on material findings from internal and external audits.

The responsibilities of boards of directors

As mentioned in our earlier comments and our contributions to the Principles, we underline the importance of this section. A key issue for SOEs is to make the board truly responsible and accountable for the SOE and its activities and performance, bearing in mind that the main duty of the board of an SOE is to the citizens of the state. The state must recognize that the board power should not be perfunctory and only on paper.

A number of issues which BIAC has identified for the review of the Principles are also relevant for the SOE Guidelines, e.g. encouraging effective Boards, recognizing that good governance starts at the top; considering issues such as board composition, director qualifications and training, skills and experience (including commercial experience); diversity of thought in the Boardroom and in the nominee selection processes; as well as the importance of independence of thought and objectivity of Board members in decision-making.

An effective board nomination framework is crucial, facilitating the participation of non-government shareholders/stakeholders in the nomination process, avoiding restrictions on board membership to nationals, enhancing transparency of the nomination process, ‘insulating’ SOE boards from inappropriate interference from the State and highlighting the importance of relevant expertise, including commercial and financial expertise as crucial qualifications for board membership.

Good boards start with good nominating committees, independent of the SOE executive and also sufficiently independent from the state as owner. BIAC’s recommendation to limit political
interference in board processes has been introduced in point D and annotation 215. Several additional clarifications have been introduced in the annotations, e.g. regarding the independence of board members and good practice.

While n° 217 introduced what kind of skills are desirable, we recommend further emphasis in the main section on skills. In particular for SOEs undertaking commercial activities in competition with the private sector, BIAC recommends that the SOE board has considerable private sector/commercial experience amongst its members. More general, SOE boards should have the appropriate skills and knowledge to exercise leadership and to meet the needs of their roles and responsibilities.

There is some tension between the responsibility and authority of the board (overarching principle) vs. the state as an owner (principle II). Board responsibilities / authorities should be aligned with overall good governance principles. This would also facilitate privatization at a later stage, if appropriate.

Additional specific comments:

A: change “company” for “entity” (here and in other relevant places)

D: “independent board members”- clarify independent from whom

For background reading: *A new framework for good governance in the public sector* (IFAC/CIPFA, July 2014)