



The Voice of OECD Business

Stakeholder Consultation

OECD Guidelines on Corporate Governance of State-Owned Enterprises

Paris, 14 February 2014

BIAC comments

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 initial comments. We look forward to remaining involved in the discussions and providing additional comments on draft Guidelines as the revision process proceeds.

General comments

- The 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, which is an overarching priority for BIAC. The revision process should be guided by a strategic vision, keeping in mind the overall OECD mission and values of promoting policies that will improve the economic and social well-being of people around the world, while minimizing the impact on the environment.
- In view of the growing importance of SOEs, in part due to their rapid growth in non-OECD countries, it is increasingly important to consider how they interact with other organizations in a global environment. We understand that this will not be a major renegotiation of an instrument which has made a positive contribution over time, but an update to reflect recent developments and to ensure its continued leadership, guidance and relevance.
- However, the revision process presents an important opportunity to ensure that the Guidelines are strengthened as a global benchmark for SOE governance with a view to ensure competitive neutrality, avoid distortions of competition, and foster open trade and investment. They should also set out how states should exercise their ownership rights responsibly and wisely with a view to achieve best possible

outcomes in the public interest. The Guidelines should help ensure that on the one hand states do not abuse their power and on the other hand that they use their power wisely. The review should take into account developments since the Guidelines were adopted to ensure that they adequately reflect and draw lessons from the changes that have taken place.

- 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. With regard to the tight timelines for the development of the Guidelines, we would like to underline that the revision should not get ahead of the update of the Principles as they should be cognisant of changes in the Principles. With regard to the suggestion to streamline multiple references to the Principles, we recommend that if this approach is adopted, the main text of the Principles should be added as an annex.
- BIAC would like to see OECD incorporating thoughts generated from its own quality research into SOEs and SOE activities. However BIAC also recommends the OECD takes account of other relevant research pieces on SOEs on individual countries, for example, research on SOEs in India, Colombia, and Lithuania undertaken by other institutions.
- From the start of the discussions on the revision, due attention should be given to encouraging implementation and ongoing application of the Guidelines. For example, in the area of competitive neutrality, while a lot of important analysis has been carried out by the OECD and others, there is still an important implementation and an enforcement gap. To be useful, the SOE Guidelines should provide constructive guidance on how to implement competitive neutrality practices, highlighting the importance of effective enforcement mechanisms in remedying non-neutrality practices (e.g. debt neutrality, fair procurement policy, etc.). Analyses and enforcement disciplines which can be effective within a domestic economy may in many cases not work so well with international, cross-border competition. We believe the most effective methods of enforcement should include the establishment of an authority responsible for hearing, investigating and resolving suspected infringements of competitive practices by both private sector entities and SOE's and which has the power to investigate whole sectors for anti-competitive behaviour.

The rationale of state ownership

- An overarching question is what the government's objectives are for establishing and maintaining SOEs. In this respect, BIAC recommends there be encouragement for each economy to provide clear rationales behind the various interests of state ownership in SOEs and in particular be clear and provide a rationale for those industries/sectors the state considers are 'strategic'. Further, each economy should make clear the particular SOEs undertaking predominantly commercial activities and the way in which the state expects to exert its shareholder role. In many cases, it would be appropriate for period reviews or "sunshine statutes" which would provide for periodic reviews of the status and mandate for major SOEs.
- An overarching criterion to establish or maintain an SOE is whether or not that would be the best way in which products or services could be delivered from a public interest perspective, balancing economic, social and environmental considerations. The state can choose to ensure that the SOE executives prioritize long-term over short term interests.
- However, certain listed SOEs that operate in highly competitive markets might be part-owned by the government in order to prevent them from being taken over by other companies, reflecting fear of foreign ownership, or concerns about excessive delisting. The annotations should include examples of the types of interventions that are considered unacceptable.
- If it is decided to add a separate chapter on the purpose of state ownership, we recommend highlighting 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.

BIAC recommends that there be clarity on the legal status of SOEs, especially those undertaking predominantly commercial activities. There should be clear distinctions drawn between, on the one hand, any inherently governmental functions an SOE may be performing and, on the other hand, commercial activities where it would be competing with current or potential private sector competitors. 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 which may reduce the accountability of the board for the SOE.

The State's role as owner

- The fundamental objective should remain to address the challenge of finding a balance between the state's responsibilities for exercising its ownership functions and ensuring that SOEs serve the public interest, while refraining from imposing political interference in the management of the company, and ensuring that there is a

level playing field so that private companies can compete with SOEs in a competitively neutral manner.

- The manner in which the state approaches this 'balance' should be publicly available. Multiple conflicting objectives can lead to state intervention and company inertia and are likely to reduce the accountability of the board. There needs to be clarity about the intended outcomes how the strategy is set and the manner in which management performance targets are set, reported and acted upon and why, at this point in time, it is in the public interest to pursue these outcomes through an SOE.
- The SOE Guidelines should also highlight concerns about advantages SOEs might have in certain segments of the economy and should provide guidance for the commercialization of certain SOEs. Advantages that certain SOEs enjoy might also lead to less efficient ways of producing services or other outputs and can create a number of unwanted distortions. Governments should therefore think carefully about how to shape their economic infrastructure beyond the apparent advantages of establishing SOEs.
- The SOE Guidelines and annotations should also include guidance on the appropriate influence of the State on SOE boards of directors, their nomination, election, and receipt of direction once directors are placed on the board. Such influence can be exerted through either formal or informal methods. Where the state or other organizations nominate people to join a certain SOE board, that board should communicate clearly to the nominating body the set of skills and perspectives that are most helpful.
- 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. Non-executive members should also be independent of management and free from any other relationship with the political establishment for example that would materially interfere with their role. The board should be accountable to the government as well as its citizens for overseeing the strategic direction, operations and accountability of the SOE and should have the commercial and other competences among its members to do so.

State-owned enterprises in the marketplace / legal and regulatory framework

- BIAC welcomes the Working Party's analysis on SOEs in the marketplace. We would like to underline that the excellent OECD work on competitive neutrality, to which several OECD committees have contributed, should be considered as important input. As a general principle, whatever rules are applied to the private sector should also have to be applied by SOEs at the national but also sub-national level of ownership. In this respect, due attention should be given to the following areas:

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- Are the SOEs competing with private sector offerings and is it in the longer-term public interest to have SOEs providing these services and other outputs?

Conditions surrounding equity, debt financing, and other resources of SOEs, including how they compare with private competitors, stress the importance of a level playing field and addressing competitive advantages as well as potential other economic, social and environmental distortions

- Do SOEs have explicit or implicit advantages (including in financing, regulatory treatment, enforcement, etc.) or disadvantages over private sector entities operating in similar industries? And if yes, are these justifiable in the light of public interest?
- Limitations to competition by SOEs benefiting from state subsidies/guarantees or with significant revenues from non-competitive markets;
- The experience of private business, and studies of the effects, in industries where they regularly compete with SOEs (e.g., energy, telecommunication, water and sanitation services, and natural resources);
- How different governments have distinguished commercial SOEs from the other SOEs, which because of social obligations or strategic importance are likely to remain under direct state control;
- Key trends in use of SOEs and to what extent they compete internationally;
- Distinguishing clearly between governments' role as shareholder in SOEs, control of SOE management and interference in daily SOE operations, in line with the regular governance rules and responsibilities between shareholders, boards and management.
- SOEs engaged in commercial activities shall not concurrently exercise any regulatory powers over activities of their own and/or private competitors. Regulatory authority should be exercised by independent government entities, not SOEs.

Equitable treatment of shareholders

- Some comment 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.

Stakeholder relations and corporate ethics

- BIAC would endorse the inclusion of additional specific requirements related to corporate responsibility and stakeholders. 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.

- Guideline IV B - BIAC would encourage reporting by SOEs on their key stakeholders and company activities with these stakeholders and the information channels the company uses to reach key stakeholders and which enable stakeholder participation.
- Guideline IV C – The annotations should recommend that codes of ethics be monitored and periodically tested for compliance and that companies devise policies for the receipt, investigation and resolution of complaints and how these are reported to the board. 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 (leading by example) and promotes an ethical culture and collaboration throughout the enterprise through a number of mechanisms (e.g., codes of conduct, staff consultation, training and performance, whistleblowing processes).

Transparency and disclosure

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. Strong transparency provisions are essential for all SOEs. When thinking about SOEs and a level playing field with private companies, levels of transparency should be as high and extensive as its private-sector competitors. Bearing in mind that as SOEs frequently use resources raised through taxation, they should be accountable not only for how much they spend, but also for the way they use the resources and the outcomes they achieve.

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- Guideline IV B - BIAC would encourage reporting by SOEs on their key stakeholders and company activities with these stakeholders and the information channels the company uses to reach key stakeholders and which enable stakeholder participation in a consistent and timely manner.
- Guideline IV C – The annotations should recommend that codes of ethics be monitored and periodically tested for compliance and that companies devise policies for the receipt, investigation and resolution of complaints and how these are reported to the board.
- To demonstrate that they are acting in the public interest, SOE boards should be transparent about their decisions, actions and outcomes. 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.
- To demonstrate good practice, 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 an action plan for improvement.

The responsibilities of boards of directors

- A key issue to be addressed in 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. There are noted practices such as keeping the company under state budgetary control that inhibit this accountability.
- A number of issues which BIAC has identified for the review of the Principles might also be relevant to the SOE Guidelines. These issues include, among other things: 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, as well as in the nominee selection processes; and the importance of independence of thought and objectivity of Board members in decision-making.
- The SOE Guidelines should highlight the importance of an effective board nomination framework, facilitating the participation of non-government shareholders/stakeholders in the nomination process, deterring the restriction of board membership to nationals, enhancing transparency of the nomination process, ‘insulating’ SOE boards from inappropriate interference and highlighting the importance of relevant expertise, including commercial and financial expertise as crucial qualifications in for the board membership. Boards must be able to fulfil their responsibilities and accountabilities and should, therefore, not be subject to political or other undesirable interference. SOEs should have binding guidelines for Boards to have a substantial number of non-political, independent members that ensure relevant expertise on the Board.
- The guidelines or annotations need to show how the state in its nomination process can take into account the needs of the enterprise and the public interest when nominating individuals for the board or when participating in the appointment. Drawing lessons from examples of poor known practices would also be helpful.
- While the SOE Guidelines convey that Boards should carry out an annual evaluation to appraise their performance (which currently does not seem to be a general practice), additional detail might be provided on modalities of on-going performance review or on a need to benchmark performance.
- Guideline VI E – The reference to board committees needs to recognize the need for these committees to enable the board’s full exercise of its powers and the need for the committees to be capable of independent objective judgment. Independence from the state is important.
- Please also see the recent [CIPFA/IFAC draft *Good Governance in the Public Sector*](#).