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Improving the Governance of Public Enterprises

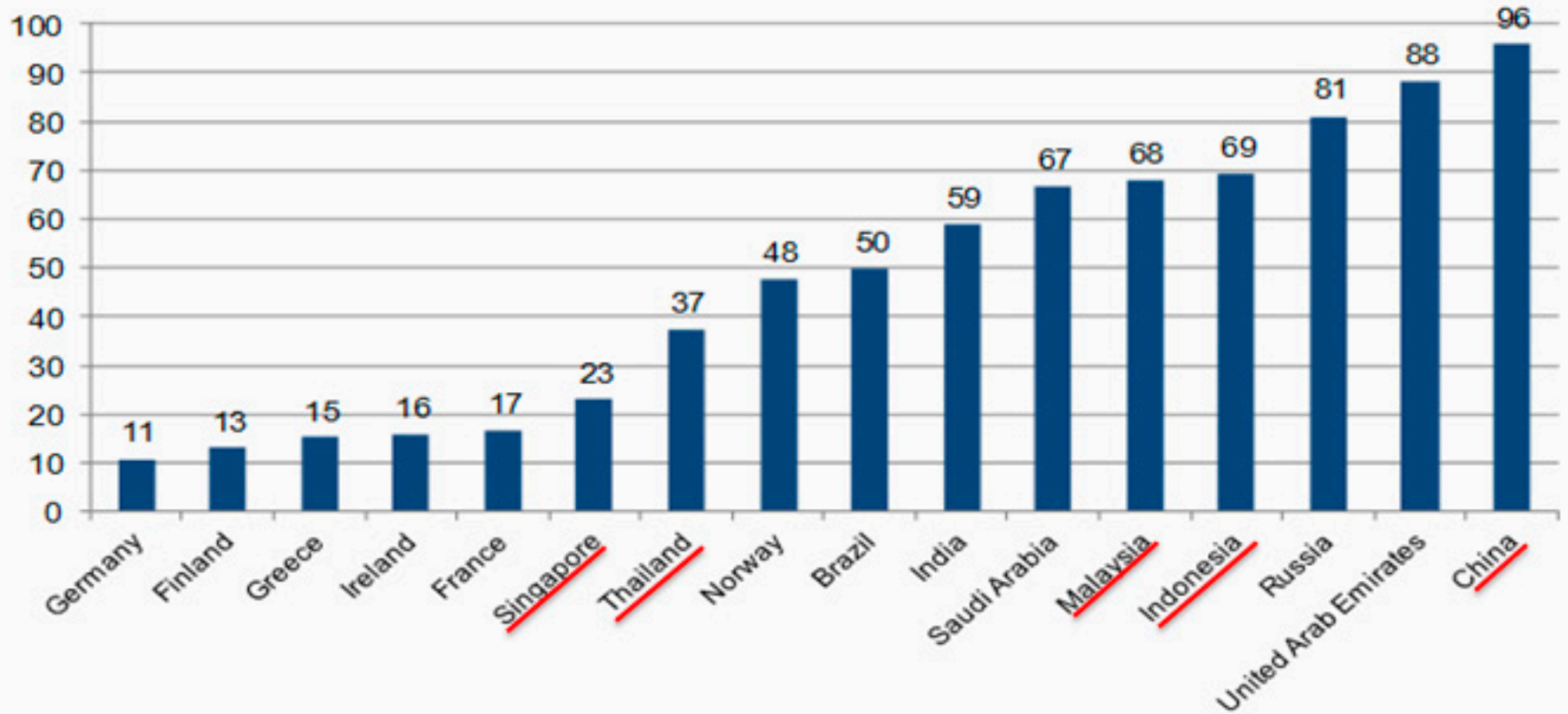
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Global Practice

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Public enterprises are economically important



Note: Only countries with shares above 10% are shown.

Source: Kowalski et al. (2013).

Their governance faces special challenges

Private firms

Value maximizing

Single agency

Market discipline

- Products
- Ownership
- Incentives

Disclosure

Clear exit mechanism

State enterprises

Conflicting objectives

Multiple agencies

Political interference

- Muted product market
- No ownership market
- Lack of incentives

Low or no disclosure

Unclear exit mechanism

And can produce a big mess

PE

Can result in

May require

- Carries out non-commercial objectives
- Incurs losses (technical)
- Mispricing

- High debt levels
- Arrears (vis-à-vis tax authorities, suppliers, inter-PEs)

- Capital injections
- Bail outs
- Clean ups of PEs balance sheets

Exacerbated by

Can lead to

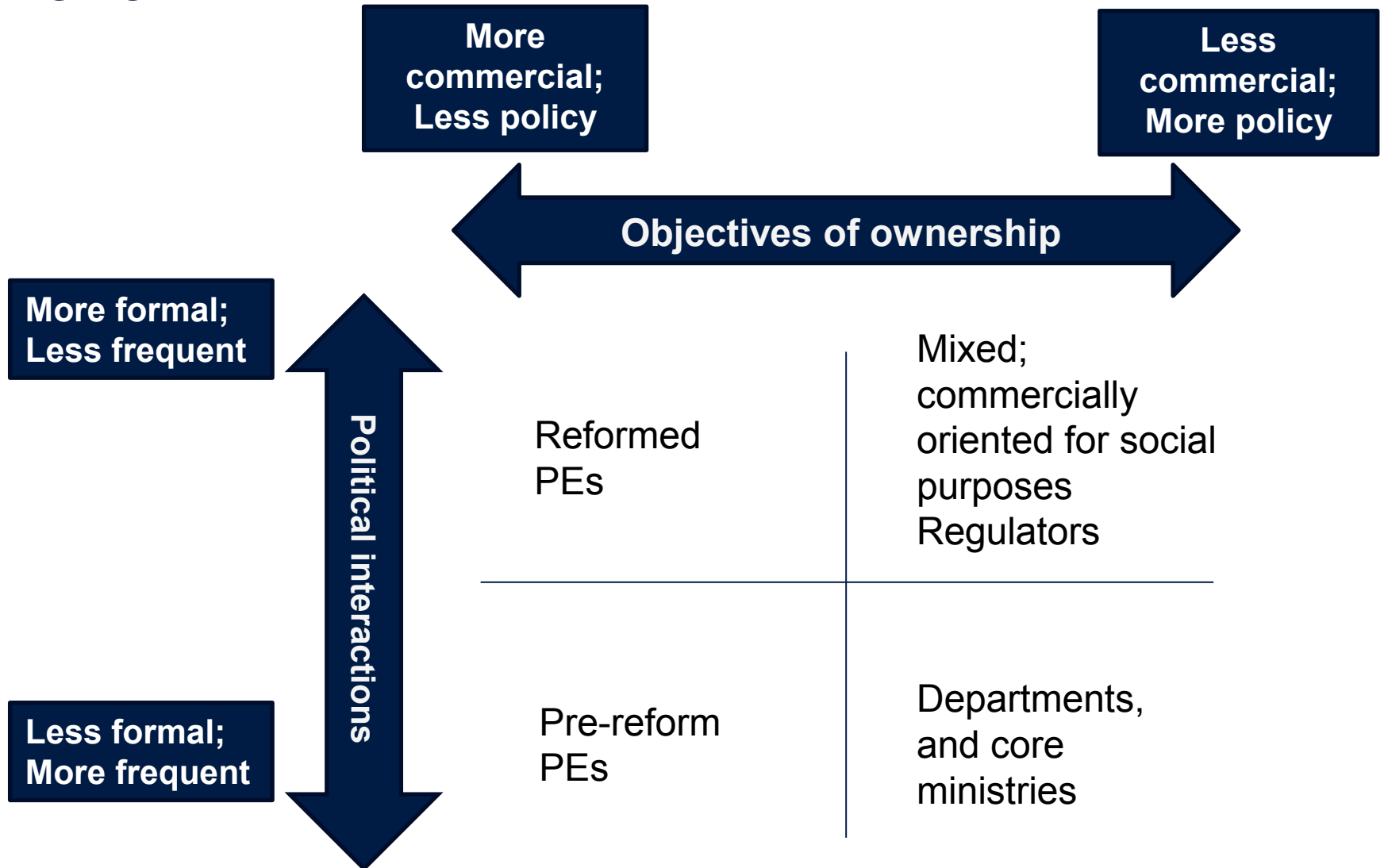
State

- Mandates PEs to carry out NCOs (sometimes unremunerated by State)

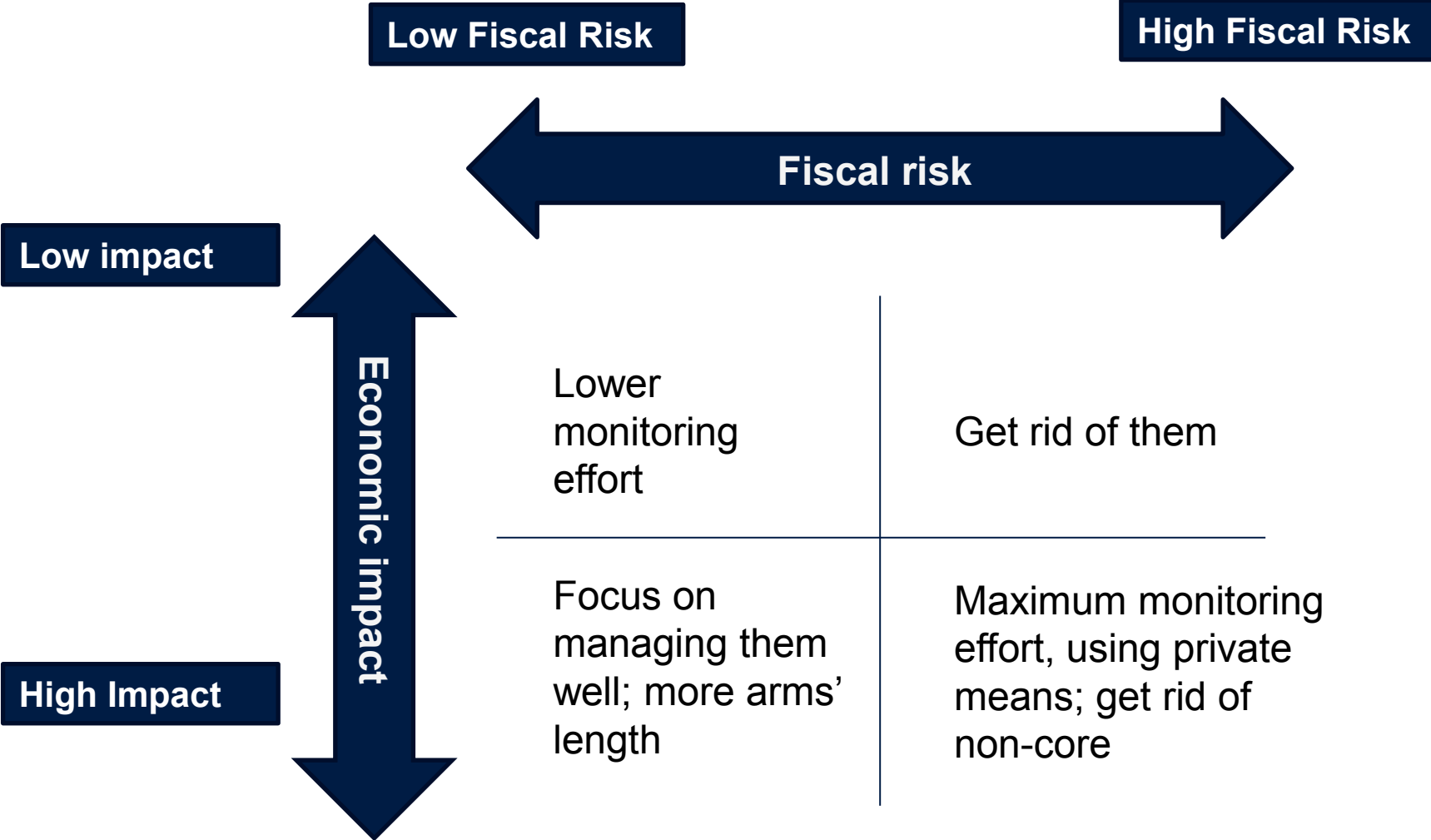
- Allows arrears to accumulate
- Subsidizes lending to PEs
- Guarantees PE debts

- Moral hazard
- Reduced fiscal space
- High borrowing costs
- Fiscal vulnerability

Many countries rebalance the state as they get richer...



Rebalancing means managing their balance sheets



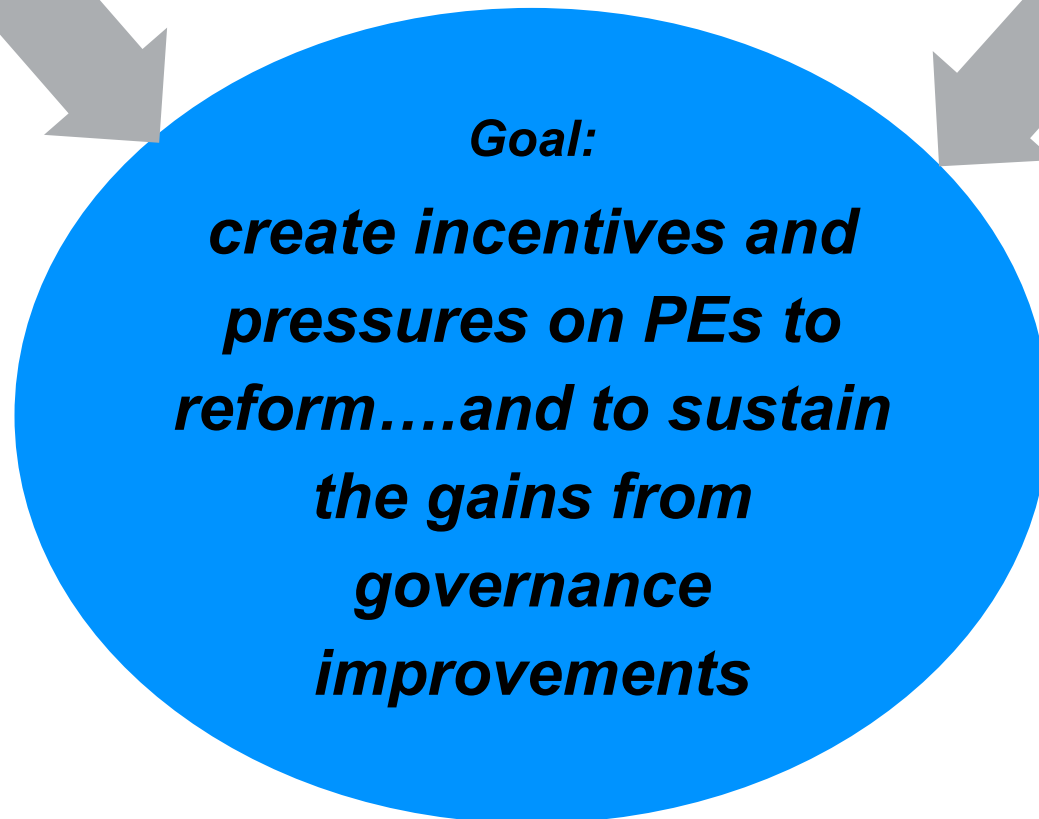
And allowing economies to flourish

Creating competitive markets

Encourage new private entry
Allowing exit of inefficient firms

Ensuring financial discipline

Hard budget constraints
Market relations with state banks



With efficient sectors

Broad state ownership goals

Separate ownership functions from policy making and regulatory functions

Clarify public enterprise objective

Identify specific public service obligations

Enforce general laws and regulations

Improve state ownership arrangements

Clear and focused mandate

Sufficient authority

Proper governance structures and policies

Dedicated resources-skilled staff, financing

Accurate and timely reporting

Stakeholder consultation

Accountability and disclosure to representative bodies

Three forms of ownership arrangements exist

Decentralized

Dispersed among different line ministries

Variation; *dual model* (a second ministry also have certain responsibilities)

Advisory

Dispersed; an advisory or coordinating body created to advise ministries on ownership matters

Centralized

Centralized in an entity (or multiple entities); independent or under the government structure

Countries apply the advisory model differently

Country	Name of Entity	Location of Entity
Finland	Ownership Steering Department	Prime Minister's Office
India	Department of Public Enterprises	Ministry of Heavy Industries
New Zealand	Crown Ownership Monitoring Unit (COMU)	Treasury
Norway	Ownership Department	Ministry of Trade and Industry
The Seychelles	Public Enterprise Monitoring Department	Ministry of Finance
Thailand	State Enterprise Policy Office (for non-financial PEs) Fiscal Policy Office (for financial PEs)	Ministry of Finance
United Kingdom	Shareholder Executive	

Centralized; now viewed as good practice

Some of the benefits of the centralized model are:

Less
Conflicts of
Interest

Separates ownership functions from policy-making and regulatory functions

Less Political
Interference

Minimizes the scope for interference and brings specialized capabilities and scarce resources

More
Coherence

Promotes greater coherence and consistency in applying corporate governance standards and exercising the state's ownership rights

More Value

Manages state assets in a way that protects shareholder value

More
Transparency

Achieves greater transparency and accountability in PE operations through better oversight and performance monitoring

But there are pros and cons

Advisory body

- Pros:
 - Ownership focus
 - Easier to do
 - Learning by doing
- Cons:
 - Continued scope for conflicts of interest
 - Continued political interference
 - Inability to influence change

Ownership agency

- Pros:
 - Implementation focused
 - Specialized capabilities
 - Better accountability
- Cons:
 - Political resistance
 - Disempowered

Holding company

- Pros:
 - Management of state enterprise assets in a commercial manner
- Cons:
 - Cross-subsidization
 - Risk of capture

No one size fits all approach – need to tailor to country circumstances

Which ever model, at the enterprise level...

Strengthen the board

- Need to professionalize board
- Clarify board duties and responsibilities
- Empower boards with decision making
- Train board of directors
- Practices private sector remuneration /evaluation

Strengthen the control environment

- Create audit committee of the board
- Improve internal controls, internal audit and use of independent external auditors

Improve transparency and public disclosure of information

- Enterprise and aggregate reporting
- Financial and non-financial information

Distinct approaches to monitoring

Country	What is monitored	Profitability/ efficiency	Solvency	Budgetary appropriations
Brazil	<ul style="list-style-type: none"> Shareholder returns 	<ul style="list-style-type: none"> Return on capital Operational margin 	<ul style="list-style-type: none"> Liquidity Assets/liabilities (including debt) Net worth Change in net borrowing 	<ul style="list-style-type: none"> Deficits/surpluses (institutional differences)
Canada	—	—	<ul style="list-style-type: none"> Changes in net borrowing from private/public Assets/liabilities 	<ul style="list-style-type: none"> New government investments Government credit injections
India	<ul style="list-style-type: none"> Sales to capital Net profit/net worth Return on capital 	<ul style="list-style-type: none"> Value added (at market prices) Production/sales cost Cost of sales/sales Inventory/sales 	<ul style="list-style-type: none"> Investments (equity/loans) Net worth Debt/equity 	—
Indonesia	<ul style="list-style-type: none"> Returns on equity 	<ul style="list-style-type: none"> Returns on assets Expense/income ratio Net interest income 	<ul style="list-style-type: none"> Nonperforming loans Capital adequacy ratio Assets/liabilities Loans/deposit ratio 	—
New Zealand	<ul style="list-style-type: none"> Dividend yield Dividend payout Equity return 	<ul style="list-style-type: none"> Return on capital Operating margins Efficiency ratios 	<ul style="list-style-type: none"> Gearing ratio Interests covered by earnings Assets/liabilities 	—

Source: World Bank staff.

Note: — = not available.

Source: World Bank. 2014. Corporate Governance of State- Owned Enterprises: A Toolkit.



Public enterprises are economically important

Economic transitions require adjustments

Focusing on their governance and on the economic environment means that those PEs that stay can be financially viable and economically efficient



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Thank you

