



Organisation for Economic Cooperation & Development



The 2006 Asian Roundtable on Corporate Governance

Network on Corporate Governance of State-Owned Enterprises in Asia

Synthesis Note

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Background of the meeting

The Asian Roundtable on Corporate Governance (hereinafter “**ARCG**”) has decided to develop, under its auspices, a specific activity on the corporate governance of SOEs to raise awareness and promote the use in Asian economies of the OECD *Guidelines on Corporate Governance of State-Owned Enterprises* (hereinafter “**Guidelines**”). These *Guidelines* were adopted in the spring 2005 and are the first international benchmark in this area.

A preliminary meeting was held in Beijing in May 2005, gathering a limited number of countries to discuss a first list of priority issues regarding corporate governance of SOEs in Asia. This preliminary discussion underlined the significance of SOEs in Asian economies and the complexity of the policy challenges related to their corporate governance. Since then, an increasing demand for exchange of experience and policy dialogue has been received from various stakeholders and countries in the region. The Guidelines were presented in the 2005 meeting of the ARCG in Bali. Discussions there underlined further the importance of developing a specific forum to carry out a focused policy dialogue and investigate in-depth the appropriate policy options to improve the governance of SOEs in Asia.

In order to reach the appropriate audience and to properly deal with the policy challenges ahead, it has therefore been decided to set up an Asian Network on Corporate Governance of SOEs (hereinafter the “**Asian Network**”), bringing together the experience and expertise of experts from all Asian economies participating in the ARCG. The Asian Network is planned to meet regularly and develop into a high-level hub for a structured policy dialogue on corporate governance of SOEs in Asia, using the Guidelines as a framework for discussion.

The objectives of the Network are:

- to raise awareness of all concerned constituencies on the importance and challenges related to the good corporate governance of SOEs;
- to evaluate the current SOE corporate governance policy frameworks and practices, and benchmarking these against international good practice as described in the Guidelines;
- to influence policy making by providing a forum in which policy makers, practitioners and experts can share knowledge and experience among themselves and with their OECD peers;
- to support viable and effective reforms in the area of SOE corporate governance, by discussing and analysing policy options, developing relevant recommendations and agreeing on priorities for reforms adapted to the conditions in Asian economies.

Participants and format of the Singapore meeting

The objective was to leave as much as possible time for open discussion, thus limiting the number of formal presentations. This objective was well achieved, as presentations were limited to half an hour in each session, speakers respected their time limits and discussion was very active, involving most of the participants in a very open and frank atmosphere.

The Network is chaired by John Lim, President of the Singapore Institute of Directors. Eleven Asian economies were represented: Bangladesh, China, Chinese Taipei, India, Indonesia, Malaysia, Pakistan, Philippines, Singapore, Thailand and Vietnam. Altogether, the meeting gathered around 45 participants, plus 5 OECD staff, including prominent, active and influential policy makers, practitioners and experts regarding corporate governance of SOEs in the region. The following constituencies were represented: a) ownership entities / ministries in charge; b) SOE management, both CEO and board members; c) members

of state audit bodies in charge of auditing SOEs; d) stock exchanges and securities commissions; and, e) institutes of directors, corporate governance institutes, private sector representatives.

Participants to the Network constitute a peer group that can press for legal and regulatory reform in this field. In order to provide the OECD experience and to ensure consistency with the Guidelines, a key feature of this Network is also the active participation of peers from OECD countries, including the Chair and the Australian delegate to the OECD Working Group on Privatisation and Corporate Governance of State-owned Assets. By actively participating in meetings and the drafting of the Policy Brief, they are expected to provide the OECD experience and ensure consistency with the Guidelines.

This first meeting focused on the first two chapters of the Guidelines, namely the legal and regulatory framework and the role of the state as an owner. Different sessions covered the following themes: 1) recent policy reforms in SOE governance; 2) challenges ahead to level the playing field between SOEs and the private sector; 3) The role of the state as an owner; 4) the organization of the ownership function within the state administration; 5) the state ownership policy; 6) the accountability of the ownership function.

Synthesis of discussions

John Lim, as Chair, opened the meeting by stressing the importance of SOEs in mostly all Asian economies. While the number of SOEs and their size differ greatly from one country to another, the State often remains a major owner, a significant employer and listed SOEs represent a major share of market capitalisations. SOEs are thus an important economic player in all Asian countries, and the quality of their governance is therefore important for their economic growth.

Lars-Johan Cederlund, the Chair of the OECD Working Group on Privatisation and the Corporate Governance of SOEs and senior advisor in the Division of State Enterprises of the Ministry of Industry, Employment and Communications in Sweden, described the development of the Guidelines and underlined the main components of their first two chapters on the legal and regulatory framework for state-owned enterprises and the role of the state as an owner. He emphasized the necessary separation of ownership from regulation as well as the transparency of specific obligations.

In the **landscape session**, six countries briefly described the recent and current policy reforms and main challenges regarding the corporate governance of SOEs:

- In **Bangladesh**, current reforms include the development of Statements of Corporate Intent (SCI) for all SOEs and training programmes for SOE boards.

- In **China**, the recent focus of policy reforms regarding SOE governance has been to set up boards in solely state owned enterprises and to improve the legal and regulatory framework. Other crucial reforms have also been achieved in the last two years, for example the establishment of the SASAC and the revision of the Company Law. Remaining challenges include clarifying the respective roles of the SASAC and other government departments, the development of a real ownership policy, the increase in SOE boards' accountability and independence and the improvement of transparency of both SOEs and the SASAC.

- In **India**, one of the key challenges remains the lack of awareness of corporate governance issues among civil servants and political leaders and the necessity to modify their incentive structure in order to mitigate their entrenched interests. There is also a need for training SOE board members and top management in order to overcome their resistance to improve corporate governance. Finally, some capacity building, procedural and governance reforms are necessary in relevant ministries and supreme audit bodies.

- In **Indonesia**, recent legal and regulatory measures have included the establishment of audit committees in SOEs, the definition of qualification for board candidates and measures to mitigate conflicts of

interests for board members. Current reforms focus on separating more clearly ownership from regulation, opening new sectors to competition and fighting corruption more vigorously.

- In **Pakistan**, main concerns regard the fragmentation of ownership across the ministries and federal/provincial governments, the applicability of procedures across all SOEs, boards' appointment and the autonomy of management. A main challenge is whether to give directions to CEOs and nominee directors or to act through the shareholders' meetings or board meetings. Public Sector Companies (Corporate Governance) Rules are being drafted, covering issues such as the composition of SOE boards, their responsibilities, powers and functions, the separation of Chairman and CEO, board committees, as well as financial reporting.

- In the **Philippines**, most current reforms focus on transparency and disclosure aspects. SOE board members begin to be systematically trained on corporate governance and an evaluation system for the performance of board members and senior management is being developed. More complex reforms concerning the exercise of ownership rights by the state should follow.

Discussion under Theme I was on **“Challenges ahead to level the playing field between SOEs and the private sector”**. Presentations by Dr. Pallapa Ruangrong, from the State Enterprise Policy Office of the Ministry of Finance in Thailand and Mr Rana Assad Amin, Joint Secretary of the Ministry of Finance in Pakistan explained current reforms and highlighted the difficulties in creating a level-playing field between SOEs and the private sector. In this regard, three key areas were discussed, the legal and regulatory regime, the access to finance and disclosure and transparency.

Regarding the legal and regulatory regime, all discussants recognised the importance of harmonizing SOEs' legal status. This is far from being achieved in a number of Asian economies, and in some cases the corporatisation process is not yet completed. Important reforms are also pending in a number of countries to ensure an effective separation between the ownership function and regulation. In this regard, regulators must be given real independence in order to counter balance the power of line ministries. A lot of indirect regulations (for example price control) also restrict *de facto* the autonomy of SOEs. Ownership entities must focus strictly on exercising ownership rights, leaving other public policy functions to other government departments.

Regarding access to finance, discussion also underlined the specific and close relationships between SOEs and state-owned banks and financial institutions. SOEs are also so used to get financial support from the State, including sovereign guarantees, debt restructuring, etc. that it is difficult to convince them to change.

Regarding disclosure and transparency, disclosing and covering the costs of SOEs' specific obligations is a complex process, notably because it touches some regional development issues which might be very sensitive in some countries, or because in some cases such obligations are stipulated in the Constitution. Some discussants suggested that there is a need to balance accountability as it can lead to excessive caution and over control. Moreover, there are vested interests in the political elite. To push for reforms it is useful to make corporate governance a public debate as political decisions are shaped by public opinion.

Discussants also agreed that the decrease in state ownership is a useful step to reduce the size of the problem and to focus policy reforms. It needs to be significant otherwise, if only symbolic, the state retains full control. In this regard, developing a clear ownership policy might be instrumental to define clearly where the state should be involved and what for. Nevertheless, an ownership policy is more than a privatisation policy and must be focused on defining the governance structure for SOEs. Delegates suggested developing a list of questions that should be addressed in an ownership policy. Some refer to typical opportunities to develop such an ownership policy, such as in a general fiscal crisis, following a major political scandal or within the framework of a broader reform agenda. Anyhow, it was concluded

that developing an ownership policy is a crucial step in strengthening the government thinking about SOE governance, in raising awareness on related issues, in making the relevant policies consistent and in rooting the issue in the public debate.

Discussion under theme II was on **“the role of the state as an owner”**. Dr Yuen Teen Mak, from the Department of Finance and Accounting, School of Business of the National University of Singapore presented the role of the Singapore government versus the role of Temasek Holding vis-à-vis Temasek linked enterprises. Hoang Duong Nguyen, Deputy Director in the Ministry of Finance of Viet Nam explained the difficulties arising from the lack of a real owner, the interference from numerous ministries and state organisations in the management of SOEs, and the absence of clear distinction between the exercise of ownership rights and management *per se*. He also presented the current attempts to clarify the respective roles of different government organs *vis-à-vis* SOEs and the establishment of a central ownership agency.

A central issue for the state is to distinguish between being an active owner and interfering in the day-to-day management of SOEs. To this end, establishing a holding structure between the government and the SOEs themselves might be useful but by no way is enough. To the contrary it can even obscure the governance structure. Moreover, the case of Temasek is specific, given the size of the economy and the political continuity. It is also important to professionalize SOE management and to link their remuneration to performance.

What is crucial is to have the right persons on boards and to empower these boards, i.e. delegate them sufficient authority and ensure their independence. A critical issue still to be addressed in many Asian economies is to avoid political appointees and to move away from the culture of complacent boards. To this aim, the focus should be on competencies. In this regard, it is useful to build up data base of qualified candidates and to involve the boards themselves, in particular the chairmen, in the nomination of new members, in consultation with the State as a dominant owner. Another important factor to ensure board independence, particularly in the case of SOEs, is the separation between the chairman of the board and the CEO. Major shareholders must play an important role in electing the chairman, which will be even more independent if elected by the AGM.

Discussion under theme III focused on **“the organisation of the ownership function within the state administration”**. Xiaoliang JIA, Deputy Director General in the Bureau of Enterprise Reform of the Chinese State-owned Assets Supervision and Administration Commission of the State Council (SASAC), and Andriati Fitrianingrum from the Ministry of State Owned Enterprises in Indonesia, explained how the ownership function has been recently centralised in their respective countries. They explained how this centralisation and the accompanying clarification of functions, with a separation from policy making and from regulation, has led to a better focus on objectives and to an increase in SOE performance. Moreover, this centralisation has favoured a transfer of responsibilities to SOE boards. Speakers also explained that this separation is not yet fully completed, with remaining interference from technical ministries in the Indonesian case and remaining regulatory and/or policy functions in the hands of the ownership agency in the Chinese case. The same trend towards centralisation and closer focus on performance with the publication of Key Performance Indicators can be observed in other economies such as in Malaysia.

The discussion was then on what are the costs and challenges in carrying out such a centralisation, especially vis-à-vis other Ministries, as well as with the Parliament. Some SOEs remain loyal to the technical Ministry formerly supervising them. It is not easy to overcome resistance to such a reform as in some cases Ministries will disappear or at least lose significant power and rent seeking opportunities. Some delegates also question the hypothesis that the centralisation of the ownership function will necessarily lead to decreased interference from the state, as the new centralised ownership agency might

become extremely powerful, and not necessarily more competent than technical ministries. In the Chinese case, it was mentioned that the State used to be considered as a combination of a mother in law and a boss, and has now become a real mother... It could be even more difficult for the SOE management to “manage the boundaries”. In this regard, some suggested that NGOs should be encouraged and supported as a bargaining power vis-à-vis the government.

Discussion under theme IV focused on “**the state ownership policy**”. Presentation by Dr. Mohammad Ayub Miah from the Ministry of Industries in Bangladesh described the overall strengths and weaknesses of the ownership policy in his country. Main issues include the lack of a central authority to exercise ownership right, the absence of clear mandates and objectives for SOEs, excessive interference in SOEs’ operational matters, and lack of competition in the nomination of CEOs and board members.

The overall discussion went back to what should be the content of an ownership policy. The ownership policy could include what the state should own and what for, but it should focus on how the state should behave to be a good owner. In a number of countries, there is still not a general ownership policy, even though some elements of it could be found in different legislative or executive documents. However, general policy or guidelines are not enough. The critical issue is to ring fence the ownership policy and to implement it effectively. In practice there are so many different cases where the State can exempt itself from following the general policy or guidelines.

Discussion under Theme V focused on “**the accountability of the ownership function**”. The presentation by Dr. S.M. Dewan, Director General Standing Conference of Public Enterprises (SCOPE) in India underlined the multiplicity of controls, some of which appear to be unnecessary and/or excessive. These controls have a positive effect to underpin investors’ confidence and thus to facilitate access to external finance. However, their multiplicity leads to demobilisation and to focus by management and boards of directors on avoiding making mistakes instead of looking for better performance. The presentation by Jonathan Juan DC Moreno, Executive Director of the Institute of Corporate Directors (ICD) in Philippines focused on the process of developing a corporate governance scorecard for SOEs. Such a benchmarking exercise aims at raising awareness on corporate governance issues among SOEs and identifying areas for improvement. Developed on the basis of the OECD Guidelines, contextualized to the national environment, and through an open and participative process, it reviewed the corporate governance of 31 SOEs, representing roughly half of total SOEs’ assets, revenues and liabilities. It showed interesting, although not surprising results, such as that SOEs in the financial and banking industries do better than public utilities and SOEs with social and cultural objectives, and that government “cash cows” score low. It also evidences that no one entity in the government is in control, that there is no overriding strategy for SOEs, and that not much is done to improve poor corporate governance. In conclusion, even if such an exercise is not perfect, it helps getting the public attention, and pushing for reform.

General discussion in this session focused on the adequacy and relevance of multiple controls and audits performed on SOEs. A lot of examples of duplication and excessive details in such controls were mentioned. Some discussants noted the paranoia in the system and urge for focusing on critical control mechanisms, without sacrificing the need for speed and delivering value. There is an overall issue of balancing the need for accountability and the level playing field with the private sector. There is a need for some relaxation in controls, but the public demand for accountability should not be forgotten. The discussion also covered the accountability of the ownership entity *per se* as this allows genuine public debate. OECD participants noted that publishing Annual Reports by the ownership entities was also a relatively recent and not yet widespread practice in OECD countries.

Conclusion and Future steps

In his concluding remarks, the Chair underlined again the importance of the corporate governance of SOEs for Asian economies, the recent progresses made in this regard but the long journey still ahead. It also insisted on the importance of this exercise, by Asians and for Asians, to exchange experience, recommend policy options and push for reforms. He called for recommendations to be practical and prioritised, focusing on key initiatives which could be undertaken by policy makers in Asia to ensure progress.

Among such priority recommendations that stood out from this first meeting are the need for a clear cut ownership policy, the necessary separation between the ownership function and other state functions vis-à-vis SOEs, including regulation, and the clear benefits from a centralisation of the ownership function, even though such a centralisation could not be recommended in all cases. There is also a widespread need to reduce excessive interference in SOE operational matters, and to reform boards which tend to be too political and complacent. Finally, controls and audits should not be excessive, duplicative, leading to over control and disincentive. The need for accountability needs to be balanced with the necessary level playing field with the private sector. The role of NGOs in raising awareness, feeding public debate and pushing for debate should be encouraged.

The Asian Network plans to meet at least three times over 2006 and 2007 to cover the six chapters of the Guidelines. Each meeting will be dedicated to comparing regional practices with one or two chapters of the Guidelines and will develop specific recommendations in this regard. Subsequent meetings will cover the other chapters, one focusing mainly on the role of the board and the relationship with stakeholders, the other one focusing on transparency and disclosure and the equitable treatment of shareholders.

To keep the dialogue focused and to produce tangible outcomes, the Asian Network will progressively develop a **Regional Policy Brief**, providing a set of recommendations and priorities for policy reform in order to improve the corporate governance of SOEs in the economies of Asia. This Policy Brief will be the product of the Network's deliberations and will be a consensus document. In the next meetings, half a day will be dedicated to discuss draft chapters of these recommendations.

Participants called for getting more background information on the respective countries' frameworks and practices, in order in particular to grasp better the historical and cultural influences on the policy and current state of corporate governance in SOEs. The next meeting will thus also have a "landscape" session allowing a selected number of countries to expose their current reforms. To complete further this information, the Asian Network will also develop a "**Comparative Report on Corporate Governance of SOEs in Asia**". This Report will provide comparative information on the current practice and framework related to the corporate governance of SOEs in Asia, based on discussion in the Network meetings and on answers to a specific in-depth questionnaire on corporate governance of SOEs.

Participants also called for completing the Network constituency with policy makers, i.e. Members of Parliament, as well as with some trade union representatives, particularly when discussing the stakeholder chapter.