



## **SOEs OPERATING ABROAD:**

### **An application of the OECD Guidelines on Corporate Governance of State-Owned Enterprises to the cross-border operations of SOEs**

## **SOEs OPERATING ABROAD:**

### **An application of the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* to the cross-border operations of SOEs**

1. The Working Group on Privatisation and Corporate Governance of State Owned Assets, through its Programme of Work for 2009/2010, agreed to investigate the role of state owned enterprises in the world economy. At the Working Group's meeting in April 2009 delegates decided that one element in the project should be a consideration, based on the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the "SOE Guidelines"), of what constitutes good practices for governments whose SOEs operate in other jurisdictions. To this end, this report identifies what concrete guidance the existing SOE Guidelines provide in this respect.

2. Importantly, the discussion in this paper applies the perspective of public officials involved in the ownership function of SOEs operating in the global economy. The considerations of host country officials and investment regulators concerning whether or not to accept foreign SOE investment are among the subjects of the OECD Investment Committee's "Freedom of Investment, National Security and 'Strategic' Industries" (FoI) project. For this purpose, the paper could serve as an input in this Committee's work: at the Ninth FoI Roundtable on 17 December 2008 the Committee expressed an interest in receiving the Working Group's analysis of how the SOE Guidelines might be used "as a governance and transparency norm in order to enhance the performance of the SOE investor and to reassure recipient countries".

3. The paper does not treat in great detail the currently much-debated issue of competitive neutrality between SOEs and private enterprises. The reason for this is that most of the concerns that this issue give rise to apply equally to domestic and foreign SOEs and hence need not be discussed specifically in the cross-border context. The issue of maintaining a level playing field between SOEs and others was the topic of a roundtable organised under the auspices of the OECD Competition Committee on 20 October 2009. The Working Group will continue these discussions in 2010 on the background of the recommendations of the SOE Guidelines.

#### **1. The main issues and current concerns**

4. The issue of SOEs operating abroad has come to the forefront in recent years for a number of reasons. First, economies with large SOE sectors have grown strongly over the last decade(s) and integrated more closely with the international economic system. Secondly, SOEs operating in certain sectors – not least the resource based industries and public utilities – of great importance to the competitiveness of the rest of the economy have been at the forefront of internationalisation in OECD as well as non-OECD countries. Thirdly, government rescue operations toward distressed financial institutions, and in some cases also manufacturing companies with international reach, have triggered a "renaissance" of the SOEs in a number of countries that had for decades abstained from government ownership of commercial entities.

5. The actual size of the SOE sectors of OECD countries is the subject of a specific study currently covering OECD and some non-OECD countries. Pilot studies previously released by the Working Group, including papers reviewing the SOE sectors of China and India, are available on the OECD website. Among the main of these empirical fact-finding exercises are:

- SOEs account for around 5% of the total economy (measured by output, value added or employment) of an average OECD country. In the largest emerging economies the share of SOEs is anywhere from 10% to 40%. Moreover, since general government (non-incorporated) activities weigh heavily in total GDP in most countries, and agriculture is still a major component of most non-OECD economies, SOEs' share of the corporate economy will in most cases be significantly higher than these percentages.
- SOEs are not (or no longer) spread thinly across the economy. The largest concentration of SOEs is found in public utilities, telecommunications and sometimes also in the banking and hydrocarbons sectors. Conversely, few countries have a significant presence of state-owned enterprises in competitive, industrial sectors (e.g. manufacturing, construction), retail service provision (shopping, hospitality) or primary activities except for the extractive industries.
- The general trend in individual countries, as measured by official statistics, is downward. In virtually all industrialised and emerging economies the share of SOEs decreased in the decade leading up to 2008. Even recent upsets such as the effects of the financial crisis and a small number of governments (outside the OECD area) reasserting ownership over "strategic sectors" do not seriously break the trend. That said, the statistics also reflect a tendency to partial divestment by governments, which reduce their holdings to a point where companies are no longer considered as SOEs, but continue to hold non-trivial and often controlling stakes. In other words, it is not clear that governments' ability to wield influence has receded as decisively as the drop in SOEs' share of the economy would seem to indicate.
- The declining importance of SOEs in individual countries does not automatically imply a receding role in the international economy. For example, the growth rates in the Indian economy over the 15 years have been so high that a decline in SOE share from 18% to 13% of GDP means that the value added of the SOE sector has actually grown by 70%.
- Whether or not this growing economic activity in SOEs is widely felt through the global economic system depends to a large extent on the internationalisation of the concerned enterprises – e.g. through international trade and cross border investment. In this respect the picture is mixed. The previous study found that:
  - The one segment of SOE sectors that have systematically become more "global" in recent years is the one involved in hydrocarbons and the extractive industries. However, this reflects a general trend in this part of the business sector; it does not appear confined to, or even particularly pronounced among, state-owned enterprises.
  - Overseas activities may be formulated at national level. One example is China where an internationalisation of the SOE sector mostly through foreign investment was codified in the Central Committee's "Go Global Strategy" in 2000. In addition to the acquisition of resources, central goals of this strategy include (1) the building of competitiveness through acquisitions of high technology, knowhow and brand power; and (2) an increasing reliance on overseas production, as opposed to direct exports.
  - Europe has witnessed a stronger cross-border integration of its utilities and network industries. This trend, largely in consequence of market-opening policies of the European Union, has not been confined to SOEs, but in consequence of a mosaic of publicly owned, partly privatised and entirely private operators in this sector it has given rise to occasional controversy.

- Generally, a country’s successful integration in the world economy does not automatically imply that its SOE sector follows suit. For instance, emerging economies like Brazil and India have seen a number of their multinational enterprises pursue highly successful overseas strategies. However, there are very few examples of SOEs domiciled in these countries being active abroad.

6. Before addressing the concrete regulatory and political concerns that may arise from the cross-border operations of SOEs, the recent public debate on this topic bears mentioning. The most commonly voiced concerns include: (1) political unease about the motivations underpinning actions of companies controlled by “rival” governments; (2) perceptions by privately owned businesses that the playing field between SOEs and others is not level, for example due to government subsidies, preferential access to finance or public procurement practices; (3) worries by labour groups that foreign SOEs threaten domestic jobs, either because they benefit from “unfair” advantages or because employment preservation ranks high among the concerns of the foreign government owners; and (4) occasional controversy in the public and press when foreign state-owned enterprises invest in sectors that have been previously privatised by the domestic public authorities.

7. Importantly, the public concerns listed above go well beyond the narrowly defined context of SOEs operating across borders. For instance, the complaints about an uneven playing field between SOEs and private companies might apply equally to any SOEs regardless of nationality (and indeed similar criticism has been levied regularly by business groups against domestic SOEs). Also, the concerns among labour and other stakeholder groups about competition from large foreign companies based in low wage or “light regulation” zones have by no means been limited to SOEs.

8. However, it would be unreasonable to dismiss such concerns as being of no consequence to this report. For example, private companies’ general concerns about having to compete with SOEs are exacerbated where enterprises are owned by governments perceived to impose softer budget constraints than the domestic administration, where foreign SOEs’ objectives are less clear or less commercial in nature, or where a more general lack of cross-border transparency adds to risk perceptions. Also, private enterprises domiciled in a country with a large SOE sector may appear particularly “threatening” to their foreign competitors for example if the SOEs in their home country supply essential goods and services (e.g. finance, raw materials) on which their competitiveness depends. Essentially, if the corporate policies and governance practices of SOEs in the home jurisdictions are not fully transparent then suspicions of subsidisation may arise and be difficult for the government owners of SOEs to counter.

### ***1.1 Some concrete concerns for regulators and policy makers***

9. The discussion of SOEs in the world economy is sometimes set in the broader context of a rebalancing of the relative economic weights of some of the main countries and trading blocks, as well as, more recently, the unfolding global financial crisis. For example, countries that see their market share or international competitiveness in certain economic activities slip may perceive a more general risk to their strategic position and political influence. Insofar as the agents of this change include foreign state-owned enterprises it might give rise to a wider discussion of the motivations of the main actors, which could include aspects of public as well as corporate governance.

10. A related issue is reciprocity among nations. Countries committed to open trade and investment regimes normally accept competition from enterprises based in partner nations, even where the latter may not necessarily allow foreign enterprises to compete on equal terms in their home jurisdiction. However, where foreign competitors are domiciled in countries that are themselves “new entrants” to the global economic system many of the concerns about a level playing field could be exacerbated. A conceptually related discussion sometimes resurfaces among, especially, European members of OECD when recently

privatised corporate entities face competition or the prospect of takeover by foreign state-owned rivals. Where doubts linger about the commercial and financial autonomy of the foreign SOE this situation has repeatedly led to concerns in the public and press about “renationalisation” of national champions through a foreign government, as well as accusations of unfairness due to non-reciprocity.

11. The concerns that may give governments and regulators cause to address cross-border activities by SOEs usually fall in four main categories: (1) strategic considerations; (2) maintaining competitive markets; (3) regulatory challenges; and (4) efficiency of SOE operations. Some of the most frequently heard arguments can be expressed thus<sup>1</sup>: (The main findings of this overview of issues are further summarised in Table 1 at the end of this section.)

- ***Strategic or political considerations.***

- *National security*<sup>2</sup>. National governments generally reserve the right to restrict the operations of foreign companies where issues of national security are at risk. Unsurprisingly, they differ with respect to what activities they consider as imperilling national security as well as – crucially in the context of this paper – to what extent state ownership should affect their risk assessment. Some of the main considerations are:
  - *Conflicts between states*. A situation generally agreed to constitute a national security risk is one where economically or militarily important national enterprises are owned by foreign states with which the host country is in a situation of conflict. In this case the foreign state ownership raises the spectre of serious disruption such as the closure or sabotage of critical facilities. Foreign owned SOEs might also limit the host government’s access to crucial information, for instance by moving data or records offshore<sup>3</sup>.
  - *Strategic rivalry*. Even in the absence of conflict states are not necessarily willing to share sensitive information and/or technologies with each other. There have been concerns that companies owned by foreign SOEs can effectively act as “Trojan horses”, serving as conduits of illicit technology transfer as well as outright espionage. A related issue is the operations of law enforcement, the secrecy of which may be impeded if it involves the cooperation of centrally-placed companies (examples might include banks and telephone operators) controlled by foreign governments.

---

<sup>1</sup> Several of the points listed in paragraph 11 were first raised by representatives of the Competition Committee’s Secretariat during the Investment Committee’s Roundtables on Freedom of Investment.

<sup>2</sup> The words “national security” has been the object of study under the “Freedom of Investment” project. Two studies of critical infrastructure protection programmes [<http://www.oecd.org/dataoecd/2/41/40700392.pdf>] and of more broad-based national security strategies have been conducted [[www.oecd.org/dataoecd/50/33/42701587.pdf](http://www.oecd.org/dataoecd/50/33/42701587.pdf)]. These studies show that the national security community: 1) shares a common practice across countries and engages in significant amount of international coordination, which has led to considerable convergence of national security related risk management practices; 2) these practices have shifted over the past two decades from a national defence-based approach to security to a broader all –risk approach (that is, to cover all risks involving substantial loss of human life or threats to nation’s way of life; 2) sources of risk include terrorism, natural disaster, foreign attack, pandemics, etc). OECD’s Declaration on International Investment and Multinational Enterprises mandates a carve-out from its national treatment obligations for reasons of “public order and essential security”.

<sup>3</sup> However, these concerns need not in practice be limited to SOEs. In a situation of large-scale conflict between nations, any enterprises with affiliates abroad might be obliged by its home country to act in a similar fashion.

- *National “champions”*. National champions is the word commonly attached to companies which, while not necessarily important to national security, are nevertheless seen as vital to the national economy. Countries will generally be sensitive to the takeover of a national champion by a foreign enterprise, regardless of whether this enterprise is privately or publicly owned. The SOE angle is particularly pronounced where the “strategic” aspect of the national champion consists either of proprietary technologies that it possesses or externalities that it generates to the domestic economy. For example, it is not uncommon for private companies to acquire foreign rivals in order to appropriate their technologies, but this is normally done with the purpose of putting these technologies to commercial use within the acquiring company. When the purchaser is a foreign state-controlled entity the ultimate purpose may be to make the acquired technologies more widely available throughout the relevant sectors of the domestic economies. If this is the objective then the value to the purchaser of the acquired technologies will often be higher than to a private enterprise – for which reason the SOE may be able to offer a higher price than alternative bidders. The point about externalities is similar: if a company is seen as more valuable to the economy than to its shareholders because it spins off external effects (e.g. know-how; trained staff and managers) then the purchase through a foreign state-controlled entity may be motivated by a wish to either internalise these effects or appropriate them for the domestic constituency in the home economy<sup>4</sup>.
- *Public service obligations*. Many state owned companies were created, or later given a mandate, to fulfil some public interest purpose. In fact, as argued elsewhere, there might not be much rationale for continued state ownership unless an SOE is expected to pursue objectives that differ from those of a privately owned undertaking. Such objectives might come in two forms:
  - *Domestic public service obligations*. SOEs may be subject to formal or regular obligations to depart from profit maximising practices. This is found in the infrastructure and network industries where public providers in many countries are expected to make available a minimum level of services at given prices. They therefore operate subject to constraints imposed by their home governments, which may influence their decisions and behaviour in global markets. In a number of contexts this may actually weaken their competitive position abroad, but it could also induce them to give preferential treatment to their home markets, including through measures that might be perceived as harmful to foreign clients or markets.
  - *Foreign non-commercial objectives*. In relatively rare cases SOEs may have a duty to serve broader national interests of their home country when operating abroad. Such duties could include the acquisition of scarce resources or advanced technologies. Cases such as this are often conceptually related to the “national champions” discussion referred to above<sup>5</sup>. Another example would be the use of publicly owned financial institutions to

---

<sup>4</sup> An illustration was the takeover of Lotus plc in 2007 through Proton and Kazanah Nasional of Malaysia. The company was long seen as a “think tank” for the auto industry, spinning off innovative ideas that were appropriated by other car manufacturers. The foreign purchase was seen as motivated by a desire to internalise some of these externalities. The move was not particularly resented in the United Kingdom, which with its small indigenous car industry was less of a beneficiary of Lotus’s externalities than a number of other countries.

<sup>5</sup> It should be stressed that such operations are not necessarily seen as unwelcome by the host country. A case recently cited in the context of the Investment Committee’s Freedom of Investment project was the investment by an Abu Dhabi SWF in private hospitals in Japan. One purpose was to acquire advanced medical technologies and know-how and make them more widely available in the home country. However, as the

subsidise the foreign operation of national companies (SOEs as well as private enterprises) for reasons other than maximising the returns of the financial institutions.

- *Ad hoc political interventions.* Day-to-day political interventions in SOEs, particularly with regards to these enterprises' foreign operations, can be assumed to be rare. However, in more extraordinary situations such as, for example, macroeconomic crises SOEs may come under pressure to preserve jobs and other economic activities in their home jurisdiction in preference over overseas locations.
- **Competitive markets.**
  - *Anti-trust policies.* The perhaps most straightforward application of anti-trust policy to cross-border activities is where a merger or takeover risks create an unacceptable degree of concentration in any given market. However, there have not been many such anti-trust proceedings involving state-owned enterprises – which would normally arise only where an SOE already has a significant presence in the host (or global) markets prior to the corporate acquisition<sup>6</sup>.
  - *A level competitive playing field.* State owned enterprises may receive implicit or explicit subsidies from their home governments (e.g. monopolies, preferential access to certain markets in the home countries, direct subsidisation, preferential access or pricing in government procurement). These are likely, not least where economies of scale are assumed, to affect the competitiveness of these enterprises' world-wide operations. More specifically, where SOEs operate as (part of) vertically or horizontally integrated conglomerates which enjoy a monopoly in some parts of their value chains there may be scope for benefiting from this to gain a competitive advantage elsewhere – including in other jurisdictions. The potential repercussions in terms of predatory pricing, raising rivals' costs and engaging in cross-subsidisation were discussed in detail in a Roundtable organised on 20 October 2009 by the Competition Committee.
  - *Financial market disciplines.* Financial market disciplines impinge differently on state-owned and other enterprises. SOEs may benefit from the explicit or implicit backing of their home government, leading to below-average interest rates even on loans granted on fully commercial terms, as well as in some cases concessionary lending by state-controlled banks. During the recent financial crisis an added concern in this respect has been that such concessionary funding might be used to finance an active foreign acquisition strategy for some SOEs. Another area in which financial market disciplines on SOEs are generally weaker than for other enterprises is the markets for corporate control. Being shielded from the risk of hostile takeovers even publicly listed SOEs are in practice often less sensitive to market signals such as a declining market capitalisation.

---

host country did not consider such technologies as “sensitive” the foreign investment in boosting hospital capacity was generally welcomed. [ See “Foreign Government Controlled Investors and Recipient Country Policies” at <http://www.oecd.org/dataoecd/1/21/42022469.pdf>]

<sup>6</sup> One somewhat related case arose from the Kuwait Investment Office's purchase of over 20 percent of British Petroleum's shares in 1988. It gave rise to concerns – among other reasons – about market control because KIO's government owners were involved in the OPEC cartel, whereas BP was considered as an independent producer. KIO was subsequently induced to lower its stake to 10 per cent.

- **Regulatory challenges<sup>7</sup>.**
  - *Regulatory efficacy and independence.* Generally, the public confidence in a foreign SOE reflects the degree of confidence that the public has in the regulatory framework of the enterprise's home jurisdictions. This depends on the quality of legal and regulatory frameworks and, perhaps most crucially, their effective and even-handed implementation. In this context, if the ownership function of an SOE is not sufficiently well separated from other functions of governments then this calls into question the adequacy of regulatory and enforcement regimes. This is a general problem, but it may be exacerbated through cross-border operations because host countries' habitual regulatory recourse in case of impropriety is the home country regulators. The problem is further compounded if foreign SOEs, through their government ownership, benefit from sovereign immunity effectively shielding them from a significant part of the host jurisdiction's enforcement mechanisms.
  - *Asymmetric information.* If foreign investors have access to the information of governments, including classified intelligence, confidential cabinet decisions, etc. then these investors trade at what will be perceived as an unfair advantage, which can seriously undermine market confidence. Additionally, government ownership potentially threatens transparency: some countries discourage or even outlaw inquiring into government affairs – including in search of information that companies might normally disclose.
- **SOE efficiency.**
  - *The “re-nationalisation” argument.* The perception that SOEs – owing to non-commercial objectives and soft budget concerns – are generally less efficient than comparable private companies is by no means limited to cross-border operations. However, the need to raise efficiency is among the principal arguments offered by governments for privatising state-owned companies. For the public to accept the presence of foreign SOEs in a sector that was previously transferred to private control, the public needs to be convinced of both the efficiency, autonomy and commercial orientation of these foreign SOEs.
  - *Additional governance challenges in international operations.* Even where the SOE owners are committed to operating at levels of efficiency equal to that of comparable private companies, the cross-border aspect may add some governance problems. These include the monitoring and incentivising staff in foreign countries. Privately owned companies in like circumstances face similar problems, but have options for solving them such as strong individual financial incentives and harsh penalties for transgressing company rules (whereas not necessarily breaking applicable law) that may in many cases not be available to the state owners.

---

<sup>7</sup> This section builds on C. Cox (2007), “The Role of Government in Markets”, Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government.



**Table 1. Summary of main arguments**

<b>Main issue:</b>	<b>Perceived challenges:</b>
National security	SOEs used for espionage; denial of services or sabotage in case of conflict; erosion of strategic advantages
National “champions”	Loss of economies of scale; loss of proprietary technologies
Public service obligations	SOEs benefiting from a privileged role at home; conflicts of interest between foreign and domestic constituency
Ad hoc political intervention	Domestic preference, for instance in the case of crisis response
Antitrust policies	SOEs obtaining a dominant position in certain markets
A level playing field	Subsidisation and other benefits at home leading to “unfair” advantages abroad
SOE financing	Unequal access to finance, such as SOEs financing foreign expansion through concessionary loans
Regulatory efficacy	Doubts about regulatory cooperation and regulatory independence in the home country
Asymmetric information	SOEs being privy to the information of foreign states
“Re-nationalisation”	SOEs purchasing private companies may run counter the arguments presented in favour of privatisation
SOE-internal governance	Efficiency losses in SOEs less able to monitor and incentivise staff across borders than private companies

## **2. The SOE Guidelines applied to SOEs operating abroad**

12. The purpose of this section is to explore the usefulness of the SOE Guidelines to governments that own SOEs operating abroad in addressing host country concerns, as well as to regulators and policy makers in gauging the intentions and likely impacts of foreign SOEs’ operations in the domestic economy. The chapter is divided into two main parts. The first part addresses the challenge of assessing the overall corporate orientations of a foreign SOE, including its commercial and other objectives, the governance arrangements in place to lend credibility to the objectives as well as mechanisms for transparency and accountability. The second part attempts to identify individual SOE Guidelines recommendations that may be useful in overcoming some of the concrete concerns about cross-border operations of SOEs identified in the previous sections.

### **2.1 The corporate orientation of SOEs**

13. In public debate about the operations of SOEs – foreign and domestic alike – the commonly heard buzzwords include a general acceptance of SOE competitors as long as they operate on “fully commercial terms”. It is less clear what this means in practice. Only where SOE activities take the form of largely financial investments can a clear distinction be made: “commercial” would in this case imply that the investments are driven by an overriding goal to maximise returns, given the placement policies that the investing entities are required to follow<sup>8</sup>.

<sup>8</sup> An example of this would be the sovereign wealth funds, where the 2008 OECD report *Sovereign Wealth Funds and Recipient Policy Policies* specifically noted that “investments by SWFs can raise concerns as to whether their objectives are commercial...” ([www.oecd.org/dataoecd/34/9/40408735.pdf](http://www.oecd.org/dataoecd/34/9/40408735.pdf)).

14. Where SOE activities abroad take the form of a “long term relationship” and a “lasting interest” (citing two of the defining characteristics of foreign direct investment) the distinctions may become blurred. The first problem is, governments’ motivations for retaining SOEs in state ownership can rarely be described as fully commercial. The Preamble of the SOE Guidelines states the rationale for state ownership thus:

*“Over the years, the rationale for state ownership of commercial enterprises has varied among countries and industries and has typically comprised a mix of social, economic and strategic interests. Examples include industrial policy, regional development, the supply of public goods and the existence of so-called ‘natural’ monopolies. Over the last few decades, however, globalisation of markets, technological changes and deregulation of previously monopolistic markets have called for readjustments and restricting of the state-owned sector.”*<sup>9</sup>

15. In this, SOEs often may not differ from privately owned companies. Most private enterprises would not publicly announce any higher objective than maximising shareholder value, but the rationale for proposing good governance practices (such as the *OECD Principles*) is basically the risk that corporate insiders or majority shareholders may use their powers to impose decisions on any given company that are not in the objective commercial interest of the company and its shareholders. In the case of SOEs, a far more realistic objective than a “quest for commerciality” would be the following three steps<sup>10</sup>:

- Establish a degree of clarity around the objectives – commercial and otherwise – that a given state-owned enterprise is instructed by its owners to pursue.
- Examine the managerial and related governance structures in place to safeguard SOEs from ad-hoc political interventions and sudden changes of direction that could imperil the credibility of the stated objectives.
- Ensure the existence of a timely and comprehensive disclosure of information concerning the SOE sector as well as individual enterprises, including with a view to quickly informing the public of changes to objectives and managerial/ownership structures.

### 2.1.1 Clarity of objectives

16. The SOE Guidelines offers strong and concise guidance concerning the clarity of corporate objectives. Guideline I.C states:

*“Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.”*

17. One ambiguity in the recommendation may frustrate government owners trying to apply “good practices”, namely uncertainty about what constitutes “the generally accepted norm”. Obviously evolving national as well as international standards of corporate behaviour need to be considered. In the case of obligations placed on individual SOEs, these furthermore need to be spelt out relative to the requirements

---

<sup>9</sup> OECD (2005), *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, p. 10.

<sup>10</sup> At the Freedom of Investment Roundtable in December 2008, citing similar arguments, several delegates also expressed their doubts about the usefulness of attempting to decide whether a potential foreign investor is entirely commercially motivated.

applying to the SOE sector more generally. In this respect Guideline II.A provides some additional guidance:

*“The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state’s role in the corporate governance of SOEs, and how it will implement its ownership policy.”*

18. If fully implemented these two recommendations would go a long way in alleviating host country concerns about uncertain corporate objectives. Taken together they provide a “blueprint” for, first, making public the objectives that underpin SOE operations in general, second, disclosing any particular responsibilities of individual SOEs. That said, in practice it is obviously unrealistic to expect all non-commercial objectives to be fully disclosed. Many such objectives will be – even within the state owning the SOEs – implicit rather than explicit. An example that comes to mind is an expectation in a number of countries that SOEs in the network industries act as captive clients to incumbent national producers of the relevant equipment – which constitutes a “non-commercial objective” that has rarely, if ever, been disclosed and cost-covered.

19. However, by establishing mechanisms for regular disclosure of such objectives a government has already taken an important first step. Further steps may include engagements with foreign partners, including governments, concerning the extent and accuracy of disclosure. The existence of such a channel for exchange of information and follow-up is an important confidence building measure – especially where cross-border operations are involved.

#### *2.1.2 Credibility of governance, credibility through governance*

20. One needs to be mindful of the fact that governments, having extraordinary powers, may in reality at any time change the directions of an SOE. SOEs are autonomous and pursuant of mostly commercial objectives if and only if governments will them to be this. Nevertheless, strong corporate governance framework play an important role in signalling governments’ commitment as well as raising the levels of transparency and accountability around any change of course.

21. In assessing whether an SOE is competent, sufficiently resourced, accountable and has the necessary autonomy to pursue its stated objectives, virtually any element of the SOE Guidelines is relevant. The SOE Guidelines is an integrated, outcomes-based instrument taking a whole-of-enterprise approach to corporate governance. For example, weaknesses in one individual aspect of corporate governance can often be compensated by strengths elsewhere – or corrected through specific intervention through the legal or regulatory frameworks. For this reason it is generally problematic to focus solely on individual provisions of the Guidelines.

22. In the concrete case, the apparently obvious place to look for credibility-enhancing provisions would be in Chapter II of the SOE Guidelines, focusing on defining (and to some extent circumscribing) the state’s role as an owner, and Chapter VI focusing on the responsibilities of SOE boards. However, depending on context other chapters could be highly relevant as well. For instance, Chapter III focuses on the equitable treatment of shareholders – a consideration which, if a state has invited minority shareholders into its SOEs, may weigh strongly on its ability to pursue non-commercial objectives. Similarly, Chapter IV on relations with stakeholders is potentially very relevant – for example in the many cases where some of an SOE’s non-commercial objectives are designed to benefit stakeholder groups.

23. The most problematic cases of SOEs being the subject of repeated “political interference” or day-to-day interventions in their management generally occur where the SOEs in question are overseen by line ministries and generally perceived as an extension of the general government service. The way out of this

situation recommended by the SOE Guidelines is twofold: establish a central ownership or coordination function at arm's length from other government functions and give SOEs a legal form that establishes them clearly as corporate entities separate from the state. In this respect, Guidelines II.D, II.E and I.B stipulate the following:

*“The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a co-ordinating entity or, more appropriately, by the centralisation of the ownership function.”*

*“The co-ordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies...”*

*“Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate...”*

24. The rationale behind these recommendations is that, other things equal, the credibility of any given corporate orientation is bolstered by subjecting the company supposed to embody it to general, enforceable legislation as well as to the oversight of a body with no direct interest in departures from the stated orientation. As for the former point, it is generally held that the credibility of a commitment to “commercial commitment” in an SOE is a function of the degree of which the SOE is made subject to generally applicable corporate law. In practice this implies a continuum from quasi-corporations operated out of government departments; to statutory corporations ruled by their own tailored legal frameworks; to incorporated entities subject to companies law; to SOEs with minority shares listed, which are subject also to securities legislation as well as the oversight of regulators and exchanges. In general, the listing of a minority stake in SOEs is considered a good practice both in establishing credibility and in dealing with a host of other corporate challenges.

25. The annotations to the SOE Guidelines particularly recommend the creating of a centralised ownership entity as an effective way to clearly separate the exercise of ownership functions from other activities performed by the state. It further notes that if the ownership function is not centralised then a minimum requirement is to establish a strong co-ordinating function among the different administrative departments involved. This will generally help ensure that each SOE has a clear mandate and receives a coherent message in terms of strategic guidance or reporting requirements. A route followed with some success in a few OECD countries (e.g. Finland) as well as non-OECD countries (e.g. Singapore) is the establishment of a state holding company to take charge of the ownership functions of SOEs. Through the holding companies own legal and fiduciary obligations a further layer of accountability and transparency is created between the SOEs and their state owners.

26. At the same time it should be stressed that the usefulness of centralised ownership structures hinge to a large extent on the quality of overall public governance. In a “weak governance environment” where, for example, the independence and commitment to stated objectives of the ownership entity itself cannot be safeguarded, the centralisation of competence and resources may not accomplish much and could in extreme cases even be counterproductive.

27. Another channel through which line ministries or other interested parties may try to influence SOEs is regulation. In this respect, Guideline I.A states:

*“There should be a clear separation between the state’s ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.”*

28. Regulatory independence is obviously a good practice for a number of reasons. In the context of credibility of commitments the challenge to overcome is the risk that overly detailed or ad-hoc regulation could be used effectively to usurp some of the powers of the ownership entity. The annotations to the Guidelines note that an important case is when SOEs are used as an instrument for industrial policy. In the words of the text, this can easily result in confusion and conflicts of interest between industrial policy and the ownership functions of the state. A separation of industrial policy and ownership may counter this by enhancing the identification of the state as an owner and will favour transparency in defining objectives and monitoring performance.

29. After organising SOEs corporate form and the state ownership function in a manner conducive to corporate autonomy, the main remaining challenge is to reduce the scope for day-to-day interference in SOE management. In this respect Guidelines II.B and II.C state:

*“The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.”*

*“The state should let SOE boards exercise their responsibilities and respect their independence.”*

30. When the state is a controlling owner it is obviously in a unique position to nominate and elect SOE boards without the consent of other shareholders. In this process, as noted by the annotations to the SOE Guidelines, the ownership agency should avoid electing an excessive number of board members from the state administration. Some OECD countries have decided to avoid nominating or electing anyone from the ownership entity or other state officials on SOE boards. This aims at clearly depriving the government from the possibility to directly intervene in the SOE’s business and management. As also noted in the annotations, directions in terms of broader political objectives should be channelled through the coordinating or ownership entity and enunciated as enterprise objectives rather than imposed directly through board participation.

31. Where boards do include state officials, some additional concerns present themselves regarding the position and lines of accountability of these individuals. A basic requirement is obviously an absence of conflicts of interest: SOE board members should neither take part in regulatory decisions concerning the same SOE nor have any specific obligations or restrictions that would prevent them from acting in the company’s interest. As for the more broadly defined board responsibilities (the subject of Chapter VI of the SOE Guidelines), Guidelines VI.A, VI.B and VI.C say the following:

*“The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company’s performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.”<sup>11</sup>*

*“SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by government and the ownership entity. They should have the power to appoint and remove the CEO.”*

*“The boards of SOEs should be composed so that they can exercise objective and independent judgement...”*

---

<sup>11</sup> This recommendation could, if fully implemented, in itself serve to circumscribe the extent of non-commercial activities by SOEs. By establishing a board responsibility to act in the best interest not only of the owners but also of the company, it effectively makes it harder for directors to pursue priorities in the public interest that do not coincide with the best interest of the SOE and its stakeholders.

32. Key to ensuring that SOE boards provide effective oversight in the interest of the company is that SOE directors should be subject to the same legally enforceable requirements as the directors of any other company. In most jurisdictions these will include duties of loyalty and care. Directors for the state should be subject to the same requirements as any other board members. In practice this implies that in a jurisdiction where SOE board members have in the past successfully defended their actions in the board room with a “just following orders” defence, serious doubts may be cast on the credibility of any commitment to government non-intervention.

33. Further safeguards may be needed to shield board members from less direct forms of pressure. For example, any request that ex-officio directors, or other directors for the state, must submit details of their voting record to their superiors would serve as a clear “warning flag”. Similarly, the removal of individual board members before the end of their term should generally not be permitted, except in the case of proven transgression of the law or company rules. Company confidentiality furthermore needs to be absolute. Public officials that serve as SOE directors should not be requested to disclose information subject to boardroom confidentiality to their superiors<sup>12</sup>.

34. Finally, a problem in some countries (as also recognised in the annotations) is that there may be strong links between SOE management and the ownership function, or directly with the government. The Guidelines state clearly that one key function of SOE boards should be the appointment and dismissal of CEOs. Without this authority it is difficult for boards to fully exercise their monitoring function and feel responsible for SOE performance. It needs to be recognised that in some countries 100% owners (the state as well as others) are allowed by law to appoint and dismiss CEOs directly. However, if a state owner were to do so in a discretionary fashion, not based on objective selection criteria and without prior consultations with the board, then serious doubts could be cast on the operational autonomy of the state-owned enterprise in question.

### 2.1.3 Transparency and disclosure

35. As mentioned earlier, once an SOE has stated its corporate objectives – commercial and otherwise – and, together with its government owners, has established a corporate governance framework that lends credibility to the pursuit of these objectives, the main remaining priority becomes adequate transparency and disclosure to allow outside observers to monitor the continued adherence to these principles and practices. Most actual SOE efforts at transparency and disclosure do, of course, focus on corporate performance rather than the enterprise’s objectives *per se*, but outsiders may nevertheless glean important operational information from high-quality and independently verified disclosure by the state-owned enterprises. Of particular interest in this respect are Guidelines V.C, V.D and V.E (sub-items 1, 4 and 5). They recommend:

*“SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.”*

*“SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.”*

---

<sup>12</sup> The OECD (2006) *Methodology for Assessing the Implementation of the OECD Principles of Corporate Governance* provides extensive additional advice to external observers attempting to assess the competence and independence of corporate directors.

*“SOEs should disclose material information... [focusing on] areas of significant concern for the state as an owner and the general public. Examples of such information include: (1) a clear statement to the public of the company objectives and their fulfilment; ... (4) any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE; (5) any material transactions with related entities.”*

36. When it comes to reassuring foreign actors that may be located far from the SOEs in question external auditing of disclosure is crucial. There is a tendency in some governments to rely mainly on existing state auditing bodies to oversee SOEs, but the SOE Guidelines go further. Their annotations note that to reinforce trust in the information provided, the state should require that, in addition to special state audits, at least all large SOEs are subject to external audits that are carried out in accordance with international standards. In the context of SOEs operating across borders, where observers in the host country may already harbour doubts about the independence of different branches of the general government in the SOEs’ home country, this recommendation is potentially even more important.

37. The SOE Guidelines further recommend that SOEs, even if they are closely held by governments, should be as transparent as publicly traded corporations. Importantly, the annotations broaden this recommendation to apply to a wide range of non-financial disclosure. The text offers that a high level of disclosure is also valuable for SOEs pursuing important public policy objectives, and that this is particularly important when they have a significant impact on the state budget, on the risks carried by the state, or when they have a more global societal impact<sup>13</sup>. To some extent this duplicates recommendations elsewhere in the SOE Guidelines regarding transparency around non-commercial objectives, but by undertaking to submit regular (annual, or even quarterly) statements to this effect, SOEs or their owner take an important further step toward transparency by improving the timeliness and relevance of information.

38. Similarly, the SOE Guidelines recommend not only one-off disclosure of financial assistance from the state to SOEs, but also the inclusion of such information in regular financial reporting. Disclosure should include details on any state grant or subsidy received by an SOE, any guarantee granted by the state to the SOE for its operations, as well as any commitment that the state undertakes on behalf of an SOE. The annotations further offer that it is considered good practice that parliaments monitor state guarantees in order to respect budgetary procedures – which, if fully implemented, may help establish further safeguards against ad-hoc government interventions in the competitive landscape.

39. Important additional guidance is provided by the OECD (2008) *Transparency and Accountability Guide for State Ownership*, which reviews national practices in enhancing the transparency of SOEs – including, but by no means limited to, in the areas identified by Chapter V of the SOE Guidelines. This document states as a principal objective of an effort to raise transparency and accountability: “It is a prerequisite to and underpins public trust. The state as a shareholder needs to justify its ownership by clearly defining and disclosing its objectives in holding SOEs. It is also important to show that political control is being exercised at arm’s length”<sup>14</sup>. The “Transparency and Accountability Guide” make a number of practical suggestions that could be useful to governments aiming to improve and document the corporate orientations of their SOEs. One example relates to the use of performance contracts instead of

---

<sup>13</sup> For example, in the European Union companies that are entitled to state subsidies for carrying out services of general interest are – in the interest of being able to monitor and safeguard a level playing field throughout the community – required to keep separate accounts for these activities.”

<sup>14</sup> However, while the “Transparency and Accountability Guide” in some cases goes beyond, and provides additional clarity to, the recommendations of the SOE Guidelines it bears mentioning that unlike the Guidelines this document does not have status of an official OECD recommendation.

government instructions in the pursuit of non-commercial objective through SOEs. By this means, in the words of the report, “non-commercial objectives are effectively converted to commercial ones”.

## 2.2 *Guidance from the SOE Guidelines on addressing specific concerns*

40. Of the potential concerns listed in section 1, fears of a “re-nationalisation” through the sale of an enterprise to a foreign SOE is the most cross-cutting concern in the sense that it relates to a perceived lack of efficiency in the SOE sector. This concern can be remedied through a consistent implementation of the SOE Guidelines, which, as also stated in the Preamble to the Guidelines are intended to provide general advice that will assist governments in improving the performance of SOEs – ideally to the point where they perform up to the standards of private enterprises in like circumstances.

41. As for the most specific points, even in the case where an SOE’s non-commercial objectives are stated clearly, underpinned by credible governance mechanisms and subject to high standards of transparency and disclosure, foreign jurisdictions may nevertheless entertain serious concerns about the actual objectives. The SOE Guidelines do not generally catalogue potentially adverse effects of SOE operations or propose remedies, but they do provide slightly more detailed guidance in two of the areas of concern identified in section 1. These relate to the maintenance of a level playing field and the even-handed application of regulation to SOEs. In practice the two areas are strongly overlapping – starting with the fact that anti-trust and related actions in themselves constitute a form of regulation. The overarching principle at the head of Chapter I of the SOE Guidelines posits:

*“The legal and regulatory framework for state-owned enterprises should ensure a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions.”*

42. Guidelines I.A, I.D and I.F recommend:

*“There should be a clear separation between the state’s ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regards to market regulation.*

*“SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.”*

*“SOEs should face competitive conditions regarding access to finance. Their relation with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.”*

### 2.2.1 *A level playing field*

43. The need to ensure a level playing field is a fundamental message in the SOE Guidelines. The perhaps strongest language in the SOE Guidelines concerning a level playing field is reserved for the access to finance. SOEs have in the past in numerous countries been propped up by concessionary financing by state owned financial institutions, but the Guidelines take a clear position against such practices. In a cross-border context a consistent implementation of the SOE Guidelines implies that host country authorities would not have to worry about such “hidden subsidisation” of foreign SOEs. That said, an issue that cannot be easily remedied is the fact that where a government guarantee for SOE liabilities is perceived even credits given on “purely commercial grounds” will favour SOEs over comparable private enterprises. The annotations to the Guidelines attempt to address this point by positing that a clear distinction is necessary between the state and SOEs’ respective responsibilities in relation to creditors.



44. The recommendation of non-exemption of SOEs from general laws and regulation touches upon competition in several ways. In some countries SOEs may be exempt from a number of laws and regulations, including – especially related to natural or legal monopolies in the utilities sectors – from competition rules. Even where no statutory exemptions exist, some SOEs enjoy a de facto monopoly that cannot realistically be contested by private enterprises. It is not always clear how the extension of the activities to such an SOE to other jurisdiction will weigh on competition concerns in these jurisdictions. Assuming that the SOE retains its monopoly at home but not in foreign locations it would be in a position to use its domestic monopoly rents to cross-subsidise its overseas activities. This would clearly upset the “level playing field”, but the host jurisdiction’s competition authorities might or might not raise objections. From the perspective of anti-trust authorities a situation where foreign consumers are made to pay an excess price to allow a lowering of prices in the domestic economy may not be onerous – and if it is then this should be a main concern for competition authorities in the foreign jurisdiction.

45. Some countries have laws against selling below cost that would apply equally to foreign providers, but many others would not necessarily consider a subsidised lowering of prices as a competition policy issue. The arguably most “ambitious” approach to competitive neutrality is embedded in the European Union’s competition rules (including with regards to state aids), which apply equally to SOEs and private companies, and equally to domestic and foreign entities within the Union<sup>15</sup>. Most countries have rules against “predatory” or “abusive” pricing, but if these are brought to bear on foreign SOEs (“foreign” here taken to mean companies that are not subject to a common enforcement mechanism such as the one applied by the EU) then the authorities in many cases have to lift a heavy burden of proof concerning, for example, economies of scale and/or the likelihood of the SOE obtaining subsequent cost recovery through excessive pricing. In the case of SOEs whose main objective might not be the maximisation of long-term profits this is particularly problematic.

46. In a sense, therefore, the SOE Guidelines go beyond many countries’ competition regulation in maintaining a level playing field. The overarching principle in Chapter 1 states that “market distortions” should be avoided, in “markets where state-owned enterprises and private sector companies compete”. This formulation would clearly apply to foreign markets as well, and the reference to market distortions extends to a wide range of concerns. A consistent application of the SOE Guidelines would therefore go a long way in alleviating concerns about a level playing field.

### 2.2.2 Other regulatory challenges

47. The SOE Guidelines’ language about non-exemption of SOEs from laws and regulations would in a cross-border context imply that SOEs need to respect laws and regulations of the host country as well. This appears *a priori* uncontroversial, but in practice some difficulties of implementation may arise. As regards ex post legal enforcement, when cross border operations involve a chain of subsidiaries established in different jurisdictions, questions of which national laws are applicable may arise. Also, foreign governments might attempt to shield their SOEs from legal responsibility behind sovereign immunity. However, as demonstrated in a recent paper by the OECD Competition Committee, evolving jurisprudence has made inroads into the so-called state-action defence, basically rendering it inapplicable to cases where the “state action” is of a commercial nature<sup>16</sup>.

---

<sup>15</sup> However, most examples of enforcement by the European Commission against SOEs have related to these enterprises’ domestic operations. A frequently cited case is the Commission Decision 2001/3534/EC of 20 March 2001 concerning Deutsche Post. The company was found to have operated parcel delivery services at loss-making prices with the purpose of restricting the activities of its competitors, effectively cross-subsidising this service area with revenues from other areas in which it retained a monopoly.

<sup>16</sup> This paper served as a background document to the roundtable on 20 October 2009.

48. For *ex ante* remedies such as regulation to be consistent with the language with the SOE Guidelines a measure of regulatory cooperation could be called for. As mentioned in an earlier section, in some areas such as securities regulation host country authorities may have little option other than to rely on home country regulators to take timely action on their behalf. This, in turn, raises the question of the independence of regulators – both from the SOEs themselves and from the general government as well as political influence. This is among the key concerns motivating the SOE Guidelines’ language about “a clear separation between the state’s ownership function and other state functions”. In the case of cross-border operations of SOEs, uncertainties about regulatory independence in the home country can therefore easily lead to doubts about the SOEs’ commitment to a level competitive playing field, as well as regulatory and legal compliance more generally.

### 3 Conclusions

49. It appears that OECD’s existing instrument, the *Guidelines on Corporate Governance of State-Owned Enterprises*, is broadly adequate to address the three overarching concerns identified: a clarity of the objectives of SOEs operating across borders; governance mechanisms and ownership functions designed to create credibility around these objectives; and sufficient transparency and disclosure to allow the public to monitor the continued adherence to these good practices. The main recommendations of the SOE Guidelines in this respect can be summarised thus. The government owners of state owned enterprises should:

- Publish an ownership policy, specifying the objectives that their SOEs should generally pursue. They should in addition make public, including through regular financial and non-financial reporting, any objectives in addition to the generally accepted norms that individual SOEs are charged with pursuing.
- Establish a central ownership or coordination function at arm’s length from other government functions. It should also give SOEs a legal form that establishes them clearly as corporate entities separate from the state.
- Ensure a clear separation between the state’s ownership function and other state functions that may influence the conditions for state-owned enterprises.
- Ensure that SOEs are governed by a board of directors assigned, by the ownership or coordinating entity, a clear mandate as well as the formal autonomy needed to pursue this mandate and assume full responsibility for its fulfilment.
- Make sure that SOE board members are shielded from undue political influence. They should only to a limited extent be picked from within the public sector and, insofar as they are public servants, they should not be directly involved in the political oversight or the regulation of SOEs on whose boards they serve.
- Make SOEs undertake regular financial and non-financial reporting according to the highest international standards for listed companies. The reporting should be certified by independent, external auditors.

50. Moreover, in addressing concrete areas of concern such as maintaining a level playing field between SOEs and other enterprises, and maintaining a credible and even-handed regulation of SOEs and others the SOE Guidelines, have concrete guidance to offer. The government owners of state owned enterprises should:

- Ensure that SOEs are not exempt from general laws and regulations, and establish efficient mechanisms of redress for competitors and others who consider that their rights have been violated.
- Subject their SOEs to the same, competitive conditions regarding access to finance as the ones faced by other enterprises and make sure that the relationships between SOEs and state-owned financial institutions are based on purely commercial grounds.