State-owned holding companies

A background note for the OECD Asia-Pacific Network Meeting on Corporate Governance of State-Owned Enterprises

8-9 December 2022

Please cite as: OCED (2022), State-owned holding companies: Background note for the Asia-Pacific Network Meeting on Corporate Governance of State-Owned Enterprises (December 2022), https://www.oecd.org/corporate/state-owned-holding-companies-background-note.pdf

Foreword

This background note aims to inform the discussions at the 15th Meeting of the OECD-Asia Pacific Network on Corporate Governance of State-Owned Enterprises on the main trends and issues in ownership structures and governance of state-owned holding companies (SOHC). With a special focus on Asia, discussions will inform the upcoming revision of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “SOE Guidelines”).

This document is a revised version of a background paper initially developed for an OECD Workshop on State-owned Holding Companies that took place on 25 October 2022 in Paris. The Workshop was organised under the auspices of the OECD Working Party on State Ownership and Privatisation Practices (the “SOE Working Party”). The document therefore focuses on national practices in OECD member countries and other countries that are regularly invited to the Working Party’s meetings. The document was developed by Ms. Lalita Som, acting as a consultant to the OECD. The factual content has been reviewed by the Working Party, but any viewpoints or policy conclusions put forward in the document are the responsibility of the author. They are not necessarily shared by the OECD or its member countries.

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1.1. Introduction

State-owned enterprises (SOEs) almost invariably are created and operate to achieve both commercial objectives and public policy obligations. But meeting the latter invokes the challenge of avoiding hands-on, politically motivated interference in SOEs. Conflicting objectives and political interference are generally recognised as the two main reasons for SOEs' inability to perform at levels comparable with their private sector counterparts. Clear ownership policies help governments manage SOEs, and their assets in a depoliticised, arms-length, more effective, and efficient manner.

The SOE Guidelines recommend that the exercise of the state's ownership rights should be centralised in a single ownership entity or, if this is not possible, carried out by a coordinating body. Two broad types of centralised entities exist: (1) government ownership agencies that are under the direct authority of the government; and (2) company type structures, such as state-owned holding companies (SOHCs) or investment companies, that have separate legal identities and greater independence.

Some OECD countries including Chile, Finland, France, the Netherlands and Sweden have one centralised ownership entity, either in the form of a specialised agency or a ministerial department, with a portfolio that includes most of the country's economically significant SOEs. Others including Austria, Spain, Hungary, Greece and Slovenia have one centralised state-owned holding company, exclusively performing the role of ownership.

Among non-member countries that engage with the SOE Working Party, some have adopted the single SOHC model, most notably Temasek (Singapore, 1974), FONAFE (Peru, 1999) and Azerbaijan Investment Holding (AIH – Azerbaijan, 2020). Others have established more than one SOHC (e.g., Kazakhstan and Malaysia), or have established a special-purpose SOHC with a limited portfolio (e.g., the Vietnamese privatisation company known in English as the State Capital Investment Corporation).

Significant non-member countries, like Indonesia, India, South Africa and Thailand are currently considering whether to establish either a single holding company for all SOEs or separate Holding Companies (HCs) for SOEs in strategic sectors like defence, energy and mining. This report reviews evidence from countries that are either members of the OECD or regularly participate in the activities of the SOE Working Party.

1.2. An introduction to holding companies in the corporate sector

A holding company (HC) is a company that does not have any operations, activities, or other active businesses itself. Instead, the HC owns assets. These assets can be shares of stock in other companies, limited liability companies, limited partnerships, private equity funds, hedge funds, public stocks, bonds, real estate, patents etc. The HC's role is executive oversight, support, setting risk management parameters and putting the right people in the right places to align with corporate strategy. The subsidiary companies that it owns actually do manufacture, sell or otherwise conduct business. These SOEs are called operating companies or portfolio companies (PCs).

Holding Companies also approve annual budgets, manage income generated from PCs and develop corporate governance rules. SOHCs are entities established by the State to own/finance new SOEs or to merge existing ones by acquiring their shares, exercising greater control over their financial resources and/or supporting their managements through operational monitoring. An SOHC therefore, owns majority or minority shares in national strategic companies in order to control or influence key economic participants, or key sectors of the economy, thus implementing a strategic role for the government. By serving as an intermediary between the government and SOEs, an SOHC can limit political interference in the running of SOEs. SOHCs typically operate under the purview of the ministries of finance. However, not all SOHCs function as the ideal type and some exist to carry out state functions as incorporated government agencies.

1.2.1. The theory of holding companies

Holding Companies have been common in the private sector for over a century. In both emerging and in certain developed economies business groups (e.g., *groups* in Latin America, *chaebols* in South Korea, *zaibatsus* in Japan, *business houses* in India, *Qiye Jituan* in China, *Hongs* in Hong Kong, *General Corporations* in Vietnam) structured under a holding company have played a prominent role (Khanna, 2000[1]).

In advanced economies diversified businesses are predominantly organised into multi divisional structures described as the M-form. Coordination in the M-form occurs through the unified internal control of business units. Operating companies under the holding company structure remain legally independent, a maze of economic and social ties (networks) typically unites each group. These ties enable subsidiary companies to coordinate their actions in product and factor markets and achieve economies of scale by centralising purchasing, training, human resource development etc. In various countries, companies owned by particular HCs present a unified front to outside constituencies.

There are two theoretical perspectives on the existence of business groups structured under a holding company as responses to market failures and associated transaction costs. These are internalised by supra-firm entities. In the presence of weak institutions, which fail to guarantee the efficient allocation of resources, firms will tend to organise themselves in ways that help them cope with the uncertainties of their environment. Business groups are the outcome of this process. Members may for example, share a brand name, raise debt and/or equity capital jointly, lobby bureaucrats and politicians together, recruit managers as a group and pool resources to invest in new projects and exchange resources ‘internally’. HCs also resolve failures in the market for cross-border transfers of capital and technology.

This notion derives from the combination of resource dependence theory and the broader transactions costs/agency costs tradition of the new institutional economics (Jensen and Meckling, 1976[2]) . It answers the Coasian question of why firms exist. Ronald Coase addressed this question by positing that firms exist because they reduce the costs of transacting in open markets where uncertainties and risks of different kinds are difficult to minimise (Coase, 1937[3]).

The second perspective — the entrenchment/exploitation (EE) one — sees HCs as opaque structures designed to extract surpluses from shareholders, government, and workers for the benefit of their owners. (Carney et al., 2018[4]). In contrast to economists’ emphasis on market failure, sociologists have suggested that the raison d’être for HCs have little, if anything, to do with a quest for economic gain or security. Rather, goals like institutional legitimacy, political power, and flexibility to adapt to changing circumstances (Di Maggio and Powell, 1983[5]) (Di Maggie and Powell, 1983) are more important.

According to this perspective, variations among HCs result from: strategic alliances of firms seeking to manage their resource dependence; coalitions among factions of capital owners to defend their interests against those of other groups in society; and corporatist patron-client arrangements between different economic sectors and state officials. Such arrangements are made to further the vested interests of those involved and/or to continue extracting rents from the economy.

Using a social network metaphor, Granovetter states that 'at the descriptive level, the question of business groups and holding companies can be posed as what the structure of all linkages among firm would look like from an aerial view'. He goes on to state that 'one can consider business groups as those collections of firms bounded together in some formal and/or informal ways, characterised by an intermediate level of binding' (Granovetter, 2005[6]).

In a similar manner to the question on 'why do business groups or holding companies exist?', the same functional logic is applied when Granovetter suggests 'that a business group is to a firm as a firm is to individual economic agents' (Granovetter, 1995[7]).

HCs are therefore viewed as a functional response to an underdeveloped institutional context that enhances the economic performance of operating firms. But HC affiliation is also seen to have attendant costs comparable to those facing diversified M-form firms, where bureaucratic coordination costs rise as the number of operating firms increases. With the development of market supporting institutions, HCs will gradually focus, restructure, and loosen their ties. Ultimately, they may even unravel and disappear. HCs are therefore seen by many to be a transitional phenomenon.

On the other hand, the EE perspective sees the pyramidal structures and opaque governance as being designed for self-dealing among related parties. This leads to the transfer of profits among units to the benefit of ultimate owners (called tunnelling) and to minority investor expropriation as profits are redirected within the group. The EE literature at times characterises HCs as being formed or facilitated by states to orchestrate a push towards industrial modernisation. It has been argued that dominant HCs exploit their monopoly power and government contacts to entrench and enrich themselves. Subsequently these elite incumbents seek to defend their sources of rents by supporting the conditions that initially favoured their economic and social prominence. So, they are not transitional. Instead, they rarely disappear but rather gain eternal life.

1.2.2. The evolution of holding companies over time

In 1888 when existing mechanisms for inter-firm coordination (e.g., trusts) came under attack in the US, New Jersey legalised holding companies, corporations whose assets included shares in other corporations. Soon permitted by Delaware and other states, the HCs offered possible reprieve from nascent anti-trust laws by allowing control over multiple companies through pyramids. Views of HCs were initially favourable, presaging the modern academic literature. HCs were perceived as efficiently allocating capital, cutting distribution costs, introducing professional management, coordinating expenditures, and reducing operating firm's cost of capital through geographical diversification and mutual coinsurance (Buchanan, 1937[8]).

HCs were therefore a commonplace in United States in the 1930s. Starting in the late 1920s these favourable views of HCs in the US gave way to scepticism. Concerns about the excessive power wielded by large HCs became widespread. Specifically, there were concerns regarding diversion of funds away from minority shareholders, monopolistic pricing, political corruption, HCs escaping state regulation by becoming subsidiaries of out-of-state HCs. President Roosevelt worried that HCs menaced consumers, shareholders and American values, initiated a series of reforms that eventually led to the demise of HCs and to the creation of the modern US corporate structure of free-standing firms.

The Public Utilities Holding Company Act of 1935 forbade HCs of more than 2 tiers and forced HCs to divest firms operating outside one industry. The inter-corporate dividend tax introduced in 1935 and hiked substantially in the early 1940s, applied taxes each time dividends passed from subsidiary to parent, leaving HCs with more tiers being more severely taxed. The Investment Company Act of 1940 stipulated that a firm whose assets are predominantly shares in other companies could not interfere in the management of the firm whose shares it owned and would be subject to additional regulatory and reporting requirements (SEC, 1995[9]).

These three reforms, augmented by other New Deal measures including, among others, increased estate taxes and enhanced shareholder rights (the Securities Act 1933 and the Securities and Exchange Act 1934) sustained by a political environment hostile to HCs ultimately wore down American groups. Today HCs are virtually non-existent in the US. Other M-form firms exist in the form of conglomerates or in the form of a single parent company with fully owned but separately incorporated subsidiaries.

In the UK, it was observed in the 1950s that the HC structure where adopted was largely the consequence of 'growth from below'. Thus, a form acquiring new operating firms as part of a corporate strategy towards diversification through acquisitions would organise itself and the newly acquired affiliates along HC lines. The HC was also associated with the growth of the multinational corporations with several overseas subsidiaries, which would then set up a head office in the UK in the form of a HC. By the 1960s, many companies underwent a process of internal restructuring and reorganisation, and most HCs were transformed into M-form firms.

1.3. Rationale for establishing State-owned Holding Companies

Since the 1980s, SOE reforms in OECD and partner countries have mostly included: legal modifications to SOE ownership and regulation; adoption of performance contracts; corporatisation; transfer to private ownership and management; minority ownership; clear explication of state ownership policies; improving transparency and accountability of the state as an owner; competitive neutrality; the professionalisation of boards; and broadening of ownership of SOEs through partial divestment.

The transfer of SOEs to *indirect* state ownership through the establishment of State-owned Holding Companies lies among the conservative solutions for SOE management and combines elements of both regulatory and ownership changes. The rationale is that this permits a separation of the state's ownership and management functions. Thus, it permits depoliticization and provides greater independence to SOEs.

Establishing an SOHC will normally reduce the multiple principal problem by introducing a two-tiered principal agent relationship; (a) the government-SOHC relationship and (b) the SOHC-SOE relationship. The SOHC assumes the role of owner-representative as an external institutional investor, while different governmental agencies assume regulatory responsibilities (Sam, 2011[10]). Under this framework, the SOHC focuses on improving the SOEs' corporate and fiscal governance by de-socialising their operational objectives. If an SOHC is legally a private entity under corporate law, it can restructure subsidiary companies with more flexibility.

SOHCs were initially set up to permit the gradual introduction of market forces in the SOE environment with an emphasis on:

- Establishing financial independence and a binding budget constraint, prior to any ownership change,
- making SOHCs responsible for the eventual transfer of its SOEs to private ownership,
- assisting with the restructuring requirements of SOEs,
- developing a new class of professional, competent, qualified SOE managers,
- improving the operational efficiency/productivity of SOEs in its portfolio through better management and adoption of the latest technology,
- increasing financial returns and dividends to the government from SOEs through active portfolio management of state assets
- assisting with the stimulation and development of the capital markets through a gradual increase in stock market trade of SOE equity shares (Kumar, 1993[11]).

Over time, ownership arrangements have been steadily evolving towards greater centralisation to concentrate focus on ownership issues and resolve many of the problems associated with SOE governance. These issues/problems have come to the fore with consensus emerging on the importance of SOEs and their long-term durability; their commitment to stakeholders; their ability to make long-term strategic investments; and their role in exigencies.

When private activity and markets are disrupted, SOEs are expected to reactivate smoothly and seamlessly as evidenced during the COVID-19 pandemic. The role of the state as an economic actor is expected to grow further as the world faces significant social and environmental challenges such as climate change, reducing inequalities and adjusting to demographic changes. In both OECD and non-OECD economies, SOEs are important players in sectors with high GHG emissions and they will be central to climate change mitigation efforts. Other than SOEs, public sector financing will affect efforts to promote transition to a low carbon global economy.

To address these challenges effectively, well-designed governance structures at SOEs are needed. SOHCs are expected to make the state a more professional owner of its assets, to give SOEs operational independence and to insulate SOEs from political intervention. SOHCs are also seen as a way to consolidate, monitor, and disclose information across all public shareholdings, thereby enhancing transparency and accountability.

With broad consensus on the current and future role of SOEs, the logical basis for establishing SOHCs has also evolved, to include:

1. *Political advantages*: When a country considers moving to an SOHC model, a unique opportunity arises to analyse its state ownership structure, size, and sectors. It allows policy makers to focus again on whether state ownership makes economic sense; the extent of state ownership; and the sectors in which it still needs to retain enterprise ownership. It also permits a re-examination of whether market failure persists in a particular sector, and whether the state sector should be allocated further responsibilities in service provision and in producing new goods. This can be done easily when decision-making is concentrated with a significant part of state ownership being under the same management. SOHCs also give the government more flexibility in intervening directly to protect itself and its SOEs from external acquisition.
2. *Insulation from political interference*: SOHCs permit 'arms-length' management of SOEs and repel any political temptation to intervene in their day-to-day affairs. SOHCs can minimise the scope for political interference and bring greater professionalism to the state's ownership role because of the presence of intermediary levels. They introduce a further degree of separation from political interference, by incorporating the characteristics of an external institutional investor. Political interference may be minimised, but it is difficult to stem the two-way direct communication flow between PCs and concerned ministries.
3. *Reducing conflict of interests*: SOHCs separate the state's ownership function from its policy-making and regulatory or supervisory functions to help avoid or minimise potential conflicts of interest. With the SOHC as the shareholder representative with oversight responsibility, the state's ownership function is transferred to a separate and autonomous entity. This allows the State to minimise the conflicts of interest it faces as both the owner and regulator of SOEs. The SOHC owns the SOE shares or is responsible for exercising all ownership functions on behalf of the State as owner, while the line ministry is responsible for policy making and the regulatory environment in which SOEs operate. The Bulgarian energy sector provides an example about how a state can avoid conflicts of interest as an owner and regulator. The incumbent companies in some key network sectors, such as electricity generation, gas import and retail supply, and rail transport, are completely owned by the state. Such an extensive presence of the state in sectors, even if they are open to competition, can generate distortions and affect the incentives for private firms to enter and expand their presence in these. The energy sector in general has undergone increased scrutiny by EU and Bulgaria has recently embarked on a series of reforms, including: the setting up of a power exchange and steps for opening the retail market to competition. The electricity

sector is composed of a regulated segment where prices/tariffs are set by an independent regulator (by reference price or formula), the Energy and Water Regulatory Commission (EWRC), and a liberalised segment with free pricing between producers and consumers. The sector is dominated by a few key players and in practice there are geographical monopolies in supply. Natural gas markets are also concentrated, and consumers have been prevented from having a choice of suppliers. The European Commission fined the state-owned Bulgarian Energy Holding (BEH) — the holding company for a number of enterprises involved in electricity generation, supply and transmission, natural gas storage, transmission and supply, and coal mining — and two subsidiaries for blocking access to other wholesale gas suppliers to its gas infrastructure in 2018. The Bulgarian Commission on Protection of Competition is putting a strong focus on investigating anti-competitive practices in the energy sector and increased measures are expected to open up the sector (OECD, 2021[12]).

4. *Repository of skills*: The structure of SOHCs allows to attract staff who are more adept at performing business functions than civil servants. HC executives usually have better managerial and technical training. A HC enables the provision of generic in-house skills training to groom talent and ensure that skill sets are of a consistent standard and serve as a pipeline for talent. HCs also enable a central approach to hiring, compensation and training of executives and staff of all SOEs in their portfolio: the training of auditors and compliance staff; the use of compatible IT systems that monitor the operations of all subsidiary companies; the adoption of standardised software for control and financial reporting; and ensuring that technology development is cost-effective. A dedicated R&D centre can assume R&D responsibilities for all subsidiary companies. This means that while sector-specific or firm-specific technological development might be taking place, there might also be the opportunity to achieve cross-sector synergies in research projects, allowing new technology to be applied across sectors and portfolio companies. This way HCs can implement better talent management practices. SOHCs often own SOEs that operate under a corporatized model. So, they usually require management professionals to lead them. They have thus, become agencies in which managerial expertise in is not only valued but quintessential. Having SOHCs with experienced, senior management professionals, creates semi-autonomous technocratic islands that work more freely to improve operations, minimise cash flow risk and manage financial risks overall. They also have professional management dedicated exclusively to monitoring and managing SOEs, designing strategic plans and processing information coming from SOEs.
5. *Maximising value*: When a significant number of SOEs are grouped under an SOHC, it strengthens their collective bargaining power, allowing for more space when negotiating with banks (in mobilising resources) and suppliers, by centralising procurement for all PCs. Often SOHCs invest excess cash into different projects as needed either as internal loans or in the form of equity. In return they receive regular interest from their PCs on loans, or dividends on any equity they put in. PCs benefit too, as they receive larger amounts of capital and pay lower rates of interest than they would if dealing with banks and capital markets. SOHCs foster joint resource and asset management.
6. *Creating synergies*: HCs enable to achieve synergies through integration within a given sector or activity. These are a specialised form of HC usually found in particular sectors. The rationale for them lies more in the theories of economies of scale and scope leading to both horizontal and vertical integration. The structure of such HCs allows for the sharing of knowledge and best practices in a variety of areas amongst all PCs. HCs serve as a means for efficient capital allocation and help facilitate closer cooperation and possible joint ventures among PCs.
7. *Better operational management*: Standardising investment policies, dividend pay-out policies, managing human resources (HR) more consistently, achieving economies of scale with procurement, contracting and auditing policies brings about efficiency and agility. When shareholders lack a coherent strategy and coordination, SOEs suffer from indiscipline which executives assume to be a sign of laxity. This leads to unnecessary or low-priority, sub-optimal

investments, discretionary misuse of resources, with lower incentives for responsible and efficient management. The opposite is equally damaging for SOEs when decisions are caught up in bureaucratic muddles. Executives, in this case, are forced to forego projects, due to the stretched-out time horizon needed to see them through. HCs have more autonomy regarding investment decisions. If HCs provide more autonomy regarding investment decisions, it is equally true that managers prefer this autonomy to escape from any scrutiny from shareholder ministries.

8. *Better Human Resources Management*: By establishing clear responsibilities and policy objectives, HCs can improve human resources management through uniform incentives and career development policies. With better qualified staff who have a deep knowledge of SOEs and the markets in which they operate, HCs are in a unique position to carry out incremental or new investments, manage divestments, or rescue unprofitable SOEs by avoiding the high social costs of liquidation through restructuring and to restoring them to financial health.
9. *Financial flexibility and reduced funding costs*: HCs can not only get funding on better terms from both banks and capital markets because of their greater bargaining power, but also help in effectively controlling their liabilities. State-owned banks, which have been known for providing credit to SOEs on loose terms with government guarantees that assure repayment, have created significant fiscal risks in several countries, often leading to criticisms of soft budget constraints and the impossibility of bankruptcy. Reduced funding costs, however, could become an incentive to shift capital around without proper oversight.
10. *Contingencies*: The global financial crisis (GFC) of 2008-12 and the COVID-19 pandemic in 2020-22 have underscored, twice within just over a decade, that when existential crises occur, markets do not function nor survive without emergency support from the state *in extremis*. Both these crises have highlighted the critical, indispensable role of the State in saving lives and protecting livelihoods. In many countries, SOEs have been a crucial part in delivering on that effort as agents of the State. The agility of HCs renders them to be effective agents of the State not only during contingencies but for post-crises recovery. For example, many countries have now set up public sector funding bodies to take equity stakes in strategically important firms and troubled medium-to-large sized industrial companies that have been affected by COVID-19 but are intrinsically viable.
11. *Branding and maximising brand equity*: An SOHC is usually a large company with a better credit rating and reputation than its PCs. This puts an SOHC in an improved position vis-à-vis its suppliers, creditors, investors, and other stakeholders. There may be other intangible benefits that derive from the brand name and reputation.
12. *Tax advantages*: SOHCs that own 80% or more of every subsidiary can reap tax benefits by filing consolidated tax returns. A consolidated tax return is one that combines the financial records of all the PCs together with that of the HC. In such a case, should one of the PCs encounter losses they will be offset by the profits of the other PCs. In addition, a HC can enjoy tax exemptions if the SOHC acquires shares in PCs, receives dividend payments from shareholdings, and disposes of shareholdings in PCs.

In addition to the above-mentioned justification, the benefits of full centralisation under one entity also accrue to SOHCs. Those benefits include:

13. *Better transparency*: Existing evidence on SOHCs has suggested that they facilitate the introduction of ex-ante procedures to guide the behaviour of SOE managers and help to standardise SOE disclosure requirements, timelines, as well as procurement policies and auditing procedures. They reduce the discretionary nature of financial governance, by reducing the soft-budget constraint problem and the government's capacity to extract the public benefits of control. By homogenising financial and accounting rules and by unifying the processes around internal audit for its PCs, HCs enable not only transparency but also facilitate comparability and better

decision-making. HCs enable the standardisation of all data -- both at the HC and PC levels -- allowing for data comparability. Unlisted PCs in the HC are encouraged to follow reporting and accounting standards of listed SOEs for the sake of uniformity.

14. *Improvement in governance*: Grouping SOEs under the same umbrella makes it easier to homogenise the legal framework for all subsidiary companies. HCs can simplify interaction with other stakeholders. The relationship with stakeholders, like Parliament, state auditors, civil society and other entities can be coordinated more effectively. HCs help to address shortcomings in areas of governance by taking up additional responsibilities. For example, if a PC has a weak board, the HC can provide support till new members of board are appointed. By participating at all the different stages of governance processes (*ex-ante*, during and ex post), HCs have an overarching and integrating effect.
15. *Mitigating the problem of multiple shareholders*: Companies with multiple and dispersed shareholders face governance challenges. SOHCs facilitate the consolidation of a variety of firms under one principal. That reduces not only the multiple principals problem but also reduces information asymmetries and monitoring problems. SOEs have had different ownership models like the centralised model (of which the HC model is one), a coordinating agency model, a dual ownership model, a twin track model and a decentralised model. An SOHC undertakes the mission as the main shareholder in all companies or a significant number of them, controlled or held, directly or indirectly by the State. With multiple shareholders, it is difficult to converge on a focused set of objectives. Finance ministries will in theory promote a dividend policy aimed at maximising revenues for the treasury, whereas, in the case of power suppliers, ministries of energy will be more concerned with service quality, proposing further investments to maintain and improve quality and seeking to increase service coverage, when profitability is limited or non-existent. They may therefore demand subsidies to reach the desired levels of quality and coverage. These objectives are not compatible. They highlight the multiple agency problem. An SOHC can mitigate the multiple agency problem with designing a common strategy for the entire group which adjusts and adapts to the peculiarities of its individual subsidiary companies.
16. *Clear strategic focus*: SOHCs are a means of controlling several SOEs because line ministries find it difficult or inefficient to deal with numerous SOEs directly. The HC in this case is essentially a facilitator of government control rather than a means of easing this control. Without multiple shareholders, HCs can facilitate the design of better management policies. Identifying and defining clear objectives and responsible executives lead to better performance monitoring. SOHCs can clearly distinguish between social and financial objectives, thereby allowing for a transparent measurement and allocation of separate funding for their social objectives.
17. *Avoiding conflicts*: Products, services and their prices, contracts, funding can be better coordinated in the HC structure, helping in avoiding conflicts. HCs allow for an internal system aimed at resolving conflicts among their PCs through better transparency.
18. *Stimulating capital markets*: SOHCs' operations are financed not through budgetary allocations from governments. Instead, they are financed by dividends from their own assets (i.e., earnings from their equity in PCs) and/or by capital raised from financial markets. SOE listings have been often cited as the driver behind the rise of capital markets in many emerging countries. The current capital markets landscape in most emerging markets includes a significant share of SOEs – according to some estimates, SOEs account for almost 13-22% of global stock market capitalisation. They play an important role in stimulating stock markets, through the volume of trading in SOE stocks and the liquidity they provide to the market.

All in all, the SOHC is useful for managing an integrated public ownership structure to add value to individual SOEs and where PCs are assembled that offset each other's risk profiles, where political interference can be reduced; where economies of scale and scope can be exploited; cash flows and human resources can be apportioned among PCs based on need, enabling HCs to judge which PCs represent the best investment opportunities. In addition, SOHCs can improve financial governance by reducing the soft budget constraint and reduce the government's capacity to extract the public benefits of SOE ownership and control, while acting as a buffer between the government and SOEs. SOHCs also enable the state to separate its ownership responsibilities from regulatory responsibilities.

Despite the convincing rationale for establishing SOHCs, they cannot fully eliminate the financial governance problem because SOHCs cannot prevent price caps on the services their PCs provide or from being subject to other quasi-fiscal operations. SOHCs, especially in Latin America, therefore, include only the less politically sensitive SOEs as their PCs (IADB, 2019[13]). SOHCs are established to maintain a healthy distance between SOEs and the government, but if those political risks materialised, SOHCs with concentrated assets under their management would be particularly vulnerable.

Where an SOHC does not own 100% ownership interest in any of its PCs, it will have to deal with minority owners. Sometimes conflicts arise when the interests of the minority owners are different from those of the SOHC.

The fact that the SOHC's management are not experts in the PCs' businesses can be both an advantage and a disadvantage. It can be a disadvantage because the SOHC's management may be overseeing and making major policy decisions for businesses in which they are not particularly familiar.

As SOHCs become larger and more complex, information asymmetries between the holding company and its PCs may increase. Therefore, the optimal size (and diversification) of an SOHC can end up being relatively small or focused on the less politically sensitive, less complex firms. In OECD member countries, SOHC investments are required to have an element of national interest and therefore they focus mainly on larger SOEs.

1.4. Some national examples of rationales

Some of the above-mentioned advantages of operating with a HC model, form the basis for setting up SOHCs in countries like Austria, Finland, Greece, Peru, Slovenia and Spain. The Box below list the rationale behind their respective HCs:

Österreichische Beteiligungs AG (ÖBAG), the Austrian HC established in 1967 underlines its *raison d'être* as being the entity to:

- manage its portfolio according to the principles of value creation and preservation;
- be an active asset manager for the government;
- appoint experienced experts to the supervisory boards of SOEs;
- be an integrative platform for knowledge exchange and cooperation among its PCs;
- promote responsible governance and control; and
- carefully balance various stakeholder interests and implement best-in-class ESG standards in its PCs.

The objectives of **Solidium**, the Finnish state HC established in 2008 are to:

- make the implementation of state ownership policy more professional;
- separate state ownership responsibilities from day-to-day politics;
- ensure a good return on the State's investment;
- grow shareholders' value in its PCs by means of a long-term, active ownership,
- ensure that its PCs outperform their peers;
- create an entity which can react quickly in situations where national interest is at stake,

- ensure that basic services continue to be provided even in emergency situations;
- ensure that strategically important companies remain under Finnish ownership.

The philosophy underpinning the **Hellenic Corporation of Assets and Participations** SA (HCAP) which was established in 2016, is to:

- ensure separation between exercising shareholders' rights in SOEs and the regulatory activities of the State and avoid any conflicts of interest between the two;
- consolidate its subsidiary operations with professional criteria without political interference;
- promote overall coherence and uniformity in corporate governance across its PCs;
- establish a stable and unified institutional structure, acting with professionalism, independence and a single framework of rules;
- finance the repayment of national debt, as 50% of HCAP's dividend is directed to the repayment account.

Slovenian Sovereign Holding was established in 2014 to manage its PCs in a responsible, professional and active manner. Its objectives include:

- pursuing profitable, effective and efficient operation of its PCs;
- creating value and implementing tasks related to the public interest;
- participating in divestment proceedings and managing the process in a transparent manner that treats all investors equally and fairly;
- restructuring the portfolio of assets under its management to achieve the objectives laid out in the State Assets Management strategy;
- providing professional competence and expertise regarding governance;
- exploiting fully the synergies among its PCs;
- implementing activities that improve the environment through sustainable operations.

The **Fondo Nacional de Financiamiento de la actividad Empresarial del Estado (FONAFE)** is an SOHC that monitors the performance of 35 Peruvian SOEs. It was created in 1999 to represent the government as an owner and to implement best practices in corporate governance and management in its PCs. FONAFE's mission objectives include:

- operating modern SOEs that provide high quality products and services, and are socially responsible;
- creating financial and real value and fostering social and environmental values;
- training and developing human capital;
- improving corporate governance;
- centralizing procurement wherever possible;
- streamlining the management of its PCs by introducing state-of-the art processes at both the HC and subsidiary company level.

The **Sociedad Estatal de Participaciones Industriales (SEPI),** the Spanish HC was created in 1995 through a royal decree to:

- coordinate the activities of its PCs;
- draw up and implement strategies for its PCs;
- assist its PCs in their financial transactions;
- implement the government's guidelines on modernisation, reorganisation and safeguarding the public interest;

- set up annual performance goals for its PCs;
- design plans to improve the operating, organisational and financial performance of its loss-making PCs and return them to profitability;
- improve the efficiency of its PCs' operations.

Table 1.1. SOHCs and their portfolio companies

Country	SOHC	No. of portfolio companies	Sectors covered	Total portfolio value	Total no. of SOEs
Austria	Österreichische Beteiligungs AG	11	Power, oil and gas, telecoms, post, real estate, casino, pension fund	EUR 34.7 billion (2021)	28
Azerbaijan	Azerbaijan Investment Holding	12	Energy and natural resources, finance, transport, public services		
Bulgaria	-Bulgarian Energy Holding (BEH) -Holding BDZ EAD (the Railway Holding Company)		-Electricity generation, supply and transmission, natural gas storage, coal mining		
Colombia	Grupo Bicenetenario		Financial services		
Finland	Solidium	12	Telecoms, steel, network infrastructure, technology for mining and metal refining, chemicals, IT, packaging	EUR 7.1 billion (September 2022)	42
Greece	Hellenic Corporation of Assets and Participations SA	15	Energy, water supply and sewerage, infrastructure, transportation services.	EUR 6 billion (2021)	39
Hungary	Hungarian National Asset Management Inc.	332	Real estate, intangible property, transportation, storage, mining and quarrying, energy, manufacturing, water supply, sewerage, casino	EUR 39.6 billion (2021)	350
Kazakhstan	Samruk Kazyna	69	Telecom, airlines, construction, post, energy, mining	USD 64 billion (2021)	25111 (2018)
Malaysia	Khazanah Nasional	31	Consumer, energy, healthcare, manufacturing, telecoms, IT, media, real estate, utilities	USD 36.8 billion (2021)	87
Peru	Fondo Nacional de Financiamiento de la actividad Empresarial del Estado	35	Utilities, energy, water, sanitation, finance, infrastructure, transportation		**36**
Singapore	Temasek Holdings	100	Financial services, transportation, industrials, telecoms, media, technology, consumer, real estate, life sciences, agri food	USD 408 billion (2022)	117
Slovenia	Slovenian Sovereign Holding	52	Energy, finance, transportation, infrastructure, tourism	EUR 10.3 billion (2022)	
Spain	Sociedad Estatal de Participaciones Industriales	124	Postal services, food distribution, agribusiness, communication, ship building, finance, energy, mining, leisure, sports	EUR 14.8 billion (2022)	
Vietnam	State Capital Investment Corporation			USD 2.4 billion (2022)	

Source: Author based on information provided by national authorities and relevant webpages.

1.5. Structure of State-owned Holding Companies

A holding structure is by definition hierarchical. The organisation of proprietary management is with the Chair as the head of the Board of Directors at the apex and the group SOEs at the base. The main shareholder of the SOHC is the executive branch of the government including ministry of finance, line ministries, prime minister's office etc. Beneath this level are the governing bodies including the Board and its committees, the top executive team, and the Board of each PC. The size of the SOHCs is small in most countries to keep management costs low.

The predominant model is for the Board to provide overall guidance and policy directions to the management. Senior management under the CEO leads the delivery of SOHC's vision and mission. Both the Board and management ensure compliance with rules and regulations. SOHCs as asset owners and active investors manage their PCs with discretion and flexibility under the guidance of the Board.

The main shareholder, the State or its executive, is not involved in SOHC's investment, divestment or any other business decisions except in relation to defending national interests, maintaining domestic ownership in strategic industries, protecting past reserves of the HC and to ensure basic services are provided even during exigencies.

The Chair of the Board is typically appointed by the government, at the nomination of the shareholder ministry. Other members of the board are appointed by the shareholder ministry. When public policy objectives are part of the SOHC's mandate, public officials or ministers become members of the Board. The Board which includes high calibre, experienced and diverse members, with the CEO operates on a commercial basis with the added constitutional responsibility of protecting national interest.

The Board has separate and independent access to information to assist it with its deliberations, including the opportunity to request supplementary or explanatory information from the management. The main shareholder ministry also has its own independent access to information. Management provides information to the Board on an ongoing basis, including minutes of key management board or executive committee and Board committee meetings, to allow the Board to effectively undertake its fiduciary duties.

Board committees including executive committee, audit, risk, nomination and remuneration committees, provide lines of defence against portfolio, operational risks and independent assurance for their performance and integrity. This is done through strategic asset allocation, asset and liability management, investment and portfolio risk management, operational risk management, business continuity management, compliance with corporate governance principles and codes of conduct, processes and procedures to ensure transparency, accountability, efficiency and transformation. Both operating and governance principles help in promoting sustainable and successful business operations and strengthen stakeholders' trust in SOHCs.

The management board is the executive body, to which the Board (supervisory) or its Chair delegate certain powers. Their responsibilities include managing the relationship between the SOHC and its PCs. SOHC is represented on Boards of all PCs. In an SOHC's daily work, the most active interaction takes place with PCs.

As an active investor, the SOHC expends considerable efforts to understand the PCs and their respective sectors. The investment team or the executive committee at the SOHC carries out an analysis of the PC, frequently meets with company management and other shareholders (if any), visits production sites, participates in industry seminars and capital market discussions and studies PCs' competitors. The information collected forms the basis of the value creation plan for the PC and its implementation so that the PC outperforms its peers.

Public control of the SOHC is through the office of the Supreme audit institutions or the Court of Auditors and through Parliament. SOHC representatives are asked to appear before lower and upper Houses of Parliament and are required to submit financial and any relevant information regularly.

Figure 1.1 Organisation chart of a sample State owned holding company

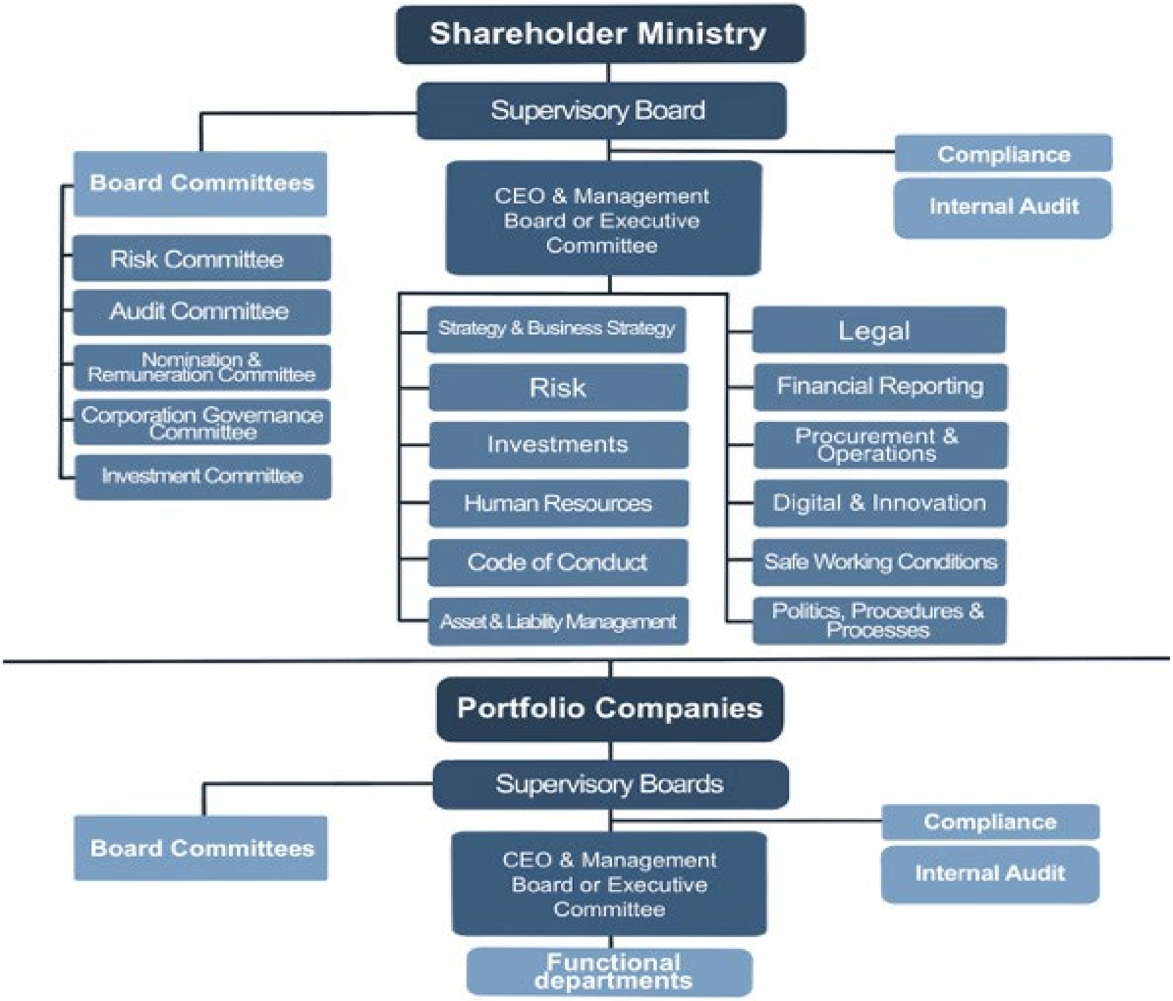

Table 1.2. Legal status of SOHCs

Country	State owned Holding Company	Shareholding Ministry	Legal Status
Austria	Österreichische Beteiligungs AG (ÖBAG)	Ministry of Finance	Joint Stock Company
Bulgaria	-Bulgarian Energy Holding (BEH) -Holding BDZ EAD (the Railway Holding Company)		Holding BDZ EAD (Under a special law, not formally considered a company)
Colombia	Grupo Bicentenario	Ministry of Finance	N.A.
Finland	Solidium	Ownership steering department of the Prime Minister's office	Limited Liability Company
Greece	Hellenic Corporation of Assets and Participations SA	Ministry of Finance	Public Limited Company
Hungary	Hungarian National Asset Management Inc.	Ministry of National Development	Limited Liability Company
Kazakhstan	Samruk Kazyna	Ministry of Finance	Joint Stock Company
Malaysia	Khazanah Nasional	Ministry of Finance	Public Limited Company
Peru	Fondo Nacional de	Ministry of Finance	Statutory corporation

Country	State owned Holding Company	Shareholding Ministry	Legal Status
	Financiamiento de la actividad Empresarial del Estado (FONAFE)		
Singapore	Temasek Holdings	Ministry of Finance	Commercial investment company
Slovenia	Slovenian Sovereign Holding	Ministry of Finance	Public Limited Company
Spain	Sociedad Estatal de Participaciones Industriales (State Industrial Holding Company)	Ministry of Finance and Administration	Public Law entity
Vietnam	State Capital Investment Corporation	Ministry of Finance	Joint Stock Company

Source: Author based on information provided by national authorities and relevant webpages.

1.6. Types of Holding Companies

HCs do not need to own 100% of a subsidiary to control it, they let the State leverage their financial strength. With the appropriate legal structuring, control can be acquired for less than 51% allowing HCs to achieve greater diversification without relinquishing control. The control exerted by an HC over its subsidiaries can differ between companies. Some HCs are completely hands off while others may force a subsidiary into less optimal business decisions to benefit another of the HC's subsidiaries. Most HCs oversee only the most significant decisions made by their PCs such as appointing high level executives, large projects, accessing funds from internal and external markets.

The accounting profession (Corporate Finance Institute, 2022[14]) distinguishes four types of HCs:

- *Pure HC*: This type of HC gets incorporated for the sole purpose of owning stock in other business entities. This stands as one of the core purposes of the entity and it is not engaged in any other business process. The HC has a diverse portfolio with both minority and majority stakes but is not involved in the PCs' operations.
- *Mixed HC:* Such an HC is not only involved in controlling the assets of PCs but is also involved in the business operations of PCs.
- *Immediate HC:* An immediate HC is already a controlled company by other business entities, despite it being controlled, it retains stock of PCs.
- *Intermediate HC*: When it comes to an intermediate HC, it stands as an HC for one business entity and on the other hand, acts as a PC for more substantial business firms.

Although it is safe to assert that most of the SOHCs belong to the mixed HC variety, the relevant categorisation for SOHCs fall into two broad types:

1. A company type structure responsible for managing the assets in the portfolio.
2. An investment company structure that also acts as the government's strategic investor.

SOHCs can be further categorised by the number of SOEs they own/cover. HCs may cover some of a country's SOEs or all of them. They usually cover enterprises that are wholly, or majority owned by the State. Some may also include minority holdings. Some SOHCs cover both commercial and non-commercial SOEs while others cover only commercial SOEs. Coverage also depends on the legal status of a company.

Some SOHCs are joint stock companies while some are Limited Liability Companies (LLCs). In some European countries LLCs have no board of directors and their management takes orders directly from the shareholder. Some SOHCs are special purpose vehicles involving special founding legislation of their own.

The nature of SOHCs' responsibilities towards its PCs can be categorised as either active or passive. An *active SOHC* typically approves annual budgets, regulates activities of PCs, manages investment income generated from PCs and develops corporate governance rules. An active SOHC is one that exercises strict control over the activities of PCs. One of its fundamental characteristics is to set goals for PCs. To guarantee compliance, a set of procedures and processes is established to ensure the adoption and achievement of stated objectives. Thus, HCs approve plans to be executed, with the appropriate investment and operational budgets. Their main functions, typically include voting at shareholder's meetings; nominating, or appointing board members; promoting sound corporate governance in PCs; monitoring PC performance; undertaking new investments internally and externally; divesting shares of PCs; and subscribing or purchasing equity, debt, or other securities (Sánchez, 2016[15]).

With the social and policy objectives of SOEs set, continued control over PCs as policy tools is no longer essential. *Passive* SOHCs generally do not get involved directly in company management. They limit themselves to activities such as appointing directors and approving the financial statements of PCs. A passive HC acts as any other shareholder does in a limited company. In these cases, the key governance body is the AGM. The passive *SOHC* concentrates mainly on the financial aspects of management. It seeks to maximise the group's financial position to earn appropriate returns on public investment and to create economies of scale that endow greater negotiating power and better financial management of its PCs. Depending on the degree of monitoring exercised, when credit availability is restricted, financial activity is centralised, in which case the passive SOHC performs treasury functions. With regard to policies established by government for PCs to achieve their public objectives, passive SOHCs become transmitters of government directives.

Passive HCs can be further classified into 3 types:

3. A *corporate investor* type of passive SOHC is akin to a private institutional investor whose primary objective is profit maximisation. Achieving social or political objectives is never a part of its remit. The corporate investor SOHC has a hard budget constraint and transfers resources transparently. Even if transfers are discretionary, they are primarily aimed at maximising financial and operational performance. The corporate investor type of SOHC incurs fewer political and agency costs. It usually has a large number of independent board members, increased autonomy, and a separation of the roles of Chairperson and CEO.
4. A *shadow investor* type of passive SOHC also focuses on operational efficiency and not solely on profit maximisation. For this type of HC, the government also requires social objectives to be met. The government (usually through the line ministry involved) oversees strategic planning and sets objectives for each subsidiary SOE, while allowing them to make operational decisions independently. The shadow investor SOHC largely acts as a facilitator by ensuring the government's stated social objectives are met through efficient resource allocation. Politicians and public officials make up a large majority of the board of directors.
5. A *submissive SOHC*, under which the government has almost complete control of the PCs. The submissive SOHC runs companies like a pass-through government agency, with the government playing an active role in setting social objectives and running the HC. Submissive SOHCs have little autonomy to manage its PCs and its board members are invariably public officials (Kim, 2019[16]).

In terms of operating models, SOHCs can be categorised into *pure* HCs; *sector specific* HCs in particular strategic industries; and *competence-based* HC with specific functions. The following table provides a summary of the different types of existing SOHCs.

Table 1.3. Typology of State-owned Holding Companies

<table>
<tr><th colspan="7">Typology of State-owned holding companies</th></tr>
<tr><td>Accounting profession</td><td>Pure</td><td colspan="2">Mixed</td><td colspan="2">Intermediate</td><td>Immediate</td></tr>
<tr><td>Main shareholder</td><td colspan="2">Ministry of Finance</td><td colspan="2">Head of government's office</td><td colspan="2">Line Ministries</td></tr>
<tr><td>Type of ownership</td><td colspan="3">Wholly or majority ownership</td><td colspan="3">Minority ownership</td></tr>
<tr><td>Of which wholly owned</td><td colspan="3">Affiliated</td><td colspan="3">Indirect ownership</td></tr>
<tr><td>Legal status</td><td>Joint Stock Company</td><td colspan="2">Limited liability Company</td><td colspan="2">Special purpose vehicle</td><td>Public law entity</td></tr>
<tr><td>Function</td><td colspan="3">Company like structure managing assets in the portfolio</td><td colspan="3">Investment company like structure acting as government's strategic investor</td></tr>
<tr><td>Responsibilities</td><td colspan="3">Active</td><td colspan="3">Passive</td></tr>
<tr><td>Of which Passive</td><td colspan="2">Corporate investor</td><td colspan="2">Shadow investor</td><td colspan="2">Submissive</td></tr>
<tr><td>Relationship with the State</td><td colspan="2">Arm's length</td><td colspan="2">Appropriately independent</td><td colspan="2">Close</td></tr>
<tr><td>Coverage</td><td colspan="2">All SOEs</td><td colspan="2">Significant no. of SOEs</td><td colspan="2">Sector specific SOEs</td></tr>
<tr><td>Social objectives</td><td colspan="2">Minimal</td><td colspan="2">Yes</td><td colspan="2">Yes</td></tr>
<tr><td>Operational Model</td><td colspan="2">Pure HC</td><td colspan="2">Sector HC</td><td colspan="2">Competence HC</td></tr>
</table>

Source: Author based on information provided by national authorities and relevant webpages.

Table 1.4. Operational model of SOHCs

	Pure holding company	Sector holding company	Competence holding company
Main shareholder	Ministry of Finance/Prime Minister's office	Line Ministries	Ministry of Finance/Economy
Legal status	Joint Stock Company	Special law/Joint Stock Company	Limited Liability Company/Joint Stock Company
Coverage	Significant no. of SOEs	Sector specific	Significant no. of SOEs
Relationship with the state	Arm's length	Appropriately independent	Appropriately independent
Social objectives	Minimal	Yes	Yes

Source: Author based on information provided by national authorities and relevant webpages.

1.7. Relationship between the Government, State-owned Holding Company and SOEs

The ability of an SOHC to improve performance of its PCs depends on its relationship with the government. An SOHC introduces a two-tiered principal-agent relationship – the government-SOHC relationship and the SOHC-SOEs relationship (Kim, 2019[16]).

1.7.1. The government-SOHC relationship:

A government's direct control over SOEs, its imposition of social objectives on SOEs, and its consequences on SOE performance and increased budgetary support are all well-known. When an SOHC assumes the role of owner representative as an external institutional investor, it focuses on improving corporate governance in its PCs and fiscal governance by de-socialising their operational objectives. This ensures that the SOHC has budgetary autonomy and does not have to make decisions that sacrifice economic efficiency for state objectives, thereby allowing it to operate profitably.

However, when the performance of SOHC is below agreed targets, politicians and officials feel obliged to intervene not only in the day-to-day functioning as well as at Board meetings.

The ownership policy document directs the strategy of the SOHC and the modalities for monitoring its PCs. More specifically, it enunciates strategic guidelines to the board of the SOHC for formulating the strategic and business plans of its PCs. Board members are shortlisted by the SOHC on criteria based in the policy document and company law, and the government appoints the board. A well-intended government usually appoints to SOHC boards not political cronies, but accomplished, experienced professionals with the experience, knowledge, and insight to guide the SOHC in monitoring the performance of its PCs effectively and to implement sound corporate governance practices that meet high standards. Key strategic decisions are the responsibility of the board; however, the responsible line ministry occasionally intervenes in exceptional cases and retains both a formal and an informal communication channel with the CEO of the SOHC for any information related to the performance of the SOHC and its PCs.

SOHCs are obliged to report periodically (sometimes ad hoc and sometimes reporting for approval) to both Parliament and the principal state entity responsible for the SOHC, on its performance and that of its PCs. The apex public audit institutions, through their oversight mandate, determine the quality of financial reporting by the SOHC.

The treasury sets up expected income from the SOHC in the state budget and the SOHC provides a forecast on dividends to the treasury.

1.7.2. SOHC-portfolio company relationship:

Appropriate organisational design enables the right kind of interaction between an SOHC and its PCs to support performance and to create synergies. An SOHC enables relationships with its PCs that: support the shared development of business strategy; apply good corporate governance practices; assure close collaboration between an SOHC and its PCs to develop and offer better services and products; increase value addition; share best-practice and technical knowledge; and to retain and develop staff across both the SOHC and its PCs.

However, in practice governments sometimes depart from this and intervene directly in board nominations in the PCs, directly communicate with PC CEOs and/or shifting money around without proper oversight.

Corporate governance standards are communicated to PCs via their Boards. The chair of the subsidiary Board, or the CEO as the shareholder representative, encourages PCs to implement the governance codes, strategic and ESG objectives. The Chair of the SOHC Board approves the appointments of Board members in PCs. The CEO and the top management in PCs are appointed by the Boards of the PCs. SOHC has its representative on boards of all its PCs. Their performance is monitored regularly on the basis of Key Performance Indicators (KPIs). These are required to be reported quarterly and SOHCs publish consolidated reports annually.

Different characteristics of the organisation structure are used as integrating mechanisms to facilitate cooperation among PCs. Centralising some of the organisational functions (HRM, IT, supply chain management, business development, finance) at the HC allows the linking and coordination of activities among PCs.

Frequent direct contact between PCs' managers is also a way to encouraging cooperation and the sharing of either competence or resources that can be used to create new advantages. Closer collaborative relationships can only develop with more extensive communication, formal and informal, via the following key interactions driven by the organisation structure:

1. *Mandated liaison meetings* between the SOHC and its PCs to discuss strategy, market conditions, performance, and other key business issues to align pursuit of strategies and project opportunities.
2. *Periodic workshops* to discuss business development and to ensure an effective two-way information flow between the SOHC and its PCs. These involve the integrating of SOHC investments and business development teams with key staff from the PCs. Outputs of these workshops are reported to both respective boards.
3. *Regular informal meetings* between the investment team and senior executives from the PCs to exchange detailed views on market conditions and PC activities.

SOHC board members ensure that PC performance meets the overall strategy of the SOHC. However, the subsidiary's board is responsible for managing the company. It is the fiduciary duty of the board to take decisions based on the best interest of the subsidiary. The directors are subject to the same corporate laws and regulations as any other Board of Directors. An SOHC representative is invariably a member of every PC Board.

The SOHC also monitors its PCs through bylaws that: clearly spell out the procedure for electing and removing directors; define the authority of the PCs' executives; and by disallowing significant amendments of the PCs' articles or bylaws without the approval of the majority shareholder (i.e., the SOHC). The table below shows the different ways in which SOHCs can be involved in the management of their PCs:

Table 1.5. Different types of management model involving SOHCs

	Investment Management	Strategic Management	Active Management	Operationally involved management
Description	Focus on results	Focus on what PCs do	Focus on how PCs implement strategy	Focus on how the SOHC can help PCs to implement strategy
Role played the SOHC	Investment company	Strategic leaders for all PCs	Consultants and strategic leaders for all PCs	Key managers for all PCs
Value created by whom	- enforce a disciplined management model. - value is created by individual PCs	- add value in the linkages between PCs. - value is created by individual PCs	- provide guidance to PCs through expertise. - value is created by PCs with SOHC expertise	- make key decisions for PCs. - value is created by SOHC expertise and control
Responsibility	SOHC sets financial goals, PCs are accountable for achieving these targets	SOHC sets financial and operational goals, PCs are accountable for achieving these targets	SOHC and its PCs share a responsibility for a broad set of financial and operating targets	SOHC is responsible for achieving financial and operating performance
Centralisation of functions	Decentralised to PCs, core and support functions are separate in each PC	Partially centralised to PCs, core and support functions are separate in each PC but there are central support functions at the SOHC that governs the overall synergy between PCs	Centralised at SOHC, core functions are separate in each PC and support functions are at the SOHC	Centralised at the SOHC, core and support functions are also at the SOHC, PCs only execute plans or daily tasks
Mechanisms of integration	No integration	Moderate integration	Extensive integration	Extensive integration
Appraising PC performance	SOHC reviews performance annually based on achieving financial objectives	SOHC reviews performance annually based on financial and strategic objectives	SOHC proactively reviews PCs' strategic plans and annual budgets	SOHC dictates PCs' strategic plans and budgets
Portfolio companies' incentive and compensation	Based on PCs' performance	Based on PCs' performance but linked to SOHC	Based on overall group performance	Based on overall group performance

Source: Baker (2019[17]), Holding Company structure overview, https://www.pesync.com/holding-company-structure-overview.html.

1.8. How do State-owned Holding Companies perform?

Despite overwhelming support in the literature on the merits of SOHCs in monitoring the performance of SOEs, and in avoiding political interference in the functioning of SOEs, there is a dearth of empirical studies that show the financial and operational performance of SOEs under SOHCs. However, Temasek's financial success has been documented widely as a case study to showcase the advantages of monitoring SOEs through a holding company structure.

Temasek Holdings has achieved an annualised real return of 3.7% for 20 years that ended on March 31st, 2017. Meanwhile its investments delivered an annual total shareholder return (TSR) of 8% between 2002-22 while Singapore's 20-year annualised core inflation was 1.5%. Longer term 40-year TSR has been 12%. Its net portfolio value was USD 403 billion in 2021-22, compared to USD 77 billion in 2001-02. Its average annual dividend income over the last decade has been USD 8 billion. Temasek's investments have benefited Singaporeans through the Net Investment Return Contribution (NIRC) to the annual budget. The NIRC framework allows the government to spend up to 50% of the long-term expected returns from the reserves. NIRC accounted for about 18% of overall revenues in 2017-18, making it the single largest source of government revenue. But the key question to be asked is — can the salient aspects of the Singapore SOHC model be copied or replicated to any meaningful extent in other countries?

A study undertaken by IADB (IADB, 2019[13]) suggests that in countries with centralised ownership entities, SOEs have had less volatile performance and lower fiscal risks. The ROA (return on assets) is less volatile and usually positive, less dispersion in income and fewer losses on average, the ratio of liabilities to GDP is lower when SOEs are monitored by HCs or centralised ownership entities.

When the correlation between variables that are proxies for financial risk, i.e., cash flow risk (payroll to revenues and financial expenses to revenues) and contingent liabilities (the leverage ratio and SOE liabilities to GDP) was measured against proxies for the type of SOE ownership regime i.e., ROA (return on assets), ROE (return on equity) and net margin, it threw up results supporting SOHCs and other centralised ownership entities.

Having a centralised ownership entity was correlated with higher adjusted ROE and ROA, it was correlated with higher or lower net margins or higher or lower payroll to revenues ratio, it was correlated positively with leverage, but negatively with the size of liabilities to GDP.

The ROA for SOEs in countries with centralised ownership entities is 10% higher on average, than in countries with decentralised ownership. Although in countries with centralised ownership entities, SOEs have performed better and have fewer liabilities relative to GDP, these entities are not reducing other sources of fiscal risk, such as the size of the payroll, the size of interest payments and the leverage ratio.

According to a study by the ADB (2020), between 2010 and 2017 the ROE (return on equity) of Samruk-Kazyna (SK JSC) declined from 12% to 6.3%. the ROE deteriorated mainly because net profit margin dropped from 15.4% in 2010 to 9.8% by 2017. Profit margins declined substantially as crude oil prices in the international market plummeted in 2014. To finance its operations and assets, SK JSC has continued to rely on debt financing between 2009-2017 about 55% of the assets were financed though debt. Meanwhile, productivity dropped from 4.4% in 2020 to 3.0% by 2017. While its net profit margin declined between 2009-2017, SK JSC continued to receive the government's preferential treatment to finance its operations. In comparison to private listed companies in Kazakhstan SK JSC lost in foregone profits USD 36.3 billion or 2.26% of GDP between 2009-2017. The forgone profits reflect underperformance of SK JSC vis-à-vis private listed companies in Kazakhstan. During 2008-2016, SK JSC received about USD 14 billion from national fund to finance its operations. The operational and allocative efficiency of capital employed also declined during 2009-2017.

Despite adopting the formal structure of holding companies, the performance of SK JSC shows that it has been unable to take advantage of the autonomy, economies of scale and scope, cash flows and human resources, and investment opportunities. The holding company structure has not reduced the soft budget constraint and has been unable to act as a buffer between the government and SOEs.

The recent financials from FONAFE suggests that the provisional full year Net Profit projected for 2022 will be USD 562 million compared to the USD 523 million that was projected at mid-year or up 7.5% but only up 1.5% from the 2021 profit level of USD 554 million. The full year Operating Profit (OP) (revenues minus all costs except tax) will be USD 813 million compared to the USD 749 million projected at mid-year. The OP will be up 8.5% from the midyear projection but 2.5% below the OP (USD 834 mln) of

2021. EBITDA (Earnings before Interest, Tax, Depreciation and Amortization) are projected at USD 1,127 million. That is 5.8% above the projection at mid-year but 0.7% below EBITDA for 2021. The Return on Equity (ROE) for 2022 is projected at 8.79% or above the 8.06% projected at mid-year but 2.1% below the 8.97% ROE achieved in 2021. That would suggest that the total equity employed by FONAFE is about USD 6.4 billion.

FONAFE's Total Income (revenue) is projected to be USD 6.052 billion in 2022, up 20.7% from the mid-year projection of USD 5.015 billion and up 22.9% over the 2021 income of USD 4.922 billion. Administrative Expenses are projected to be USD 613 million for 2022. That is 10.5% above the mid-year projection of USD 554 million but 20.3% above the actual admin expenses of USD 505 million in 2021. Operating Efficiency (which FONAFE seems to define as Admin Expenses/Income) is 10.12% or below the mid-year projection of 11.05% and just under the level of 10.26% achieved in 2021. Total Capital Expenditure (Investment) for 2022 will be USD 601 million, well (22.49%) above the USD 499 million projected at mid-year and 37.9% above investment of USD 436 million in 2021.

In terms of FONAFE's forecasting of key financial parameters wide variations seem to occur from projections/forecasts done just three months ago. Administrative expenses seem high relative to assets and profits. On the other hand, capital expenditure (investment) seems low compared to the total equity employed. The sharp jump (23%) in expected income from 2021 to 2022 has seen a similar proportionate increase of 21% in admin expenses. But despite the one-fifth jump in income, there is no similar increase in either operating profit or net profit.

In Finland, the total return on equity has been to 10% p.a. since the establishment of Solidium. The value of the equity holdings that the Finnish State has transferred to Solidium has increased from EUR 5.6 billion in 2008 to EUR 7.1 billion in 2022 and EUR 7 billion has been paid to the State since 2008.

1.9. A granular look at national practices

Ownership policy documents, corporate governance guidelines, codes on ethics set the floor and not the ceiling for practices which affect the relationship between the State and SOEs, their governance bodies, the behaviour of their managers, employees, and Board members but it is up to individual SOHCs and PCs to decide on implementing practices over and above the legal minimum required of them. Below are governance practices in different SOHCs which positively diverge from the norm.

The choice of PCs to be included in an SOHC is determined by strategic relevance, driving and enabling evolving structural trends, adding value by introducing private sector standards into the management of SOEs, by changing the existing culture in SOEs and by introducing international corporate governance measures in SOEs, provision of high-quality services, leading by example in fostering social and environmental values. Strategic interest in a prospective PC is defined by its line ministry in Finland.

To facilitate communication with portfolio companies, Temasek has established the Portfolio Development Group to work together with its PCs to enhance value through partnerships and innovation. This group allows PCs to directly engage with Temasek instead of always communicating through the representative of Temasek on their board. Line ministries in Peru communicate directly with PCs, but they have no channel to negotiate ad hoc budget allocations with their line ministries during the fiscal year. FONAFE shares experiences and practices from the private sector from within Peru and elsewhere from neighbouring countries.

Innovation has been encouraged at Temasek by deploying capital in start-ups and growth sectors, it also partners with industries to pilot or scale sustainable solutions. It plays a role as a catalyst for change in its PCs, bringing together relevant stakeholders and committing capital to support critical R&D advancement. HCAP encourages competitions to crowdsource technological solutions for its PCs.

In some cases, subcommittees of the SOHC Board have worked with the incumbent CEO to review potential successor candidates. The list includes candidates from within the SOHC as well as those from outside. The candidates are grouped according to the timeline for possible CEO succession. This approach has enabled SOHCs to identify future CEO candidates early on, and nurture them as part of its pipeline of future successors.

A culture of integrity has been encouraged to take root by establishing that ignorance of codes of ethics and associated laws provides no defense to any employee or Board member. SOHCs have shared experiences and best practices in preventing corruption. In some cases, employees have been required to take online tests annually to check their awareness of the laws. A portion of their bonuses are withheld if any case of non-compliance has been reported. However, higher remuneration has provided an incentive for compliance. Managers and employees are required to make compliance declarations not only when joining HCAP or its PCs but also every year. A conflict-of-interest screening process has been established for all members of HCAP's supervisory Board and management Board. A similar process is followed with respect to Board members of its PCs.

When a case of non-compliance or corruption has been detected, PCs are required to refer the case to the Ethics Committee of the Board and senior management, followed by an internal investigation, employee sanctioning and reporting to relevant external authorities.

In terms of reporting requirements, PCs are required to report every 6 months to FONAFE on the implementation of the internal system of control including a series of risk management controls, information security protocols, prevention of corruption and corporate social responsibility plans. The reporting requirements under the ÖBAG law are stricter than as required under the joint stock company law in Austria. While HCAP compares its PCs' performance with relevant peers in the same industry.

PCs in Slovenian Sovereign Holding (SSH) belonging to the banking and insurance sector which prepare consolidated financial reports, are required to follow IFRS standards. It is also an option for other PCs to prepare financial reports according to IFRS if their shareholders decide so. While other PCs prepare their reports according to the national law (Slovenian Accounting Standards). Operational risks which SSH is exposed to are recorded in the Master Risk Register in a systemic manner.

The Ministry of Finance appoints the supervisory Board members of ÖBAG, it includes only well accomplished and experienced professionals with knowledge and insight of business. ÖBAG is free to appoint board members and use headhunters to search for the right mix of skills on the board. In Finland, board members are selected by nomination committees in listed companies, in non-listed companies, consultants provide a long list of potential candidates which is narrowed down and is presented at the AGM. No politicians or civil servants serve on Boards of HCs in Austria, Singapore, Greece or in Finland. HCAP's supervisory board is independent from the Greek state and is appointed in part by Greece's creditor institutions.

In general, Temasek is not represented on the boards of its PCs. But Solidium as the minority shareholder in its PCs is working towards having its representatives on the Boards of its PCs in the coming years. The CEO of Solidium is appointed by the Board and the shareholding ministry plays no role in the selection or appointment of the CEO but expects to be informed about the selected candidate before a formal announcement is made.

Although Solidium has minority holdings in nationally important listed companies, Solidium participates in selecting board members of its PCs through their nomination committees together with other major shareholders. Proceeds from divestments are used for new investments or for strengthening existing holdings.

Solidium has its own balance sheet, which allows for the use of leverage and financial leeway to operate independently. Its operating model emphasizes in-depth insight into the holdings, enabling long -term support to PCs in order to add shareholder value.

In Finland, the decision-making in terms of ownership percentages, budget and laws are exercised by Parliament. All decisions on incorporation including acquisitions and divestments are made by the Government Plenary session. Issues related to ownership policy and steering are addressed by the Ministerial Committee on Economic Policy. While the Ownership Steering Department of the Prime Minister's Office is responsible for - corporate governance policies for the entire portfolio and ownership steering of commercial companies, while the ownership steering of special assignment companies is mainly done by relevant ministries.

2 Country case: Österreichische Beteiligungs AG in Austria

Österreichische Beteiligungs AG (ÖBAG) is an independent Holding Company that manages 11 companies partially or wholly owned by the Republic of Austria. The total value of its portfolio companies (PCs) was €34.68 billion as of Dec 2021 accounting for 23% of the Austrian stock market's capitalisation. The company was founded in 1967 and has since gone through several structural changes. ÖBAG has existed in its current form since 2019. Its statutory mandate is to secure and develop Austria as a prime location for business and research, to increase the value of its PCs, and to create and secure jobs in the country.

ÖBAG's PCs can be clustered in three groups according to their corporate form i.e. (a) listed companies; (b) going concerns (which includes a Casino and a real estate company) and (c) a small group of companies which were to be divested during the late 1990s and early 2000s (steel companies) but have still remained in the State's ownership. Some of the SOEs in the third cluster have been portfolio companies of the Austrian State Holding Company since the 1940s. The current law does not provide for their privatisation as the assets are not considered suitable for divestment due to legacy costs, including pension liabilities and the valuation of land holdings.

PCs in ÖBAG are included on the basis of their strategic relevance to the Republic of Austria. Of the listed companies, ÖBAG owns between 28-100% stake in its PCs, while ÖBAG itself is 100% owned by the Republic of Austria. The rationale for setting up ÖBAG in its current legal form stemmed from a common understanding that Austrian capital markets and industrial groups needed protection from political influence and external predation. But the State retains veto rights when it comes to the identity of PCs and securing headquarters for companies in Austria. The current legal status of ÖBAG as a joint stock company provides it strong protection against political interference, its management is autonomous and so is its supervisory board. The State participates only during the AGM.

The process of changing the legal status of ÖBAG from a Limited Liability Company (LLC) to a joint stock company (JSC) was not difficult, though the transformation was lengthy, given new requirements for staffing. There has been a significant change in the management of ÖBAG, with the supervisory board and its independent members being the key top-level decision-makers; unlike in the past under LLC when board members were representatives of the ministry and when information on strategic issues was not shared with ÖBAG's management.

Apart from complying with domestic company law, there is a separate ÖBAG law which specifies its reporting obligations to both internal and external stakeholders. The reporting requirements under the ÖBAG law are stricter than required under joint stock company law. The ÖBAG law also specifies how: boards should be appointed at HC and PC levels; ÖBAG should help the State maintain its importance as a regional/global HQ location for multinational businesses; its budget administration and corporate governance norms should be applied to itself and its PCs.

The supervisory board of ÖBAG is appointed by the Ministry of Finance. It includes accomplished, experienced professionals with knowledge and insight of business. The board has not yet been able to attract foreign professionals as its members, although the supervisory boards of some of the PCs have managed to attract expert foreign professionals.

Key strategic decisions are made by the board; however, the Ministry of Finance retains its right to intervene in exceptional cases (diversity requirements). The Ministry has an ownership policy document but that is not applicable to ÖBAG. It has direct access to the CEO of ÖBAG for any information related to the HC and its PCs in addition to informal meetings on the performance of PCs. ÖBAG receives no direct instructions from the Ministry.

The public corporate governance code (CGC) is applicable to ÖBAG and all its PCs, while the listed corporate governance code is applicable to PCs listed on the stock market. The public CGC provides standards for different processes, including the appointment of top managers, succession planning, remuneration and ESG. These standards are communicated to PCs via their supervisory Boards. The Chair of the Supervisory Board, or the CEO as the shareholder representative, encourages PCs to implement the public CGC, strategic and ESG objectives.

ÖBAG is free to appoint board members and use headhunters to search for the right mix of skills on the board. ÖBAG then screens prospective directors on the basis of criteria approved by the CEO. The Chair and deputies of the supervisory Board, approve the appointments of supervisory boards in PCs. The CEO and management boards of PCs are appointed by the supervisory boards of the PCs. ÖBAG has its representative on supervisory boards of all PCs. The CEO of ÖBAG chairs its supervisory board but he/she cannot be the chair of more than 2-3 supervisory boards of PCs. Supervisory boards of PCs have independent chairs and there are no overlapping board members in PCs. This helps in avoiding interlocking Board memberships. Communication among PCs is facilitated through regular workshops and other informal events where companies and their board members share best practices in ESG.

PCs' investment projects are funded after they have applied to ÖBAG for a project budget, with the exception of one PC whose budget is allocated directly from the Ministry of Finance. The ÖBAG supervisory board approves the budget, taking into the strategic value of the investment and the relevant risks involved. Dividends from PCs fund the operational costs of ÖBAG. A significant proportion of the dividends are reinvested after pay-out to the Treasury. There is regular communication with the Ministry on dividend expectations and realistic payouts.

ÖBAG's management performance is measured on the basis of overall HC performance, investment management and KPIs. Other criteria include how PCs grew in the last year; changes in their market capitalisation; and how ÖBAG helped Austria in developing its reputation as an international business destination. ÖBAG applies IFRS accounting standards to report on its financial performance and position. Internal auditors and the court of external auditors, through their oversight mandate of all processes/procedures, determine the quality of financial reporting. ÖBAG is obliged to report annually to Parliament, providing an overview of its performance and that of its PCs.

ÖBAG implements anti-corruption measures by making both management and supervisory Board members aware of the different conflicts of interest situations and are reminded annually of these situations and appropriate disclosure. The compliance departments at PCs are responsible for implementing anti-corruption measures. Risk management is done at HC and PCs through risk management departments and audit committees. There are laws prohibiting lobbying but are not applicable to ÖBAG.

3 Country case: Hellenic Corporation of Assets and Participations in Greece

At present, 90% of Greek SOEs are structured under the auspices of the Hellenic Corporation for Assets and Participations (HCAP), an independent holding company for state assets mandated by Greece's 2015 bailout and formally launched in 2016. The August 2015 ESM bailout agreement required Greece to consolidate the Hellenic Republic Asset Development Fund (HRADF), the Hellenic Financial Stability Fund (HFSF), the Public Properties Company (ETAD), and a new entity that will manage other SOEs into the HCAP, formed by Law 4389/2016. In March 2017, HCAP received short- and long-term guidelines from the Minister of Finance, and in September 2017, it received strategic guidelines from the Greek state (HCAP's sole shareholder).

Some SOEs are still supervised by the Greek Finance Ministry's Special Secretariat for Public Enterprises and Organizations, established by Law 3429/2005. There are plans to bring these under HCAP to increase their value. Since 2016, one of HCAP's PC has been divested and 22 airports and real estate assets are to be privatized in the coming years. There are currently three PCs which are listed on the stock markets and one PC which will be listed soon.

HCAP includes SOEs operating in core sectors of the Greek economy such as energy, water and sewerage, infrastructure, transportation, and services. Examples are the Public Power Corporation SA, Corinth Canal Company SA, Athens Water Supply and Sewerage Company SA (EYDAP), Railway Property Management SA (GAIAOSE), HELEXPO SA (Thessaloniki International Fair), Hellenic Saltworks SA, Hellenic Post SA (ELTA), Central Market of Thessaloniki SA, OASA SA, and Central Markets and Fishery Organization SA.

The reasons behind choosing the holding company structure by Greece's creditors was to: ensure that there was minimal political interference in the functioning of SOEs; introduce private sector standards in the management of SOEs; change the culture in SOEs at the time; and introduce international corporate governance measures in SOEs. Although the establishment of the holding company structure was a controversial move in 2015-16 with fiery debates in Parliament over a long time, the dividends received from HCAP by the Treasury since then have put to rest any reservations over its creation and functioning.

HCAP is subject to a special legal regime, but Company Law provisions and procurement rules for the private sector apply to it as well. HCAP's statutory legal framework includes references to OECD' standards on corporate governance, supervision and transparency of procedures, best practices on social and environmental issues, responsible entrepreneurship, and stakeholder engagement, as well as the EU legal framework and the common values of the European Union regarding SOEs and Services of General Economic Interest (SGEI). HCAP is required to have an in-depth knowledge and understanding of these frameworks to implement their principles in its internal procedures and in its decision-making process.

HCAP's supervisory board is independent from the Greek state and is appointed in part by Greece's creditor institutions. There are 5 members in the supervisory board, three of whom are selected by the Ministry of Finance, with the agreement of the European Commission (EC) and the European Stability

Mechanism (ESM). The other two members, one of whom is the Chairman of the Supervisory Board, are selected by EC and ESM, with the agreement of the Minister of Finance. The Board of Directors is appointed by the Supervisory Board in accordance with the provisions in article 192 of Law 4389/2016.

The Board is made up of five to nine members appointed for four years. The supervisory board also appoints the CEO and its decision on this matter is final, even if the Ministry of Finance flags its reservation over the candidacy. No politicians or civil servants serve on HCAP's Boards but there is active collaboration with the State with specific guidelines for communication with the Ministry of Finance. HCAP is autonomous but maintains a sound balance in its relations with the Ministry of Finance. Strategic guidelines are provided by the Ministry of Finance, following which the management Board prepares a strategic and business plan for HCAP.

The State and HCAP interact essentially through three channels – General Assembly, during the preparation of strategic plan and the coordination mechanism. Despite these channels of interaction, managerial autonomy of HCAP is complete in every material respect. The General Assembly approves the Annual Financial Report, any modification of capital, approves decisions of HCAP, internal regulations and decides on the establishment of any new subsidiaries. The Strategic plan is prepared by HCAP based on the strategic guidelines of the Minister of Finance. Ministerial guidelines define the State's ownership policy concerning HCAP's PCs. The factors that are taken into account for the preparation of the ministerial strategic guidelines are the State's general development strategy, sectoral policy and financial performance. The Strategic Plan is approved by the General Assembly. The Coordination Mechanism is a forum where the government, HCAP and its PCs are in consultation to produce three key documents – each PC's mandate, the Statement of Commitments for each PC and special obligations of PCs. The Statement of Commitments states strategic, operational and financial targets for each PC for a specific time horizon. The Special obligations are commissioned following the European framework for Services of General Economic Interest.

Article 189 of Law 4389/2016 establishes the Internal Regulations that govern the operation of HCAP and its PCs. That document is based on international best practices and OECD guidelines. It has been adopted after consultations with all the key stakeholders including the EC and the Ministry of Finance. The document provides frameworks for: performance auditing, performance monitoring, corporate governance, conflicts of interest, confidentiality obligations, coordination mechanisms, investment policy, dividends policy, and procurement. The Strategic Plan of HCAP serves as the state ownership policy document specifying how the state exercises its role as the owner.

HCAP follows a communication protocol with the senior-most official at the Ministry of Finance, the general secretary once a month to report on regular financial matters with specific regular meetings on significant projects. Discussions with the shareholder ministry are usually related to PCs.

HCAP sets KPIs annually for its PCs which cover four areas of strategic importance including targets related to financial performance, quality of the offered services, implementing best practices in corporate governance, compliance and accountability, stakeholder engagement and improving the environmental footprint. Once KPIs are set the shareholder ministry is notified.

However, specific public policy initiatives need to be implemented to achieve objectives set by the state. HCAP's Strategic Planning department supervises and enforces its mandate through meetings which take place monthly. There is a constant flow of information between PCs and HCAP with directors at PCs being required to make regular presentations to HCAP. The PCs and HCAP communicate regularly regarding the latter's expectations, strategic plans and public policy initiatives through workshops, technical dialogues with each PC.

The principal source of funding for PCs is the state, although there is a future possibility that PCs might be able to raise funds directly from capital markets with HCAP providing credit guarantees to creditors of its

PCs. HCAP has the autonomy to use €40 million of its authorized and paid-up capital of €140 million for this purpose.

The dividend policy at HCAP is determined by liquidity needs of PCs. 50% of the dividends are used to repay debts. Of the rest, 55% goes to the treasury and 45% goes towards investment.

As an intermediary, HCAP has introduced horizontal cooperation initiatives and exchanges of best practices across its PCs to accelerate digital transformation, enrich human capital and promote innovation. It encourages: the adoption of advanced technologies to meet the real challenges of PCs, incentivized competition to crowd-source technological solutions for its PCs, and synergies within the innovation ecosystem.

It coordinates initiatives to strengthen and promote data generation and management activities, as well as the implementation of an Open Data Hub. HCAP implements programs to upgrade cybersecurity in its PCs, and provides training, information, and awareness of compliance for executives. It supports PCs in transitioning to e-mobility, with initial focus on corporate vehicles and/or auxiliary vehicles. It provides assistance to the finance department in drafting and correcting financial statements, along with technical knowledge to the internal audit department.

HCAP's Management Board appoint members to the Boards of its PCs following proposals received from the Nomination Committee. The Ministry of Finance reserves the right to appoint one non-executive Director on the Board of any PC. The Supervisory Board’s consent is required to make any changes in the Boards of PCs. The HCAP Management Board also appoints the CEOs of PCs. Boards of PCs communicate with HCAP Management Board committees, and it is the Management Board which informs the Supervisory Board.

There is a representative of HCAP on each PC Board and in the case of strategically important PCs, executive members of HCAP are members of PC Boards. There is a Board effectiveness review every two years at both HCAP and PC levels. HCAP reviews the performance of its PCs on a continuous basis, through regular meetings with PC Boards, reports received from HCAP’s representatives on PC Boards, and by comparing PCs’ performance with relevant peers in the same industry. Ongoing performance monitoring is carried out through monthly or quarterly progress reports. Regular performance review is done through aggregate reports.

These reports contain information on how the Strategic Plan has been implemented. Financial reports are prepared by following the IFRS standards. Financial reports are audited by independent external auditors. State audit can take place in exceptional cases. HCAP reports to Parliament but not on a regular basis.

HCAP's compliance function has also developed mechanisms and procedures to prevent conflicts of interest. Managers and employees are required to make compliance declarations when joining HCAP or its PCs and repeat that every year. A conflict-of-interest screening process has been established for all members of HCAP’s supervisory and management Boards. A similar process is followed with respect to Board members of all PCs.

The implementation of compliance policies and procedures in PCs is systematically monitored through specific KPIs. Compliance officers have also been appointed in most PCs in order to implement compliance rules and procedures. In addition, quarterly meetings are held between HCAP’s Compliance department and that of its PCs.

Much emphasis has been placed on training and professional development of Compliance Officers with regular seminars and workshops being organised to bolster this effort. HCAP's Compliance organizes a number of interactive workshops/seminars to promote compliance/business ethics and raise awareness. A new whistleblowing system for illegal and/or inappropriate conduct has been introduced by HCAP in early 2022 along with new laws that criminalize the bribing of foreign and domestic public officials.

Risk management at HCAP involves risk assessment by an outside consultant, a risk officer at HCAP and by risk managers at PCs, all of whom coordinate with the risk committee. There are no such risk committees at PC level. HCAP and the National Transparency Authority (NTA) have signed a cooperation agreement aimed at the exchange of best practices and know-how regarding business ethics, integrity, and internal audit. The HCAP-NTA collaboration will focus on the development of new policies, on the evaluation and implementation of existing practices and tools towards the enhancement of transparency and accountability, as well as the development of a methodology for the corruption and fraud risk assessment.

4 Country case: Samruk-Kazyna in Kazakhstan

The Samruk-Kazyna Joint Stock Company (SK JSC), the SOHC of the Republic of Kazakhstan was created in 2008 by a Presidential Decree, through the merger of two large state conglomerates: Sustainable Development Fund Kazyna and Kazakhstan's Holding for the Management of State Assets Samruk. The fund was established to: facilitate modernization and diversification of the economy; participate in diversifying and stabilizing the economy; and to enhance the efficiency of companies. The sole shareholder of SK JSC is the government of the Republic of Kazakhstan.

The current mission of the SOHC is to create long-term value and stimulate sustainable economic development through effective asset management. The holding company structure in Kazakhstan was inspired by the models of Temasek (in Singapore) and Khazanah (in Malaysia) to monitor and facilitate the functioning of SOEs; to increase value addition by SOEs; better structure financial flows between the State and SOEs; and to create a political buffer.

SK JSC controls almost all of Kazakhstan's strategic corporate assets amounting to 40% of its GDP in 2017 (ADB, 2020). Five of its PCs (in the telecoms, railways, and energy sectors) are listed on the stock market. Between 2021-25, SK JSC plans to privatise 25 of its PCs including 8 large (KazMunayGaz, Air Astana, QAZAQ Air, Kazpost, Samruk-Energy) and 17 small companies. These companies have been identified for divestment on the basis of their profitability, financial performance and a competitiveness criterion.

There is an "Agreement" between the SOHC and the State that sets out the principles of their interaction, the roles of different relevant ministries, and how the State should exercise its role as the shareholder through the Board. There is a separate law for the Sovereign Wealth Fund (SWF) and a separate charter that are applicable to the SOHC and its board, shareholder, and executive bodies. The government appoints the Board, which has six Board members. Two of them are representatives of the government i.e., the Minister of National Economy and the Adviser to the President. Three directors are independent, one is the Chair of the SOHC. There are no civil servants or political appointees on the Boards of PCs. The SOHC provides advice to the government on matters related to industrial policy.

The shareholder ministry has no direct access to the top executives of PCs who are required to report only to the management and Board of the HC. The CEO of each PC reports to the HC Board on a quarterly basis. Although, the HC is not required to report to the shareholder ministry, matters related to large investment projects which may affect the government's fiscal objectives are discussed with the Ministry of Finance through the Board. Informal channels between the HC and shareholder ministry exist to exchange views on new investments and to propose new ideas. In addition, the Ministry of National Economy sets strict limits on the HC's borrowing from foreign sources. The shareholder ministry decides on HC dividend policy. The HC attracts funds from the government to fulfil social objectives and is therefore obliged to report to the shareholder ministry on implementation and achievement.

The SOHC develops the strategy for its PCs and sets corporate and strategic KPIs. These are reviewed every 6 months at PC Board level and reviewed by the HC every quarter. In addition to monitoring the KPIs, the HC sets standards for returns from investment projects, informs its PCs of best practices from around the world, help raise funds for its PCs from capital markets, negotiates with banks on behalf of its PCs, and provides credit guarantees to its PCs.

PCs have autonomy in allocating these funds for their projects as long as they follow the set framework on allocation for certain projects and budget guidelines. For Special Purpose Vehicles (SPVs), as the funding is provided by the HC, there is stricter scrutiny of what PCs do. If PCs seek additional funding, there is a review of the current allocation of funds.

The HC also acts as an intermediary for human capital, by establishing a committee of experts and special departments in PCs to provide technical advice on projects. If in-house expertise is not available, the HC helps PCs in sourcing consultants from outside.

Under the HC's CEO, there are five Managing Directors, each of whom is a Board member in 4 of the PCs. So, there are 2-3 HC Managing Directors who serve as directors on a PC Board at any point of time. Managing Directors are the representatives of the HC on Boards of PCs. PCs seek expert advice from the HC. HC intervenes operationally in PCs only when KPIs are not met.

CEOs, along with CFOs, report to their respective PC Boards on a quarterly basis on their plan of activities and on matters (investment, health, and safety) underlined in the overall strategy. The HC reviews these business plans annually to see if they are realistic or not. Boards of PCs comprise representatives of shareholders (approved by the management board), independent members and the CEO of the company. The number of Board directors depends on the size and complexity of operations of the PCs. The HC appoints PC Board members on the basis of technical criteria. If the HC is not the sole shareholder of the PC, it provides only its opinion on Board candidates. Managers of the HC or CEOs of PCs do not serve on the Boards of other PCs.

The HC has ambitious plans to introduce a 30% quota for women directors of the Boards of both the HC and PCs. Samruk-Kazyna also seeks significant changes to the existing corporate governance code, in order to make it concise and easy to comprehend. It plans to incorporate the OECD guidelines and the UK corporate governance code and separate the regulatory guidelines from the corporate governance code.

Large PCs are required to transfer 50% of their declared dividends to the treasury. Listed PCs have an autonomous dividend policy. Smaller PCs are required to pay minimum dividends from their free cash flows to the Treasury. Financial reports of both the HC and PCs are prepared for key stakeholders, including investors and a wider range of interested parties, in accordance with IFRS. Financial reports are audited by independent auditors annually. Once every three years the State accounting committee audits the use of funds provided by the State. The HC is not required to report to Parliament but is required to participate in relevant Parliamentary discussions. The HC implements best practices related to corporate governance, accounting, and audit from the private sector.

All managers and employees of the HC are subject to integrity checks by the Compliance department including illegal activities, nepotism, etc. The Audit and Security departments inform the Compliance department of their critical findings biennially. Detected cases are analysed by both the Compliance and Security departments and CEOs of PCs are informed accordingly. The Compliance Department reports directly to the Supervisory Board and the Security Department reports to the Management Board. When significant corruption has been detected, it is first reported to the CEO and then to State authorities, low level corruption is reported to the CEO for further action. There are anti-corruption laws which apply to all employees of HC and PCs. There are laws criminalising bribery of domestic public officials.

5 Country case: Fondo Nacional de Financiamiento de la actividad Empresarial del Estado in Peru

The National Fund for the Financing of the State-owned Enterprises (FONAFE) began its activities in 1999, under Law No. 27170, created as a public law company. It has 35 portfolio companies under its management except Petroperu. It also monitors ESSSALUD, the public entity that provides workers health insurance. FONAFE's PCs belong to diverse sectors electricity, health, manufacturing, oil and gas, water and sewage, infrastructure, transportation, financial services. In addition, FONAFE controls a variety of PCs in sectors like printing, security, janitorial services, airplane maintenance, and weapons manufacturing for the Army of Peru.

FONAFE's contribution to the Peruvian economy includes: 3% of total public investment, 2.2% of GDP, 19% of electricity production, 62% of electricity distribution, 50% of water distribution, 86% of healthcare coverage and 87% of districts have been covered by Banco de la Nacion (as of Dec 2020). Thirteen of its PCs are listed on the stock market.

FONAFE's three main functions are to monitoring and disciplining business activities of its PCs, approve their budgets, and manage the proceeds from returns on investment in its PCs. Its mission is to operate modern SOEs, recognized for providing high-quality services and goods responsibly. Its strategic mission includes the creation of economic value, provision of high-quality services, fostering of social and environmental value, training of human capital, and improvement of corporate governance.

The rationale for setting up FONAFE was to gain better control and coordination of SOEs under the Ministry of Finance. The legislative process of establishing FONAFE was arduous. It was established with special legal status, although many of the provisions of domestic Companies Law apply to FONAFE as well.

FONAFE promotes efficiency in its PCs by issuing directives and management guidelines that encourage best management practices, according to a study by the IADB (IADB, 2019[13]), FONAFE's performance has been improving and its total income has been consistently positive. FONAFE has been effective in keeping the size of the liabilities of its PCs constant and at low levels relative to GDP.

FONAFE has accomplished these consistent results with its corporate guidelines which include steering its PCs in drafting five-year strategic plans, annual management plans, and annual operating plans. Its aim is to: operate profitable SOEs that are socially responsible, streamline the management of SOEs by introducing state-of-the-art processes. These relate to compliance, project evaluation, transparency, integrity and ethics at both FONAFE and its PCs, following the Code of Best Practices of Corporate Governance and centralising procurement where possible.

The organization structure of FONAFE has the Ministry of Finance as its main shareholder, with a Board that comprises five sector ministers (including the Minister of Economy and Finance as the Chairperson, the Prime Minister, the Minister of Energy and Mining, Minister of Housing, Construction and Sanitation, and the Minister of Transportation and Communication), the CEO, and its top management which functions through management committees. The National Congress of Peru oversees the budget and investments of FONAFE. However, FONAFE enjoys a degree of separation from the government as it appoints top managers and Boards at its PCs, approves their strategic and investment plans, and monitors and approves their funding plans.

FONAFE is required to report to all ministries on the Board and other line ministries on a quarterly basis. In addition, it needs to report to Parliament, to the Chair of the Parliamentary budgetary committee and the budget and accounting division of the Ministry of Finance. There is fluid coordination and relationship with Ministry of Finance and communication takes place on a regular basis.

Line ministries communicate directly with PCs, but they have no channel to negotiate ad hoc budget allocations with their line ministries during the fiscal year. Formal proposals from different ministries are reviewed by FONAFE specially to assess if PCs will be able to comply with the new proposals. FONAFE or its PCs do not receive any direct instructions from line ministries.

FONAFE is responsible for preparing a technical document called the strategic planning document which incorporates inputs from PCs. These inputs are gathered by an external consultant. The plan document is then presented to the FONAFE Board which evaluates it on the basis of its alignment with relevant government policies and sector policies.

Boards of PCs set out their annual objectives for their respective PCs in consultation with line ministries and FONAFE. The plans are finally approved by FONAFE Board along with the performance indicators used to measure progress in these objectives. FONAFE can make modifications to the plan annually as long as they are approved by the Board.

Annual operating plans outline how the objectives set out in the strategic plan are to be accomplished. These are submitted before the end of December every year. The plan outlines the goals and the scorecards and key performance indicators used for evaluation. Budget plans have to be submitted for approval to FONAFE and have to be approved by the Board before December 31 every year. The budget has to follow the strategic and operating plans and should be consistent with the fiscal objectives of the government (IADB, 2019[13]).

FONAFE monitors its PCs using balanced scorecards indicators and strategic planning goals. Strategic alignment is monitored through indicators that measure long -term goals and objectives, indicators that measure yearly objectives aligned with long-term objectives, and a management agreement between FONAFE and its PCs, in terms of closing gaps in quality and coverage, improving results and efficiency, and implementation of good management practices. FONAFE reaps the benefits of synergies arising from budgeting, logistics, treasury services, specialised networking, social responsibility, planning, accounting, legal services and human resources.

FONAFE tracks progress and follows up on the execution of proposed plans on a quarterly basis. PCs are required to report on the progress for the year and include a strategic plan progress report that tracks whether the PC is making progress in accomplishing the goals set out. In addition, PCs must prepare quarterly management reports which include detailed financials and track the execution of the operating and strategic plans.

PCs are required to report semi-annually to FONAFE on the implementation of the internal system of control, including a series of risk management controls, information security protocols, prevention of corruption, and corporate social responsibility plans. PCs annual reports must detail the implementation of the code of best practices of corporate governance. When objectives are met, PC staff are rewarded with bonuses.

FONAFE communicates regularly with its PCs in order to ensure that PCs are aware of new laws, and new quality and performance indicators. It shares experiences and practices from the private sector from within Peru and elsewhere from neighboring countries. FONAFE conducts surveys, workshops, and meetings to communicate on new initiatives and best practices.

As FONAFE not only monitors the budgets and capital projects of its PCs but also approves PC expenditures and projects, it has the financial autonomy to provide funds to PCs to incur such expenditure. The principal source of funds for PCs therefore is funds from FONAFE for capital increases. FONAFE also lends medium to long-term funds to PCs. FONAFE raises funds from the markets only for short-term needs of its PCs. FONAFE management's autonomous funding decisions go up to the limit of USD 6 million, beyond which it needs the approval of its Board.

FONAFE's financial reports include balance and profit and loss statements, a statement of budget execution, a report of the execution of capital projects, and cash flow statements. They are publicly available on the pages of each PC on FONAFE's website, and they are required to follow IFRS standards.

6 Country case: Temasek in Singapore

Temasek due to its long history and financial success has been a reference model for many governments around the world. It was established in 1974 under the Singapore Companies Act as a private company. It took over the responsibility of monitoring an eclectic collection of government investments in 35 companies from the Ministry of Finance. While the government is the sole equity shareholder of Temasek, the company owns its assets outright as a commercial investment company, rather than as a fund manager for the government.

The Government since independence felt the need to separate governance from running businesses. It was this principle that led to the establishment of Temasek to own and manage assets previously held by the Singapore Government. The objective of a commercial investment company, owning and managing these assets, was to allow the government to focus on its core role of policymaking and regulating. Temasek has provided valuable inputs over the years to government policies aimed at changing business behavior through incentives and regulation.

Over the years, successive Finance Ministers, have publicly reaffirmed that Temasek has been run with commercial discipline in order to maximise long-term risk-adjusted returns, with its investment decisions being independent of any government interference or influence. This unique governance principle has been strictly observed by Singapore over the years. The government has respected fully Temasek's commercial mandate, its expertise in maintaining and running the assets it owns, and its strict commercial discipline. Its experience has affirmed its willingness to be a benign, arms-length shareholder.

With the sole objective of seeking investment opportunities that deliver good returns, Temasek has expanded its reach from Singapore into Asia (especially the ASEAN member countries and India), Europe and the US. Currently, 71% of Temasek's portfolio is comprised of foreign assets. Temasek's initial portfolio in 1974 reflected Singapore's early stages of industrialisation. In 2002, it started investing in Asia and has since increased its exposure outside Asia to capture global opportunities for returns and keeping up with technical innovation.

The global, structural trends that have guided Temasek's recent investments include digitalization, future of consumption, sustainable living, and longer lifespans. Aligning its portfolio with such trends includes investing in companies that directly enable and drive these trends, as well as those that harness future the potential of the trends for growth. Temasek has accordingly invested in innovations and technologies at pre-commercialised stages in the areas of Artificial Intelligence, Blockchain, Cyber and Deep Tech.

But, despite these shifts at the margin, Temasek's portfolio consists predominantly of investments in financial services, transportation and industrials, telecommunications, media and technology. Decisions to invest, divest or hold its investment positions are based on Temasek's intrinsic value-test. Taking this pragmatic approach has meant that Temasek does not consider any of its investments as 'sacred cows'.

Accordingly, Temasek's portfolio has evolved, alongside the risks and opportunities that present from time to time, and the structural trends that have developed globally. Along with its investment activities, Temasek has cultivated business relationships by introducing American companies to Asia, combining know-how (value-addition) with know-who.

In addition to Temasek, the government of Singapore also owns the Government Investment Company (GIC) and the Changi airport group. To encourage inward foreign investment into Singapore and globalization of Singaporean companies, there is also the Economic Development Board, an agency under the Ministry of Trade and Industry.

Temasek was birthed as a pragmatic experiment of 20th century Singapore, as Singapore was defining its place in the world, after a tumultuous beginning. Three years after unexpected independence in 1965, Britain announced it would accelerate the withdrawal of their armed forces from Singapore, by 1971. A fifth of economic activity in Singapore at the time, was attributed to British forces and associated defence industries. British naval military dockyards and electronic workshops were converted and transformed into commercial start-ups and civilian businesses. the workforce was retrained to prepare for new jobs being created through massive industrialisation and investment promotion. Singapore grew at 12% of GDP in 1971, averting a potential economic disaster. The experience gained by the young government of the time helped instill the principles of efficiency, frugality, optimum use of resources, and prudence in all its operations.

The relationship between Temasek and its PCs is similar to the relationship between Temasek and its shareholder, the Minister of Finance. Neither the President nor the Government is involved in Temasek's investment or other business and corporate decisions, except in relation to the President's role in the Temasek's reserves. Similarly, Temasek does not direct the business decisions and operations of its PCs. Instead, Temasek expects the boards and management of these companies to take responsibility and accountability for their actions and activities. Temasek regularly shares its views and outlook with its PCs.

Discussions with PCs boards are held when Temasek is concerned about its investment and when new directions or strategies need to be implemented. Senior management of Temasek communicates with PCs but only in cognizance of the board. As an active and engaged shareholder, Temasek supports the formation of high caliber, experience and diverse boards and advocates that boards be independent of management and comprise majority independent board members. Temasek seeks to add value to its PCs through all stages of growth, from early stage to mature enterprises. Temasek keeps abreast of industry developments that affect its PCs and tracks their performance. It engages regularly with their boards and management, to better understand their strategies and responses to changing operating environments, and long-term trends. Temasek has established a Portfolio Development Group to work together with its major PCs to enhance value through partnerships and innovation. The Portfolio Development Group encourages PCs to engage with Temasek directly, instead of communicating only through the representative of Temasek on their boards. Temasek does not encourage its top managers or board members to be on the boards of PCs. But that has been done in exceptional cases when the need arose to understand the day-to-day operations of a particular PC to assess its value as a Temasek asset.

In general, Temasek is not represented on the boards of its PCs. Temasek promotes sound corporate governance in its PCs by supporting high caliber, experienced and diverse boards to complement management leadership. By leveraging its wide network of contacts, Temasek can suggest qualified individuals for consideration by the respective boards, Temasek employees on boards would be appointed in their personal capacity and are expected to meet their fiduciary responsibilities as directors of companies.

Temasek's long term investment horizon puts Temasek in a position to support companies to become more sustainable. It can deploy capital in start-ups and growth sectors, partners with industries to pilot or scale sustainable solutions, and invest with PCs to help during the transition phase towards a zero-carbon economy.

It engages with PCs regularly on their climate transition plans by organizing annual fora, conferences to communicate on all new initiatives, share the best examples from within the Temasek group. In its engagements with PCs, Temasek shares its expectations around setting climate targets, drawing up transition plans and providing relevant disclosures in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TFCFD).

In hard to abate sectors such as heavy industry and transportation, where broader system and technology changes are required for a successful sector transition. Temasek plays its part as a catalyst for change in its PCs, bringing together relevant stakeholders and committing capital to support critical R&D advancement. One example of this approach has been the establishment of Centre for Hydrogen Innovations in partnership with the National University of Singapore to advance research in hydrogen production, transportation, storage, and end-use applications that push technological frontiers.

Temasek has continued to support its PCs in building capacity in carbon management by partnering with academic institutions to build board and executive-management level capacity to drive the sustainability and climate agenda. It continues to provide hands-on training on carbon measurement and disclosures for relevant operational teams in its PCs.

The Temasek Portfolio Companies Sustainability Council brings together the CEOs and Sustainability Leads of its major PCs twice a year to share successful sustainability strategies and forge potential collaborations on sustainability initiatives. Re-insurance providers have helped PCs to better understand their exposure to physical climate risks.

Temasek declares dividends annually in accordance with its dividend policy. Its Board sets its dividend policy, balancing the sustainable distribution of profits as dividends to its shareholder with the retention of profits for reinvestment. Its Board recommends the dividend pay-out for the shareholder's acceptance at the annual general meeting. Under the Net Investment Returns (NIR) framework[12], the government can spend up to 50% of the expected long term real rates of return of Temasek. The NIR framework does not affect Temasek's dividend policy.

As a policy, Temasek does not issue financial guarantees for the debt obligations of its PCs.

The process is consistent with the long-term perspective that Temasek takes as an investor. Once a candidate has been identified as a potential CEO, he/she is interviewed by the Board, individually and as a group. After the Board's assessment of the candidate to be suitable and the best one available, the Board's recommends the appointment of the CEO, to the President for his/her approval.

Temasek's current Board consists of 13 members, the majority of whom are non-executive independent private sector business leaders. The annual Board schedule includes quarterly two-day meetings, and additional meetings as needed, such as for approve large investments. There are four Board committees (Executive, Audit, Leadership Development & Compensation, and Risk & Sustainability), each chaired by a non-executive Director, who is independent of management.

The Board has separate and independent access to information, including the opportunity to request supplementary information from management. Management provides information to the Board on an ongoing basis, including minutes of key management committee meetings, to allow the Board to effectively discharge its responsibilities.

In 2018, Temasek adopted the International Financial Reporting Standards (IFRS), in line with Singapore's convergence with IFRS. Management is responsible for the preparation and presentation of the Group Financial Summary which are audited by external auditors. Temasek is

[1] The investment returns of our reserves supplement the annual Budget through the Net Investment Returns Contribution (NIRC). Net Investment Returns Contribution (NIRC) comprises of up to 50% of the Net Investment Returns (NIR) on the net assets invested by GIC, MAS and Temasek; and, up to 50% of the Net Investment Income (NII) derived from past reserves from the remaining assets.

not required to report to Parliament. Temasek complies with all its obligations under Singapore laws and regulations, as well as those of the jurisdictions where it has investments or operations. Likewise, Temasek expects its PCs to comply with their obligations under the laws and regulations of jurisdictions in which they have investments or operations.

Temasek encourages and facilitates the development of a sound corporate culture that incentivizes good staff behaviour. All employees and the Board of Temasek and its PCs must comply with the Prevention of Corruption Act. In addition, they must also comply with the Corporate Governance Code, and the Code of Ethics.

Temasek's Organisational Risk Management Framework includes Risk Return Appetite Statement (RRAS) which set out various levels of risk tolerance, from reputational risk to liquidity risk and sustained loss of overall portfolio value over prolonged periods. To minimize operational risks, Temasek embeds risk management in its systems and processes. These include approval authority delegation, company policies, standard operating procedures, and risk reporting to the Board.

7 Country case: Slovenia Sovereign Holding

Between 1991 and 2000, SOEs were managed by various ministries including the Ministry of Finance, Trade, & Infrastructure. In 2010, the Capital Assets Management Agency was established to centralize the management of some 70 SOEs. The law founding the Agency defined the role, as well as the governing mechanisms and structure of the new body. It led to more transparent management of SOEs, including: the public disclosure of State votes during shareholder meetings, the appointment of a nomination committee for evaluating candidates for SOEs supervisory boards, and for monitoring/benchmarking of SOEs' performance.

In 2014, the Slovenian Sovereign Holding (SSH) was established by merging the Capital Assets Management Agency with the Slovenian Restitution Fund. The State also adopted a new asset management strategy classifying state assets into three: strategic (80%), important (14.8%) and portfolio (5.2%) categories. The assets are predominantly in four sectors: i.e., transport (42%), energy (30.6%), finance (17.9%) and tourism & general economy (9.6%). There are 11 PCs that are listed on the stock market.

SSH was established with the purpose of providing a concerted, transparent, professional management of the State's capital assets separated from political interference. SSH is authorised to manage assets held by the State. The term "asset management" covers the acquisition of capital assets, the disposal of capital assets, as well as the exercise of shareholder's or member's rights, in accordance with relevant laws. Before the establishment of SSH, SOEs were under the management of several line ministries and could not function freely or independently.

SSH has been established as a Joint Stock Company with the provisions of the Companies Act applying to it. The organization of SSH includes a dual board structure with a supervisory Board and a management Board. The SSH supervisory Board consists of five members proposed by the government but appointed by Parliament after the Ministry of Finance has established a committee to search for qualified candidates. The management Board has three members: its President and two members appointed by the supervisory Board.

The management Board appoints an Expert Committee for Economic and Social Affairs -- a seven-member consultation body of the SSH. Its members are appointed by Slovenia's representative trade unions and confederations (members of the Economic and Social Council) and approved by the SSH management Board. There is a representative from the Ministry of Finance and Economy on the supervisory board. He/she has no voting rights and is an observer member. In addition, the Chair of the finance and budget committee of Parliament, who is a member of an opposition party, also has an observer status on the supervisory Board.

The SSH supervisory board evaluates its own performance/efficiency and reports on the extent to which the self-assessment has contributed to changes in its functioning. It assesses its current structure, operation, potential and actual conflicts of interest with regard to its individual members and the Board as a whole and its cooperation with the management Board.

There is no specific ownership policy document, but the state communicates its expectations of SSH about state asset management through the State Assets Management Strategy. SSH has to present annual reports to Parliament, and a quarterly report to the Ministry of Finance & Economy. Regular meetings are held between representatives of SSH and the Ministry of Finance & Economy. Reporting to other line ministries may be required, depending on the nature of PC activities. SSH needs to seek approval of the Ministry of Finance and Economy on its remuneration policy, Corporate Governance Code, and the annual asset management plan.

SSH sets annual goals for its PCs and helps in formulating their future plans. Appointing members to supervisory bodies of PCs is one of its most important duties and responsibilities. SSH communicates with members of the supervisory boards of PCs in a manner that respects their independence. Though it provides its opinions and points of view to members of supervisory Boards of PCs, these are not binding on PCs to implement. SSH pursues the goal of improving the quality of corporate governance in PCs by organising educational events for members of supervisory Boards. SSH also communicates with the management boards of PCs, again in a manner which does not compromise their independence. PCs report to SSH monthly and meetings with SSH are determined by the nature of PC activities/operations.

SSH plays no effective role as an intermediary in internal factor markets. Its role is primarily to manage state owned assets – in setting goals (financial, strategic, ESG) and measuring the performance of its PCs. PCs in which SSH exercises less than 75% of voting rights, are required to establish nomination committees, as a sub-committee of their supervisory boards. Nomination committees are responsible for the selection and evaluation of candidates for PC supervisory boards, to whom they propose a list of candidates for appointment.

PCs in which SSH exercises at least 75% and more of voting rights, are not required to form any nomination committees. In such companies, a SSH recruitment panel proposes names of candidates for appointment to supervisory boards. Candidates whose appointment has been proposed by the recruitment panel, are evaluated by supervisory boards. Managers of SSH can serve as supervisory board members of its PCs within the limits of the Companies Act. CEOs of PCs with a majority state ownership cannot be members of supervisory boards of any other PC.

The CEO as the president of the management board is appointed by the supervisory board. The division of responsibilities between the supervisory and management boards is defined by law and internal acts (Article of Incorporation, Asset Management Policy). The management board has the autonomy to run the business at SSH, but it needs to seek supervisory board approval for sales of assets above €5 million. The supervisory board also approves the yearly financial plan of SSH and its annual report.

The dividend policy of PCs is determined after careful scrutiny of their investment plans, accumulated retained profits from previous years, tax liabilities to the state, capital adequacy requirements, the relevant industry dynamic, as well as the applicable Annual Asset Management Plan. Dividends paid for the SSH share in a PC are retained by SSH, dividends paid for the State's share are funnelled directly to the Treasury.

The supervisory board of SSH is responsible for the ongoing performance review of the Holding Company. PCs in banking and insurance sector which prepare consolidated financial reports, are required to follow IFRS standards. It is also an option for other PCs to prepare financial reports according to IFRS if their shareholders decide to do so. While other PCs prepare their reports according to the national law (Slovenian Accounting Standards). SSH is audited by both independent external auditor and the State Auditor.

PCs are responsible for managing their own risks, though these are carefully monitored by SSH, acting in the capacity of an asset manager. SSH guides PC efforts in managing risks through various protocols (i.e., Corporate Governance Code, SSH Recommendations and Expectations) and training. Risk management at SSH is based on a centralised and integrated system. Operational risks which SSH is exposed to are recorded in the Master Risk Register in a systemic manner. Decision-making bodies, which are involved in risk management, include the management Board, the Risk Commission and the supervisory board's Risk Committee.

SSH and most of its PCs have compliance departments. SSH has a number of internal Acts that govern employees’ conduct along with codes of conduct, which address these issues at PC level. SSH has a Compliance Officer who reports to the management board and to the supervisory board’s audit committee.

When suspicion of corruption or an irregular practice is detected by SSH, a special internal committee reviews the case and demands additional explanation and information from the PC (usually from its supervisory board). If the committee finds after a review of the case, that there is a suspicion of a criminal act, the case file is sent to the police and/or State Attorney for further action. The Criminal Code of the State defines various types of criminal conduct in business; bribery is one such case. The Integrity and Prevention of Corruption Act is responsible for regulating lobbying and undue influence, but these rules do not apply to the SSH or its PCs.

Conclusions

The evolution of centralisation in state ownership function calls for a reassessment of the virtues of a coordinating agency and a holding company structure, especially in the context of ownership policy and public policy objectives. This will consequently have implications for the SOE Guidelines i.e., to what extent the changes occurring in the ownership function and structure should be compliant with the Guidelines.

Theoretically, the structure of an SOHC allows for an ‘arms-length’ management of SOEs and minimise the scope for political interference and bring greater professionalism to the state’s ownership role because of the presence of intermediary levels. When the state’s ownership function is transferred to a separate and autonomous entity, that structure allows for a separation of the state’s ownership function from its policy-making and regulatory functions and help avoid or minimise potential conflicts of interest. The structure of an SOHC allows to attract staff who are more adept at performing business functions than civil servants.

When a significant number of SOEs are grouped under an SOHC, it strengthens their collective bargaining power, allowing for more space when negotiating with banks (in mobilising resources) and suppliers (by centralising procurement for all PCs). HCs enable to achieve synergies through integration within a given sector or activity. The rationale for them lies in the theories of economies of scale and scope leading to both horizontal and vertical integration. The structure of such HCs allows for the sharing of knowledge and best practices in a variety of areas amongst all PCs.

Standardising investment policies, dividend pay-out policies, managing human resources (HR) more consistently, achieving economies of scale with procurement, contracting and auditing policies brings about efficiency and agility. The agility of HCs renders them to be effective agents of the State not only during contingencies but for post-crises recovery.

An SOHC is usually a large company with a better credit rating and reputation than many of its PCs. There are other intangible benefits that derive from the brand name and reputation. SOHCs can reap tax benefits by filing consolidated tax returns when they own 80% or more of its portfolio companies.

In addition, the benefits of full centralisation under one entity also accrue to SOHCs including, better transparency, improvement in governance, mitigating the problem of multiple shareholders, clear strategic focus. HCs allow for an internal system aimed at resolving conflicts among their PCs through better transparency. SOHCs’ operations are financed by dividends from their own assets and/or by capital raised from financial markets. SOE listings have been often cited as the driver behind the rise of capital markets in many emerging countries.

However, in practice, SOHCs cannot fully eliminate the financial governance problem, *inter alia* because their portfolio companies are subject to public policy obligations that originate with the state rather than the SOHCs themselves. SOHCs are established to maintain a healthy distance between SOEs and the government, but if a continued politicisation pervades the state-owned sector regardless of the statutory and institutional frameworks then SOHCs with concentrated assets under their management tend to be particularly vulnerable. As SOHCs become larger and more complex, information asymmetries between the holding company and its PCs increase. The structure of SOHC would also allow for shifting of money amongst PCs if systems for proper oversight are not in place.

Yet the “best practices” at some SOHCs to streamline their governance processes have proved to be an important tool in making sure that an SOHC does not become a pool of irregular practices. The research indicates that this concern can be overcome by handing down some very rigorous financial and non-financial objectives to SOHCs and their portfolios and establishing comprehensive legal regulatory frameworks that are conducive to transparency and accountability.

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