OECD Corporate Governance Working Papers No. 6

Balancing Commercial and Non-Commercial Priorities of State-Owned Enterprises

Hans Christiansen

https://dx.doi.org/10.1787/5k4dkhztkp9r-en

OECD

OECD CORPORATE GOVERNANCE WORKING PAPERS

OECD Corporate Governance Working Papers provide timely analysis and information on national and international corporate governance issues and developments, including state ownership and privatisation policies. The working paper series is designed to make select studies by the OECD Corporate Governance Committee, OECD staff members and outside consultants available to a broad audience.

The papers are generally available only in their original language English or French with a summary in the other if available.

The opinions expressed in these papers are the sole responsibility of the author(s) and do not necessarily reflect those of the OECD or the governments of its member countries, unless otherwise noted.

Comment on the series is welcome, and should be sent to either corporate.affairs@oecd.org or the Corporate Affairs Division, OECD, 2, rue André Pascal, 75775 PARIS CEDEX 16, France.

OECD CORPORATE GOVERNANCE WORKING PAPERS
are published on www.oecd.org/daf/corporateaffairs/wp

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

© OECD 2013
Applications for permission to reproduce or translate all or part of this material should be made to: OECD Publishing, rights@oecd.org or by fax 33 1 45 24 99 30.

Abstract

BALANCING COMMERCIAL AND NON-COMMERCIAL PRIORITIES OF STATE-OWNED ENTERPRISES

By Hans Christiansen*

The overarching question for the government owners of state-owned enterprises (SOEs) is why these companies need to be owned by the state. The OECD Guidelines on Corporate Governance of State-Owned Enterprises provides a "blueprint" for the corporatisation and commercialisation of such enterprises, but it may be assumed that the reason for continued state ownership is that they are expected to act differently from private companies. A relatively clear case occurs when SOEs are established with the purpose of pursuing mostly non-commercial activities. In many cases, their activities might otherwise be carried out by government institutions; the SOE incorporation has been chosen mostly on efficiency grounds.

A number of other rationales for public ownership of enterprises have been offered, including: (i) monopolies in sectors where competition and market regulation is not deemed feasible or efficient; (ii) market incumbency, for instance in sectors where competition has been introduced but a state-owned operator remains responsible for public service obligations; (iii) imperfect contracts, where those public service obligations that SOEs are charged with are too complex or malleable to be laid down in service contracts; (iv) industrial policy or development strategies, where SOEs are being used to overcome obstacles to growth or correct market imperfections.

This Working Paper takes stock of the rationales for public ownership of enterprises in five countries, namely Hungary, Israel, Netherlands, New Zealand and Norway. It addresses the overall ownership priorities (and "expectations") formulated by governments, the specific obligations that may be communicated to individual SOEs, the political decision processes leading to these priorities and the disclosure and accountability arrangements underpinning them. The Working Paper compares the national practices with the Guidelines and attempts to assess the implementation of the latter.

Overall, the countries under review apply mostly Guidelines-consistent practices when it comes to transparency around non-commercial priorities for SOEs. However, a problem sometimes arises where companies are instructed to pursue both commercial and non-commercial priorities from within an integrated corporate platform. When it comes to practices toward measuring the implementation of non-commercial priorities, and providing compensation to SOEs for such priorities, national practices are more "uneven" and not necessarily aligned with the Guidelines.

JEL classification: G03, G34
Keywords: corporate governance, state-owned enterprises, public service obligations, corporate social responsibility.

* Hans Christiansen works in the Corporate Affairs Division of OECD Directorate for Financial and Enterprise Affairs.

TABLE OF CONTENTS

1 Main issues and synthesis of national practices 6
1.1 The main issues for SOE owners 6
1.2 What the SOE Guidelines say about commercial and non-commercial priorities 8
1.3 Review of national practices 9
2 Hungary – an overview 17
2.1 The purpose of state ownership 17
2.2 Corporate social responsibility and other overall “expectations” to companies 18
2.3 Classes of SOEs with different orientations 19
2.4 Specific objectives for specific enterprises 20
2.5 Compensating SOEs for non-commercial priorities 22
2.6 Assessing the achievement of non-commercial priorities 22
3 Israel – an overview 24
3.1 The purpose of state ownership 24
3.2 Corporate social responsibilities and other overall “expectations” of the companies 25
3.3 Classes of SOEs with different orientations 25
3.4 Specific objectives for specific enterprises 26
3.5 Compensating SOEs for non-commercial priorities 27
3.6 Assessing the achievement of non-commercial priorities 28
4 Netherlands – an overview 29
4.1 The purpose of state ownership 29
4.2 Corporate social responsibility and other overall “expectations” to companies 30
4.3 An absence of classes of SOEs with different orientations 31
4.4 Specific objectives for specific enterprises 31
4.5 Compensating SOEs for non-commercial priorities 32
4.6 Assessing the achievement of non-commercial priorities 32
5 New Zealand – an overview 33
5.1 The purpose of state ownership 35
5.2 Corporate social responsibility and other overall “expectations” to companies 35
5.3 Specific objectives for specific enterprises 36
5.4 Compensating SOEs for non-commercial priorities 38
5.5 Assessing the achievement of non-commercial priorities 39
6 Norway – an overview 41
6.1 The purpose of state ownership 41
6.2 Overall “expectations” to companies 44
6.3 Classes of SOEs with different orientations 47
6.4 Specific objectives for specific enterprises 48
6.5 Compensating SOEs for non-commercial priorities 48
6.6 Assessing the achievement of non-commercial priorities 49

ANNEX 1: ORGANISATIONAL DESIGN OPTIONS IN NEW ZEALAND FOR CROWN-OWNED ORGANISATIONS WITH SOME COMMERCIAL FUNCTIONS 51

Tables

Table 1. National practices in overview 13

Figures

Figure 1. Hungary's SOE controls system 23
Figure 2. New Zealand Institutional Forms 34

Boxes

Box 1. Hortobagy Non-profit Company 20
Box 2. Non-commercial priorities for New Zealand Post. 37
Box 3. Performance Targets established by Corporate Statement of Intent: New Zealand Post.... 40
Box 4. The Norwegian State's Principles for Good Ownership 42
Box 5. Examples of non-commercial objectives of Norwegian SOEs 49

I. MAIN ISSUES AND SYNTHESIS OF NATIONAL PRACTICES

This document was prepared as a first step in delivering intermediate output 3.4 of the Working Party's Programme of Work and Budget (PWB) 2011/12, which deals with balancing the commercial and non-commercial priorities for state-owned enterprises (SOEs). It takes stock of the main non-commercial priorities in the SOE sectors of five OECD member countries (Hungary, Israel, the Netherlands, New Zealand and Norway), including the processes through which these priorities are established, communicated and evaluated. The national practices are described using the recommendations of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the "SOE Guidelines") as a benchmark.

The document serves a second purpose as well. The PWB 2011/12 foresees the conduct of peer reviews of country practices subject to the SOE Guidelines. However, the resourcing available to the Working Party does not allow conducting such work at a level of ambition comparable to, for example, the Corporate Governance Committee's peer reviews. By reviewing country practices on non-commercial priorities against the SOE Guidelines, a similar but more limited process has been obtained.

1.1 The main issues for SOE owners

The overarching question for the government owners of SOEs is why these companies need to be owned by the state. The SOE Guidelines may provide a "blueprint" for the corporatisation and commercialisation of such enterprises, but it may be assumed that the reason for continued state ownership is that they are expected to act, at least in some respects, differently from private companies in like circumstances. The one exception from this rule may be certain listed and highly competitive SOEs, which are part-owned by the government in order to prevent them from being taken over by other companies. Where this occurs it often reflects a fear of foreign ownership, or, in some countries which have used public offerings of SOEs to nurture national stock markets, concerns about excessive delisting.

A relatively clear-cut case is provided by those SOEs that are established with the explicit purpose of pursuing mostly non-commercial activities. In many cases, their activities might otherwise be carried out by government departments or autonomous institutions. The SOE incorporation has been chosen mostly on efficiency grounds. Occasional controversy about the "non-commercial objectives" of such entities may nevertheless arise when governments have not expressly reserved certain activities for them. Private companies have sometimes raised concerns about incumbency advantages in segments of the economy which, from the perspective of the public providers, they had entered "uninvited".

A number of other rationales for public ownership of enterprises have been offered. Among the examples are:

- *Natural monopolies.* The main potential advantage of transferring a public monopoly to a private monopoly is efficiency gains, but if the SOE is properly corporatized the gains may be limited, and they need to be weighed against additional regulatory costs that

might follow from privatisation. For this reason a number of governments prefer to retain natural monopolies in public ownership.

- *Incumbent operators.* In the network industries, in particular, it is not uncommon to have a state owned incumbent in competition with private operators. The rationale for state ownership in these cases is often tied to public service obligations that remain with the incumbent (e.g. the duty to distribute mail to all parts of the country, in the case of postal operators). State ownership is the preferred option when purchasing the additional public services through competitive tender is deemed unfeasible or inefficient.

- *Imperfect contracts.* Where the operations of an SOE have important ramifications for other parts of the economy, this may militate toward its privatisation. Such societal obligations as it currently has could be codified and imposed on a private buyer of the company, but in a changing environment it is impossible to predict every future event. Some governments have used this as an argument for maintaining public control over, among other things, airports and airlines.

- *Industrial policy and development strategies.* Governments may decide to use such externalities as certain SOEs provide as a policy tool. This thinking is essentially what underpinned the debate about "national champions" a few years back. The use of SOEs as tools of government policy can be defensive as well as proactive.

  - *Defensive practices*. The classic cases of using SOEs for "defensive" policy purposes include inducing these enterprises to maintain a larger share of employment, research & development or headquarter functions in the national economy than would private operators in like circumstances. This may be justified on groups of economic externalities *per se*, or by a political wish to use certain companies to help stabilise the business cycle. The latter motivation has in some cases led to the use of SOEs as "job pools" to prevent politically unacceptable increases in unemployment or, in more extreme cases, to cater to specific political constituencies.

  - *Proactive strategies*. Governments may be tempted to use the externalities that SOEs generate as a tool for broader economic development. This is seen in the occasional use of state-owned enterprises as a vehicle of classic industrial policy, and also in the "state capitalism" development policies that are being currently pursued by some emerging economies. The strategies may include investment through the SOEs in areas where long-term economies of scale are perceived, to develop infrastructures seen as vital to business developing in other sectors or in order to generate know-how or technology spinoffs[1].

Apart from these more formal justifications, a reason for state ownership in some countries seems to be the fact that it provides the State with leverage to intervene if or as this is deemed necessary. (An oft-cited example of the latter was French president Sarkozy's public announcement in 2009 that government-invested companies should abstain from moving productive activities to other European countries.) Also, in the privatisation debate of some OECD countries (mostly concerning utilities companies) the argument has been heard that a

[1] A frequently cited example of the latter is the purchase of corporate proprietary knowledge by SOEs which thereafter disseminates them widely in the home economy.

gradual divestment is preferred because it allows government intervention during a period when there is still uncertainty about the strength of newly-established regulators.

State-owned enterprises are often expected to operate at higher standards of corporate social responsibility than their private counterparts, but – apart from the SOEs of some emerging economies which are expected to engage in corporate philanthropy – this is normally not a decisive factor behind their state ownership. It does, however, give rise to important additional issues regarding their priorities.

Recent academic literature concerning SOE governance has focused on the "third agency problem" that may arise when the government officials responsible for the ownership of SOEs pursue interests that differ from those of the populace on behalf of whom the enterprises are ultimately held. In the case of corporate social responsibility, this issue comes to the forefront. On the one hand, SOEs would be expected to operate in a way that is consistent with the wishes and long-term interests of the general public, including when this implies a departure from short-term profit maximisation. On the other hand, the CSR issue should not be used as a smokescreen, nor should it allow ministers and civil servants to err excessively on the side of caution to save themselves from embarrassment.

The discussion above lends itself to the conclusion that, when it comes to the stated priorities for SOEs, a top priority is to ensure a sufficient degree of transparency and accountability around these priorities[2], including to ensure that they have been established through procedures that are truly representative of the public interest. Once this has been properly addressed, the main remaining issue is the impact of SOEs that have non-commercial priorities but nevertheless operate in the market place on the competitive landscape. This is the special topic of the Working Party's undertaking on competitive neutrality. In the context of balancing commercial and non-commercial priorities, suffice to say that an important challenge for policy makers is to ensure that SOEs receive an adequate compensation for the public policy priorities they are asked to undertake. They should neither be put at a competitive disadvantage, nor have their competitive activities effectively subsidised by the State.

1.2 What the SOE Guidelines say about commercial and non-commercial priorities

The SOE Guidelines are generally relevant when assessing the balance between commercial and non-commercial priorities. A proper implementation of the Guidelines creates transparency around SOE objectives and lends credibility to the processes involved in putting these objectives into practice. That said, the recommendation offered by the SOE Guidelines that most directly concern non-commercial priorities for SOEs relate to company objectives and corporate ethics. With regards to direct objectives, the most relevant text is found in Guideline I.C:

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

[2] The OECD (2010), "Accountability and Transparency – A Guide for State Ownership" offers extensive advice on how to obtain this in practice.

On corporate ethics, Guideline IV.C offers the following advice:

The board of SOEs should be required to develop, implement and communicate compliance programmes for international codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.

The ethics recommendation is open to either a narrow or a broad interpretation by the owners of SOEs. It could be seen as simply referring to company-specific compliance programmes for employee conduct, or it could taken as a sweeping recommendation of corporate social responsibility commitments. The annotations to the Guidelines lend some support to a broader interpretation in that they refer to the OECD Guidelines for Multinational Enterprises, the Anti-Bribery convention and the ILO Declaration on Fundamental Principles as codes of behaviour with which SOEs should comply.

1.3 Review of national practices

As mentioned above, the current section provides a comparative analysis of five countries – Hungary, Israel, the Netherlands, New Zealand and Norway – on the background of the SOE Guidelines. The details of these countries are found in the following sections 2 through 6. Sweeping generalisations should not be attempted, but the degree to which the countries have implemented the Guidelines can be assessed, and the exercise may lead to useful conclusions about the applicability of the Guidelines. An overview of the findings is provided in Table 1.

1.3.1 The purpose of ownership

Comparisons across countries are complicated by the fact definitions of state-owned enterprises differ significantly. For example, the Israeli authorities have corporatized a number of entities that would in many other OECD countries be autonomous institutions or operate out of government departments. New Zealand reserves to sobriquet ‘state-owned enterprise’ for strictly commercial undertakings, but operates a number of other public entities that would in an average OECD country be considered as SOEs. Focusing on the mostly commercially-oriented SOEs, it seems that Israel, Netherlands and New Zealand foresee a more limited role for the state than do Hungary and Norway.

The Hungarian state may according to the law acquire corporate assets in order to execute state functions; fulfil societal needs; and realise government economic policy goals. In practice, state ownership is usually justified by a “general public interest (e.g. the provision of subsidised services) or natural and/or legal monopolies in sectors where regulation would either not be feasible or efficient.

The Israeli procedures (formal as well as informal) for assessing a need for an SOE includes the question of whether the products and services from such companies are provided, or could be provided, by private enterprises. In addition, the SOEs are incorporated subject to the general Companies Law, which allows no higher corporate objective than profit maximisation.

Conversely, the Norwegian ownership policy expressly cites a diversified ownership of enterprises as one of the chief rationales for the existence of SOEs. In other words, it is seen as healthy that the state, as well as private investors, control parts of the corporate sector. As sub-rationales are cited a need to keep companies in Norwegian hands, overcoming market failure, as well as a need to ensure control of, and revenues from, natural resources. It should be added that this policy is anchored in a relatively strong faith in the intentions and abilities of the State on

the part of the Norwegian public. Popularly speaking, it is generally believed that "the government can be as good a capitalist as any".

In the Netherlands, the main rationale for establishing, or maintaining, state ownership in enterprises are influenced by a sectoral distribution of SOEs that is strongly biased toward infrastructure. In consequence, many SOEs have come into being as a consequence of structural separation or in order to handle public-private partnership and other investment projects carried out at arms' length from general government.

The authorities of New Zealand have tended to view state ownership (not unlike a situation that prevailed in the Netherlands some years ago) as a deviation from a preferred option of transferring corporate assets to the private sector. The decision not to privatise is justified by an assessment that, in the case of private ownership, the public interest attached to a given entity could not be adequately protected through regulatory and other mechanisms. In practice this may militate toward a situation where enterprises remaining in public ownership are those with strong elements of natural (or legal) monopoly in their value chains. Conversely, entities with an orientation toward sector policy and only limited commercial objectives tend to be classified as "Crown Entities" and hence not be corporatized as SOEs.

1.3.2 Corporate social responsibility and other overall "expectations"

Somewhat related to the previous topic, practices differ markedly with regards to corporate social responsibility. The Israeli model leaves little room for SOEs to behave in a different way from private companies – except for a few selected areas, including affirmative action *vis-à-vis* women and ethnic (as well as one Jewish) minority groups. Even if Guideline IV.C is interpreted narrowly to apply only to company-internal codes of ethics, one would have to conclude that it is only partially implemented in the case of Israel. The development of such codes and practices is currently (as of 2011) ongoing.

The approach to CSR in Hungary is not systematic, and in practice it differs radically according to types of SOEs. Non-profit companies are often charged with CSR-related tasks, which are then seen as part of their main operating purpose. Large commercial SOEs are expected to measure up against their private competitors. Conversely, small (and often loss-making) SOEs – of which Hungary for historical and other reasons has many – are typically not expected to embrace CSR. It would occur that Guideline IV.C is only partially implemented by the Hungarian government.

The Norwegian government has published wide-ranging "expectations" to enterprises that have the State as an owner or significant shareholder[3]. The expectations cover traditional CSR ground (e.g. environment, human rights, health and safety, gender equality, minority protection), company-internal ethics (including anti-corruption measures) as well as more specific topics such as the promotion of research and development as well as managerial remuneration[4]. The ownership policy stresses that SOEs' boards of directors must "ensure a balance of the different considerations in a manner that furthers the interests of the shareholders as a whole". If

[3] The expectations make express reference to several OECD recommendations, including the Guidelines on Corporate Governance of State-Owned Enterprises.

[4] The Norwegian authorities have informed the Secretariat that they consider their CSR requirements to be reactive rather than proactive. In the recent past authorities have been embarrassed by the withdrawal of institutional investors from SOEs on account that these companies did not comply with the institutional investors' standards for ethical investment.

interpreted literally, could imply a narrower scope for implementing the government's expectations where minority shareholders participate in SOEs.

It should be added that the Norwegian authorities have gone to considerable length to ensure transparency and accountability. Not only are the expectations made publicly available, they have been approved first by cabinet and secondly by parliament as an official government policy. Conversely, they are not written into law or company bylaws. The expectations serve as a basis for the ownership unit's dialogue with SOE boards rather than as a formal performance criterion for the companies and their directors. If an assessment is made of the Norwegian performance under Guideline IV.C, it must be concluded that Norway has fully implemented this recommendation.

Every state-owned enterprise in the Netherlands is expected to establish a "credible" CSR policy, but there are no formal requirements regarding its content. The underlying principle is that as private companies take steps to implement CSR so should SOEs, but on the other hand state-ownership should not put companies at a competitive disadvantage. The expectation is that companies implement CSR as part of their corporate strategies and that, therefore, they will be consistent with the practices of any private sector competitors in a given sector. Finally, all Dutch SOEs are required to maintain high standards of "triple bottom line" transparency, by reporting according to the standards established by the Global Reporting Initiative. While the government does not prescribe any one level of aspiration for SOEs' CSR commitments it is clear that enterprises are in practice expected to act as "good corporate citizens", and the GRI reporting requirement provides management and boards to take steps in this direction. One would conclude that Guideline IV.C is either partly or largely implemented.

The authorities of New Zealand place on their SOEs corporate social responsibility obligations that in many cases go beyond those undertaken by private enterprises. State-owned enterprises are expected to formulate and report CSR objectives on an equal footing with financial objectives – through their statements of corporate intent and as an integral part of their annual reports. That said, there is no notion that corporate social responsibility is in conflict with value creation: SOEs have publicly asserted that CSR is good business practices, in many cases it is fully integrated in their day-to-day corporate operations. Crown Entities are subject to less rigorous CSR obligations but are expected, when carrying out commercial operations, to align themselves with such practices. Assessing New Zealand under Guideline IV.C would lead to the conclusion that the recommendation is fully implemented.

1.3.3 Classes of SOEs with different orientations

In Hungary, all SOEs that are essentially maintained for sector policy reasons are classified as non-profit companies, and sub-categorised as "public benefit organisations" ("non-profit companies" is a general concept – numerous such entities are found in the private sector as well). These companies are not allowed to distribute dividends. All other SOEs are, at least in principle, expected to maximise their earnings and, at a minimum, not lose money and perform as least as well in financial terms as in the previous year.

In Israel, reference is often made to commercial versus non-commercial SOEs, though formally there is no such designation. Because of the Companies Law, to derogate from the profit maximisation objective, special provisions must be written into the company bylaws. Most "non-commercial" SOEs as identified by official communications fall in this category. However, Israeli law allows for another kind of incorporation as well, in the form of "public benefit companies"

under general corporate law. These are allowed to pursue specific objectives, and are legally barred from declaring dividends. Currently seven such companies are owned by the State[5].

The Norwegian government makes extensive use of categorisation. All SOEs are officially designated as being either sector-policy oriented (i.e. having other primary objectives than profitability) or commercial. The latter category is sub-divided into three categories, namely (i) fully commercial; (ii) commercial but with an obligation to maintain headquarters in Norway; and (iii) commercial but required to pursue certain additional objectives. The categorisation is a government policy, subject to parliamentary approval. It would appear that, perhaps reflecting the high degree of transparency around these procedures, political considerations sometimes play a direct role in the categorisation of SOEs. Certain enterprises seem to operate almost fully commercially while being designated a slightly different role. This could reflect the fact that "fully commercial" SOEs are commonly perceived as candidates for privatisation.

In the Netherlands and New Zealand there is no formal classification of SOEs, neither according to their corporate form (all SOEs are incorporated under ordinary company law) nor their operational priorities. However, as mentioned earlier, a number of New Zealand public institutions that might in other countries have been categorised as SOEs are classified as Crown Entities and may engage in certain commercial activities.

[5] One point of current discussion relates to the incorporation of SOEs as "public benefit companies", since it is not clear whether the interdiction of dividends is consistent with the general demand that SOEs should have a commercial orientations.

Table 1. National practices in overview

	Hungary	Israel	Netherlands	New Zealand	Norway
Main purpose of ownership	Ownership as an alternative to over-regulation. Assure sufficient investment in some sectors.	Providing activities where no private sector alternative exists.	Structural change in the network industries, and redressing market failure.	Preparation for privatisation or efficient delivery of public services	Diversification of corporate ownership
Corporate social responsibility	No overarching approach. Large SOEs expected to perform well compared to similar private firms.	Similar to private sector practices, plus a duty to address diversity.	Similar to private sector practices, plus a duty to apply GRI reporting.	CSR targets exceeding those of most private companies included in SOE performance requirements	Extensive "expectations" are communicated as a basis for ownership dialogue.
Classes of SOEs	For-profit versus non-profit companies.	Commercial versus non-commercial enterprises.	Not applicable. All SOEs are incorporated under general law and expected to maximise profits	Profit maximising SOEs contrasted with mixed purpose "Crown Entities".	Four categories: * Commercial; * Commercial with headquarters in Norway; * Commercial plus some non-commercial objectives * Sector policy
Company specific objectives[6]	Established through bylaws (non-profit) or ownership decree (for-profit)	Established through corporate bylaws	Mostly through performance contracts	Established through corporate statements of intent	Established by parliamentary decision, on the recommendation of government
Compensation for non-commercial objectives	Lowering of earning requirements (for-profit) or a mix of subsidies, levies and market earnings (non-profit).	Cross-subsidisation within individual SOEs[7].	Mostly contractually established. Other special objectives are not compensated.	Not universally applied. May include budget support, performance contracts and levies on the public.	Compensation is offered for universal service obligations in two SOEs[8].
Performance Evaluation	Direct monitoring of SOEs on an ongoing basis.	No formal review mechanism.	Regular scrutiny of the outcome of performance contracts.	Annual reporting based on the corporate statements of intent.	Mostly limited to the subsidised objectives, as part of the state audit of budget outlays.

[6] In addition to sector regulation.

[7] In the network industries the sectoral regulators approve of general tariffs that are sufficiently high to cover the cost of universal service obligations, etc.

[8] Other non-commercial obligations (including headquarter requirements) are uncompensated. CSR and other "expectations" are considered integral to corporate strategies.

1.3.4 Specific SOEs with specific objectives

Regarding specific obligations for specific enterprises, a commonality between Israel, New Zealand and Norway is that some of the most important such obligations are found in the network industries and to a large extent imposed through sectoral regulation. Where economic activities are in the hands of one monopoly provider (e.g. the national railways in both countries) the difference between regulation and direct government can be unclear, and it may depend mostly on the autonomy of the regulatory bodies. However, both countries have taken recent steps to bolster independent regulation. The Netherlands also rely on sector regulation, but generally places greater emphasis on performance contracts. Specific objectives appear (whereas no concrete data are available) to be more widely enforced in the case of Hungary.

As for other specific obligations, in the case of Israel they are almost exclusively the ones that were specified for any given SOE at its inception and written into its bylaws. The government could of course alter the bylaws, but in practice concerns about stakeholder rights has made this very rare. One of the only cases was the interdiction of flights by the state-owned air carrier during Jewish holidays.

The Hungarian SOE framework allows ownership ministers and/or the holding company to instruct SOEs to depart from normal earnings objectives through an “owner’s decree”. This is sometimes done to finance large capital investments, and sometimes because a given company is tasked with specific non-commercial objectives. Potentially problematic is the fact that such decrees are confidential and not generally shared with the public.

In Norway, when it comes to specific objectives the main dividing line is between commercial companies with specific objectives and SOE charged with principally with sectoral policy goals. The commercial SOEs are charged with specific objectives pursuant to parliamentary decision. Parliament makes its decisions based on proposals by the government. There has not to date been independent parliamentary initiatives in this area. Commercial SOEs are requested to maximise their earnings, subject to such constraints as the non-commercial obligations may impose.

In the Netherlands, the reliance on performance contracts is justified by the maintenance of a level playing field. In markets where SOEs compete with private enterprises, the latter are usually offered a chance to bid for the contracts. More generally, government works on the assumption that all SOEs are profit maximising, but since SOEs are not (in a departure from earlier practices) subject to rate-of-return requirements there is in practice a certain “room for manoeuvre”. This is compounded by the fact that the (State) shareholder retains the right of approval for corporate strategy, which gives it an effective veto over any board decision that is not consistent with its ownership priorities.

In New Zealand, the core element in specific objectives is the Statement of (Corporate) Intent that every SOEs and Crown Entities is requested to develop in concert with the ownership ministries and make public. The ownership ministries may authorise deviations from the SCIs but, owing to the largely commercial orientation of SOEs, this would mostly be the case where significant investment/divestment is involved or when a SOE moves substantially outside the agreed scope of its business. In practice, the relatively limited number of pre-agreed specific objectives relate to public service obligations in the network industries.

The degree of transparency around “non-commercial objectives” is generally high in Israel and Norway. In Israel this is so largely because the bylaws of SOEs are freely available to the

public. In Norway the objectives of SOEs are communicated to the public through the annual ownership report. Moreover, both countries have relatively wide-ranging public information acts, under which the public has a right to information both about the exercise of the ownership function and the sectoral regulation of state-owned enterprises. The combination of performance contracts, regulation and shareholder action in the Netherlands, and the ministerial discretion to allow departures from Statements of Corporate Intent in New Zealand, could in theory and in practice be somewhat less transparent. Hungary is very transparent about non-commercial objectives in designated public interest companies, but much less so in the case of for-profit SOEs with certain non-profit assignments.

1.3.5 Compensating SOEs for non-commercial priorities

In the case of non-commercial SOEs the most common practice is to finance as much as possible through the SOEs' earnings in the market and cover the remainder through fiscal allocations. When it comes to utilities companies practices differ somewhat. In Israel, public sector monopolies negotiate tariff structures with regulators that are deemed sufficient to cover their operating costs. In practice this applies that universal service obligations tend to get covered by implicit transfers among clients within the same tariff category. One example cited in the accession review is the uniform pricing of water in arid and water rich parts of the country, at tariffs high enough to ensure that the national water company does not lose money on its universal service obligation.

In Hungary, non-profit companies may rely on a number of channels to supplement their market earnings, including levies on the public and subsidies from both the state and the sub-national levels of government. In for-profit companies compensation is liked with the owner's decrees, the mechanism usually being a lowering of the earnings requirements imposed in tandem with the non-commercial objectives.

In the Netherlands, the reliance on performance contracting contributes to relatively transparent compensation practices, which, as mentioned above, are equally available to private competitors willing to offer the same services in the market. Conversely, objectives imposed on SOEs via regulation or by shareholder action are normally not subject to financial compensation.

In Norway, this works a bit differently because the State largely acts as a purchaser of services from the utilities companies. Once the sectoral regulators have decided that they are requested to deliver the additional cost (relative to a "commercial" baseline) becomes the object of negotiations between SOEs and the authorities. The agreed extra costs are covered by the State via budgetary allocations. In a few areas where potential competitors exist, the amount of compensation for public service obligations is made subject to competitive tender.

In New Zealand, the picture is mixed because of the dichotomies between SOEs and Crown Entities, and between sector regulation and specific obligations. As a general rule the (few) cases where SOEs are requested to deliver non-commercial services give rise to direct compensation from the national Treasury – as directly stipulated by national SOE legislation. However, regulatory action such as the universal service obligations in some network industries is not subject to compensation. Also, a number of Crown Entities with (certain) commercial obligations are authorised to fund the public service obligations through user changes or levies imposed on groups or industries.

On the basis of the preceding sections it is tempting to conclude that Norway has fully or largely implemented Guideline I.C (the one exception being that specific obligations are not

necessarily covered by law or regulation). Israel and New Zealand might by the same standards be characterised as having partly or largely implemented the recommendation: there is little explicit cost coverage in these countries, but where it occurs it is mostly transparent and/or pursuant to law. The Dutch SOE landscape is split between those enterprises which are subject to performance contracts, where Guideline I.C appears fully implemented, and others where the implementation is much weaker. Some allowances should arguably be made for a different composition of the SOE sectors of the four countries. It may be easier for the Dutch and Norwegian governments to operate SOEs in a market-conform way since many of these SOEs are in segments of the economy which they share with private commercial operators. Hungary has partly implemented the recommendation as it applies fully to non-profit SOEs whereas the non-commercial objectives assigned to for-profit SOEs are subject to confidentiality.

1.3.6 Performance evaluation

The SOE Guidelines do not deal at length with performance evaluation, although Guideline V.E.1 does recommend that SOEs disclose "a clear statement to the public of the company objectives and their fulfilment". This topic, in turn, was the topic of an entire chapter in the Transparency and Accountability Guide that the Working Party issued in 2010[9]. The Guide basically recommends that SOE objectives be subject to ongoing and annual performance reviews, plus benchmarking against the performance of similar companies in the private sector or abroad.

Israel and Norway have not gone particularly far in this area, which is the topic of ongoing considerations in both countries. The scrutiny of performance is stronger in non-commercial SOEs, which because of their dependence on fiscal funding are subject to budget-related scrutiny. Monitoring of the fulfilment of non-commercial objectives in mostly commercial SOEs is in most cases, if at all, conducted as part of the ongoing monitoring of the board work of these enterprises. In the Netherlands there is obviously a stronger performance evaluation in the many SOEs whose non-commercial priorities are guided by performance contracts. A case cutting across the three countries is presented by the regulated utilities, which are subject to direct monitoring by the regulators and in some cases regular reporting on their performance to parliament.

Hungary appears to be the country in this report whose ownership entity practices the most regular and ongoing monitoring of the performance of individual SOEs. Through its "corporate monitoring system" (see below) the fulfilment of commercial and non-commercial priorities is monitored jointly in real time. The setup is backed by system of early warnings, feedbacks and accountability for non-fulfilment of goals.

New Zealand is arguably the country that has gone the furthest in the direction of non-financial performance evaluation – again reflecting the reliance on Statements of (Corporate) Intent in both SOEs and Crown Entities. In addition to the corporate annual reports, the monitoring agencies receive quarterly reporting from all State controlled entities, detailing their performance against the agreed financial and non-financial performance criteria. In addition, the state auditor, as well as the relevant parliamentary select committee, has the power to investigate any aspect of any entity's operations.

[9] OECD (2010), Accountability and Transparency: A Guide for State Ownership.

II. HUNGARY – AN OVERVIEW

Hungary has, compared with the average OECD economy, an unusually large number of state-owned enterprises. A 2010 survey by OECD counted a total 158 enterprises with a total 153,000 employees[10]. In addition to this, the State retains (very small) minority stakes in a number of companies, which are currently subject to a process of portfolio clean-up. With the exception of 12 statutory corporations, all Hungarian SOEs are incorporated as companies limited by shares under general company law, and in addition subject to specific SOE legislation which, among other things, impose standards of transparency and disclosure at par with (and in some cases exceeding) those applying to listed companies.

The main ownership function is vested in the Hungarian State Holding Company (HSHC), which replaced the National Privatisation Agency in 2008. HSHC continued ongoing privatisation programmes in the first two years of its existence, but is now essentially an asset management company operating pursuant to ordinary commercial law[11]. The Holding Company is placed under the responsibility of a government minister designated in the SOE Act as "The Minister Responsible for State Assets". There is no stipulation of which Ministry should hold the post (and in the past this responsibility has shifted around), but it will normally be a part of government without significant direct responsibilities for SOE regulation. The responsibility is currently with the Minister for National Development.

2.1 The purpose of state ownership

State ownership of enterprises in Hungary is to some degree "path dependent" in the sense that almost the entire business sector prior to 1990 was state owned. SOEs are those enterprises that have not been privatised with the so called spontaneous privatization. The decision process is influenced by the experiences from an early privatisation process that, in its early stages lacked a strategy and took place amid a weak legal and regulatory basis. This may in some instances have created a culture of "if in doubt, retain state ownership".

According to the 2007 CVI Act on State Ownership the State may acquire (or dispose of) assets in order to: (1) execute State functions; (2) fulfil societal needs; and (3) realise government economic policy goals. In practice, some rationales for state ownership that have been put forward, in addition to the "general public interest" have included energy security, delivering country-wide, affordable mail services (the Hungarian Postal Service Co.) or fulfilling cultural facilitation functions (the Hungarian National Film Fund).

---

[10] H. Christiansen (2011), "The Size and Composition of the SOE Sector in OECD Countries", *OECD Corporate Governance Working Papers*, No. 5. Many of this large number of companies are quite small and economically insignificant. One reason for their state ownership is that the State automatically takes over enterprises if their owner dies without an heir, or if (for example when a company is loss-making) the heirs refuse to assume ownership. A large number of SOEs are in the process of liquidation.

[11] In addition to HSHC's portfolio of companies a number of SOEs are held through the Hungarian Development Bank, chiefly in the infrastructure and forestry sectors. Statutory corporations are controlled by sector ministries. The information in this report refers to the HSHC portfolio only.

The legal case for state ownership is made most clearly in the case of a number of activities that are formally (or de facto) reserved for state ownership. These include at HSHC portfolio:

(i) water supply;

(ii) certain environmental services;

(iii) nuclear power generation;

(iv) high voltage power transmission operator,

(v) local/inter-urban transportation services,

(vi) railway services,

(vii) certain parts of the gaming industry (lottery)

The main rationale provided for these legal monopolies is that the sectors concerned are such that an effective regulation would either be unfeasible or so costly as to be inefficient.

In other sectors where private competition is not prohibited by law, the maintenance of SOEs in public ownership is also sometimes justified by a limited regulatory capacity. Another argument relates to a perceived need of HSHC to act essentially as a provider of private equity. This is linked with the path dependency mentioned above: during the privatisation process a number of apparently viable companies got into trouble due to a perceived underinvestment by their new owners.

2.2 Corporate social responsibility and other overall "expectations" to companies

There is no comprehensive, cross-cutting approach to corporate social responsibility (CSR) or environmental performance in Hungarian SOEs. Earlier attempts to formulate general CSR guidelines have failed, mostly because HSHC's very large portfolio of enterprises was deemed too diverse for a one-size-fits-all approach. Instead, an individual approach to CSR has been embarked upon, which focuses on approximately one dozen of particularly large commercially operating SOEs. Smaller SOEs are also encouraged to embrace good practices for CSR, but many are in practice so underfinanced that it is difficult to demand that the devote corporate resources to such activities. As for SOEs designated as non-profit companies (see below), insofar as they pursue societal or environmental goals these would be considered as part of their corporate objectives and appear in their articles of association.

The companies that HSHC expect to embrace CSR activities are asked to adhere to the highest industry practices within their sectors of operation. Reflecting the Hungarian ownership architecture, rather than being communicated to the SOEs as "expectations" or "objectives" this is implemented directly by the Holding Company on a case-by-case basis. The majority of the supervisory board members in these companies are HSHC employees, and the operations of the SOEs are further monitored through regular meetings between HSHC's management and the managements of the individual enterprises.

Concerning environmental performance, HSHC does not demand that its portfolio companies exceed the regulatory standards in their sectors of operations. However, it monitors regulatory compliance quite vigorously and has established a department dedicated to environmental issues. The biggest SOEs (like many of their counterparts in the private sector)

have also put company-internal policies in place to reduce energy consumption and carbon emissions. Finally, most SOEs have in place codes of ethics that are enforced as part of the employment contracts of their employees. However, rather than focusing on CSR per se, these codes deal mostly with the treatment of shareholders, stakeholders and stamping out irregular practices.

2.3 Classes of SOEs with different orientations

As mentioned before, according to Hungarian law there are no specifically designated corporate forms for SOEs .The State may be the owner of company forms that stipulated in general company law (e.g. joint stock corporations; partnerships limited by shares). In terms of profit orientation, there are two groups of companies: (i) for-profit companies; and (ii) non-profit companies. (If a company is classified as non-profit then this status must be suffixed to the company name.)

Non-profit status means that the company is subject to specific law. Among other things, such companies cannot pay dividends. They are usually connected to public policy objectives and/or help in the execution of certain tasks related to the state. However, it bears mentioning that this is not an exclusive characteristic of non-profit SOEs. For-profit SOEs may also pursue public policy objectives alongside with their commercial tasks[12]. The distinction between non-profit and for-profit is not based on either public policy or business orientation, but on the actual profitability of a given company orientation. Examples are provided in the following sections. The Hungarian authorities have argued that it is a highly complex task to determine whether to establish a non-profit or for-profit company for a given purpose. In practice, this is decided on a case-by-case basis, taking into account factors such as legal requirements, public benefit characteristics and expected profitability.

2.3.1 Non-profit companies

A further subdivision of non-profit companies exists. According to the Act CLXXV of 2011, non-profit companies can file for a status “public benefit organization” – provided that they specify clearly (e.g. in their articles of association) a public benefit profile. This designation is highly relevant to SOEs; there are plenty of non-profit companies in the private sector, but companies run for the public benefit tend to be publicly owned. Among other things the public benefits status paves the way toward (but does not guarantee) public subsidies. Such companies are requested to provide yearly “public benefits reports” alongside with their financial reporting. The Hungarian SOE economy at HSHC includes 31 majority owned non-profit companies, of which 18 have designation as public benefit organizations. An example of the business purpose, organization and funding modalities of one such public benefit organization is provided in Box 1.

[12] For example, as also mentioned elsewhere, the Hungarian Postal Services Co. is a fully state-owned for-profit company, but it carries out tasks arising from the Act CI of 2003 on Postal Services.

Box 1. Hortobagy Non-profit Company

Hortobágy is both the name of a village in Hajdú-Bihar county and an 800 km² national park in Eastern Hungary, rich with folklore and cultural history. The park was elected among the World Heritage sites in 1999. The Hortobágy is Hungary's largest protected area, and the largest natural grassland in Europe.

The Hortobágy Non-profit Company for Nature Conservation and Gene Preservation conducts nature preservation tasks on one-fifth (17 000 hectares) of the National Park area, while also fulfilling the requirements of organic farming. Thus, Hungary's and Europe's largest joint and fully converted organic farming area formed. The company has 199 full-time employees.

The Hortobágy Non-profit Company multiplied the population of traditional Hungarian farm animals in the puszta (Hungarian Grey Cattle, Nonius horse, Racka sheep, Mangalica pig and water buffalo), while preserved the amazing beauty of this unique landscape, the clean waters, air and the natural values. Thanks to these stock improvements more than half of the gene bank livestock population of Hungarian nature protection can be found here.

The Company is proud of its almost sixty herdsmen. Animal raising knowledge, traditional clothing and cooking skills of horsemen, herdsmen, shepherds and swineherds becomes public treasure at the Herdsmen's Competition, the Equestrian Days and the Grey Cattle Bull Autumn Fair.

In summary, the Company's public benefit activities include nature conservation, animal protection, environmental protection, and preserving the natural heritage site. Above the hereby mentioned public benefit activities the company tries to find business opportunities to be able to fulfill the public benefit goals. The business activities (for profit) have two pillars:

Organic farming

Tourism activities

Income streams:

a) Support for land use

b) Support for gene preservation

c) Business activities

The non-profit companies are clustered into the following six categories: (i) rehabilitation employment; (ii) agricultural research; (iii) monument management; (iv) therapeutics companies; (v) cultural companies; and (vi) specialized other activities.

2.4 Specific objectives for specific enterprises

Other than the non-profit companies described above, for-profit companies may as mentioned also be requested to perform services in the public interest. Moreover, HSHC itself may be requested to carry out such functions, *inter alia* by acting as an agent for industrial policy through its investment and portfolio allocations. An example of the latter is a recent transaction by which the Holding Company acquired a coach manufacturer in order to capture externalities and realise synergies with other parts of its industrial portfolio, namely a number of coach services companies.

In more general terms, HSHC seeks to capture synergies within its entire portfolio to improve effectiveness. As an example, there has in the past there been a number of tenders and public procurements undertaken by SOEs where adequate competition could not be assured – and in some cases the process was seen as biased in favour of private market participants to the point where bidding by other SOEs was essentially ruled out. HSHC is trying to ensure fair competition that result in equal opportunities for all participants.

As also mentioned earlier, compared with other OECD countries' ownership agencies HSHC is quite "hands-on" when it comes to overseeing individual SOEs and formulating their objectives. Consistent with private equity practices, a comprehensive planning guideline is prepared by HSHC yearly, specifying the principles and basic requirements for next year's business planning. The "Guideline" is essentially an owner's decree, which shall be applied generally to every SOE under HSHC's asset management power[13]. There is a clear competence matrix for every single case. The decision-making process is based on competence systems defined in the Memorandum of Association of each SOE. There are exclusive owner's competences and there are competences based on the value of a given transaction. In the case of HSHC itself, the minister responsible for state assets can issue an owner's decree.

The main objectives in the management of for-profit SOEs are (i) operating efficiently; and (ii) increasing the rates of return. In practice, therefore, capital effectiveness is monitored closely and minimum expected yields are defined individually for major SOEs. As a general principle, the minimum target is earnings before tax that are positive and not smaller than those of the previous year. However, exceptions can be made. Opting out from the general planning principles requires an owner's decree, which can be issued by HSHC, or directly by the shareholding minister at his discretion (which are based on legal regulation, for example government decisions). Ownership decrees can be issued instructing SOEs to execute business policies and principles arising from the specificities of the state as an owner. One example would be remuneration policies for SOEs in certain industrial sectors. The ownership ministry in 2012 ordered a prior notification process before companies could agree to payments to employees that are considered above general salary levels.

Legislation and lower-level acts such as discretionary government decisions may also direct SOEs to (1) deliver state tasks; (2) fulfill societal needs; and (3) realize government economic policy goals. Such ownership decrees may have a characteristic to lower the expected return on capital[14]. Ownership degrees/government decisions can serve to direct SOEs to deliver certain tasks related to the activities of the company. For example, Government Decision No. 1285/2012 (VIII. 9) addressed Castle Management Non-profit Ltd. (which operates and maintains the Royal Castle of Buda) to develop the Castle Garden Bazaar with the assistance of EU funds. A new activity has also been added to the Hungarian National Film Fund Public Benefit Non-Profit Ltd (whose main aim is to support the Hungarian movie industry). The ownership ministry instructed the company to add "providing support for film industry marketing" to its field of activities, effectively creating a new area of operation.

The ownership decrees themselves are generally subject to corporate confidentiality and not shared with the general public, because of the technical manner of decrees. However, the non-commercial objectives of individual SOEs are publicly disclosed in the form of laws, and publicly available government decrees. Also, as a result of a decision-making process that involves

[13] For example, remuneration guideline is a general guideline issued by HSHC and is applied by SOEs.

[14] It should be noted that ownership decrees lowering the expected return can also be used to facilitate major investment projects.

ministries, HSHC and the boards of SOEs, ownership decrees of a truly “game changing” nature are rare. Finally, the results of such objectives are always disclosed at company level.

2.5 Compensating SOEs for non-commercial priorities

Regular non-commercial priorities for SOEs that are otherwise characterized as for-profit are usually established by law – for instance the public service obligations that are laid down in the legislation bearing on various public utilities. In these cases the earnings requirements imposed on the respective SOEs are lowered correspondingly. The process leading to setting of requirements is complex and usually involves a multitude of meetings and negotiations between HSHC, sectoral regulators and the management of the SOEs. Owner’s meetings are held quarterly where the company’s management and HSHC senior officials meet and discuss the company’s current affairs with special regard to financials and regulatory issues.

In the non-profit sector there are various financing models, most of which specified in sectoral law. They include loss reimbursement, expense reimbursement and normative per capita subsidies. In addition, non-profit SOEs are encouraged to raise supplementary funding through a number of channels: (i) sales revenues from certain for-profit as well as other activities; (ii) gift agreements; (iii) local government support; and (iv) loans provided by the owner. As regards the latter point, HSHC’s loan funding is founded in formal “loan agreements” and contingent upon the debtor providing a detailed expense reports.

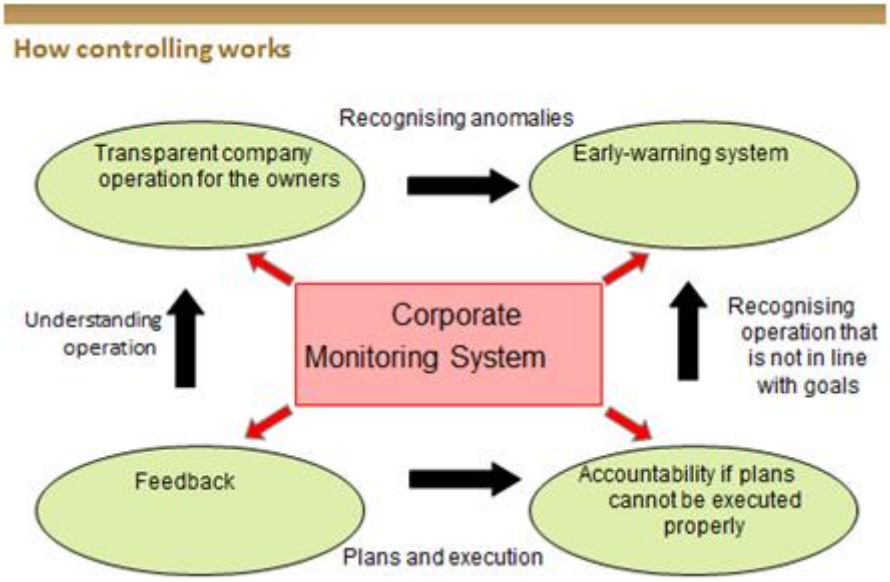
2.6 Assessing the achievement of non-commercial priorities

Reflecting the Hungarian hands-on approach to SOE oversight, a large part of what might in many other OECD countries be subject to ex-post monitoring is in the case of Hungary part of the ongoing monitoring of companies and involvement in their supervisory boards. Figure 1 below provides a stylised representation of the control system actually in place.

In addition to the fully or largely commercial SOEs which are overseen by HSHC alone, a number of enterprises that are strongly connected to public policy execution (and hence heavily regulated) have important oversight functions vested in the respective line ministries. However, in some cases HSHC has an agreement with the line ministries to make a contribution to the decision making, regarding any or all of the following issues: company strategy; business plan; control systems; equity ratio and indebtedness; material capital transaction; and HR issues. In this case the sectoral supervision and the “ownership governance” of the company are essentially divided. Sectoral supervision is executed via non-profit agreements signed with the ministry responsible for the sectoral public policy (For example, the Ministry of Rural Development signs agreements with the agricultural non-profits).

Specifically for non-profit SOEs, HSHC assumes a direct oversight role of their delivery of their stated non-profit objectives. The focus is not so much on their ability to fund themselves (this, by definition, being secondary) but to ensure efficient use of such funds as are available to them. In this (and in other cases where public subsidies are involved) HSHC is overseen by the Hungarian state audit body, which issues an annual report on the operations of the Holding Company and has a right to undertake value-for-money assessments of individual SOEs as well as individual transactions.

Figure 1. Hungary's SOE controls system



III. ISRAEL – AN OVERVIEW

State-owned enterprises in Israel are officially divided into three categories: government companies, government subsidiaries and mixed companies. Government companies are considered to be those where the state possesses over half of the voting power or the right to appoint over half of the board members. Government subsidiaries are separately incorporated entities subordinate to existing government companies where the government company alone or together with the state possesses over half of voting power or the right to appoint over half of the board of directors. Those companies where the state has a degree of ownership or control that do not meet these thresholds are considered to be mixed companies. According to these definitions, the SOE sector in Israel comprises 68 government companies, 6 government subsidiaries and 18 mixed companies. Of these, a number of companies and subsidiaries are operating with non-commercial objectives – in fact, only 33 SOEs are considered to be operating with commercial motives[15].

The Government Companies Authority (GCA) is the government body charged with exercising the ownership function in SOEs. The GCA was created through the Government Companies Law (GCL) as a unit of the Ministry of Finance responsible for exercising the State's ownership functions vis-à-vis all government, mixed companies and government subsidiaries. The GCA acts on behalf of, and as an advisor to, the Ministers with whom the actual ownership function as holders of the shares of the SOEs is vested. The Ministers responsible for a particular SOE are the Ministry of Finance and the line ministry designated for the SOE by the Government decision regarding the establishment of the SOE. Both enjoy essentially equal powers with respect to the ownership function, having to make decisions by consensus (except in specific provisions where the Minister of Finance is the sole authority) based on the GCA's professional opinion.

3.1 The purpose of state ownership

Paragraph 4(a) of the GCL addresses the "lines of action or a government company". These are defined as follows:

> *A Government company shall act in accordance with the business considerations by which a non-Government company is generally guided, unless the Government, with approval by the [Knesset Finance] Committee, prescribed other considerations for action. This provision shall not apply to a Government company, the basic documents of which prohibit the distribution of profits.*

In combination with the general Israeli Companies Law, which stipulates that incorporated companies may have no higher objective than profit maximisation, this enshrines a rather strong commercial orientation for SOEs. No legislation or government decision provides clarification on

[15]This information is drawn from the Israel Accession Review. It relates to year 2009.

why any given commercial activity may be considered as suited (or ill suited) for government ownership. Also, there's no overall ownership policy bearing generally on Israeli SOEs[16].

In practical terms, the process of establishing a new SOE involves a formal government decision, based on a series of mandatory parameters. These are reviewed by GCA, whose opinion and recommendation is presented to the government. The parameters include the company's proposed objectives and the expected ways of financing its activities. As to the justifications for the establishment of SOEs, few formal criteria have been made public, but informally the main criteria are reported to be: (1) is the private market unable to offer the goods or services (i.e. is there a "market failure" in that field); and (2) is there a national interest or need in the provision of that activity? The presence of private companies in the market would militate against establishing SOEs, whereas the second criterion is a matter of policy. The prospect of a strong commercial orientation would count in favour of creating the new enterprise. Otherwise, alternative ways of financing the SOE will have to be ensured.

Once a government decision is final, the objectives of any given SOE are subsequently included in the company's bylaws.

3.2 Corporate social responsibilities and other overall "expectations" of the companies

No overarching guidelines have been established for the social responsibility of Israeli SOEs. They are mostly expected to operate like private companies in this respect. However, regarding several specific issues one can find legislation and regulations, as well as guidelines issued by the GCA via circulars to the companies. This is the case in areas such as public procurement, non-discrimination and affirmative action. Some provisions are moreover aimed at the prevention of nepotism and sexual harassment as well as the encouragement of development based on principles of sustainability. The courts also consider the dual nature of some of the SOEs, being commercial on the one hand, but also, on the other hand, responsible for the provision of essential services to the public. Therefore, some of the SOEs activities could be subject to various high standards of public law.

Somewhat related to the previous point, specific rules apply to employee representation on boards, women and minority groups in government companies. Two employee directors are appointed by ministers from among six candidates elected by majority vote among the SOE staff.[17] The employee directors are subject to the same duties and rights as any other director (however most of the requirements that the GCL places on nomination of directors do not apply to them). Legislation aimed at securing women a suitable representation at all positions in the public sector applies to SOEs as well. Furthermore, GCL establishes a legal requirement concerning affirmative action regarding women and the Arab population on SOE boards.

3.3 Classes of SOEs with different orientations

There has in the past been a strong tendency in Israel to incorporate non-commercial activities subject to GCL even if they are budget financed and not commercial by nature. This reflects a general belief that this corporate form is the most developed form of incorporation and therefore the most suitable and useful vehicle for the enhancing efficiency of public service providers. This has lead to a situation where, after major privatisation processes (including in

[16] The Israeli authorities are currently in active consideration of whether to formulate an ownership policy.

[17] This applies only to non-bank SOEs with more than 100 employees.

fields of communications, aviation, energy sector etc.) nearly half of Israel's remaining SOEs are designated by GCA as being "non-commercial".

Importantly, this designation is not a blanket exemption from the GCL and other regulations applied to SOEs; it is used as a practical classification to identify companies that have important non-commercial objectives established by their bylaws (described further below). Enterprises in this category include, among other things, a few educational institutions[18]; urban maintenance services; and entities involved in the provision of subsidised housing to low-income families. These SOEs are still required to fulfil these objectives based on business considerations, as required by Article 4(a) of the GCL.

An example of a non-commercial SOE is The Israel Association of Community Centers, established in1969. This fully owned government company's objectives are to establish, organise, operate and develop community centres and projects in the fields of community and society, education, science, culture, immigration and health. The company's mission is to improve the quality of life in Israel's diverse communities. Another example of this category is The Old Acre Development Company Ltd., established in 1969, which objectives are the maintenance, renovation and restoration of the ancient city of Acre, its cultural treasures and archeological sites and development of the city's infrastructures.[19]

A further category of SOEs operating in a non-commercial way is state-owned companies incorporated as "public benefit companies" under the general Companies Law. Such companies are conceptually close to the non-profit organisations – and like these they are legally barred from declaring dividends. Today, this category contains 7 companies. An example of this category is Israel Oceanographic and Limnological Research Ltd, established in 1967. This is a fully owned government company, which objectives are to initiate and develop Oceanographic and Limnological research in Israel in order to promote the discovery and economic use of nature resources (animals, plants, minerals and chemicals), as well as promoting prevention of pollution of the ocean and its shores and coordinating the Oceanographic and Limnological research between all relevant governmental and public entities.

3.4 Specific objectives for specific enterprises

As indicated above, the formulation of specific objectives for SOEs is done pursuant to government decision. The objectives are subsequently written in the company's bylaws. Subject to these requirements, the SOEs in question are required to operate on the basis of business considerations, as stipulated by Article 4(a) of GCL. Although the designation of SOEs as being either "commercial" or "non-commercial" can be changed by government decision, which could in principle impose non-commercial objectives on any one commercial SOE that it decides, in practice this has been very rare.

Such action regarding an already existing SOE would be subject to other shareholders' rights under the general law and existing mutual obligations and take into consideration the companies' existing obligations with other stakeholders Similarly, the option to exercise the authority under article 4(a) of prescribing non- business considerations for a specific company's activity was hardly ever used . Almost the sole example of a use of this option was a government decision made in the 1980's, preventing El-Al, the Israeli national air carrier, from operating on

[18] Established before the establishment of the state of Israel or in the 1950s and 60s.

[19] The site of the ancient city of Acre was included in 2001 by a World Heritage Committee of UNESCO on the World Heritage List.

the Jewish Sabbath. This decision, made prior to the privatisation of El-Al in 2003-4, expired upon the privatisation of the company.[20]

Additional performance requirements or public service obligations may derive from the actions of sectoral regulators, particularly in essential services and utilities sectors[21]. Since there is currently little competition in many of these areas, regulation may in practice be company-specific rather than generic or market-wide. Benchmarks for financial performance of individual SOEs are established by the relevant regulators for the purposes of the relevant regulation.

As regards transparency, the regulations and legislation imposing public service obligations and other requirements to SOEs are publicly available, as are the bylaws of individual SOEs. In addition, agreements between the state and government companies considered to the operating on its behalf are also publicly available.

The Freedom of Information Law allows citizens to request information relating to the operation of SOEs, with exceptions of provident funds and a few companies which have been excluded for reasons of commercial confidentiality or national security.[22] The public has access to parts of the relevant information through the published annual and quarterly reports of listed government companies. A reform recently implemented by the GCA enabled the publication of annual reports of all SOEs on its website. This measure will further increase the transparency regarding the obligations and responsibilities of SOEs and their ability to fulfill these said obligations.

3.5 Compensating SOEs for non-commercial priorities

On the issue of covering costs in a transparent manner, the Israel Accession Review concluded that the government has not progressed very far. The change of regulatory structures over the last 15 years has meant that the costs in connection with obligations imposed by the regulatory or other requirements on SOEs are mandated through transparent decision processes. However, there is no ongoing or systematic effort to identify actual costs incurred or cover them via public budgets.

To some extent the previous point reflects a widely held perception in Israel that universal service obligations (which account for much of what would be considered as “special obligations” in the case of Israeli SOEs) are part of the *raison d’être* of SOEs in the network industries rather than something for which they should be compensated[23]. Given the reliance on sectoral regulation to ensure that these SOEs fulfill their assigned non-commercial objectives, the main tool for “compensating” them lies in the negotiation of tariff structures. Authorities are mindful of a need to prevent cross-subsidisation of activities in any competitive segments of the economy that

[20] The GCL further stipulates that in the case of prescribing such non-business considerations using the option in article 4(a), private shareholders in that company have the right to sell their shares to the government.

[21] Again, one should bear in mind that many utilities sectors are currently part of the private sector, after major privatisation process that took place in Israel in the last decade.

[22] In general, SOEs can request to be exempted from the application of the Freedom of Information Law on a case–by-case basis.

[23] Discussions with the Water Authority during the accession process even revealed a degree of unease at the thought of differential tariff structures: water is a “strategic resource” which all Israeli households have a right to acquire at equal prices. Costing the provision of water to outlying or arid parts of the country was seen as irrelevant.

SOEs may operate, but apart from this universal service obligations are generally financed through implicit transfers within client groups. One example is the national water company, which charges one uniform tariff on households and another on agriculture. The household tariff is high enough to cover the costs of providing water in arid areas and render desalination feasible. The agricultural tariff reflects the shadow cost of providing aquifer water.

In cases the government wishes a specific action or activity will be performed by the company, this will be achieved by agreement based on arm-length principles.

3.6 Assessing the achievement of non-commercial priorities

Other than regular assessment and evaluation based on financial and specific reports, supported by the presence of a representative of the GCA on the boards of SOEs, no formal review mechanisms are currently in place to assess the achievement of non-commercial priorities. This is, however, an area of “work in progress” and GCA expects to develop further evaluation mechanisms within the next couple of years.

Given the Israeli practice of normally communicating specific objectives to SOEs partly through their bylaws, and partly through sectoral regulation, an evaluation is implicitly hierarchical, with an assessment, first, of whether the objectives have been met, and secondly if they have been met in an efficient manner – i.e. whether the obligation to operate “commercially” apart from the special objectives has been fulfilled. GCA evaluates this on an ad-hoc basis, relying on companies’ regular reporting as well as assessments by the Agency’s observers that must be present in SOE board meetings.

A practical outcome of this informal monitoring process in the past has been that certain SOEs have been dissolved because GCA concluded that they were not delivering on their non-commercial objectives (or, in some cases, on the reasons they had been established), or that other SOEs could deliver the same objectives more efficiently. One example of this is the unravelling of the Arad & Dead Sea Region Development Company Ltd, whose objectives were the development of the Dead Sea shore and its surroundings for purposes of health and other tourism.

IV. NETHERLANDS – AN OVERVIEW

Despite takeovers by the government of two distressed enterprises during the financial crisis, the Dutch SOE economy remains relatively small. At end-2009 it comprised 28 enterprises with a total 60,000 employees, mostly concentrated in the finance, infrastructure and transport sectors. All SOEs are incorporated according to general company law. No Dutch SOE is currently listed on the stock exchange, but some SOEs have minority non-state shareholders including private enterprises and municipalities (for example in the transport sector).

The ownership function for SOEs (with three exceptions) resides with the Ministry of Finance[24]. Line ministries have regulatory powers over the SOEs in their respective areas, and in some cases also initiate legislation bearing on the SOEs. They are also involved in the monitoring of SOEs' fulfilment of management contracts[25]. This relatively strong separation of powers is related to a central dictum of Dutch ownership policy: state control over SOEs should be exerted through legislation, regulation or contracts (e.g. management or concession contracts), but only as a last resort through the exercise of shareholder powers. The main justifications for this approach include transparency and the maintenance of a level playing field in areas where competition occurs or could occur. However, a partial revision of the approach occurred in 2007 when a new ownership policy established that aspects of corporate policy that are closely linked with the public interests that lie behind the state ownership can be influenced through shareholder power and enshrined in SOEs' articles of association.

4.1 The purpose of state ownership

State ownership in the Netherlands is set against a long history of privatising enterprises that the government did not perceive as expressly needing to remain in public ownership. In consequence, additions to the SOE sector typically took place when parts of the general government sector were corporatized, or in connection with structural separation in the network industries. SOEs were mostly privatised once legal and regulatory frameworks had been sufficiently developed. The 2007 ownership policy to some extent reversed this trend. This reflects a political shift as well as the fact that the remaining SOEs operate in much less competitive environments than those previously privatised. It should however be noted that the current government (in office since October 2010) considers allowing some SOEs to raise private capital for investment purposes. In effect this will amount to what has been called by earlier OECD documents a "self privatisation" by these enterprises.

The Dutch SOE policy provides some guidance on when and how to set up new SOEs. New SOEs can only be established (i) on the basis of well-formulated strategic and public interest, (ii) which can effectively be realised neither within a public setting, nor by other market parties, (iii) and only if the organisation is financially and commercially viable.

---

[24] The ownership of two state-owned financial institutions has recently been transferred to an autonomous body, NLFI, which is expected to function broadly like the UK Financial Investments Ltd.

[25] This may contrast with the practices of some other OECD countries where the monitoring of contractual obligations tends to reside with the ownership function rather than the regulators.

The creation of a new state-owned enterprise is possible only pursuant to parliamentary approval. The Ministry of Finance and relevant line ministry (except in the case of the financial sector where the Ministry of Finance plays both roles) send a joint proposal to parliament stating the public policy interests that are to be served by the proposed SOE[26]. The justifications offered in recent years have mostly been one of the following:

- *Market restructuring.* The separation of infrastructure and operations in utility sectors has led to several new SOEs. Some are carve-outs from existing SOEs (railways); some are acquired from market parties (electricity grid).

- *PPPs, PFIs and infrastructure*. The redesign of tendering procedures and prioritisation of public funds have led projects to become corporatized as SOEs, allowing them to raise funding in the market and engage in public-private partnerships.

- *Remedying market failure.* In the past, certain sector policy objectives were pursued by the establishment of SOEs with specific purposes such as providing technological and other assistance to parts of the business sector.

- *Rescue operation.* As mentioned above, two companies in the financial sector (a bank and an insurance company) have been taken into public ownership because their failure might have triggered wider systemic consequences. Rescue operations before 2000 include a truck manufacturer, an aircraft manufacturer and shipyards.

Traditionally, the main justification for continued state ownership has been that an adequate legal and regulatory framework cannot be established, for which reason (1) the company cannot be considered for privatisation; and (2) the State needs to be able to exert continued shareholder powers. Around 2006, Schiphol Airport was subject to intense political debate, with the Minister of Finance arguing pro-privatisation and a major political party against. It was finally decided to cancel the intended IPO.

Another example of this is the state-owned monopoly casino operator, which (because of public unease about gambling) has been perceived as operating subject to continually changing public policy priorities. This has been a main argument for continued state ownership. However, the growing pressure from internet gambling sites has now induced the government to undertake work toward a formalised sectoral regulation and, as a corollary, consider the privatisation of the company.

Formally, existing SOE ownership is subject to an annual review by parliament as part of the fiscal budget procedures. It is fair to say that this review is not very extensive. The justifications for public ownership that have been offered in this context include (i) the difficulty in legislating an obvious but complex public interest (e.g. nuclear energy and waste); (ii) financial inviability of vital public services (e.g. water; rail transport); and (iii) disputes or deferred decisions concerning the nature of public interest. Perhaps unsurprisingly, political conflicts regarding the privatisation process can sometimes also play a role.

4.2 Corporate social responsibility and other overall "expectations" to companies

All state-owned enterprises in the Netherlands are expected to establish a "credible" corporate social responsibility (CSR) policy, but there are no specific requirements from the

[26] If Parliament does not respond within 60 days the proposal is agreed on a no-objections basis.

ownership function regarding the contents. The lack a commonly enforced level of aspiration is based partly on the premise that, to avoid market distortions, there should be no unique requirements to SOEs. The view of the Dutch authorities is also that a good CSR policy needs to be internalised as a part of corporate strategies and hence specific to the individual SOEs or the sector in which they operate. Finally, the strong reliance on legislation and regulation to influence the path of SOEs in the Netherlands has contributed to a widely held view that "if the government wants its companies to implement specific CSR standards then it will have to issue these as regulations".

To encourage individual companies to implement sound CSR practices, high standards of transparency are applied. SOEs are requested to report according to the Global Reporting Initiative, at least at the lowest (category C) level of application of this guideline. They further participate in the Transparency Benchmark of the Ministry of Economic Affairs, which jointly benchmarks the CSR practices of around 500 Dutch companies, most of which private enterprises.

The CSR performance of state-owned enterprises is also subject to frequent, incident-driven parliamentary attention. Parts of the political spectrum regularly ask ministers to provide information to parliament on, among other things, the human rights and value-chain related practices of Dutch SOEs. This has not in the past given rise to political intervention by ministers in SOEs, but it may, in connection with the transparency enhancing measures mentioned above, have provided incentives for SOE boards of directors to review their CSR practices.

4.3 An absence of classes of SOEs with different orientations

There is no formal classification of Dutch SOEs, neither according to their corporate form nor to their operational priorities. As mentioned earlier, all SOEs are fully corporatized and the government works on the assumption that all enterprises, including SOEs, are profit maximising. This implies that SOEs cannot be expected to perform loss-making duties. However, rate-of-return requirements are, in a departure from earlier policies, no longer imposed on SOEs. The ownership function conducts discussions with the boards of individual SOEs regarding their financial performance, which may include benchmarking against similar private enterprises.

4.4 Specific objectives for specific enterprises

Specific non-commercial objectives may be imposed on individual state-owned enterprises in one of the following fashions:

1. *Performance contracts.* This is the preferred form of imposing specific objectives for individual SOEs. The advantage is that, if the SOEs operate in a competitive environment, a level playing field can be maintained by offering the contracts in tender.

2. *Regulation/Legislation.* The sectoral legislation and attendant regulation by the line ministries applies to all enterprises regardless of ownership. However, in the (relatively few) sectors where an SOE has a monopoly, the exercise of regulatory powers is effectively equivalent to establishing company objectives.

3. *Shareholder action*. The shareholder (Ministry of Finance, pursuant to cabinet decision) retains the right of approval for the corporate strategy, major (dis-) investments and remuneration and dividend policy. There is no 'instruction right' for any shareholder under Dutch law, but the State can thus effectively block major decisions that are out of sync with the intention of its investment.

An example of a performance contract is the competitive tender of regional bus lines throughout the Netherlands. The incumbent SOE, Connexxion, was just one of many market parties. It should be noted that the *raison d'être* of the State as an investor effectively disappeared once the market became fully competitive. Were shareholding minister and line minister not separated, the tender procedure could even be undermined. Hence, Connexxion was subsequently sold to a French party. *Shareholder action* can be illustrated by Tennet (electricity grid), where a major take-over in Germany was only approved after the Ministry of Finance thoroughly examined the financial implications and the contribution to the stated public interests.

4.5 Compensating SOEs for non-commercial priorities

Insofar as non-commercial priorities are imposed in the form of contracts then the compensation is provided as part of the contractual arrangement. It is ideally market consistent, obtained where possible by competitive tendering or otherwise through bilateral negotiations. An example of this is the railway service, where a separation has been made of the central network, which is part of the core operations of the national state-owned railway company, and regional, non-profitable lines. The non-profitable lines are offered in public tender every 10 or 15 years to establish which rail operator is able to fulfil the public service obligation at the lowest price. Currently, affiliates of Deutsche Bahn (Arriva) and SNCF (Syntus) act in this capacity in the Netherlands. The 15-year transport concession on the high-speed railway was won by a consortium led by the state-owned incumbent NS. Recent controversy has arisen because the concession contracts were won at a price subsequently deemed too burdensome for the company.

Objectives imposed indirectly on state-owned enterprises via sector regulation or by shareholder action are normally not subject to financial compensation by the government.

4.6 Assessing the achievement of non-commercial priorities

The achievement of non-commercial priorities is, in bullet points 1 and 2 above, monitored by the respective line ministries. The processes involved are relatively stringent. In the second case it becomes a question of legal and regulatory compliance. In the first case, the contracts involved are subject to private contract law. In the case of non-compliance with the contractual terms, the ministries are expected to take recourse to the court system to either enforce the contract or impose fines on SOEs found to be in breach.

Share ownership on itself is not considered effective to enforce these priorities. Under Dutch corporate law, shareholder rights are not specific enough and do not allow interference in operational activities. The General Meeting also lacks proper enforcement measures (in practice only dismissal and disapproval of major decisions).

Public oversight bodies such as the state audit function are not involved in the monitoring of SOE performance. However, where contractual awards with consequences for the public purse are involved they play a, limited, role in monitoring value for money.

V. NEW ZEALAND – AN OVERVIEW

New Zealand differs from many other OECD countries in the sense that, rather than operating a number of SOEs with varying degrees of commercial orientation, the country undertakes a rather strict separation of entities owned by the State (or, in local vernacular, "the Crown") according to the nature of their objectives. Figure 1 shows the mechanism that guides the appropriate structural form for enterprises that are owned by the Crown. Organisations that by standard OECD definitions would count as SOEs are mostly found in the categories of the (significantly narrower) New Zealand definition of "State Owned Enterprises" as well as certain Crown Entities (CEs)[27]. (A full overview of New Zealand's organisational forms is provided in Annex 1.)

State-Owned Enterprises. SOEs, according to national definition, are owned by the Crown but operate as commercial businesses. They were set up by the State-Owned Enterprises Act 1986 (the "SOE Act"), are – with one exception – registered as public companies and are bound by the provisions of the Companies Act. This ensures that SOEs are subject to the same market and regulatory conditions as their competitors. SOEs are distinguished from other kinds of Crown entities and structured as companies because they provide services directly to the public through market transactions, i.e. the quality and quantity of services provided and their prices are determined through the market. The underlying principle is that SOEs should compete on a level playing field with organisations that are not Crown-owned.

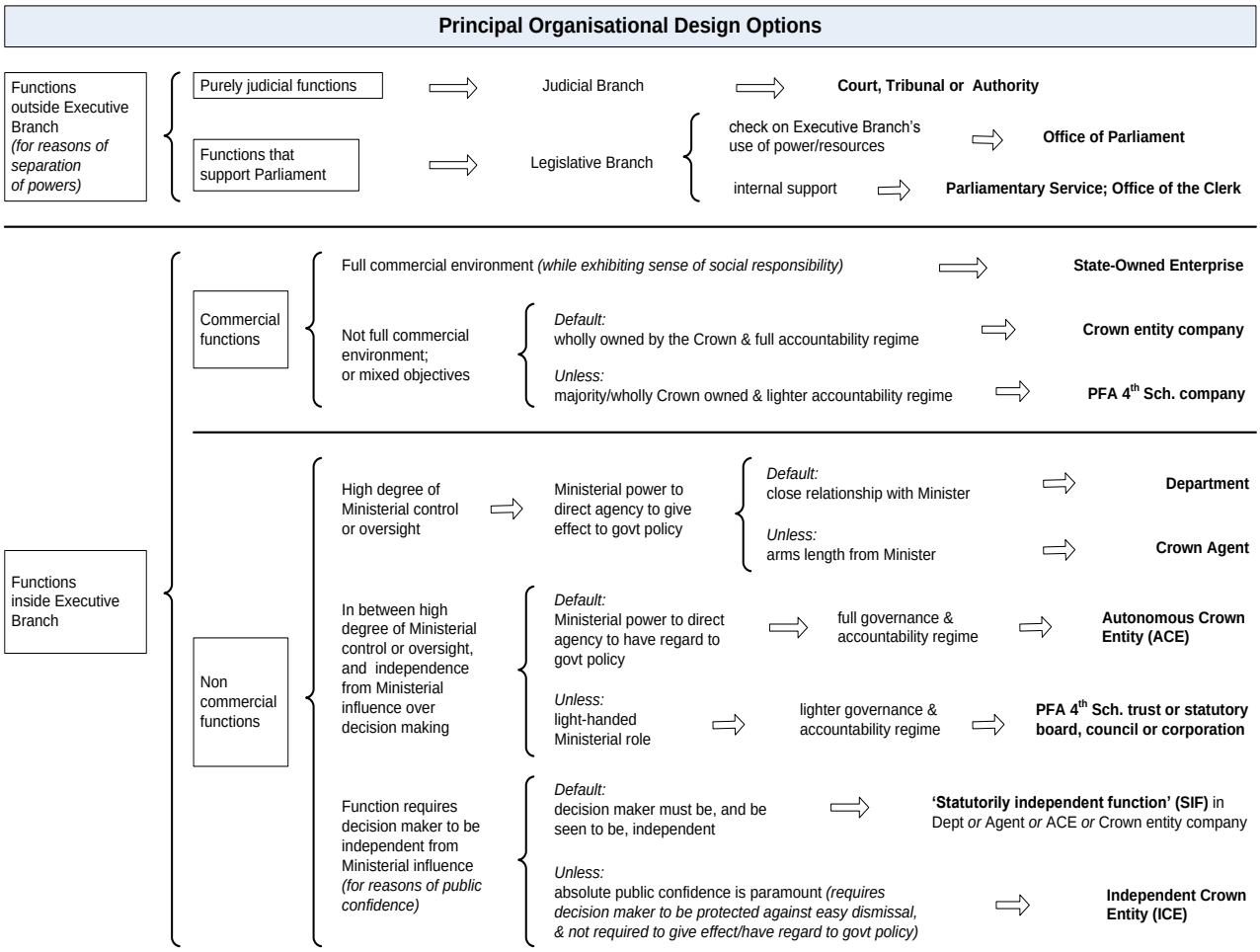
There are currently 16 SOEs in New Zealand. Each SOE has two shareholding Ministers – one is the Minister of Finance and the other is the relevant portfolio Minister. The Crown Ownership Monitoring Unit (COMU), a unit within the Treasury, provides shareholding Ministers with advice on the performance of each SOE[28]. COMU also provides advice to the Ministers of Finance as a shareholding Minister.

Crown Entities*.* There are five types of CE in New Zealand, essentially differing in respect of their degree of "closeness" to the Crown. Perhaps most closely related to SOEs are the "CE companies". Under the Crown Entities Act, CEs have non-commercial functions but some (including the CE companies) also have commercial imperatives. There are eleven CE companies, including eight Crown Research Institutes (CRIs).

[27] The Crown also has ownership interests in a number of organisations with other legal forms which (amongst other characteristics) have, or allow for, less than 100% Crown ownership. These include 8 Public Finance Act Schedule 4 companies, 4 council-controlled airport companies and one publicly listed company. However, consideration of the SOEs and CEs is sufficient to fully describe New Zealand's approach to commercial and non-commercial services.

[28] Four SOEs have been transferred to the Commercial Transactions Group (also in Treasury) because these companies are being readied for partial sale and public listing on the New Zealand Stock exchange.

Figure 2. New Zealand Institutional Forms



"Statutory CEs" are generally established by the Crown to deliver many of the public services of importance to New Zealanders. They are wholly Crown-owned non-company entities with boards, and have been given greater operational freedom than government departments on the principle that services will be more efficiently produced if the entity has discretion within a framework. Each statutory CE usually has its own establishing legislation and falls into one of the five categories of Crown entities subject to the Crown Entities Act. The entity's establishing legislation contains entity specific objectives. These objectives can contain a mix of social, cultural, public policy and commercial statements.

There are three types of statutory CEs: Crown agents (Agents), autonomous Crown entities (ACEs) and independent Crown entities (ICEs). Each type of entity is subject to different provisions of the Crown Entities Act, depending on how close they are to the government. For example, Agents must give effect[29] to government policy, ACEs must have regard to government

[29] 'Give effect to' means that a CA must implement/comply with specific policy if directed by its responsible Minister (for example to follow a sector-wide policy regarding IT standards or procurement policy. 'Have regard to' means that the responsible Minister may direct an ACE to take a specific policy into account when setting its own policy. This may imply that the government expects the entity to follow government policy in this matter unless there is a compelling reason for the entity to apply a different policy. The final decision, though, rests with the entity's board. Any direction given by a Minister needs to follow consultation with the entity, and the direction needs to be presented to the House of Representatives and

policy, but ICEs are not required to give effect to or have regard to government policy. As is the case with SOEs, most CEs with commercial interests are overseen by COMU. COMU acts on behalf of, and as advisor to shareholding Ministers. The CRIs and some CEs have these functions wholly or jointly (with COMU) managed by the appropriate policy Ministries.

5.1 The purpose of state ownership

New Zealand does not have a specific ownership policy, though a purpose for ownership may be inferred by the choice of institutional ownership designated in Figure 1. One of the underlying principles of the SOE model as it was conceived in the 1980s was that government-owned trading entities would operate according to normal commercial disciplines. These would include capital market disciplines in the form of an option to privatise, and an understanding that the Government would exercise this option wherever the public interest was adequately protected through regulatory or other mechanisms. Successive governments have operated different policies regarding the public ownership of SOEs, and the current government is implementing a programme to sell up to 49% of four SOEs.

The primary purpose of SOEs (as defined in the SOE Act) is to be profitable. The purpose of CEs (under the CE Act) is to:

- Act consistently with objectives, functions, statement of intent and output agreement;
- Perform functions efficiently, effectively and consistently with the spirit of service to the public; and
- Operate in a financially responsible manner.

The specific purpose and objectives of an SOE or CE is described in its Statement of Corporate Intent (SOEs) or Statement of Intent (CEs), which is a public document produced annually by the entity board and tabled by the responsible/shareholding Minister in the House of Representatives.

COMU, on behalf of shareholding Ministers has issued, and periodically updates, an Owner's Expectations Manual, which guides boards and management within SOEs regarding a range of behaviours and policies that their SOE is expected to adopt. These expectations range from performance reporting and the relationship with Ministers and monitors, through to expectations regarding board processes. Mostly, the expectations outline guiding principles rather than being prescriptive. The Owner's Expectations Manual does not constitute an ownership policy, but it fulfils some equivalent functions.

5.2 Corporate social responsibility and other overall "expectations" to companies

5.2.1 State-Owned Enterprises

The SOE Act requires every SOE to: exhibit a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.

---

published in the Gazette. It is worth noting that instances of direction are rare, and when they do occur, follow a transparent and consultative process. Ministers may not direct ICEs.

This means that SOEs have corporate social responsibility (CSR) obligations that go beyond other companies. SOEs are expected to formulate and report on CSR objectives on an equal footing with financial objectives. Specifically, shareholding Ministers expect each SOE to have the following in place:

- specification of CSR values and behaviours, and how these are incorporated into the fabric of the company;
- objectives and performance targets reflecting good social responsibility practice;
- specific CSR programmes; and
- the reporting framework to be used.

CSR objectives and targets are therefore included in each SOE's Statement of Corporate Intent and reported on in its Annual Report, both of which are public documents. A prescriptive approach to CSR is not seen as helpful, and a number of SOEs have adopted versions of the international frameworks that provide guidance and/benchmarking on CSR.

A principle of CSR is that integration within an organisation's day to day operations is critically important. There is no evidence that any SOE has found its CSR obligations to be in conflict with value creation, and commonly SOEs publicly assert that CSR is simply good business practice. Where SOEs have been found to underperform financially relative to private sector peers, CSR obligation has not been cited as a contributory factor.

5.2.2 Crown Entities

CEs do not have specified CSR objectives beyond the obligation to act as good employers. However, where a CE has a commercial imperative, there is an implicit assumption that CEs will behave consistently with the intent of CSR. CEs are not obliged to report on CSR performance. A 'no surprises' expectation covers both SOEs and CEs, and potential or actual deviations from CSR practice would be expected to be notified to Ministers at the earliest opportunity.

5.3 Specific objectives for specific enterprises

5.3.1 State-Owned Enterprises

SOEs have an obligation to act commercially and to this end they set their own objectives. Shareholding Ministers (advised by COMU) have the opportunity to assess and give feedback on draft business plans and Statements of Corporate Intent and expect to be consulted about significant investments (generally, those worth more than 10% of the SOE's total assets), as well as any substantial moves outside of the agreed scope of core business. Some specific powers of Ministerial direction exist in the SOE Act, but in practice these have been rarely used. In law and in practice, the SOE's board is the accountable body for setting and achieving the SOE's objectives.

Occasionally, because of a unique position or natural monopoly, an SOE may fulfil a specified national role (for which no extra remuneration is provided). A good example is New Zealand Post (Box 2). The SOE Act can be viewed as separating out ownership from the policy in so far as the objectives of SOEs do not include a policy function. Policy advice affecting a

sector in which an SOE operates is formulated by the relevant policy ministry, and, where applicable, the policy advice is provided to shareholding Ministers, via the Treasury.

There is also an on-going convention on the allocation of Ministerial portfolios, which operates to separate out the ownership and policy functions of the New Zealand government: The SOE Act requires SOE's to have two shareholding Ministers, one being the Minister of Finance. By convention the second shareholding Minister is the Minister for State Owned Enterprises, and that second Minister is not given the responsibility for policy and regulation of the same area.

Box 2. Non-commercial priorities for New Zealand Post.

New Zealand Post is the designated postal administrator for New Zealand and is the operator of the only nation-wide postal network. The government has a deed of understanding (administered by the Ministry of Business, Innovation and Employment (MBIE), and periodically reviewed) with NZ Post to set social, price and service undertakings that must be met within the postal services market. Essentially, this ensures that NZ Post's rural and urban postal services are provided at universal pricing (despite the likely higher costs of provision of rural services), whilst enabling other postal operators to offer competing services, including services which access NZ Post's national network at fair and transparent cost.

The terms of the Deed of Understanding are currently under review, in a process involving NZ Post, MBIE, other industry players, shareholding Ministers in NZ Post, the Minister of Communications, and public consultation. NZ Post receives no Crown funding or other subsidy for its services and operates as a fully commercial SOE. There are about 28 private sector postal operators competing with NZ Post in segments of the postal market.

5.3.2 Crown Entities

The function and objectives of each CE is generally set out in that entity's Act, and the CE is required to behave consistently with this specification and with its Statement of Intent (which sets out the CEs intentions and undertakings over the next three years).

The Statement of Intent (which Ministers and officials give feedback on during the CE's drafting process) is updated annually, and includes specific impacts, outcomes or objectives that the CE seeks to achieve or contribute to, and , if the CE is directed to give effect to or have regard to government policy, how those objectives may relate to the direction. As with SOEs, a CE's board is accountable for setting and achieving the entity's objectives.

The Statement of Intent includes financial and non financial measures and performance standards by which the CEs services can be judged. The CE's annual report must include a statement of service performance identifying its output classes and for each output class specifying the standards achieved compared to those forecast in the Statement of Intent, and the actual revenue and output expenses compared to forecast.

5.3.3 Other public service obligations and public policy objectives

The SOE model was established to ensure profit maximisation and to enable SOEs to operate without imposition of policy objective or political interference that may detract from performance. There are a few obligations that result from Crown ownership, such as being subject to Official Information Act requests from the public, and being subject to annual parliamentary scrutiny by Select committee. However, these obligations are not materially

onerous, and overall the burden on an SOE may be no greater than the reporting disciplines placed on publicly listed companies by the New Zealand Stock exchange.

5.4 Compensating SOEs for non-commercial priorities

5.4.1 State-Owned Enterprises

As mentioned earlier there are very few examples where SOEs deliver non-commercial services, and where these are undertaken, the SOE Act makes provision allowing these to be specifically paid for by the Crown. In these instances, the Crown and SOE agree in advance the outputs to be delivered and the funding needed, and an appropriation bid is made in the Crown's annual Budget.

A unique situation exists in public rail transport. As a minor part of its business, New Zealand Railways Corporation (an SOE) provides urban commuter rail services in two major centres on behalf of regional councils (who have responsibility for the provision of public transport). These services are funded by a mix of passenger fares (i.e. user pays), council payment for contracted services, and government grants (from transport policy funding). As is commonly the case with public transport, it would be unlikely that these services could be commercially sustainable without transport grants. However, rail competes for all three of its funding sources with other public transport options (such as bus services operated by the private sector).

Detailed contracts and performance monitoring arrangements ensure that costs are clearly identified (and separated from NZRC's other business activities) and that service delivery is scrutinised (with penalties for under-performance). The rail corridor land and associated track and signalling equipment is owned by NZRC, but other assets (stations, parking and rolling stock) are owned by the regional council. At their discretion, councils can contract NZRC or other service providers to run train services and maintain assets, and some of these services are contracted to other providers in one centre[30]. These arrangements have been derived to maximise contestability of funding and transparency of cost and service delivery for public services that are not fully commercial.

5.4.2 Crown Entities

CEs, being closer to the Crown that SOEs, are subject to greater public service and policy expectations, according on the precise form of the CE. The mix of commercial and non-commercial objectives will depend on the nature/purpose of the entity, the extent of its "commercial" activities and the sources of its "revenue" (e.g. user charges, levies, contestable funding or direct Government funding). Depending on its Act, a CE may receive its "revenue" funding:

- from a purchasing department or Ministry (e.g. ESR, a CRI, provides forensic services on behalf of NZ Police under an 'evergreen' 5 year contract, paid from the NZ Police Budget vote);

- from levies imposed on groups or industries (e.g. Civil Aviation Authority is primarily funded via levies on the aviation industry and the flying public);

[30] Currently, the structure of NZRC is under review, with the aim of providing greater clarity regarding its level of financial performance.

- via user pays charges to the public (e.g. vehicle registration charges); or
- a combination of the above.

CEs may also derive commercial revenues from other services provided to the public or contestably to other parts of the Crown; if they are consistent with their Statement of Intent (for example Television New Zealand derives almost all of its funding from commercial advertising sources). Normal market conditions apply to these services in terms of contestable bidding, pricing and performance expectations etc.

5.4.3 Independent scrutiny of market behaviour

An independent body, the Commerce Commission (an ICE) enforces legislation that promotes competition in New Zealand markets and has wide ranging powers to investigate and remedy alleged or possible misuses of market power, including those by organisations owned by the Crown.

5.5 Assessing the achievement of non-commercial priorities

Where SOEs or CEs provide non commercial services, as mentioned above their Statements of (Corporate) Intent identify services, standards, and forecast revenues and expenses for each output class. Their annual reports are required to identify actual performance against the same metrics.

Both the Statement of (Corporate) Intent and the annual report are public documents. They are tabled in the House of Representative, and published by the entity (both physically and via its website, if appropriate). An example is provided in Box 3.

Monitoring agencies receive quarterly reports from SOEs and CEs, and advise responsible Ministers regarding entities' performance against financial and non-financial criteria and objectives, including any non-commercial priorities (this information is not generally made public, for commercial reasons). The SOE Act and CE Act empower Ministers to request and receive information from the entities as required.

All SOEs and CEs are also subject to annual review by New Zealand's state auditor, the Office of the Auditor General (or its appointed agent), and by the relevant parliamentary select committee. The cross-party select committee has the power to investigate any aspect of an entity's operation, without restriction.

Box 3. Performance Targets established by Corporate Statement of Intent: New Zealand Post

	2010/11 Actual	2011/12 Plan	2012/13 Plan	2013/14 Plan
Shareholder Returns				
Total shareholder return*	NZ$ -150.5 mill	NZ$ 5 mill.	NZ$ 5 mill.	NZ$ 5 mill.
Dividend yield (excl. Kiwibank)	0.4%	0.7%	0.7%	0.7%
Return on equity	-5.3%	4.1%	6.4%	8.3%
Return on equity adjusted	-7.8%	6.0%	.1%	11.4%
Profitability/Efficiency				
Return on capital employed	-2.6%	5.2%	8.8%	12.3%
Operating margin	2.4%	10.2%	12.2%	13.9%
Leverage and Solvency				
Gearing ratio (net)	89.4%	89.6%	89.9%	90.0%
Interest cover	3.2	9.6	12.6	16.3
Solvency (current ratio)	104.3%	104.8%	104.7%	104.9%
Good Employer				
People Engagement Index**	73%	73%	74%	75%
Lost Time Injury Frequency Rate (lost time injuries per million hours worked)	6.3%	5.8%	5.4%	5.0%
Corporate Responsibility				
Standard Letter Service Performance (letters delivered to standards)**	95.5%	96.5%	96.5%	96.5%
Customer Favourability**	45%	56%	59%	60%
Emissions Reduction (annual reduction in emissions)	10.1%	12%	TBC	TBC

* Assumes no change in the commercial valuation during the plan years.

** As indicated by specific surveys among staff and customers.

VI. NORWAY – AN OVERVIEW

Norwegian SOEs are mostly incorporated subject to ordinary company law, but statutory corporations also exist. According to a recent OECD survey[31], at end-2009 there were 36 ordinary companies and 10 statutory corporations. The enterprises are found across a broad spectrum of the business sector, but in terms of capitalisation the sector is totally dominated by hydrocarbons and the network industries (power and telecom). In terms of employment, four regional health service companies are also very important.

In terms of the organisation of ownership, a more relevant separation is between companies that are designated as fully or largely commercial and those that have been tasked with pursuing sector political goals. The Norwegian ownership structure is "dual", in the sense that commercially-operating SOEs are, with one exception, overseen by the Ministry of Trade and Industry, whereas the ownership function vis-à-vis sectorally-oriented SOEs is in the hands of various line ministries. Nineteen state-owned enterprises were in 2009 classified as having a commercial orientation[32].

6.1 The purpose of state ownership

The Norwegian government's purpose with maintaining state ownership of a number of enterprises was provided in a revised policy statement issued in the first half of 2011[33]. The rationale for SOEs was spelt out as follows (OECD Secretariat's translation):

> *The Government considers it is both right and important that the State should contribute to the development of the business sector through a significant and active ownership stake in Norwegian enterprises. State ownership implies predictability and an opportunity to aim for long-term industrial development and value creation. State ownership also matters greatly in ensuring a strong Norwegian ownership. Often the only investor communities large enough to absorb the ownership stake of the State would be foreign. A privatisation of State assets would therefore in many cases imply that the ownership relocates away from Norway.*
>
> *The Government emphasises that there should be clarity about why the State acts as an owner in various companies. This will create transparency about the State's ambitions for the ownership and makes it easier for the companies to relate to the State's interests as a shareholder. A t the same time, clarity about*

[31] Christiansen, H. (2011), "The Size and Composition of the SOE Sector in OECD Countries", *OECD Corporate Governance Working Papers*, No. 5.

[32] To this can be added a five listed companies in which the Norwegian State had minority shares large enough (in the case of SAS, jointly with the governments of Denmark and Sweden) to confer effective control. The State's interest in these companies is also entrusted to the Ministry of Trade and Industry.

[33] "Aktivt eierskap – norsk statlig eierskap i en global økonomi", ("Active ownership – Norwegian state ownership in a global economy"), White Paper no. 13 (2010-2011).

the State's objectives makes it simpler to communicate expectations to the companies and to follow up on their implementation within the State ownership function.

Compared with a number of other OECD countries, this is an unusually "broad" statement in that it does not limit itself to providing a rationale for state involvement in specific enterprises. It argues that having the state as a major player in the corporate sector is an economic advantage, inter alia contributing to long-term investment and value creation. It also effectively establishes the avoidance of an "excessive" foreign ownership as a priority for state ownership.

The policy statement further enshrined a list of ten "principles of good ownership" which are closely aligned with the recommendations contained in the SOE Guidelines (Box 4). The priorities state ownership were further fleshed out as follows by the policy statement.

National base. The state wishes to ensure that important companies in society remain based in Norway. The fact that large companies have head office functions in Norway is important in terms of value creation. That is why this is an important political issue in Norway and many other countries. If strategically important companies have their head offices in Norway, this contributes to securing and developing specialised industrial and financial expertise as well as management expertise in general.

Box 4. The Norwegian State's Principles for Good Ownership[34]

1. Shareholders shall be treated equally.
2. There shall be transparency regarding the State's ownership of the company.
3. Decisions regarding ownership and company statutes are made by a shareholder meeting.
4. The State will, if relevant jointly with other owners, define objectives for the company. The company's Board of Directors are responsible for implementing the objectives.
5. The capital structure in the company shall be adapted to the purpose of State ownership as well as the company's financial situation.
6. The composition of the Board shall reflect competence, capacity and diversity, based on the characteristics of the individual company.
7. Remuneration and incentives should be designed with a view to enhance value creation in the company and be perceived as reasonable.
8. The Board shall perform an independent oversight of the company's management on behalf of the owners.
9. The Board should have a work schedule; it should actively work to develop its own competencies. The Board's work must be evaluated.
10. The Company must be aware of its social responsibilities.

[34] Translation by the OECD Secretariat.

The cooperation between head offices and various national institutions within a sector is of great importance in terms of economic development. A head office will normally have considerable strategic competence in order to be able to manage a company's affairs in an adequate manner. Nationally based decision-making and management competence is also of great importance to the supply industry, and thus also in terms of national value creation and jobs. Through its ownership, the state wishes to contribute to head offices in areas of national strategic importance remaining in Norway.

A holding of more than one-third of the votes and capital gives so-called negative control of decisions that require a majority of two-thirds. Such a holding ensures that the share owner can block important decisions such as moving the head office. An ownership interest of more than a third of a company is thus necessary to ensure a Norwegian domicile. The size of the interest the state wishes to own in a company must also be seen in light of the importance of the company to the Norwegian economy and value creation, and the ownership interest will in many cases be much higher than a third.

Ensuring control of and revenues from natural resources. The state wishes to ensure national ownership and control of the country's extensive natural resources, particularly in the energy sector. State ownership of Statkraft (hydroelectric power) and Statskog (forestry) help ensure that such resources are exploited for the common good. The state wishes to retain Statskog and Statkraft as wholly state-owned companies. Partial privatisation of these companies is therefore out of the question.

The state's ownership of energy companies is an element of the Government's policy for ensuring as far as possible that the revenues generated by natural resources benefit the society as a whole. As a result of increasing energy prices, companies such as Norsk Hydro and StatoilHydro have increased strongly in value and provided good returns in recent years. The same applies to Statkraft. Extensive state ownership in the energy sector has thus provided extra revenues for the state through the distribution of large dividends in recent years. This shows that state ownership can be a supplement to the tax system that provides income for the society as a whole.

Securing other political objectives (non-commercial SOEs only). Ensuring good national infrastructure is an important public task. Through state ownership, the state wishes to ensure that Norway has well developed infrastructure as regards roads, railways, airports and the national transmission grid for electric power.

The authorities have a particular responsibility for ensuring that society has a rich and diverse cultural sector in areas such as the theatre, opera etc. Ownership of the Norwegian broad-casting corporation, NRK, contributes to cultural diversity. The state wishes to utilise its ownership in the cultural sector to meet society's needs for quality, diversity and innovation.

State ownership of the regional health authorities and the organisation of the specialist health service as health trusts allows for overall management and good utilisation of resources with a view to maintaining and further developing good services for the population as a whole.

Market failure and the oversight of monopolies. Some goods and services need to be produced in a context not involving market-based competition. This is the case where a production process involves important societal externalities or natural monopolies. This justification for state ownership needs to be seen in connection with sector political goals, and

involve an assessment, in each individual case, of whether and incorporated company is the most suitable institutional way of meeting the objectives.

6.2 Overall "expectations" to companies

The Norwegian government's ownership policy lays down clear expectations with respect to sector-independent considerations of companies in which the state has an ownership interest. The Government's expectations include factors such as: returns and dividends; corporate social responsibility; R&D, innovations and competence building; management remuneration; composition and conduct of boards; and diversity and gender equality. These are matters which it is expected that the boards of directors will take into consideration in their deliberations and which are intended to underpin a long-term high rate of return and good, sustainable industrial development. It is the responsibility of the boards and companies' management to ensure that the companies take these sector-independent considerations into account. The boards must ensure a balancing of the different considerations in a manner that furthers the interests of the shareholders as a whole. The position of the government is that the pursuit of responsible practices in the above areas does not impede high rates of return and dividends. SOEs are expected to deliver on both without any perceived trade-off. The main issues (other than returns and dividends) of concern to the government are summarised in the following sub-sections.

6.2.1 Corporate social responsibility

The 2011 White Paper goes in great detail with the expectations that the government owners have to SOEs in terms of CSR, and the linkages between these expectations and existing internationally endorsed recommendations. These expectations are broadly similar to those previously stipulated for "ethical investment" by the Government's two oil-funded pension reserve funds. They draw generously on existing international recommendations, including by OECD. Regarding SOEs' overall efforts toward corporate social responsibility, the following expectations are communicated. SOEs shall be expected to:

- Be leaders in the work on CSR within their field. They are expected to follow actively, and help shape, good practices in the areas relevant to their activities.
- Have ethical guidelines which are communicated to the general public.
- Develop guidelines for their work with CSR, which are communicated to the general public.
- If they have international activities, associate themselves with the UN Global Compact. (Companies with international value chains are should consider doing the same.)
- If they have international activities or value chains, study and implement the OECD Guidelines for Multinational Enterprises.
- If they have international activities or value chains, base their activities on ILO's eight core conventions.
- Develop indicators for the extent of their social responsibility, in cooperation with main stakeholder groups.

- Report on their work toward CSR, including the challenges, objectives and performance indicators. Companies of a certain size are expected to report according to GRI standards.

- Place responsibility for their work on CSR with the board of directors, which will report annually on areas of significant importance.

- Implement strong warning systems to alert management to possible abuse.

In addition to the above general expectations, specific expectations are applied to the areas human rights; work conditions; bribery and corruption; as well as environment and climate change. These involve the following:

- *Human rights.* SOEs are expected to:

  - If they have international activities, integrate aspects of human rights that appear in international conventions in their CSR guidelines.

  - If they operate only in Norway, especially if they have international value chains, nevertheless give due consideration to these conventions.

- *Employee rights and work conditions.* SOEs are expected to:

  - If they have international activities, integrate employee rights into their CSR Guidelines.

  - If they operate only in Norway, especially if they have international value chains, nevertheless give due consideration to these conventions.

  - Operate in a long-term and responsible fashion where corporate restructuring processes are concerned and carry these out in consultation with staff and local communities.

  - Operate according to best practices in operational health and safety, including in their international activities, and make similar demands of suppliers and business partners.

- *Anti-corruption and transparency.* SOEs are expected to:

  - Integrate the fight against corruption in their CSR Guidelines[35].

  - Implement the highest possible degree of transparency regarding financial flows, including tax payments.

  - If they have international activities, follow OECD recommendations in the tax area, including by trying to avoid using “tax havens” that do not apply the standards of the Global Forum on Transparency and Exchange of Information for Tax Purposes.

- *Environment and climate measures.* SOEs are expected to:

[35] Applies to all companies with a government ownership share.

- Integrate work on environment and climate in their CSR guidelines[36].

- Be leaders in their area concerning environmental practices.

- Contribute to develop and apply environmentally friendly technology in their area. Large companies are expected to assume a particular responsibility.

- Identify and report significant indicators of environment and climate impact, in a dialogue with main stakeholder groups.

6.2.2 Expectations in selected other areas

The government's ownership policy expresses expectations in several other areas that are somewhat related with CSR, but focused specifically on the economic externalities of corporate actions. The areas covered include research, development and competencies; managerial remuneration; the composition and performance of boards of directors; and diversity and equal opportunities. The expectations can be summarised as follows.

- *Research, development and competencies*. SOEs are expected – especially those operating in a competitive environment – to use innovation and the rapid adoption of new technologies and competencies as a key element in their corporate strategies. The government takes the position that this is entirely consistent with maximising long-term profitability. Some additional expectations seem to relate to broader economic spillovers as well as profitability, for example SOEs are expected to communicate the outcomes of their research as widely as possible, and invest proactively in training, education and competence building among their staff.

- *Managerial remuneration.* The government's general policy is that wage differentials in the Norwegian labour market shall be relatively small and the social model based one widespread consultations and cooperation. The existing government policy (from 2006) on managerial remuneration has as one of its centrepieces that a widening wage differential between managers and other staff in government-invested enterprises should be avoided. Central elements in the expectation include a reliance on fixed salaries, with the reliance on bonuses limited and stock options banned. The state's expectations will be developed in more detail in a directive to be issued in April 2011. The expectations are communicated equally to actual SOEs and companies in which the state has a minority share. All state-invested companies will be requested to implement the directive on a comply-or-explain basis.

- *The composition and performance of boards.* The appointment of SOE directors is done through elections at general shareholder assemblies. In the case of listed SOEs, the nomination is done by external nomination committees, in whose work the State participate at par with other shareholders. The main criterion for the State's nomination practices is – in addition to securing that all board members have sufficient competence and capacity to do the job – obtaining a good mix of relevant experiences. Parliament has decided that parliamentary representatives cannot serve on the boards of SOEs under political oversight. It is furthermore an "unwritten rule" that Secretaries of State and politically appointed top-level civil servants should not be SOE directors. The

[36] Applies to all companies with a government ownership share.

government's expectation is that the board takes a lead role in strategic choices and act as both a support and discussion partner for the executive management of each SOE.

- *Diversity and equal opportunities*. Norwegian SOEs, as well as publicly listed companies over a certain size, are required by law to reserve 40% of their board positions for women. While this rule has been implemented without much difficulty, the government is concerned that this has not yet translated into any increase in the number of hiring of women to high-level executive positions. A better gender diversity at all corporate levels is considered as a key element in improving international competitive. Similar considerations apply to ethnic diversity. The State expects that companies undertake programmes to develop diversity and report to their owners and the public on their performance in this respect.

6.3 Classes of SOEs with different orientations

The Norwegian government has a stated commitment to clarity of SOE objectives. It has argued that clear objectives for state ownership forms the basis for more active, value-creating ownership. Among other things, it will make it easier to formulate expectations and assess the companies' performance. It will also be easier for the companies to define their main tasks and to know when the owner's involvement is required. If the state is clear on what the objective for its ownership is, it will be easier to evaluate afterwards whether the capital invested has been utilised efficiently. Unclear objectives can also lead to the capital markets believing that the state has other objectives than it actually does, which in turn can have a negative effect on the value of the company's shares.

Categorisation of ownership by the objective for the ownership is an expedient approach to this question. Following parliamentary approval, the state has (as briefly mentioned above) divided its ownership into two main categories, namely companies with commercial objectives and companies with sector policy objectives. The SOEs in the first category are further subdivided into three sub-categories, namely: (i) fully commercial companies; commercial companies required to maintain their head office functions in Norway; and (iii) companies pursuing commercial as well as other, specifically defined objectives. Concrete examples are the following:

- *Companies with commercial objectives:* SAS AB (airline). The company is not strictly speaking a Norwegian SOE, but together with the governments of Sweden and Denmark the state holds a dominant influence in the company.

- Companies with commercial objectives and ensuring head office functions in Norway: Telenor ASA (telecommunications).

- *Companies with commercial objectives and other specific, defined objectives:* Posten Norge AS (postal service). The specific objectives include mostly universal service obligations regarding the country-wide distribution of mail.

- *Companies with sectoral policy objectives*: Avinor AS (airport and civil aviation infrastructure and services). The sectoral policy objectives are linked with Norwegian regional priorities – including the maintenance of an airport infrastructure in different parts of the country.

Companies intended to ensure the achievement of sectoral policy objectives and important public objectives will, in addition to the sectoral policy objectives, also have commercial objectives. However, their degree of commercial orientation varies considerably. The state stipulates requirements for the companies in order to ensure that sectoral policy objectives are achieved as efficiently as possible.

6.4 Specific objectives for specific enterprises

1. Specific objectives are communicated to SOEs in categories 3 and 4 above. They rely on a formal government decision which is publicly stated (including in the State's annual Ownership Report), but not specified as a legal requirement or written into the companies' bylaws. Companies combining commercial and specific objectives are mostly found in the network industries, where the specific objectives can be largely addressed through sector-specific regulation (for an example, see also Box 4).

2. As a rule, the companies with a commercial orientation are required to maximize their long-term earnings, subject to such specific obligations as they may be subject to. Conversely, the SOEs with a sector policy obligation are required to fulfill this obligation first and secondarily earn as much as they can in the market to make them self-financed to the largest extent possible. Box 5 contains a couple of examples of this type of companies – including the Vinmonopolet alcohol retailer, which is actually extremely profitable because of its monopoly position.

6.5 Compensating SOEs for non-commercial priorities

The companies receiving compensation from the State for the cost of pursuing non-commercial objectives are found in categories 3 and 4. The demands on headquarter functions in category 2 are not seen as a competitive disadvantage which is needy of compensation.

The SOEs charged with sector policy objectives (category 4) are expected to deliver, first, on these objectives and, secondarily, raising as much funding as possible through their commercial operations. Where the latter are insufficient to finance the pursuit of the sector policy objectives, the government covers the shortfall through a budgetary allocation.

The SOEs that are asked to combine a commercial orientation with other specific objectives (category 3) are mostly subject to public service obligations. The main examples are Posten Norge (the postal service) and NSB (the national railway company), which both receive their specific objectives via sector regulation. The state acts as a purchaser of services from these companies. Once the regulators have specified the amount of services they are requested to deliver, the additional cost (relative to a "commercial" baseline) of delivering them becomes the object of negotiations between the companies and the authorities. The agreed extra costs are covered by the State via budgetary allocations.

Finally, in a few areas where potential competitors to the SOEs exist (one recent example being the provision of high-speed ferry services) the amount of compensation for public service obligations is made subject to competitive bidding. Contracts are awarded to those operators that are willing to provide the extra services in return for the lowest subsidy.

Box 5. Examples of non-commercial objectives of Norwegian SOEs

Posten (commercial and other objectives)

Posten is a postal and logistics group that views the Nordic countries as its home market, and is engaged in the business areas postal services, logistics and IT. The group comprises the parent company Posten Norge AS and the wholly and partly owned subsidiaries gathered under the brand name Bring, as well as the IT company ErgoGroup.

A key element in Posten's strategy is to maintain its position as the market leader for postal services and develop leading positions in the Nordic countries.

Posten shall ensure the nationwide provision of mandatory delivery services and basic banking services in the branch network. Furthermore, the company shall ensure proper management of the State's assets and good industrial development of the company. The sectoral policy objectives are mainly safeguarded through sector-specific regulations, including licenses.

Avinor AS (sector policy objectives)

Avinor is responsible for owning, operating and developing a nationwide network of airports for civil aviation and a joint air navigation service for civilian and military aviation. This encompasses 46 airports in Norway, as well as control towers, control centres and other technical infrastructure for safe flight navigation.

The objective of State ownership of Avinor is to facilitate safe, efficient and environmentally friendly air services throughout Norway. Avinor shall, to the greatest possible extent, be self-financed through its own revenues from the primary activities and business activities in connection with the airports. Financially, the entire enterprise is managed as a single unit, which means that the financially profitable airports finance the financially unprofitable airports.

AS Vinmonopolet (sector policy objectives)

Vinmonopolet is a state-owned company with exclusive rights to sell alcoholic drinks containing over 4.7 per cent alcohol volume to consumers through retail outlets. Vinmonopolet was founded on 30 November 1922. To ensure legitimacy with the general public, the company places emphasis on being a specialised trade chain with a wide range of products and personal customer service. Vinmonopolet is one of the most important instruments in Norway's alcohol policy and is intended to help limit alcohol consumption by regulating accessibility. The alcohol-policy responsibilities safeguarded by Vinmonopolet are expressed through effective social control, measures to create positive attitudes, efficient operations and no pressure to buy

Source: The Norwegian State's Ownership Report 2009

6.6 Assessing the achievement of non-commercial priorities

The government's overall "expectations" are not considered as company objectives, and are not made subject to evaluation. Informally, it would be expected that a failure to fulfil the expectations (for example if the government suffered a political embarrassment due to the actions of an SOE) might have consequences for board members and managers.

All commercially oriented SOEs are subject to rate-of-return requirements and are expected to maximise their earnings (subject, in some cases, to the fulfilment of any additional objectives that they might have). No formal mechanisms for evaluation of non-commercial objectives are in place. However, the two companies that are mostly subject to public service obligations (Posten Norge; NSB) are subject to a biannual white paper discussed by parliament. The white papers include evaluation of the efficiency with which the companies have pursued their service obligations.

The performance of SOEs charged with sector policy objectives are not subject to a regular performance reviews. However, insofar as budgetary allocations are made to finance their activities an evaluation must be made, and their operations are subject to the occasional review of the state audit function. Insofar as concerns about the performance of these SOEs have been brought to the attention of the ownership function, it has mostly been done by the state auditors.

ANNEX 1

ORGANISATIONAL DESIGN OPTIONS IN NEW ZEALAND FOR CROWN-OWNED ORGANISATIONS WITH SOME COMMERCIAL FUNCTIONS

Entity Design or Grouping	Company or Not	Commercial or Non-commercial	Principal Objective	Ownership	Key Ministerial Powers to Direct the Board	Legislative Regime[2]
State owned enterprise	Company The exception is KiwiRail which is not a company but a statutory corporation.	Commercial, while exhibiting a sense of social responsibility and being a good employer.	To be a successful business.	Wholly owned by the Crown through two Shareholding Ministers. Equity bonds can be issued. To date, none have been issued.	Can direct on content of statement of corporate intent (which Ministers can also do with most other boards they wholly own) and determine dividends.	State-Owned Enterprises Act 1986 (Legislation website), Companies Act 1993 (Legislation website). The exception is KiwiRail, which is subject to the New Zealand Railways Corporation Act 1981 (Legislation website) and the State-Owned Enterprises Act 1986 (Legislation website), but not the Companies Act 1993 (Legislation website).
Crown Research Institutes (CRIs)	Company. Generally known as Crown entity companies.	Not fully commercial with multiple objectives, while exhibiting a sense of social responsibility and being a good employer.	To carry out research for the benefit of New Zealand.	Wholly owned by the Crown CRIs must have two or more Shareholding Ministers. Shares in a Crown entity company may only be held by Ministers.	Can direct CRIs to have regard to any whole of government direction.	Crown Research Act 1992 (Legislation website), Companies Act 1993 (Legislation website), Crown Entities Act 2004 (Legislation website).
Crown Financial Institution (CFI). This term is not a legal grouping.	Currently none of the CFIs are companies.	Have non-commercial functions but operate in a	The objectives are entity specific. This grouping of entities either pre-fund future expenditure,	Wholly owned by the Crown, CFIs have one Responsible Minister.	Depends on the establishing legislation. For example, the Minister may direct the NPF Board	EQC, ACC, GSF and NZSF are subject to the Crown Entities Act 2004(Legislation website),

Currently made up of 4 statutory Crown entities and one other statutory entity.		commercial environment. The statutory Crown entities are required to be good employers.	either for specific liabilities (Government Superannuation Fund Authority[1], Earthquake Commission[1], Accident Compensation Corporation investments[1]) or expected future expenditure (New Zealand Superannuation Fund[1], National Provident Fund).		in respect of matters relating to Crown guarantees. Under the Crown Entities Act 2004 (Legislation website), ACC and EQC can be directed to give effect to government policy and are subject to whole of government directions. NZSF, GSF can be directed to have regard for government policy and are subject to whole of government directions.	and their individual establishing legislation. NPF is subject to its own legislation National Provident Fund Restructuring Act 1990 (Legislation website).
Air New Zealand	Company publicly listed	Fully commercial environment.	To be a successful business.	Crown is a majority shareholder.	No power to direct.	Companies Act 1993 (Legislation website)
Airports	Company. The four airports are known as council controlled trading organisations.	Not fully commercial with multiple objectives.	Achieve both its commercial and non-commercial objectives while aiming to make a profit.	Crown has various levels of shareholding.	No power to direct.	Local Government Act 2002 (Legislation website), Companies Act 1993 (Legislation website)
Other Crown entity companies e.g. Television New Zealand, Radio New Zealand, New Zealand Venture Investment Fund	Company.	Not fully commercial with multiple objectives, while exhibiting a sense of social responsibility and being a good employer.	The objectives are entity specific. These objectives can contain a mix of social, cultural, public policy and commercial statements.	Wholly owned by the Crown, these companies must have two or more Shareholding Ministers. Shares in a Crown entity company may only be held by Ministers.	Depends on the legislative framework the entity is operating under.	Each entity may also have its own legislation and / or a constitution, Companies Act 1993 (Legislation website), Crown Entities Act 2004 (Legislation website). Each entity may also have its own legislation and / or a constitution,
Companies listed on the 4th schedule of the Public Finance Act 1989 e.g. Crown Fibre Holdings	These companies are also known as *other* Crown entity companies.	Not fully commercial and/or with multiple objectives.	The objectives are entity specific. These objectives can contain a mix of social, cultural, public policy and commercial statements.	Majority/wholly owned by the Crown, with a lighter accountability regime than Crown owned or Crown entity companies.	Depends on the specific framework the entity is operating under.	Companies Act 1993 (Legislation website), Public Finance Act 1989 (Legislation website)

Statutory Crown entities e.g. Public Trust and New Zealand Lotteries Commission plus the CFIs mentioned above excluding the National Provident Fund.	Not companies.	Not commercial, however, some may be operating in a commercial environment with a specific requirement of being a good employer.	The objectives are entity specific. These objectives can contain a mix of social, cultural, public policy and commercial statements.	Wholly owned by the Crown, these entities have one Responsible Minister.	All are subject to whole of government directions. Crown agents can be directed on government policy. Autonomous Crown entities must have regard for government policy. In relation to Independent Crown entities, the Responsible Minister has no power to direct unless specified in the entities' establishing legislation. Generally speaking for these entities, the Responsible Minister's power to direct will depend also on the specific establishing legislation for each entity.	Each entity usually has its own establishing legislation and the Crown Entities Act 2004 (Legislation website) also applies. The establishing legislation can expressly modify or negate provisions of the Crown Entities Act 2004.
Shipping line – Pacific Forum Line	Company, privately held.	Not fully commercial environment with multiple objectives.	Operate a viable shipping line and be an instrument for regional development.	The New Zealand Government holds 23.2% of the shares in PFL and 8.3% of the voting rights, which are divided equally between 12 of the South Pacific Forum countries.	No power to direct.	Memorandum of Understanding, which has legal status. The company is registered in Western Samoa and Samoa's Companies Act applies.

Notes

- [1] Statutory Crown entities.
- [2] Most companies will also choose to have a constitution that provides further information on rights and responsibilities of shareholders.