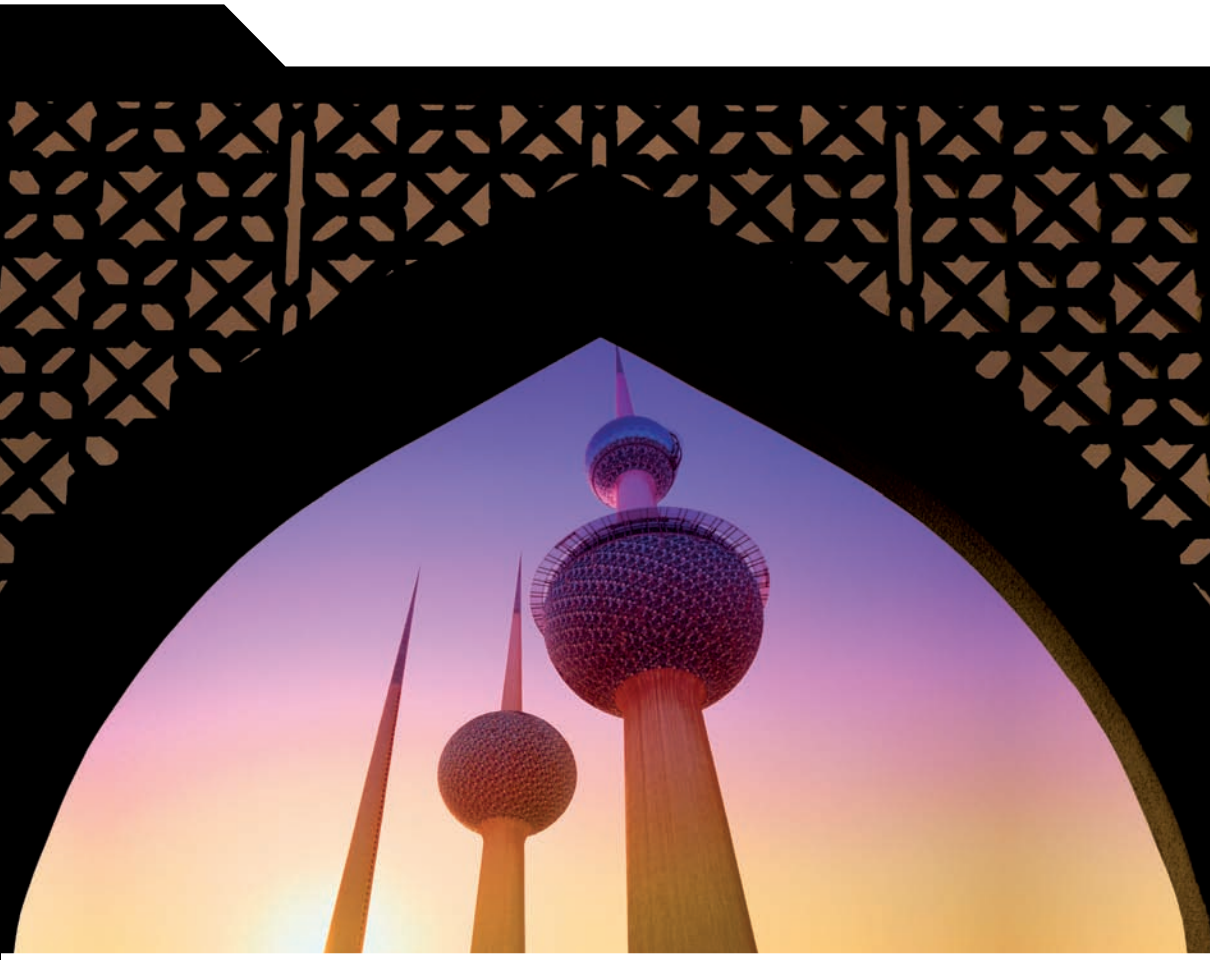
Towards New Arrangements for State Ownership in the Middle East and North Africa



OECD

Towards New Arrangements for State Ownership in the Middle East and North Africa

OECD

This work is published on the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the Organisation or of the governments of its member countries.

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.

Please cite this publication as:
OECD (2012), *Towards New Arrangements for State Ownership in the Middle East and North Africa*, OECD Publishing.
http://dx.doi.org/10.1787/9789264169111-en

ISBN 978-92-64-11090-8 (print)
ISBN 978-92-64-16911-1 (PDF)

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Photo credits: Cover
© Mark Karrass/Corbis/Inmagine ltd
© wong yu liang/Shuterstock.com

Corrigenda to OECD publications may be found on line at: *www.oecd.org/publishing/corrigenda*.

© OECD 2012

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgement of OECD as source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to *rights@oecd.org*. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at *info@copyright.com* or the Centre français d'exploitation du droit de copie (CFC) at *contact@cfcopies.com*.

Foreword

The role of state-owned enterprises (SOEs) in the Middle East and North Africa (MENA) has historically been and remains significant in terms of their contribution to the economic value added, employment and provision of vital services. State-owned enterprises operate across a wide range of sectors in the region - in hydrocarbons, banking, and construction, as well as network industries. Despite the privatisations carried out during the past 20 years, the role of the state in Arab economies has not declined and indeed in many ways has increased, reflecting the growth of oil and gas SOEs, sovereign wealth funds and infrastructure development projects, often carried out with the involvement of the state.

Recognising the central role of state-owned enterprises in economies of the Middle East and North Africa region, a regional *MENA Taskforce on Corporate Governance of State-Owned Enterprises* was launched in 2008. Since its establishment, the Taskforce has acted as a unique regional body to consider issues relating to governance of state-owned companies, to facilitate the sharing of experience in the region and with OECD countries, and to advise MENA governments on national priorities. The Taskforce, to which the OECD serves as a Secretariat, serves as a forum for discussion among varied constituencies, including state audit institutions, ministries, boards and management of SOEs from across the region.

This publication is a key product of work of the regional Taskforce and has been developed at the latter's request by the OECD. It leverages the discussions and debates among Taskforce members, who gathered in Paris and in Cairo in 2010 and again in Rabat in 2011 to discuss regional priorities such as the organisation of the ownership function and the nomination and functioning of SOE boards. The book also builds on country-specific projects where the OECD's input was welcomed, such as the support to establishing SOE corporate governance codes in Egypt and Morocco, both inspired by the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*.

Table of Contents

Executive Summary 9

Chapter 1. **Priorities for improving governance and performance of state-owned enterprises in the Middle East and North Africa**

by Alissa Amico, Manager, Middle East And North Africa, Corporate Affairs Division, Directorate of Financial and Enterprise Affairs, OECD 13

Introduction 14
Role of the state in MENA economies 14
Current reform priorities 27
Conclusions 43
Notes 47
Bibliography 50

Chapter 2. **The Arab Spring emphasises better corporate governance of state-owned enterprises**

by Nasser Saidi, Executive Director, Hawkamah Institute for Corporate Governance with the assistance of Jahanara Ahmad, Manager, Hawkamah Institute for Corporate Governance 53

The Arab Spring and corporate governance 54
State capture: relevance to MENA countries 56
SOE sector reform 57
Sovereign wealth funds 63
Recommendations 67
Notes 68
Bibliography 68

Chapter 3. **How the GCC did it: formal and informal governance of successful public enterprise in the Gulf Co-operation Council countries**

by Steffen Hertog, Lecturer, the London School of Economics and Political Science 71

Introduction 72
Absence of conventional governance mechanisms 73
A level playing field – but who wants to play? 75

The institutional context of GCC SOEs: governed well without good governance? 77
Legal status and regulation: measured privilege 79
Do GCC boards matter? 81
Evolution of SOE governance in the Gulf....84
Lessons for non-GCC countries? 88
Notes 90
Bibliography....91

Chapter 4. **State-owned enterprises in Kuwait: history and recent developments**

by Mithqal Sartawi, Managing Director and President, Privatisation Holding Company of Kuwait....93

Introduction 94
Historical background 95
Current composition and practices 102
Corporate governance of Kuwaiti SOEs 106
SOE performance and prospects 111
Notes 114
Bibliography....115

Chapter 5. **Transparency of Egypt's public-private joint ventures**

by Jennifer Bremer, Associate Professor of Public Policy and Chair, Public Policy and Administration Department, School of Global Affairs and Public Policy, American University in Cairo 117

Introduction 118
Structure of the public joint ventures sector....120
Corporate governance of public joint ventures 123
Assessment of the disclosure provided 129
Considerations for future improvements....137
Notes 140
Bibliography....141
Annex 5.A.1. Ownership structure of two public-private JVs....142
Annex 5.A.2. Methodological notes....144

Chapter 6. **Corporate governance of state-owned enterprises in Morocco: evolution and perspectives**

by Abderrahmane Semmar, Head of the Division of Programming and Restructuring, Department of Public Enterprises and Privatisation, Ministry of Economy and Finance of Morocco 151

Introduction 152
The SOE landscape in Morocco....153

Progress in the governance of public enterprises 163
Ongoing initiatives 167
Conclusions 169
Notes 169
Bibliography.....170

Tables

1.1. Classification of MENA SOE sectors.....17
1.2. State-Owned Enterprises among 100 largest listed MENA companies.20
1.3. Privatisation transactions in the MENA region, 2000-2008.....24
1.4. Top 20 largest privatisation transactions in the MENA region 2000-2008 25
1.5. Holdings of Sovereign Wealth Funds in GCC capital markets 35
2.1. Fiscal policy measures announced during 2010-2011 55
2.2. Ownership frameworks in the MENA region.....59
2.3. Sovereign Wealth Fund Rankings 64
4.1. Kuwait Investment Authority local holdings, 1993.....100
4.2. Kuwait Investment Authority local holdings, 2011.....102
4.3. Independent and dependent budget SOEs 105
5.1. Holding companies studied 120
5.2. Summary of joint venture firms studied 121
5.3. Laws governing joint ventures examined 125
5.4. Distribution of public sector ownership in the 100 firm sample 126
5.5. Year of joint venture establishment.....127
5.6. Ownership of the 100 JVs by public sector institutional investors 127
5.7. Control of joint ventures studied by public sector investors 128
6.1. Performance of the Moroccan SOE sector (MAD bil) 157

Figures

3.1. Profit margins of successful Gulf SOEs.....73
3.2. Saudi gross fixed capital formation since 1969 (SAR mil) 76
5.1. Disclosure of information on holding company websites 131
5.2. Distribution of all JV firms studied by web presence and functionality 133
5.3. Disclosure of information on joint venture websites.....134
5.4. Overall JV disclosure level by sector and listing status 135
5.5. Comparison of disclosure by listed and unlisted JVs.....136
6.1. Breakdown of privatisation revenue by year (MAD mil).....155
6.3. Liberalisation of the telecommunications sector: a model for success...160

Boxes

4.1. Privatisation of the Kuwait Airways Corporation 113
6.1. Moroccan National Commission on Corporate Governance.....168

Executive Summary

This publication seeks to provide insight into the varied and rich experience of SOE sector reform in the Middle East and North Africa over the past decade, highlighting country specific initiatives and challenges. Promoting good governance of SOEs will remain an imperative for policymakers in the region, considering the calls for greater public sector transparency and accountability sounded during the events of the Arab Spring. It is hoped that this book will be useful for policymakers, academics and civil society groups as they revisit SOE governance frameworks and practices in the region.

In the introductory chapter, Alissa Amico summarises key regional challenges that SOE governance reform should attempt to address in the future. This chapter provides a review of the composition of MENA SOE sectors, drawing on the limited available information, and traces an evolution of these sectors in the Maghreb, the Levant and the Gulf. The thrust of the chapter is on prioritising policy reforms that are common to many countries of the region and that need to be addressed in order to improve the effectiveness of the state as the owner of commercial assets, namely: nomination and functioning of SOE boards, disclosure and transparency frameworks, as well as ownership frameworks and policies.

In the second chapter, Nasser Saidi highlights the impact of the Arab Spring on the public's expectations of governance of state-owned assets. One of the key arguments advanced in this chapter is that privatisation is not the only solution to SOE sector reform and that - insofar as many Arab states will remain important owners of commercial assets - addressing arrangements in a variety of enterprises, be they minority- or majority- state-owned, will be crucial. As argued in this chapter, SOE governance reform cannot be seen as divorced from broader public governance reform. The "signalling" effect, whereby the state demonstrates to citizens and the private sector its commitment to good corporate governance of SOEs, is important for broader corporate governance progress in the region.

In chapter three, Steffen Hertog highlights formal and informal governance mechanisms that have contributed to the success of some SOEs in the Gulf. This chapter seeks to explain why some Gulf-based SOEs have performed very well even though their governance arrangements are in some respects different from conventional good practices. This research highlights that political patronage of some SOEs and their isolation from the rest of the state apparatus have helped their performance. The chapter concludes by attempting to isolate the factors that have fostered strong performance of some Gulf SOEs with a view to investigate whether these can be replicated outside the socio-economic context of the Gulf states.

Several chapters take a more country-specific approach. In the fourth chapter, Jennifer Bremer explores the quality of public disclosure provided by public-private joint ventures in Egypt. This analysis constitutes an initial effort to close the information gap on corporate governance of joint ventures with public participation. A review of web-based reporting provided by public-private joint ventures points to a low level disclosure by these firms. The findings and recommendations of this chapter have broader regional implications since the formation of public-private joint ventures is by no means unique to Egypt.

Also taking a country-specific approach, Mithqal Sartawi provides an overview of the SOE sector in Kuwait, discussing the governance arrangements of local SOEs, and analysing the impact of the 2010 Privatisation Law on the future restructuring of the sector. This chapter provides a historical perspective on the evolution of the SOE sector in Kuwait over the past 60 years, framing the challenge of SOE sector reform in the context of the social obligations of the state and resistance by special interest groups. This chapter concludes with an examination of the privatisation of the Kuwait Airways Corporation.

In the last chapter, Abderrahmane Semmar highlights the experience of the Moroccan authorities in restructuring national SOEs. This chapter presents an evolution of state ownership arrangements in Morocco, including through privatisation, liberalisation of certain sectors and increasing competition between SOEs and private sector operators. The latter part of this chapter focuses on recent regulatory initiatives, including the introduction of a corporate governance code specifically aimed at SOEs in October 2011. This code is a second of its kind in the region and constitutes an important step towards enhancing governance practices in Morocco.

The OECD would like to thank all contributors to this publication: Nasser Saidi, Steffen Hertog, Jennifer Bremer, Mithqal Sartawi and Abderrahmane

Semmar. Chapter authors contributed to this book in their personal capacity and their views do not necessarily reflect those of the OECD or its member countries. This book was edited and prepared for publication by Alissa Amico (Koldertsova), Manager of OECD's corporate governance work in the MENA region. It benefited from valuable insights of members of the regional *MENA Taskforce on Corporate Governance of State-Owned Enterprises* and input from members of the Corporate Affairs Division of the OECD. An earlier version of this book was also presented for feedback to the *OECD Working Party on State Ownership and Privatisation Practices.*

Chapter 1

Priorities for improving governance and performance of state-owned enterprises in the Middle East and North Africa

by

Alissa Amico
Manager, Middle East And North Africa,
Corporate Affairs Division, Directorate of Financial and Enterprise Affairs
OECD

The purpose of this introductory chapter is to contextualise recent efforts to reform corporate governance of state-owned companies in the Middle East and North Africa against the backdrop of the development of these economies. This chapter provides a brief overview of the origins of state-owned sectors in the region, outlining key trends that have affected their evolution, including privatisation and the establishment of sovereign wealth funds. The objective is not to cover all challenges that policy makers face in improving the governance frameworks and practices of state-owned enterprises in the region. Rather, the chapter seeks to provide an overview of a few high-priority issues with a view to identify good practices as well as highlight issues that deserve ongoing attention.

Introduction

The purpose of this chapter is to contextualise recent efforts to reform corporate governance of state-owned companies in the Middle East and North Africa (MENA) region against the backdrop of the development of regional economies. It is only by reviewing the reasons for the presence of the state in the economic activity, and the socio-economic context in which state-owned enterprises (SOEs) operate, that their corporate governance practices can be understood. A review of the development of SOE sectors in the region over the past two decades allows for a better insight into the challenges facing policy makers today in improving SOE performance and competitiveness.

This introductory chapter provides a brief overview of the origins of state-owned sectors in the region, outlining key trends that have affected their evolution, including privatisation and the establishment of sovereign wealth funds. The objective is not to cover all challenges that policy makers face in improving the governance frameworks and practices of SOEs in the region. Rather, the chapter seeks to provide an overview of a few high-priority issues with a view to identify good practices as well as highlight issues that deserve ongoing attention. Other chapters comprising this book will present practical illustrations of challenges as well as outline potential policy responses to them.

Role of the state in MENA economies

Origins and evolution

Understanding the political economy of the emergence of the state as an owner of commercial enterprises in MENA countries is essential to better grasping the context in which MENA SOEs operate and the challenges they face. As a starting point, it is important to keep in mind that most countries in the region have at one point or another adopted a variant of the development model based on significant state intervention in most areas of economic activity. The legacy of this model has over the years shaped the structure and objectives of state ownership in the region and dictated choices regarding SOE governance frameworks and practices.

Despite some similarities, the evolution of SOE sectors in the region has differed in important respects. From the outset, the motivation of governments for establishing SOEs has varied depending, among other factors, on their degree of reliance on state interventionism. In countries that followed a socialist-oriented development model (e.g. Egypt, Iraq, Syria, Yemen[1]), SOEs were established across a range of strategic and non-strategic industries. In

countries such as Jordan or Lebanon, their establishment was arguably more selective. In Gulf Co-operation Council (GCC) countries, the emergence of the SOEs was gradual and focused on strategic sectors over which governments wished to retain control.

Apart from the hydrocarbons sector, the emergence of large SOEs in the Gulf is a relatively new phenomenon. The establishment of large SOEs in the hydrocarbons sector, generally dating to the 1970s-1980s, was a starting point for the development of SOE sectors in most GCC countries. For instance, Saudi Aramco, originally established in 1933 as a result of an oil concession granted by the Saudi government to the affiliate of Standard Oil of California (today, Chevron), was nationalised in 1980. Indeed, the establishment of some of the largest SOEs in the region followed government decisions to nationalise strategic assets. This is the case for most oil and gas companies in the GCC countries, but also other strategically important SOEs such as the Suez Canal in Egypt.

The evolution of state-owned enterprise sectors has had a significant impact on all economies in the region. Despite the ambitious privatisation programmes ongoing in some countries for more than 20 years, the socio-economic impact of SOEs has not necessarily waned. SOEs have acted - and continue to act - as major providers of employment, goods and services (ranging from the basic foodstuffs to military equipment) and fiscal revenue. State intervention across sectors of commercial activity has been perhaps most pronounced in Algeria, Egypt, Iraq and Syria.

In these countries, the reform of SOE sectors needs to be approached as part and parcel of a fundamental re-thinking of the development model. "The characteristics of [the old] model were state planning, industrial development though protected local markets, nationalisation of private sector assets and redistributions of wealth though vast public expenditures directed to social development and large-scale public sector employment" (World Bank, 2009b). Naturally, in countries where the state has historically played a smaller role in commercial activities, restructuring of SOEs has been less controversial, in large part owing to the absence of social resistance.

In most MENA economies, the reform of SOE sectors met significant resistance from stakeholders. For instance, the privatisation legislation introduced in the Kuwaiti Parliament in 1993 was finally adopted in 2010, after significant public debate.[2] Likewise, in Egypt, announcements of privatisation plans have often met with labour strikes and large-scale protests, not least due to the perception that privatisation will be accompanied by layoffs.[3] In Jordan, the

Executive Privatisation Commission (EPC) has also faced significant public criticism in implementing its privatisation plans. The EPC sought to overcome this by lobbying individual Parliament members and seeking to convince the religious authorities to address specific concerns in their sermons.

In addition to privatisation, reform of SOE sectors is ongoing across the region at an uneven pace and with different objectives and challenges. Yet some common challenges in improving the performance and governance of SOEs can be noted (see Table 1.1). For instance, Iraq and Yemen are currently seeking to corporatise their SOEs with a view to attract private investment and, in the longer term, to prepare them for an eventual listing.[4] In both of these countries, reform of the SOE sector is complicated by valuation difficulties and concerns about privatisation since public enterprises provide employment and contribute to political stability. Algeria and Syria are arguably ahead in this process, having corporatised most SOEs. These countries are now attempting to restructure a number of sectors where SOEs are present, including by reforming monopoly sectors and divesting from loss-making enterprises.

While the scope of activity and performance of state-owned firms in Egypt, Jordan, Lebanon, Morocco and Tunisia differs, these countries have made important steps in restructuring their SOE sectors and have been the primary beneficiaries of privatisation proceeds in the region. Policy makers' concerns in these countries are arguably more directly related to optimising their ownership portfolio, improving the governance standards of SOEs, establishing joint ventures between public and private companies, and ultimately seeking to bring SOE performance in line with that of the private sector.

Finally, the performance of GCC-based SOEs varies enormously, making generalisations about current objectives and challenges difficult. As highlighted by Steffen Hertog in Chapter 3, the Gulf region is home to many successful SOEs, even though a number of GCC jurisdictions are not perceived as having adopted internationally accepted good governance practices. Nonetheless, there are significant differences in the performance of SOEs between and even within individual Gulf states. What is certain is that recent floatations of SOE minority stakes or debt have improved SOE governance by subjecting the entities to market discipline.

Table 1.1. Classification of MENA SOE sectors

Countries	SOE Sectors	Country Priorities
Iraq, Yemen	Numerous unincorporated enterprises; SOEs major recipient of state subsidies; state seen as an employer of last resort; some interest in privatising SOEs	Corporatisation of SOEs and preparation of some SOEs for privatisation; creating mechanisms to reduce redundant employment in the SOE sector; reviewing the legal framework applicable to SOEs
Algeria, Egypt, Libya, Syria	Large SOE sectors owing to the socialist legacy; banking sector historically dominated by the state; high non-performing loans in state-owned banks; state seen as a major source of employment	Rethinking the role of the state in specific sectors (e.g. textile, food processing); re-organisation of the state-ownership function; reducing political interference on SOE boards; streamlining legal framework applicable to SOEs
Lebanon, Jordan, Morocco, Tunisia	Rationalised by the privatisation during 1980s-1990s; state present in select sectors and is generally not seen as a major source of employment; SOEs are not highly present in the financial sector but remain active in network industries	Reviewing state ownership in loss-making enterprises; better co-ordination of the state's ownership function; improving the professionalism of SOE boards; reducing political interference in SOE boards; separation of ownership and regulatory functions
Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE	Oil and gas SOEs not listed and a key source of fiscal revenues; minority stakes in non-strategic SOEs listed in part to develop capital markets; new SOEs being established in recent years; SWFs important owners of listed and unlisted companies	Improving SOE transparency and accountability; preparing listings of minority stakes in some SOEs; consolidating SOE ownership under professional management; reproducing successful ownership experiences in other SOEs

Continuing importance of SOEs

Undeniably, the role of the state as an owner of commercial enterprises remains significant in MENA countries. What is less clear is just how significant it is. While privatisation data for the region is generally available, data on the underlying size of SOE sectors is not. Even where data is available,

it does not allow for any comparative or even national level analysis. The data collection challenge is not, as in OECD member countries, related strictly to measurement and comparability issues, but rather appears driven by the fact that at the national level, ownership responsibilities in SOEs are neither consolidated nor co-ordinated. In addition, in some jurisdictions, the boundary between private and public ownership is difficult to establish.

For all of these reasons, it is challenging to gauge the size and composition of MENA SOE sectors and therefore their contribution to employment, investment or fiscal budgets. This is a challenge the OECD and the Hawkamah Institute sought to address by disseminating in 2008 a statistical survey to all countries in the region, and one that remains a key priority for the SOE reform agenda in the region. Detailed data on the size, composition, productivity, and governance of MENA SOEs is necessary to support regional policy makers' efforts to restructure domestic SOEs with a view to make them more competitive. Several attempts at better gauging the size of national SOEs have already been made. The Iraqi government, for example, has attempted to collect data on local SOEs in order to corporatise and re-structure them, as well as to eventually dispose of some stakes.

Overall, it is estimated that state-owned enterprises continue to account for approximately half of the economic activity in the region. As mentioned above, the Algerian, Iraqi and Syrian economies have a legacy of particularly large SOE sectors and this remains the case today. In the GCC countries, the contribution of SOEs to GDP is also substantial and is probably underestimated considering that the largest hydrocarbon SOEs are not listed and disclose very little information publicly. The growth of sovereign wealth funds (SWFs), which have large stakes in SOEs and private companies both domestically and abroad[5], further compounds the difficulty of estimating the size and composition of state-owned sectors in these countries.

In most MENA countries, with the exception of Egypt[6], Morocco and Tunisia, the size of the sector has not declined significantly in recent years. Despite some shifts in the role of the state in the economy, available data suggests that SOEs continue to play a crucial role in employment generation or preservation, contribution to fiscal budgets, infrastructure creation and industrial development. On average, SOEs account for 20%-50% of the economic value added across the region. They also benefit from generous subsidies and state investment, the withdrawal of which is politically sensitive and could indeed be socially harmful considering the role of SOEs in providing basic services and foodstuffs.

In the GCC countries, despite some divestments, SOE sectors have actually grown. This is attributable to the establishment of new SOEs – often with explicit or implicit industrial development agendas – and, less directly, through state rescue of companies in the aftermath of the financial crisis.[7] The former phenomenon is driven by important infrastructure development mandates placed on local SOEs. While Dubai with its large real estate developers such as Nakheel is a prime example, it is certainly not alone in entrusting local SOEs with sizeable infrastructure development responsibilities.

In the absence of reliable data, inferences on the size of SOE sectors in the region can be made from other economic data. In the oil producing countries, a reasonably good proxy of the importance of the SOE sector is the size of the hydrocarbons sector, usually entirely state-controlled.[8] For instance, in Qatar, the oil and gas sectors collectively contribute more than half of the country's GDP, in Kuwait this is estimated at 65%. Although both of these countries have taken steps towards diversifying their economic base away from the hydrocarbons sector, the figures have not changed significantly in recent years.

Following recent listings of minority stakes, the number of listed SOEs in the region has grown. Indeed, 32 of the top 100 largest listed companies in the region, corresponding to approximately 45% of total market capitalisation of these companies, remain under partial control of the state (see Table 1.2). Of course, this statistic hides wide disparities across the region, from the Palestinian National Authority, which has no listed SOEs, to Algeria, where the state has a stake in all listed companies. Nonetheless, this figure is still impressive when compared with OECD member countries, where listed SOEs rarely account for more than 30% of market capitalisation (OECD, 2005b).

The number of non-listed SOEs significantly exceeds the number of listed ones in all MENA countries. In the 17 MENA jurisdictions, it is estimated that there are close to 2000 non-listed SOEs, primarily concentrated in Egypt, Iraq, the UAE, Algeria and Syria (Zawya, 2010). In contrast to those in most OECD countries, it cannot be assumed that listed SOEs are the largest ones. For example, strategic SOEs such as Saudi Aramco and Oman Oil are not listed. Thus the value of the state's stake in non-listed SOEs, at least in some countries, by far exceeds the value of its ownership in listed ones.

Table 1.2. State-Owned Enterprises among 100 largest listed MENA companies

Rank in Top 100	Company	Country	Sector	Market capitalisation (USD mil)
1	Saudi Basic Industries Corporation	Saudi Arabia	Petrochemicals	70 799
3	Saudi Telecom Company	Saudi Arabia	Telecoms	23 520
4	Etisalat	UAE	Telecoms	23 188
6	Zain Group	Kuwait	Telecoms	17 121
7	Industries Qatar	Qatar	Conglomerate	16 413
10	Saudi Electricity Company	Saudi Arabia	Utilities	13 555
12	Qatar National Bank	Qatar	Financial services	12 770
13	Riyad Bank	Saudi Arabia	Financial services	11 280
16	Saudi Arabian Fertilizer Company	Saudi Arabia	Petrochemicals	9 400
20	Etihad Etisalat Company (Mobily)	Saudi Arabia	Telecoms	8 587
23	Rabigh Refining & Petrochemical Company (PetroRabigh)	Saudi Arabia	Petrochemicals	7 709
25	Saudi Kayan Petrochemical Company	Saudi Arabia	Petrochemicals	7 240
26	National Bank of Abu Dhabi	UAE	Financial services	6 423
27	DP World	UAE	Transport	6 358
31	Telecom Egypt Company	Egypt	Telecoms	6 054
33	Yanbu National Petrochemicals Company	Saudi Arabia	Petrochemicals	5 640
35	Alinma Bank	Saudi Arabia	Financial services	5 100
37	Emaar Properties	UAE	Real estate	4 776
41	Saudi Arabian Mining Company (Maaden)	Saudi Arabia	Metals & mining	4 156
43	Arab Potash Company	Jordan	Metals & mining	4 000
50	Emirates NBD	UAE	Financial services	3 728
60	Dubai Financial Market	UAE	Financial services	3 094
61	Emirates Integrated	UAE	Telecoms	3 093

Rank in Top 100	Company	Country	Sector	Market capitalisation (USD mil)
	Telecommunications Company (Du)			
70	Qatar Electricity & Water Company	Qatar	Utilities	2 781
76	Oman Telecommunications Company	Oman	Telecoms	2 564
77	Aldar Properties	UAE	Real estate	2 506
81	Bahrain Telecommunications Company (Batelco)	Bahrain	Telecoms	2 234
82	Barwa Real Estate Company	Qatar	Real estate	2 217
83	Dubai Islamic Bank	UAE	Financial services	2 206
88	Abu Dhabi Commercial Bank	UAE	Financial services	2 161
91	Abu Qir Fertilizers Company	Egypt	Petrochemicals	2 071
95	Abu Dhabi National Energy Company (Taqa)	UAE	Oil & gas	2 000

Source: OECD, based on MEED Top Listed Companies Report, Issue No 14, 2-8 April 2010.

From an employment perspective, the role of SOEs is also far from negligible, estimated at close to 30% of total employment in the region, compared with 2%-3% in OECD member countries. The state is often considered a preferred employer because government jobs are associated with employment stability. In addition, remuneration in the public sector is in some cases comparable to or even higher than that in the private sector. Even where government jobs are not widely coveted, the state is often seen as an "employer of last resort", obligated to create opportunities for a large young workforce.

This pressure was reflected in the announcement made by the King of Saudi Arabia in March 2011 of a USD 36 billion programme whose key outcome will be to provide lifetime employment to Saudi citizens. Mithqal Sartawi, in Chapter 4 of this book, also highlights employment security expectations of staff of Kuwaiti SOEs. Such pressures have resulted in overstaffing problems in MENA SOEs that are likely to prevail in the near future considering that the sector is still often used to preserve employment, even if it is now less used to create employment in most countries.

Sectoral distribution of SOEs

In terms of the sectoral distribution, SOEs in the MENA region remain prominent in energy, infrastructure and other network industries, as they do in OECD member countries. They are also present in heavy and light manufacturing sectors, shipbuilding and chemicals. In the Gulf region, SOEs are prominent in real estate and construction, as well as in banking and other service sectors such as hospitality. State ownership in the banking sector has historically been high, especially in Algeria, Egypt, Libya and Syria. Despite the privatisation of banks and the liberalisation of foreign investment regimes, state-owned banks are still estimated to account for about half of total banking assets in the region (World Bank, 2009a).

The long-term repercussions of state ownership in the financial sector have arguably been higher than in other sectors. In Algeria, Egypt Libya and Syria in particular, state-owned banks have historically played a crucial role in providing loans to industrial SOEs, often not on arm's length terms, a practice inconsistent with the recommendations of the *OECD Guidelines on Corporate Governance of SOEs* (hereinafter "*SOE Guidelines*"). This practice has resulted in the accumulation of high non-performing loans (NPLs) by SOE banks[9], the loss of competitiveness of these banks and a diversion of capital away from the most productive uses. In many MENA countries, including Egypt, Morocco, Syria and Tunisia, policy makers have recognised the negative consequences of this practice and have made efforts to decrease the role of the state in the banking sector, thereby reducing the fiscal burden associated with bank recapitalisation.

The reduction of the state's role in the banking sector has occurred through partial or complete divestitures of government stakes in individual banks, as well as through the relaxation of foreign investment restrictions, leading to the establishment of privately owned foreign banking institutions. This process has been ongoing for more than 10 years, with Syria being the last country to move towards the opening of its banking sector to foreign competitors.[10] In parallel, SOE banks have gradually reduced connected lending to industrial SOEs and, in the case of Egypt, have even occasionally seized collateral of SOEs unable to fulfil debt-repayment terms (Hassouna, 2010). However, as highlighted by the restructuring of the Egyptian banking sector -- and in particular the privatisation of the Bank of Alexandria -- effective solutions to address high NPLs are often required before privatising in order to optimise proceeds.

Recent restructuring and privatisation of SOE sectors

Much like the establishment of SOEs in the MENA region, their subsequent restructuring and privatisation was motivated by a mixture of political, social and economic considerations. In a number of MENA countries, the "Washington consensus" has triggered or at least to some extent influenced the divestment of stakes in many SOEs or their outright sale. Furthermore, the collapse of oil prices in the mid-1980s resulted in balance-of-payment crises in some MENA economies, thereby raising their interest in privatisation as a source of fiscal revenue.

In countries with vestiges of socialist development models, efforts to reform and restructure the sector have proved especially difficult, owing to the sheer size of the sector and, as mentioned, to social resistance associated with reform. With the possible exception of Egypt, the reform of SOE sectors in MENA countries with a heavy legacy of state intervention in the economy is still nascent. For instance, the governments of Iraq and Yemen have only recently moved to corporatise SOEs, and in Syria - where many SOEs are already corporatised - the SOE restructuring and privatisation programme is taking significant time to design (Ayobe, 2010). In the case of Yemen and Iraq, reform has been marked by concerns related to political stability and the role of SOEs as a source of patronage.

While privatisations in the Maghreb and the Mashreq were generally driven by objectives related to improving the efficiency of state-controlled companies and boosting fiscal revenue, privatisations in the Gulf were often motivated by an interest in deepening capital markets. This is related to the fact that in the GCC countries, national governments have sought to establish themselves as regional, or potentially international, financial hubs. For instance, the privatisation programme in Qatar was launched in 1998, one year after the establishment of the Doha Securities Market, in large part to boost the size and liquidity of the local market. Initial Public Offerings (IPOs) of stakes in SOEs have contributed substantially to energising local capital markets, especially given that family-controlled companies in the region are reluctant to list.

Overall, the privatisation ambitions and progress in the region have been uneven. The most significant privatisation proceeds have been witnessed in Egypt, followed by Morocco and Tunisia (see Table 1.3). In Egypt, this has led to a substantial reduction of the total number of SOEs under administration.[11] In the case of Morocco, while privatisation proceeds have accrued to the state almost every year, the number of SOEs has not declined dramatically.

Table 1.3. Privatisation proceeds in the MENA region, 2000-2008 (USD mil)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	Total
Algeria	7	369	-	360	421	158	-	161	-	**1 476**
Egypt	308	207	-	-	52	2 173	7 583	311	926	**11 560**
Iraq	-	-	-	-	-	-	-	1 250	-	**1 250**
Jordan	658	20	112	173	2	55	319	556	104	**1 999**
Lebanon	-	-	-	-	-	236	-	-	-	**236**
Libya	-	-	-	-	-	205	-	-	-	**205**
Morocco	2 110	-	-	1 551	2 616	147	650	847	-	**7 921**
Oman	-	-	-	-	-	852	-	-	-	**852**
Syrian Arabia	-	70	-	-	-	-	-	-	-	**70**
Tunisia	230	227	-	-	247	121	2 282	61	480	**3 648**
Yemen	20	-	-	-	-	-	214		-	**234**
Total	**3 333**	**893**	**112**	**2 084**	**3 338**	**3 947**	**11 048**	**3 186**	**1 510**	**29 451**

Source: World Bank Privatisation Database, latest available data.

The largest privatisation transactions in the MENA region have been in telecommunications. Other major privatisations were in the banking sector (e.g. Bank of Alexandria in Egypt) or utilities (e.g. Central Electricity Generating Company in Jordan). To execute these complex transactions, a number of countries have set up privatisation agencies (e.g. Jordan and Kuwait). The institutional and legal frameworks for privatisation are hence fairly well developed in most MENA countries. That said, allegations of a lack of transparency in major privatisation deals have been made in Egypt, Syria and elsewhere in the region. In some cases, business interests aligned with incumbent governments appear to have received preferential treatment.

The activity in the telecoms sector has been considerable, not only in terms of privatisation (see Table 1.4), but also in terms of opening entry to private sector participation through granting of additional licenses. However, the selection of bidders in public tenders has sometimes been tainted by allegations of opaque selection procedures. For example, the Syrian government has in 2010 announced its intention to award a third telecom license. The deal required the winning bidder to transfer a quarter of its annual revenues to the state, which would retain a 20 per cent stake in the company to be awarded the license. International investors have reportedly complained about the structure of this deal and made allegations regarding the lack of transparency in this process (Kippreport, 9 December 2010).

Table 1.4. Top 20 largest privatisation transactions in the MENA region, 2000-2008

Rank	Country	Year	Company	Amount (USD mil)
1	Egypt	2006	Etisalat Misr	2 900
2	Morocco	2004	Maroc Telecom	2 530
3	Tunisia	2006	Tunisie Telecom	2 250
4	Egypt	2006	Commercial International Bank	2 225
5	Morocco	2000	Maroc Telecom	2 110
6	Egypt	2006	Bank of Alexandria	1 610
7	Morocco	2003	Régie des Tabacs	1 551
8	Iraq	2007	Korek Telecom	1 250
9	Egypt	2005	Telecom Egypt	892
10	Oman	2005	Oman Telecommunications Co	748
11	Morocco	2007	Maroc Telecom	552
12	Jordan	2000	Jordan Telecommunications Co	508
13	Morocco	2006	Altadis Maroc/Régie des Tabacs	466
14	Algeria	2004	Wataniya Telecom Algerie	421
15	Algeria	2001	Djezzy GSM	369
16	Algeria	2003	Djezzy GSM	360
17	Egypt	2005	National Fertlizer Company	341
18	Egypt	2005	Suez Cement	339
19	Jordan	2007	Central Electricity Generating Co	320
20	Egypt	2008	MobiNil	286

Source: World Bank Privatization Database, latest available data.

Privatisation activity in the region has slowed down in recent years for a variety of reasons, not least due to the slump in international capital markets following the financial crisis. According to the latest available data, the total value of privatisation proceeds declined by 45% from 2007 to 2008. Although more recent consolidated data is unavailable, it is known that few privatisations have taken place in the region over the past three years. In addition to the market downturn, this reflects more politically motivated delays in privatisation transactions in Egypt and elsewhere, as a result of criticism of past privatisation deals.

In some countries, imperfect sequencing of reforms has imperilled an effective privatisation process despite the necessary infrastructure being in place. For instance, the Algerian National Privatisation Council (Conseil

National de Privatisation, CNPE) was established in 1995, yet the privatisation process did not ensue as envisaged (Werenfelds, 2002). Another reason for the slowdown in large-scale privatisations is that policy makers in a number of MENA countries feel constrained to dissolve loss-making SOEs. Many governments remain owners of loss-making enterprises that they cannot divest for political reasons (e.g. the spinning and weaving companies in Egypt or food-producing companies in Syria).

In the GCC countries, privatisation has not been an overriding objective, and has typically been motivated by capital markets development. A notable exception is Kuwait since the adoption of the privatisation legislation in 2010 and Dubai, which is also reported to be considering privatisation options.[12] In most GCC countries, sales of minority stakes and debt floatations have been common. The listing of Aluminium Bahrain (Alba)[13] on the Bahrain and London stock exchanges in November 2010 is a representative privatisation transaction in the Gulf, whereby the state initially relinquishes a non-controlling stake though an IPO. Minority share listings such as Alba are still beneficial from the governance perspective since they bring SOEs in line with the securities legislation and the local corporate governance code.[14]

MENA countries have used a wide range of privatisation techniques with varying outcomes for post-privatisation efficiency and performance. Limited empirical research has been carried out to examine the relationship between privatisation and performance in the MENA region. Moreover, available studies are mostly focused on Egypt. Omran (2009) argues that in Egypt, larger ownership by foreign investors had a positive impact on post-privatisation firm performance, while employee ownership had a negative one. Hassouna (2010) also suggests that sales of equity stakes to employees in Egypt have not been successful. Jamal (2008) found that privatising infrastructure SOEs in the MENA region is linked to better performance but should be preceded by managerial and financial reforms. Dawley and Haidar (2008) have suggested that infrastructure privatisations in Saudi Arabia and Morocco worked better than those in Tunisia and Jordan, owing to a more competitive environment in the former.

Significant additional research at both country and sectoral levels is necessary to better understand the relationship between privatisation methods on the one hand and post-privatisation performance on the other. Existing research is limited and inconclusive at best. Further granularity in research questions and methods is required to understand the specific circumstances leading to post-privatisation improvements. The *MENA Taskforce on Corporate Governance of SOEs* (hereinafter "MENA SOE Taskforce") will seek to shed light on this complex issue.

Current reform priorities

Ownership framework and policy

A clear ownership framework and policy are essential to establish a solid basis for the state's effective exercise of its ownership rights in SOEs. The *SOE Guidelines* recommend that a co-ordinating or an ownership agency should be established in order to clearly identify the exercise of ownership rights within the state administration (OECD, 2005a). The Guidelines recommend that the co-ordinating or ownership agency be held accountable to representative bodies such as the Parliament and have a clearly defined relationship with relevant public bodies, including the state audit institution (SAI). Although the institutional and legal arrangements related to the ownership of commercial assets by MENA governments have been evolving, establishing effective arrangements remains an area of priority for policy makers.

In terms of the institutional framework, the *SOE Guidelines* do not favour the establishment of an ownership entity over a co-ordinating body. In the OECD member countries the trend is clearly towards centralisation, but the most prevalent method of organisation remains a dual model whereby the ownership responsibility is shared between a sectoral ministry and a "central" ministry or entity, usually the Ministry of Finance. Currently, very few jurisdictions in the MENA region are operating close to the dual ownership model, with the possible exception of Morocco. The Department of Public Enterprises within the Moroccan Ministry of Economy and Finance acts as a "central ministry", but more in the sense of overseeing the budgets and performance of SOEs than in the exercise of ownership rights.

The underlying reasons for this lack of co-ordination are both historical and bureaucratic. Many SOEs were originally established by sectoral ministries which have often proved unwilling to relinquish control, particularly over strategic companies. This situation might have been exacerbated by a more general fracturing in governance of the public sector. In the GCC countries in particular, it has been argued that governmental offices (ministries, companies, etc.) were born out of the need to allocate resources and posts to members of the royal family, sometimes resulting in structures with unusual and/or overlapping mandates (Hertog, 2009). This has arguably made future co-ordination or centralisation more challenging.

None of the MENA countries have established a centralised ownership entity; most jurisdictions operate on a decentralised ownership basis, with little or no co-ordination. The closest example of a centralised ownership entity is in

Iraq, where the administration of state ownership is somewhat consolidated under the Ministry of Industry and Minerals. The Egyptian Parliament was, until the revolution in early 2011, examining a legislative proposal to establish a central ownership entity, in line with an earlier recommendation of the OECD. The proposal sought to establish a first centralised ownership entity in the region that would exercise state ownership responsibilities in all SOEs (Gamal, 2010). Following the revolution, it is now unclear whether this project will go forward.

One notable trend in the region is the wide adoption of the holding company model, whereby ownership rights in some SOEs are allocated to a sovereign investment entity (e.g. Mumtalakat) or to a sectoral holding company organised under a particular ministry (e.g. the Ministry of Investment of Egypt). The growth of sovereign wealth funds and their stakes in local SOEs has increased the centralisation of state ownership. For example, the Investment Corporation of Dubai, formed in 2006 by a transfer of the government's portfolio of investments from the Ministry of Finance, is charged with exercising ownership rights in a portfolio of 25 SOEs. Although these SOEs account for only a fraction of Dubai's overall SOE portfolio, this represents some progress towards centralisation.

A key task of the state as an owner of SOEs is to define a clear and consistent ownership policy. The *SOE Guidelines* recommend that governments develop and disclose an ownership policy, defining the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and the way the state will implement its ownership policy (OECD, 2005a). Ownership policies should be widely disseminated and not be subject to frequent modifications in order to give SOE management, boards and the general public a clear view of the state's objectives and a sense of predictability about the state's behaviour as an owner.

To date, no MENA jurisdiction has defined an ownership policy to clarify and prioritise the objectives of state ownership, although Morocco is understood to have started this process. This is because SOE ownership remains fragmented, thereby requiring a consensus among the various state owners on the content of such a policy. A related factor that has impeded the development of state ownership policies in the region is the variety of SOE legal forms, and the fact that in some countries (e.g. Iraq and Yemen), many SOEs are not corporatised. The variety of legal forms of SOEs complicates the creation of a unified ownership policy and insulates some SOEs from the application of legal or regulatory requirements applicable to their peers and private sector companies.

Some MENA jurisdictions have introduced legislation that sets out corporate governance requirements for SOEs, attempting to streamline ownership forms and governance practices. An example is the Egyptian Public Business Sector Law 203 of 1991 (PBSL), which aims to lay out the governance framework for SOEs. While the Ministry of Investment of Egypt had made considerable progress in its implementation (until its dissolution in 2011), the law still differs in important respects from what can be qualified as an ownership policy. The law does not apply to all SOEs in Egypt. Exempt from its application are a number of concerns in the military, banking, telecoms and water sectors, not overseen by the Ministry of Investment.

Nonetheless, the PBSL is unique in the region in terms of its comprehensive coverage of corporate governance practices that must be implemented by SOEs subject to it. The law covers in detail a number of key corporate governance questions, including the constitution of the general assembly and the board, quorum requirements, requirements for the selection of board members and stakeholder participation. In other MENA jurisdictions, the legislation tends to be more fragmented in that the overall legal and regulatory requirements for SOEs are outlined in multiple decrees and regulations, promulgated by sectoral ministries and in some cases the "central ministry". As a result, corporate governance arrangements in companies subject to regulations of different sectoral ministries differ, in some cases significantly.

One unique aspect of the PBSL is that it explicitly subjects SOEs to the general Companies Law. In addition, the PBSL states that companies subject to its provisions shall not be deprived of any benefits or be subject to any burdens that are prejudicial to equating them with joint stock companies governed by the provisions of the Companies Law. This provision has significant positive implications for creating a level playing field between SOEs and their private sector competitors. Other governments in the region are also seeking to bring SOE governance arrangements closer to those of private companies, by making them comply with commercial and securities legislation and subjecting them to the general competition frameworks.

This is quite different than the situation in most OECD member countries, where SOEs (other than statutory corporations) are as a matter of course subject to the same corporate legislation as private companies. Indeed, in OECD member countries, SOEs are most often organised as private limited liability companies or joint stock companies. The experience of converting enterprises originally created by virtue of special legislation to the prevailing corporate form may be of interest to MENA policy makers. For instance, in France the state-owned electricity and gas companies were initially established under

special legislation and were later brought into line with the general corporate law. The Moroccan government began streamlining SOE forms and bringing SOEs under the general commercial legislation as early as 1998 and has accumulated some instructive case studies in this area (Belfahmi, 2010).

While the relevant legal frameworks have been evolving, so too have the voluntary corporate governance standards applicable to SOEs. In some MENA countries, the legislative framework is now complemented by a corporate governance code or guidelines for SOEs, which address issues like board appointments, responsibility of board members, disclosure requirements and treatment of stakeholders.

Egypt was the first country in the region to develop such a code in 2006, one year after the formulation of the general corporate governance code. The code complements existing legislation, in particular the PBSL discussed above. Morocco has released a corporate governance code for SOEs, developed with the OECD's support in November 2011. Whereas the Egyptian code is voluntary, the Moroccan one applies on a "comply or explain" basis. In Egypt, instead of making the code's requirements mandatory, the Ministry of Investment (dissolved in 2011) concentrated its efforts on raising the awareness of the code's recommendations among SOE board members and management.[15]

Separation of ownership from regulatory functions

Governments often play a dual role of a market regulator and an owner of SOEs with commercial operations, particularly in network industries. As owners of state-owned commercial entities, they often find themselves pursuing conflicting objectives. The *SOE Guidelines* recommend separation of the state's ownership functions from its regulatory responsibilities. Full administrative separation of ownership and market regulation responsibilities is necessary to create a level playing field between SOEs and their private sector competitors, especially when SOEs are used as an instrument of industrial policy. The latter concern is considered especially relevant to Gulf economies.

With the exception of Egypt, Iraq and Morocco, where ownership responsibilities have to some extent been centralised, sectoral ministries continue to exercise ownership rights in SOEs on behalf of the state, while discharging their regulatory responsibilities. This gives line ministries the power to "protect" incumbent SOEs from private sector competition and shield them from market pressures through subsidies or other anti-competitive arrangements that might conflict not only with good governance of SOEs, but also with their long-term performance. In addition, these types of institutional

arrangements might place commercially oriented SOEs at particular risk of being required to fulfil social obligations without being formally compensated.

Effective separation of regulation and ownership has often been a challenge in the region for a variety of reasons. First, many MENA SOEs operate in strategic sectors where governments prefer to retain complete and direct decision making powers. Second, the separation of the two functions has been difficult to achieve due to the historical presence of SOEs in monopoly sectors. Indeed, if an SOE is expected to retain its monopoly indefinitely, it may be economically inefficient to separate the regulatory and the ownership functions. In addition, in many MENA countries, SOEs continue to be seen as an important part of line ministries' portfolio; line ministries may be therefore reluctant to give up their regulatory powers while retaining their ownership rights.

Independent sectoral regulators

Considering the lack of clarity between ownership and regulatory functions in the region, the role of independent sectoral regulators cannot be underestimated, except in some monopoly sectors. Yet, with the exception of the telecommunications and the transport sectors, they remain relatively scarce. In addition, even where regulatory functions have been split from the relevant line ministry, the independence of regulators has been questioned. That said, in some cases regulators have shown their independence by taking action against state-owned incumbents. For instance, the Supreme Council for Information and Communications Technology of Qatar is operating in a spirit of independence and has even issued rulings against the state-owned Qtel.[16] Considering the business opportunities afforded by the opening of telecom sectors across the region, there have been considerable legal suits in this sector, including against regulators.[17]

The establishment of independent sectoral regulators has helped to address another corporate governance challenge often encountered in sectors where SOEs operate; that is, establishing a level playing field between SOEs and their private sector competitors. This was accomplished by virtue of regulators' creating a clear regulatory framework and intervening in cases of anti-competitive practices, often by local state-owned incumbents at the expense of their foreign competitors. Considering that competition authorities appear to have been constrained in investigating the allegations of anti-competitive behaviour against SOEs, the role of sectoral regulators appears all the more important. Judgements against SOEs by competition authorities have been rare, in part because the burden of proof has often been placed on the private sector.

The establishment of sectoral regulators to separate ownership from regulatory functions is likely to stay on regional policy makers' agenda for decades to come. At the same time, this is likely to remain a politically and administratively challenging issue, considering that ministries might prefer to continue exercising direct control over SOEs, both through board representation and direct instructions to the management. This might be particularly the case for strategic SOEs or those with social obligations for which they are compensated.[18] Maintaining direct control over the regulatory functions might lead to additional benefits for the SOEs and agencies exercising ownership rights in them at the detriment of the SOE performance and the economy more generally.[19]

In establishing sectoral regulators, the question of timing and sequencing of reforms is paramount. The discussions in the *MENA SOE Taskforce* revealed that creating a competitive framework in industries where SOEs operate is important prior to any restructuring and privatisation. When privatisation transactions are undertaken in the absence of a competitive framework, the state may facilitate the creation of abusive private monopolies or oligopolies. Splitting out and corporatising services formerly provided by ministries, as well as breaking up state monopolies vertically or horizontally, are examples of measures that may lead to the creation of a healthier competitive landscape before privatisation.

Reform of the Lebanese telecom sector illustrates some of the challenges and pitfalls in sequencing of reforms. In 2002, the Lebanese government passed the Telecommunications Act to establish the legal framework for creation of Liban Telecom as a joint-stock company, effectively transferring the commercial activities from the Ministry of Telecommunications, at the same time creating the Telecom Regulatory Authority. Whereas the regulatory authority was established, the company was never constituted. The result is that currently most telecom services continue to be provided directly by the ministry, which the regulator does not have the mandate to oversee. This situation is reported to have resulted in some serious conflicts of interest (The Executive, May 2009).[20]

Experience shows that successful MENA SOEs have an arm's length relationship with the government (by regulation and de facto) and are regulated by independent regulatory bodies (Hertog, 2009). Although progress in establishing independent regulatory bodies has been slow, a positive development is that commercial activities are generally no longer performed by the ministries directly, with some exceptions as highlighted above. Commercial

services have increasingly been split from line ministries, most often through corporatisation, which has generally led to improved SOE performance.

Strategic industries

Examples of the missing separation of ownership and regulatory functions are numerous, and especially prevalent in the hydrocarbons sector. For instance, in Egypt, the Holding Company for Petrochemical Products regroups a number of fully and partially state-owned companies, but also acts a sectoral regulator. The Egyptian authorities have recognised the potential conflicts of interest that this governance practice can give rise to and have initiated the establishment of an ownership entity following an earlier recommendation of the OECD (OECD, 2010).[21] The status of this project is currently unclear.

In the GCC countries, the lack of a separation between state ownership and regulatory responsibilities is also arguably most pronounced in the hydrocarbons sector, where SOEs operate as monopolies and are regulated through special councils that effectively exercise both ownership and regulatory rights. For example, the Supreme Council for Petroleum and Mineral Affairs in Saudi Arabia has the mandate to decide on all matters concerning the hydrocarbons sector. This includes approving policies and strategies for petroleum, gas and other hydrocarbon areas, including specifying quantities for production and approving plans for pricing.

At the same time, the council is responsible for setting policies for Saudi Aramco, including approving its investment programmes, appointing a chair of the company (based on a board nomination), appointing an auditor and deciding on the remuneration of the board (SAMA, 2009). Indeed, in accordance with a Royal Decree of 2000, the Supreme Council has assumed the powers of the Higher Board of Saudi Aramco, which essentially eliminates any separation between the regulator and the company. However, considering that Saudi Aramco operates as a monopoly, the implications of this are less severe than if it operated in a competitive climate.

This arrangement is indeed common in the GCC countries. For example, in the United Arab Emirates, the Supreme Petroleum Council has taken over the ownership responsibility of the former Petroleum Department, as well the functions commonly performed by the board of the Abu Dhabi National Oil Company since 1988. Similar arrangements apply to the governance of hydrocarbon SOEs in Bahrain, Kuwait and Oman.

The role of sovereign wealth funds

While many SWFs started as financial investors with an international focus, in recent years they have increasingly been charged with nurturing domestic business activities. This transfer of ownership responsibilities from line ministries to SWFs has acted to separate ownership and regulatory functions. For example, Mumtalakat, Bahrain's sovereign wealth fund, was established in 2006 to discharge ownership responsibilities in all strategic non-oil and gas commercial assets (e.g. Aluminium Bahrain, Batelco, Gulf Air). Similarly, the Kuwait Investment Authority (KIA), established in 1982, now exercises ownership in a number of key SOEs, entrusted to it by the Ministry of Finance.

The role of SWFs in influencing corporate governance of SOEs can generally be characterised as positive. First, the governance structure of SWFs, or rather, the asset management companies that oversee them, is entirely separate from that of the line ministries or sectoral regulators. Second, their objectives are predominantly commercial and therefore they appear not to be prone, as ministries might be, to politicising SOE objectives or their governance. In addition, to the extent that some SWFs have been charged with restructuring SOEs, including privatising stakes (e.g. Alba's 2010 privatisation was overseen by Mumtalakat), their role in reviewing governance arrangements of SOEs has also been constructive.

Apart from the known, large asset management companies such as Abu Dhabi Investment Authority (ADIA) and KIA, some SWFs operate as units within ministries of finance or central banks. For instance, Saudi Arabia's Public Investment Fund (PIF) is formally a part of the Ministry of Finance and has the mandate to invest in commercial projects that are wholly or partially state-owned, either alone or in partnership with other government agencies. Currently, PIF manages investments in 37 domestic companies, including some that it has established (e.g. the Saudi Rail Road Company and the Stock Exchange Company - Tadawul) (PIF website, 2010).

At the time of publication of this book, PIF did not play a very active role in the governance of SOEs in which it had an ownership stake, but this is starting to change as the Saudi authorities begin to promote good governance practices through training workshops and other activities. More generally, to the extent that some of the SOEs owned by SWFs might have industrial policy objectives or be of strategic value to the government, the insulation from the political considerations might be less effective.

Recent research estimates that in the GCC countries alone, local SWFs hold stakes in more than 130 listed companies, accounting for 27% of the combined GCC market capitalization (Markaz, 2008) (see Table 1.5). An aggregation of SWFs' holdings reveals that they hold a significant share of large caps, effectively drying up free float in the market (Markaz, 2008). The value of Gulf-based SWFs' holdings grew by 81 billion USD in 2010, with the combined assets of ADIA, KIA, the Qatar Investment Authority (QIA), and the Oman General Reserve Fund (ORF) estimated at more than USD 800 billion at the end of 2010 (Zawya, 28 November 2010).

Table 1.5. Holdings of Sovereign Wealth Funds in GCC capital markets

	Number of Sovereign Wealth Funds	Number of companies held by SWF	Total market universe	Amount held in local market (USD mil)	SWF's holdings as a % of market capitalisation
Saudi Arabia	5	27	101	166 713	36%
UAE	7	27	102	61 002	25%
Qatar	6	9	40	28 744	21%
Kuwait	5	33	180	25 054	12%
Oman	9	21	128	5 998	23%
Bahrain	4	14	43	5 045	18%
Total	**36**	**131**	**594**	**292 557**	**27%**

Source: Markaz Research, 17 March 2008.

In the GCC countries, state-owned institutional investors such as insurance and pension funds invest in other state-controlled companies and therefore act similarly to SWFs. The fact that private companies might have state controlled enterprises as part of their ownership base raises separate governance issues. Indeed, private companies in which public institutional investors hold stakes might be qualified as state-controlled. This raises the question of what type of governance arrangements need to be put into place in these companies, particularly with a view to ensure an equitable treatment of shareholders.

Disclosure and transparency

The disclosure practices of MENA SOEs should be seen in the context of the evolution of the overall corporate reporting agenda in the region. Improving disclosure has been particularly challenging in the region, both in non-listed companies, which shy away from disclosure, and in listed companies, which are

attempting to absorb the pace of regulatory change. Keeping this general context in mind, it is unsurprising that disclosure is one of the weakest points in corporate governance of MENA SOEs.

Improving SOE transparency has been a global challenge, as highlighted in past discussions in the OECD's *Global Network on Privatisation and Corporate Governance of SOEs*. In MENA SOEs, the lack of transparency raises issues of public accountability and public sector governance more generally. These precise concerns were emphasised during the Arab Spring, with many voices calling for greater government accountability. This section explores two areas of SOE reporting, first focusing on company level reporting and later exploring challenges associated with aggregate reporting by the authorities.

Accounting and auditing

State-owned enterprises often remain behind a curtain, revealing little information beyond their general mandate and performance. In the MENA region, many SOEs, even large companies with otherwise sophisticated communication strategies, do not publish any information beyond a general description of their business. One reason for this lack of transparency may be that their objectives are unclear or conflicting, but it can also be traced to political expediency, desire to avoid comparisons with the private sector, or inexperience with corporate communications (McKinsey, 2009).

The *SOE Guidelines* provide that SOEs should be subject to an annual external audit based on international standards and that they should be subject to the same quality accounting and auditing standards as listed companies (OECD, 2005a). *The OECD Accountability and Transparency Guide* further recommends that to ensure appropriate disclosure and transparency practices, the state as an owner should first develop a coherent disclosure policy for its portfolio companies (OECD, 2010b). In fact, the lack of general ownership policies, as discussed above, is a fundamental reason that SOE objectives are often unclear and that reporting on them might be ad hoc or limited.

Detailed financial and non-financial reporting by SOEs is rare; a more common practice is the publication of financial statements in newspapers or official bulletins (e.g. Egypt, Morocco). Financial reporting has been improving, thanks to the gradual rapprochement between national accounting and auditing standards and international accounting and auditing standards. With the exception of Oman, where the International Accounting Standards (IAS)[22] have been mandatory for all companies since 1986, the adoption of International Financial Reporting Standards (IFRS) has been less swift in the

region. Even where IFRS standards have been introduced for listed companies, local accounting standards have often remained the relevant standard for SOEs, and certainly for non-listed ones.

Non-financial disclosure, particularly on corporate governance practices, is generally limited. It is still rare for SOEs to include a corporate governance chapter in their annual report, though elements regarding their corporate governance frameworks can often be gleaned throughout. The most widely reported corporate governance characteristic is the composition of the board. On the other hand, little information is available about the functioning of boards, composition of board committees and issues raised during board meetings. Finally, executive compensation – whether in aggregate or disaggregated format – is seldom available even for listed SOEs, unless required by the relevant accounting standard. Only some large listed MENA SOEs such as SABIC and Etisalat have started to provide a certain amount of remuneration data.

For SOEs not seeking to attract private capital, disclosure practices may seem as lacking a business case. As a result, it is not uncommon for financial and other reporting to be provided only to the ministry or government agency exercising the ownership rights in that particular SOE. On the other hand, SOEs that have listed debt instruments or equity have seen their transparency improve substantially owing to the demands of securities regulators and exchanges, albeit from a modest starting point. In the GCC region, the recent increase in sovereign issues has encouraged SOEs to issue their own debt due to the emergence of liquid markets throughout the yield curve. Transparency improvements as a result of bond or sukuk offerings by SOEs are particularly notable since these companies were often not subject to any public disclosure requirements before such offerings.

A point of particular weakness is that SOEs are rarely, if ever, required to publicly disclose whether they have any special obligations and how the costs related to these are covered. Discussions in the *MENA SOE Taskforce* confirmed that SOE objectives are often not clear and that they are not communicated to the public, therefore making disclosure, including in relation to special obligations of SOEs, challenging and less meaningful. Given the scale and scope of non-commercial objectives of SOEs in a number of key MENA economies, the transparent costing and funding of these objectives is politically sensitive and technically complex to implement.

In the future, additional transparency by SOEs and entities that exercise ownership rights in them would be useful in understanding governance-related challenges in this sector. The lack of such disclosure might in fact create a false

impression of a lack of governance awareness in public companies that may in fact have effective arrangements in place. While the business case for better transparency in the listed sector no longer needs to be made, the rationale for greater transparency in non-listed SOEs is not widely understood or accepted. The drive for greater SOE transparency is likely to come from institutional investors, from peer pressure and from the ongoing evolution of financial reporting and audit standards applicable to SOEs.

Aggregate reporting

In terms of aggregate reporting, progress has arguably been slower, as is indeed the case in OECD member countries. The *SOE Guidelines* recommend that the co-ordinating or ownership entity develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report. Given the fragmentation in ownership and challenges in co-ordinating the state's ownership responsibilities, aggregate data on SOE performance is generally not collected and hence not publicly reported. Consolidated performance reports are sometimes produced to facilitate future privatisation or investment decisions of the state as well as serving, in some cases, as a more general reporting mechanism to the Parliament or an equivalent oversight entity.

A notable exception to this is the Department of Public Enterprises in the Ministry of Economy and Finance of Morocco, which produces detailed consolidated statistics on SOE performance, support provided by the state to SOEs and plans for future restructuring of the sector. The information is made publicly available on the ministry's website.[23] This consolidated reporting is facilitated by the fact that the department monitors the performance and budget of all state-owned entities, even those in which it does not exercise any ownership responsibilities. Apart from Morocco, aggregate reports on the performance of the SOE sector are not made public, although some reporting is available either at the holding company level (e.g. Egypt) or at the level of SWF holdings (e.g. Bahrain's Mumtalakat).

Reporting to the Parliament, the Diwan, the Council of Ministers and/or to the relevant audit body on SOE performance is fairly common. For instance, in Iraq, the Ministry of Investment and Minerals reports to the Parliament providing an outline of SOEs' achievements. In Jordan, the Parliamentary Committee on Public Enterprises receives ministerial reports and those of the state audit body, although there is no consolidated reporting on SOE performance.[24] In Egypt, the Ministry of Investment (until its dissolution in 2011) co-ordinated the interaction between SOEs and the Parliament on a case-by-case basis.[25] In some MENA countries, the state audit body reports directly

to the Parliament (e.g. Kuwait, Morocco). In other cases, SOEs may report to the Council of Ministers, in addition to reporting to the line ministry (e.g. UAE).

Reporting to the Parliament or an equivalent body has been facilitated by the emergence of relatively powerful State Audit Institutions (SAIs) across the region. A number of SAIs in the region have the right to examine closely the performance and governance arrangements of wholly but also partially state owned companies. In many cases, SAIs conduct strategic and operational audits, and in some instances even pre-audits (e.g. Kuwait, Oman). The status of state audit bodies in the region is reinforced by their direct reporting relationship to the highest levels of the executive (i.e. president, prime minister or monarch). In Morocco, Oman and Saudi Arabia[26], the SAI reports directly to the monarch.

In addition to the formal reporting arrangements, SAIs in the region have a variety of powers, in some cases greater than their counterparts in OECD countries. For instance, the Kuwaiti SAI has the right to send a permanent representative to any company where state ownership exceeds 50%. Egypt's SAI also has important powers, since the offence of “wasting public funds" is considered criminal in Egyptian law (Gamal, 2010). It has the right to audit any company in which the state has over 25% control or ownership, as is the case in Kuwait and Oman. In addition, some MENA SAIs have a mandate to oversee sovereign investment fund vehicles. For instance, Bahrain's Mumtalakat has reporting requirements to the Parliament as well as to the National Audit Court (Som, 2009).

By and large, neither the reports of the ministries on SOE performance nor SAI reports to the Parliament or an equivalent body are made public. This is because most SOEs report to the state on an ad hoc basis, usually upon request. One recent survey of SOEs showed that 45% of SOEs report to the controlling agency on an ad hoc basis, and that only 25% of surveyed SOEs are required to provide periodic reporting (IFC, 2008). Experiences of countries such as Canada and Italy might be instructive for further evolution of aggregate reporting on SOE performance in the region. Likewise, the experience of the Moroccan SAI (Cour des Comptes) might be of interest, as it publishes aggregate annual reviews on the SOE sector, including recommendations on corporate governance arrangements of individual SOEs.

Nomination and functioning of boards

The *SOE Guidelines* recommend that SOE boards be given the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. Recognising the business case for independent and competent SOE boards, a number of countries all over the world have taken steps to professionalise and empower them. In the MENA region however, SOE boards still tend to feature state representatives who may lack not only the necessary independence but also industry knowledge.

In order for boards to collectively have the necessary authority, competencies and objectivity, it is crucial to structure an appropriate nomination and selection process for all companies, irrespective of whether they are wholly or partially state-owned. If the nomination process is appropriately structured, transparent and objective, politicisation at the board level should be reduced to the minimum. In such circumstances, the primary consideration in selecting and appointing board members is their ability to monitor and positively affect company performance.

Creating a structured nomination process and reducing the presence of political nominees on SOE boards continues to be a challenge for policymakers all over the world. The OECD has already advised a number of countries to reduce the political influence in the appointment of SOE board members (e.g. Chile). In order to better understand how this can be accomplished in MENA countries, more information on the SOE board nomination processes would be necessary. Such information is currently lacking, in large part because nomination processes have not yet been formalised in most MENA countries. Oman's Ministry of Finance is currently trying to introduce a standardised nomination process, establishing concrete selection criteria to be met by prospective SOE board members.

The absence of streamlined nomination processes in the region stems primarily from a lack of co-ordination of the ownership function. As a result, different ministries that exercise the ownership rights in SOEs establish varying formal or informal criteria and procedures for the nomination of board members. In addition, in cases where SOEs are established by a special law or by royal/ministerial decree, the criteria for board composition, commonly specified in the company's articles of association, might not provide the basis for a rigorous board selection process. Often, these criteria are quite vague, and by no means substitute a nomination process where candidates' qualifications are reviewed to ensure that the appropriate skill mix is represented on the board.[27]

SOE boards constituted solely with reference to the relevant company legislation, which establishes minimal criteria for board members such as age, nationality and absence of a criminal record, often also reflect the lack of a rigorous selection process. Moreover, in some countries (e.g. Egypt), state appointees on SOE boards are interchangeable with other state representatives, which might not allow for a structured and consistent oversight of company performance. Experience shows that these practices often compromise the objectivity and independence of boards and curtail their ability to perform effectively.

More specific selection criteria and processes have been established in countries which have introduced legislation specifically targeting the SOE sector. For instance, in Egypt the PBSL, mentioned earlier, outlines in detail the board nomination process. The law stipulates that nominations for board positions in holding companies be put forth by the Minister of Investment, while board nominations for "affiliate companies" (i.e. actual SOEs) be put forth by the board of the holding company. A similar model is in place in Syria, whereby the prime minister nominates the management of each holding company.

Additional recommendations on board nomination and composition are available in corporate governance codes. For example, the Egyptian SOE code has a chapter on the structure of the board, proposing good corporate governance practices in this area. However, the code remains silent on board member selection requirements and processes. The code is voluntary, even though the Ministry of Investment has encouraged SOEs under its purview to comply with it. Comply-or-explain type corporate governance codes developed in some MENA jurisdictions should in principle be more effective in subjecting listed SOEs to the same good practices as private sector boards. The Moroccan corporate governance code for SOEs, released in November 2011, adopts the comply-or- explain approach for all SOEs, even those which are not listed.

Mostly by government choice but also absent standardised nomination processes in MENA countries, SOE boards remain dominated by government representatives, either from the responsible line ministries or the "central" ministry. Government representation on SOE boards typically ranges from mid- to high-level public sector appointees. In the case of companies perceived as strategic (i.e. in natural resources or defence sectors), boards are often almost entirely composed of high ranking government officials, including ministers. A review of disclosures provided in the annual statements of listed SOEs reveals that this situation prevails even in companies of considerable size and with private participation.[28]

MENA SOE boards often do not feature as many non-executive or independent board members as their private sector counterparts. A survey of 34 SOEs in Egypt found that only 9% involved non-executive directors in selecting other board members and deciding on their remuneration, whereas 80% of the CASE 30 index did so (EIOD, 2008). In SOE boards, unlike in private sector ones, the question of board independence is often not vis-à-vis the controlling shareholder *per se*, but vis-à-vis the state more generally. This is because the state often has greater powers than implied by its ownership even on boards of partially owned SOEs, through mechanisms such as golden shares or less explicit mechanisms, enabling it to exercise disproportionate influence. In some cases, the state has the right to appoint a number of board members disproportionate with its ownership.

Existing surveys of SOE boards in the region demonstrate that a key criterion for nomination is for the nominee to hold a high profile public post, whereas competence and skills are considered less important (IFC-Hawkamah, 2008). Discussions in the *MENA SOE Taskforce* meetings showed that current nomination procedures in MENA countries do not lead to an optimal mixture of competence and skills on MENA SOE boards. In particular, the presence of ministers or other high-level government officials is of concern as they might have conflicts of interest, might not have sufficient time to attend to their duties and could stifle debate within the board. Country-specific considerations further complicate and politicise board nomination procedures. For instance, in Lebanon board composition has to proportionally reflect the representation of religious communities in the country.

The presence of company executives on SOE boards appears to have given rise to a degree of confusion regarding the respective roles and responsibilities of board members and management. While this particular challenge is uncommon in OECD member countries, it is reportedly also quite widespread in private sector boards in the region.[29] This is in part related to the lack of clear objectives set for SOEs by the government as well as the lack of training made available to SOE board members. For instance, the Egyptian Institute of Directors estimates that only 35% of local SOEs give newly appointed directors a formal orientation process, compared with almost all CASE 30 companies (EIOD, 2008).

The apparent confusion about the respective roles of the board and management has been accentuated by the fact that the roles of the chairperson and the CEO are not always segregated, even in jurisdictions with relatively sophisticated governance frameworks. Companies where these roles have already been systematically and formally separated are often listed SOEs

subject to corporate governance codes (i.e. Qatar National Bank). In Egypt, the two posts are often combined because separating the roles had in practice led to confusion. The *SOE Guidelines* state that a clear definition of the function of the board and the chair could help prevent situations where the separation of functions might give rise to inefficient opposition between the two company officers.

Limits on the length of director mandates and their accumulation are often not established in MENA SOEs. This has led to a situation where the duration of board appointments can be very high in some cases. For example, some of the board members in Arab Potash, a large listed Jordanian SOE, have been on the board for more than 20 years. Likewise, limits on the number of board posts an SOE director may hold at the same time have rarely been established, with the possible exception of Morocco, where state representatives cannot sit on more than seven boards simultaneously. This is still a relatively high limit which raises concerns about the ability of board members to discharge their duties.

Another issue affecting the performance of SOE board members is their remuneration. In the region, it appears that just over half of SOE directors are remunerated for their services (IFC-Hawkamah, 2008). This raises questions as to why board members accept such appointments and what might be their motivation for dedicating time to board duties.[30] Disclosure of remuneration (aggregate or disaggregate) by SOEs is not common; hence conclusive recommendations are difficult to make. In Egypt for instance, only 38% of SOEs disclose compensation to board members, even though this is recommended by the corporate governance code. It bears mentioning that SAIs appear to have played an important role in reviewing and – in some cases publicly criticising – remuneration arrangements in SOEs.[31]

Conclusions

The evolution of state-owned sectors in the MENA region is rooted in historic developments, and yet is responsive to emerging global and national trends. As highlighted in this introductory chapter, the establishment of SOEs in the region was an important development that in some cases followed closely the emergence of modern nation states. The size and composition of SOE sectors have been fairly dynamic in almost all MENA economies, owing to the reduced role of the state in the economy in some countries and to the growing role of the state in industrial policy via SOEs and SWFs in other jurisdictions. Both the historical reasons for the establishment of SOEs and the adoption of

new objectives for state ownership have affected the composition of MENA SOE sectors and their governance.

Good corporate governance of SOEs, although a critical policy issue for the future economic development of the region, has taken some time to emerge as a priority for regional policy makers. This is partly because historically, SOEs were part of government ministries and therefore were not seen as separate from the overall public governance framework. It is also partly because some SOEs in the region have important social obligations and/or are considered as being of strategic importance. Finally, this lag is also attributable to the slowly emerging awareness of the benefits and nuances of good corporate governance of SOEs, as opposed to privately owned companies.

As a result of these factors, the development of frameworks and practices in the state-owned sector has generally lagged behind those in the private sector. Only a few MENA countries have developed corporate governance codes or laws that address challenges specific to SOEs. Currently in the region, only Egypt and Morocco have corporate governance codes specific to SOEs. Although some counties have introduced legislation or regulations clarifying the role and obligations of the state as a shareholder, no MENA country has so far introduced a comprehensive and consistent ownership policy, which would clearly position the state as an owner, prioritising its objectives and recognising possible trade-offs in achieving these.

The development of ownership policies is a high priority for all MENA countries, and yet the achievement of this objective is contingent on the design of the ownership function itself. Fragmentation of ownership, whereby different government bodies exercise ownership rights in an uncoordinated fashion, is a common phenomenon in the region. Complete centralisation of ownership might be practically difficult to accomplish in the short run for a variety of political and administrative reasons. Nevertheless, co-ordinating agencies would be extremely useful in harmonising the policies adopted by different national owners.

If implemented, these arrangements would allow for the centralisation of information and data on various aspects of SOE performance and governance, allowing the state to make better decisions. The centralisation or co-ordination of ownership would also enable MENA governments to better communicate with the stakeholders and, therefore, to effectively deal with potential concerns linked to restructuring or privatising SOEs. Bringing additional clarity about the objectives behind state ownership might help address the contentions that have arisen in the past during restructuring or privatisation transactions. It might also be beneficial in situations where the state finds itself as a temporary owner of

previously private enterprises that for one reason or another, had to be nationalised.

Indeed, considering that SOE performance in some jurisdictions remains very much a "black box", policy makers' attention might be warranted on transparency and disclosure practices, both at the aggregate and at the individual SOE levels. Disclosure practices of non-listed SOEs might warrant particular consideration, while some large, listed SOEs are beginning to provide disclosure similar to that of their private sector peers. The general interest of GCC jurisdictions to continue developing their capital markets through floatations of minority stakes in SOEs and listings of SOEs' debt or sukuk is likely to continue having a positive effect on transparency of listed SOEs.

Last but not least, the nomination practices and composition of SOE boards has generated considerable interest and discussion in recent years. There is a growing interest in how SOE boards should be appointed, how they should be structured, what responsibilities they should be endowed with and how they should be held accountable. These questions were addressed during the *MENA SOE Taskforce* meeting held in April 2011 in Morocco. A key recommendation that emerged from these discussions is that a structured nomination processes should be introduced and that independence requirements should be further reviewed, including for non-listed SOEs that are not already subject to corporate governance codes. Independence requirements for SOE board members, unlike for their private sector counterparts, should take into consideration the need for them to have operational independence from state organs.

Looking ahead, the sharing of experience with reforming national and company-specific SOE governance frameworks and practices will be essential. Indeed, this is the objective of the *MENA SOE Taskforce*, which remains a unique platform for policy makers to exchange experiences in this field. For regional policy makers to introduce better governance standards, further empirical and qualitative research on the topics discussed in this chapter and other topics treated as part of this book will be required. To date, very little academic research has been undertaken on issues related to MENA SOEs and their governance, in large part owing to the absence of reliable and comparable public information.

This lack of research has led many observers to conclude that either the awareness of good governance practices in the SOE sector in the region is low, or that governance practices in MENA SOEs are not necessarily in line with international best practices. This is a misconception and a generalisation that needs to be addressed, and the most effective means of challenging it is though

public communication of available information on corporate governance practices of SOEs. An examination of the performance and governance arrangements of MENA SOEs shows that the region is home to some successful and professionally run companies.

While a number of the region's successful SOEs enjoy some strategic advantages, their impressive performance in recent years underscores that there are lessons to be learned from the experiences. It is notable that most Gulf-based SOEs have survived both oil-price contractions and the global economic crisis rather well. It is also worth noting that Gulf SOEs' track record stands in contract to that of public companies in other resource-rich states or to SOEs in other parts of the region (Hertog, 2009). Isolating the factors that have helped make these companies successful is crucial. To do so, researchers and policy makers will need to consider both national differences as well as company-specific factors that have improved SOE performance.

Better corporate governance of SOEs in the region will require at once developing a research agenda to allow policy makers to make informed choices, and as well as continuing efforts to raise the awareness of SOE boards and management regarding good practices. A recent survey (IFC, 2008) indicated that only half of the respondents were familiar with the content and scope of the *SOE Guidelines* -- many fewer than with the OECD Principles. The example of the Egyptian awareness-raising campaign, conducted following the adoption of the Egyptian SOE code, demonstrates the potential benefits of such an exercise.

As a result of this campaign, a competitive dynamic among chairpersons of the holding companies emerged, which resulted in significant improvement in practices at the level of individual SOEs. Both competitive dynamics and sharing experience among policy makers will be required to narrow the governance gap between MENA SOEs and private sector companies. SOEs in the region could and should take a leadership role in defining the corporate governance agenda, as opposed to merely attempting to keep up with the governance arrangements in the private sector. The Arab Spring has only reinforced this message.

Notes

1. South Yemen in particular before the country's unification.
2. The final privatisation bill contains a number of sectoral exceptions (education, health, etc.) and specifies that Kuwaiti nationals cannot be dismissed or have their wages altered as a result of any privatisation transaction.
3. More than 1.7 million Egyptian workers are reported to have engaged in some 1,900 strikes and other forms of protest from 2004 to 2008. In December 2006, workers in the Nile Delta town of Mahalla conducted a three-day strike involving more than 20,000 workers, until their demands were eventually met (Al Masry Al Youm, 3 March 2010).
4. Yemen does not have a stock exchange, but envisaged launching one.
5. Cumulative FDI by sovereign wealth funds has reportedly reached US$100 billion (Columbia FDI Perspectives, 2 December 2010).
6. In Egypt, SOEs are estimated to account for 34% of GDP, down from 70% of GDP 10 years ago (OECD, 2011).
7. The exact figures on state funding offered to recapitalise troubled banks are not available, nor is it known to what extent this support has resulted to de-facto ownership by the state. Nonetheless, it would be logical to assume that following significant injections of capital into failing banks, MENA governments have assumed a stronger role in the governance of these institutions, in addition to the prudential oversight exercised by the Central Banks.
8. Petrochemical sectors across the region remain predominantly in the hands of the state, although privatisation of some natural resource companies has happened (i.e. Jordan Potash).
9. As of 2007 (latest available information), MENA banks had the highest rate of non-performing loans (NPLs) in the world, estimated at about 20%. Algeria had the most vulnerable banking sector, with more than 35% of NPLs, whereas Saudi Arabia had the least, with 3%, similar to that of OECD member countries (World Bank, 2009a).
10. Only a few years ago, the Syrian banking sector was entirely state-controlled. Today, in addition to 6 state-owned banks, 14 foreign banking institutions are operating in Syria. This is in large part attributable to the gradual relaxation of foreign-investment rules, leading to foreign investors' being able to own at first 49% of a bank's equity and, as of January 2010, up to 60% (Oxford Business Group, 11 January 2011).
11. From 2004 to 2008, the portfolio of SOEs under the oversight of the Ministry of Investment of Egypt was halved and re-organised entirely under the holding company structure. It includes most SOEs in the country, except banks and

strategic companies, which are overseen by and report to individual line ministries (and the Central Bank in the case of state-owned banks). After the Egyptian revolution, the Ministry of Investment was dismantled and the SOE portfolio transferred to a dedicated SOE Ministry.

12. Considering its USD 18 billion of loans that matured in 2011, Dubai has reportedly been considering privatisation of stakes in strategic domestic companies. The unlisted value of Investment Corporation of Dubai, which holds government assets in companies such as Emirates Airlines, is estimated at USD 19 billion. (Financial Times, 30 November 2010).

13. Alba was incorporated by Emiri Charter in 1968 and today is one of the largest single-site producers of aluminium in the world. Its shareholders are Bahrain Mumtalakat Holding Company and the Saudi Public Investment Fund. In November 2010**,** 10% of the capital of Alba was listed in the form of ordinary shares on the Bahrain Stock Exchange and Global Depository Receipts representing ordinary shares at the London Stock Exchange.

14. That said, some jurisdictions (e.g. the UAE) have exempted listed SOEs and banks from the application of its corporate governance code applicable to all other listed companies. The government of Dubai has issued a decree in November 2011 addressing specifically corporate governance of state-owned companies.

15. Progress has proved to be contingent upon the importance assigned to good governance by holding-company chairpersons. A competitive dynamic between holding companies has acted as pressure to raising governance standards (Gamal, 2010).

16. In a recent case, Vodaphone Qatar lodged a complaint with the Supreme Council against the state-owned domestic operator Qtel for misleading advertising. The essence of the dispute was that Qtel's promotional activities branded Virgin Mobile products without any reference that the brand was part of the Qtel portfolio. Vodafone Qatar filed a formal complaint on the grounds that Qtel's actions contravened the contractual terms of its license, namely that a third mobile operator could not enter the market for three years. Vodaphone won the case in July 2010 (MEED, 17 September 2010).

17. In January 2011, Jordan Telecom Group, in which the state retains a 15% stake, sued the Jordan Telecommunications Regulatory Committee for breaking the terms of its 3G license, allowing a Kuwaiti telecom operator, Zain, to commence providing a similar service before the expiry of Jordan Telecom's exclusivity rights on this service (Reuters, 15 January 2011).

18. Competitive advantages of SOEs may include subsidisation, concessionary financing and guarantees, monopoly or oligopoly advantages, exemptions from bankruptcy rules and information advantages, or other preferential treatment of the government.

19. For instance, in Syria the winner of an auction to purchase a third telecommunications license conducted by the Ministry of Telecommunications was required to transfer 25% of its revenues to the state and relinquish 20% of the stake to the Syrian state-owned telecoms company. The auction was criticised for not being transparent (Kippreport, 9 December 2010).

20. For instance, a director of the Ministry of Telecommunications was appointed to be the Chairman and the General Manager of OGERO, a Lebanese SOE which contracts with the same Ministry to provide fixed-line and Internet services (The Executive, May 2009).

21. Following the Egyptian revolution, the status of this project is unclear.

22. The IAS was a precursor of the IFRS.

23. For additional information, refer to the annual report on public companies in Morocco produced by the Ministry of Economy and Finance.

24. In addition, the Financial Committee of the Jordanian Parliament examines reports of the state audit body and has the right to conduct additional hearings, during which SOE management and responsible staff at the relevant line ministry are called upon.

25. The newly created SOE ministries will presumably continue fulfilling this role.

26. Oman's SAI has the right to report to Council of Ministers on any other challenges encountered during the course of its work.

27. It should be noted, however, that where the CEO is appointed directly by the state executive, this in itself limits the likely influence of the boards.

28. For instance, the chairman of the Arab Potash Company, a listed Jordanian SOE, was Jordan's Minister of Finance until end of 2009.

29. The GCC BDI 2011 survey of GCC company boards shows that less than half of the respondents thought that there was a clear division of responsibility between the board and management. In addition, the 2008 IFC-Hawkamah survey noted that the roles of the chairperson, CEO and company secretary were not clearly understood in the region.

30. In practice, these are usually civil servants or ex officio directors for the state.

31. For instance, the UAE SAI found that Etisalat chairman and board members paid themselves more than USD $10 million in bonuses, and it noted a number of discrepancies in payments of bonuses and salaries in 2009.

Bibliography

Arab Potash Company (2010), *Annual Report*.

Arbache, Ayoub Milad (2010), *Presentation to the OECD Taskforce on Corporate Governance of State-Owned Enterprises*, Cairo.

Belfahmi, Ahmed (2012), *Presentation to the OECD Taskforce on Corporate Governance of State-Owned Enterprises*, Cairo.

Columbia FDI Perspectives, 2 December 2010.

Dawley, David and Jamal Ibrahim Haidar (2008), "Privatization and Financial Performance: Can Value Be Created by Privatizing State-Owned Enterprises in the Middle East & North Africa (MENA) Region?", *Journal of Economic Valuation and Economic Loss Analysis*, Vol. 3, Issue 1.

Egypt Ministry of Investment (2005), *Egyptian Code for Corporate Governance of State-Owned Enterprises,* Cairo.

Egyptian Institute of Directors (2008), *A Study of Boards of State-Owned Enterprises,* Cairo.

Executive magazine (2009), *Lebanon – Telecom's Tortuous Tangle*, Issue 118.

Financial Times (2010), *Dubai Mulls the Sale of Corporate Champions*.

Gamal, Ashraf (2010), *Presentation to the OECD Taskforce on Corporate Governance of State-Owned Enterprises*, Cairo.

Gulf Co-operation Council BDI (2011), *A Review of Board Effectiveness in the Gulf*.

Hassouna, Mohamed (2010), *Presentation to the OECD Taskforce on Corporate Governance of State-Owned Enterprises*, Cairo.

Hertog, Steffen (2009), *Explaining Successful State-Owned Enterprises in Rentier States*, Muse Project.

International Finance Corporation (2008), *A Corporate Governance Survey of Listed Companies and Banks Across the Middle East and North Africa,* Hawkamah Institute, Washington, DC.

Jamal, Ibrahim (2008), "Infrastructure Privatisation: A Multinational Review of Five Initiatives in the Middle East and North Africa", *International Journal of Arab Culture*, Management and Sustainable Development, Vol. 1, Issue 1.

Kippreport (2010), *Rare meeting spotlights Syria cell phone licence risk*.

Markaz (2008), *The Golden Portfolio: Reach of Sovereign Wealth Funds in the GCC*, Kuwait Financial Centre.

Masry, Al and Al Youm 2012), *Egyptian Workers Protest Privatisation.*

McKinsey (2009), "Improving Performance at State-Owned Enterprises", *McKinsey Quarterly*.

MEED (2008), "State Firms in Egypt Fall Behind on Governance".

MEED (2010), "Top 100 Listed Companies Report", Issue No. 14.

MEED (2010), "Competitor Shakes Up Qatar's Telecoms Market", Issue 38.

Morocco Ministry of Finance (2010), *Report on Public Establishments and Public Enterprises,* Rabat.

Organisation for Economic Co-operation and Development (OECD) (2004), *OECD Principles of Corporate Governance,* OECD, Paris.

OECD (2005a), *OECD Guidelines on Corporate Governance of State-Owned Enterprises,* OECD, Paris.

OECD (2005b), *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries,* OECD, Paris.

OECD (2010a), *Business Climate Development Strategy for the Arab Republic of Egypt,* OECD, Paris.

OECD (2010b), *Accountability and Transparency: A Guide for State Ownership,* OECD, Paris.

OECD (2011), *Competition Law and Policy in Egypt, Global Forum on Competition,* OECD, Paris.

Omran, Mohamed (2009), "Post-privatisation corporate governance and firm performance: the Role of Private Ownership Concentration, Identity and Board Composition", *Economic Research Forum*, *Working Paper 495*.

Oxford Business Group (2011), "Syria: A Year in Review", Online version.

Qatar National Bank (2010), *Annual Report.*

Reuters (2011), *Jordan Telecom sues regulator over 3G licence*.

Saudi Arabian Monetary Authority (2009), *Forty-Fifth Annual Report*.

Som, Lalita (2009), *Stocktaking Report on Corporate Governance Practices of State-Owned Enterprises in the Region*, Consultant's report.

United Nations Development Programme (2010), *Iraq SOE Restructuring Roadmap,* Draft version.

Werenfels, Isabelle (2002), "Obstacles to Privatisation of State-Owned Industries in Algeria: the Political Economy of a Distributive Conflict", *The Journal of North African Studies*, Vol. 7, No. 1.

World Bank (2009a), *Economic Developments and Prospects, Navigating Through a Global Recession*, Washington, DC.

World Bank (2009b), *From Privilege to Competition: Unlocking Private-Led Growth in the Middle East and North Africa*, Washington, DC.

World Bank (2010), *Privatization Database*, accessed 5 November 2010.

Zawya (2010), *Business Development Database*, accessed on 29 April, 2010.

Zawya (2010), *Gulf Sovereign Wealth Funds Gain 81 Billion in 2010*.

Chapter 2

The Arab Spring emphasises better corporate governance of state-owned enterprises

by

Nasser Saidi
Executive Director, Hawkamah Institute for Corporate Governance
with the assistance of Jahanara Ahmad, Manager, Hawkamah Institute for Corporate Governance

This chapter situates advances in and obstacles to better governance of state-owned enterprises in the Middle East and North Africa in the context of the overall public sector governance. The main message is that better corporate governance of SOEs diminishes or eliminates corruption, lowers the risk of state capture, improves SOE efficiency and supports the development of the private sector. There is also a "signalling" effect from improved SOE governance, whereby the state demonstrates to citizens and the private sector that it is committed to the values of corporate governance. The chapter provides recommendations, based on the work of the Hawkamah Institute in the region, on further measures to increase the transparency and accountability of SOEs and governments as their ultimate owners, as well as to ensure that SOE governance arrangements approach those of private sector enterprises, with which they compete in some sectors.

The Arab Spring and corporate governance

The political tensions and transformations in the Middle East and North Africa (MENA) region that began in Tunisia in December 2010 quickly spread to Egypt, Libya, Syria, Bahrain, Yemen and other countries. This more aptly termed "Arab firestorm" started off with protests against longstanding undemocratic regimes. Over the past year, protestors have demanded and continue to demand a deep transformation of both political and economic governance in their countries. In the directly affected countries and more widely across the region, weak political and economic governance is reflected in the public's concern about loss of dignity (*karama* in Arabic) and a lack of social justice.[1] One of the parameters in this debate is access to basic goods and services, many of which continue to be provided by state-owned enterprises (SOEs).

Dissatisfaction with governance in many Arab states is fuelled by a sense that all too often natural resources and national assets — including state-owned enterprises — are captured by special interests, preventing citizens from benefitting from certain public goods. In addition, state control of the telecommunications sector, including print and other media, has stifled the voices of citizens and society. Political and economic repression has, not surprisingly, led to widespread calls for the restoration of *karama*. Although it is difficult to predict the outcomes of the Arab Spring, recent events have highlighted some pressing demographic, political and socio-economic vulnerabilities, which call for major corporate governance reform in the region.

Systematically, popular uprisings have pointed the finger at weak governance, the absence of accountability and the implementation of policies serving special interest groups at the expense of the general public. Poor governance, which has over the years become widespread and pervasive, can be destructive in that it encourages corruption within the state and its agencies. In these circumstances, it may well be the case that while natural resources are plentiful, growth and development are inadequate. At the core of the Arab firestorm lies the issue of governance in its many dimensions, including the governance of state-owned enterprises, whether partially or wholly controlled by the state.

Public governance generally, and SOE governance in particular, has not been seriously addressed in the business climate reforms introduced during the course of the past decade. This is particularly striking given that a number of countries in the MENA region that have undergone important political transitions were ranked as top reformers for the past five years in the World

Bank's Doing Business reports. It appears that the introduction of business climate reforms in the region has not been very effective, with no trickle-down effect leading to greater inclusiveness. The lack of public engagement and support for the proposed measures at the time that these reforms were designed and implemented is a major factor in this.

The last year has seen a shift in focus from business-climate reforms that dominated the agenda in 2005-2010. MENA governments have reacted to the revolutions and protests by enhancing subsidies and other handouts as well as increasing public sector employment. Table 2.1 provides an overview of fiscal policy measures announced during 2010-2011, demonstrating their significant cost to Arab countries. It is doubtful that these measures would satisfy the demands of the protestors in the long term. Fundamental structural reforms are required to address the chronically high youth unemployment rate and provide economic security to citizens of MENA countries.

Table 2.1. Fiscal policy measures announced during 2010-2011

Country	Subsidies	Social welfare and/or cash transfers	Government salary/benefit increases	Tax or other breaks	Annual cost as a percentage of GDP
Bahrain		✓	✓	✓	>1.5
Egypt			✓	✓	0.7-0.9
Jordan	✓	✓	✓	✓	2.0-2.2
Kuwait	✓	✓			>2.5
Lebanon				✓	1.0
Oman	✓	✓	✓		>1.5
Pakistan	✓				0.3
Qatar	✓	✓	✓		>5.0
Saudi Arabia	✓	✓	✓		>23.0
United Arab Emirates	✓		✓		>1.0

Source: IMF REO, April 2011; DB Research, June 2011; DIFC Economics.

Public sector employment in the general government service and in SOEs constitutes a short-term palliative to the regional employment challenge but it cannot raise productivity growth in the long term. Indeed, increasing the size of government by offering attractive public sector jobs is likely to crowd out private sector investment and employment that are needed to revitalise growth rates across the Arab world, which in many countries have either stagnated, or – in the case of Syria, Yemen, Tunisia and Egypt – declined substantially.

A more basic obstacle to resolving the unemployment challenge – perhaps the most significant socio-economic priority in the region — is that education systems have delivered generations of youth without skills and aptitudes that can be used in the market. Educational reform is required urgently to produce a labour force capable of supporting the MENA economies as they respond to challenges presented by the global economy: greater international competition, increased access to technology and enhanced labour mobility. The transformation of the educational systems and of the broader MENA economies and societies will require leadership with the political courage to implement necessary reforms, including to governance frameworks so that they promote fairness, accountability and transparency.

State capture: relevance to MENA countries

In a region where the public sector acts as a key employer, one needs to consider the future development of the public and private sectors and how their growth can be complementary. In this regard, useful lessons can be drawn from the economic transitions of Eastern European countries after the fall of the Berlin Wall. In 1999, The European Bank for Reconstruction and Development (EBRD) and the World Bank produced the Business Environment and Enterprise Performance Survey (BEEPS) using questions about governance obstacles to business development. The survey assessed the quality of governance in 20 countries of Central and Eastern Europe and the former Soviet Union.[2]

The results of this survey provided one of the first opportunities to consider the problem of state capture by empirically exploring the mechanisms by which firms and individuals seek to influence the state. The survey explored the relationship between different firm characteristics such as ownership and size and their effect on the firms' interactions with the state. It analysed the types of "services" for which firms paid bribes and provided a perspective on the "costs" and "benefits" of corruption. The BEEPS survey results are directly relevant to the Arab world.

The impact of corruption on human development in the Arab world has been analysed by the Lebanese Transparency Association and the Fares Foundation in a paper published in 2006. This study highlighted the effects of corruption on political legitimacy in the Arab world. Although the impact of corruption varies across countries, it is clear that corruption increases the risk of state capture in the Arab world and beyond, as evidenced by the experience of many Eastern European countries before their transition to a market economy model.

At the very extreme, the state can become captured in large-scale corruption whereby firms and individuals shape the laws and regulations to their own advantage by providing illicit private gains to public officials (Hellman and Kaufmann, 2001). State capture is naturally a manifestation of poor public sector governance and can have a significant impact on how SOEs are operated, reformed or privatised. Rather than directly address SOE governance issues, a number of MENA countries followed the wave of privatisation that swept many European countries during the past 20 or so years — without, however, putting into place safeguards for competition or establishing a regulatory framework for privatised entities. A number of governments in the region have recently come under heavy public criticism as evidence of assets being sold significantly below market value to government insiders and related parties has emerged.

SOE sector reform

Privatisation outcomes

Between 2000 and 2008, the MENA region raised some USD 29.8 billion from 136 privatisation transactions, representing 6.6% of the total receipts by developing countries. In 2008 alone, Egyptian privatisation proceeds nearly tripled to USD 926 million due to sales of a mobile license, several manufacturing companies and government stakes in 17 joint ventures. Tunisian proceeds from privatisations increased from USD 61 million in 2007 to USD 480 million in 2008, most of it from partial share sales in three financial companies. Other countries including Algeria, Iraq, Jordan, Lebanon, Libya, Morocco, Oman, Yemen and Syria, have conducted some privatisation activity during this period.[3]

However, the potential benefits of privatisation appear to have been diluted by an absence of transparency in the privatisation process: often, the main beneficiaries were close to the incumbent regimes, notably in Egypt and Tunisia. Private monopolies or oligopolies replaced state monopolies, defeating the purported efficiency objectives of privatisation and the potential corporate

governance benefits. The absence of competition/anti-trust frameworks and enforcement has resulted in growing crony capitalism and has led to a widely shared perception in the MENA region that privatisation has been a failure.

There are two important consequences of this perception. First, policy makers in the region will from now on consider privatisation as a high-risk policy reform. Second, some international financial institutions viewed as being proponents of privatisation and related reforms might suffer reputational damage and face credibility issues in assisting the transition and transformational processes, particularly when it comes to SOE sector reform. That said, it is important to keep in mind that privatisation is not the only policy option on the table.

The MENA region offers alternative, successful models of SOE governance. There are “islands of efficiency” in SOE governance, typically found in the Gulf States (Hertog, 2010). For example, SABIC, Saudi Aramco, Dubal and Emirates Airlines are successful and profitable state-owned enterprises. Although the availability of oil and natural gas wealth makes cross-country comparisons difficult, these examples highlight the importance of SOEs' having clear mandates as well as a professional management that is autonomous in its daily operations and insulated from political and bureaucratic predation.

Clearly, there is no "one size fits all" solution with respect to corporate governance of MENA SOEs, but the cross-country variation in SOE performance outcomes raises the question: why are some countries more successful than in others in governing their SOEs? Steffen Hertog argues that a combination of two factors explains the solid performance of some Gulf-based SOEs, namely the absence of a populist-mobilisational history and substantive regime autonomy in economic policy making. Indeed, the Gulf Co-operation Council (GCC) countries have small populations with tribal cultures not prone to populism.

Despite the apparent success of these non-conventional models of governance, some internationally accepted guidelines and good practices are relevant to further enhance the governance of MENA SOEs. MENA countries should consider developing and implementing national corporate governance codes or guidelines for their SOEs, based on the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* as well as other relevant instruments and experiences. A number of MENA and OECD countries have introduced codes specifically targeted at SOEs. Egypt was the first in the region to develop and implement a corporate governance code for its SOEs in 2006.

More recently Morocco has developed a code on corporate governance of SOEs and is moving towards its implementation.

Codes and guidelines in countries outside the region can serve as an inspiration for further initiatives in this area. Examples of relevant guidelines and reports include the Netherlands Code for Good Public Governance - Principles of Proper Public Administration (2009), the South African Protocol on Corporate Governance in the Public Sector (2002), IFAC's Public Sector Committee's study on Governance in the Public Sector (2001), and the UK Audit Commission for Local Authorities report on Corporate Governance (2003).

The ownership policy

One of the most fundamental challenges to advancing corporate governance frameworks for SOEs relates to the scattering of ownership among different ministries and government entities. Table 2.2 shows that a significant majority of SOEs surveyed by Hawkamah and IFC in 2008 responded that they were owned directly by a federal or municipal entity. Only 19% of the respondents indicated that they were owned by a central national unit acting as an ownership entity. This is arguably inconsistent with good practice, which increasingly calls for the centralisation of the ownership function or, at the minimum, for its co-ordination.

Table 2.2. Ownership frameworks in the MENA region

Who owns your company?						
	TOTAL		TYPE			
			BANKS		LISTED COMPANY	
	N	%	N	%	N	%
A central ownership entity	4	19.0%	2	16.7%	2	22.2%
Federal/ municipal entity	14	66.7%	9	75.0%	5	55.6%
Another state-owned company/bank	3	14.3%	1	8.3%	2	22.2%
TOTAL	21	100.0%	12	100.0%	9	100.0%

Source: IFC-Hawkamah, 2008.

The absence of a common framework for SOE ownership and governance, and the absence of centralised monitoring and reporting, results in limited and diffused oversight of SOEs. SOE management often has to negotiate with

several principals, impairing clear accountability, skewing incentive structures and resulting in an absence of a well-defined corporate strategy. In this context, SOE managers and bureaucrats can use their pivotal positions to maximise their own budgets and exercise unjustified discretion in hiring decisions.

Essential to ensuring accountability and efficiency of SOEs is the development and disclosure of an ownership policy. Clear and published ownership policies provide a framework for prioritising SOEs' objectives and are instrumental in limiting the pitfalls of either passive ownership or excessive intervention in management of SOEs. Few countries in the MENA region have a clear ownership policy, much less a published one. In MENA countries that have ownership policies, they are typically embodied in Prime Ministerial Circulars, Royal Decrees and other laws that specify financial control of the state over SOEs.

Ownership policies should spell out expectations of SOE performance, including for companies not operating with commercial objectives and that can therefore be structured in a different legal form. When possible, SOEs should have the same legal form and be subject to the same legal framework as their private sector counterparts. Among other policy objectives, this can help reinforce competition between SOEs and their private sector competitors with a view to ensure a level playing field between them. At present, SOEs in a number of MENA countries continue to benefit from advantages not afforded to private sector companies, and the competition authorities have in many cases not been able to address this challenge.

SOE objectives

The diffuse ownership structures prevalent in most MENA countries lead to a lack of clarity in SOE objectives. When the objectives of the firm are ambiguous or conflicting, managers have substantial discretion to run the firm effectively in their own interest. Governments, as owners of SOEs, may also abuse the discretion that comes with weakly defined objectives, interfering in SOEs' operations for political gains. Experience shows that the state should explicitly define SOEs' objectives to allow for greater political autonomy, provide clarity for management and allow for improved monitoring.

The objectives of SOEs should be as explicit as possible. SOEs may have additional non-commercial objectives, many of which may be explicit; others may be implicit but no less important in practice. In practice, MENA SOEs are often not compensated for their exercise of various social mandates. Typically, no clear link exists between transfers or subsidies that SOEs receive and their

various non-commercial objectives. To ensure efficient use of state resources, maximising enterprise value should be considered as the primary objective for commercially oriented SOEs. Emirates Airlines and Dubal are two examples of companies run on a competitive, commercial basis with the aim of maximising shareholder value.

Clear objectives are difficult to set when ownership and regulatory functions are not separated, as recommended by the *OECD Guidelines*. In the MENA region – with the partial exception of the telecommunications sector — the exercise of state ownership rights is not separated from regulatory functions. One way to address this issue is to establish a single dedicated ownership entity, such as a specialized ministry, agency or holding company for all SOEs – as has been done in Bahrain with the creation of the Mumtalakat Holding Company. Once the ownership is centralised, separate bodies can perform regulatory functions, with sufficient legal independence from the general government. Alternatively, different portfolio holding companies can be established, separating, for example, financial and non-financial SOEs.

Reforming SOE boards

At the very heart of ongoing discussions of corporate governance of state-owned enterprises is the structure and operation of SOE boards. The board is particularly important because SOEs are often subject to specific agency problems. To complicate matters, many SOEs operate in non-competitive industries and are therefore not subject to market pressures and oversight. In the MENA region, specific governance challenges affecting SOE boards include conflicts in reconciling competing social and commercial objectives, opaque nomination procedures for directors and senior managers, and competing ownership interests among government agencies.

In order to be effective, SOE boards must have the power to exercise their own judgement and should be given responsibility for strategic decisions, including major investments and choice of senior management. A certain level of board independence is required if SOE boards are to fulfil their functions. Research shows that the best SOE boards focus heavily on performance management and meet regularly with government owners to shape joint strategy (Institute of Government, 2010).

In addition to independence, SOE boards should also have an appropriate balance of competencies. Directors should have a strong command of the strategic issues in the sector where the company operates. The competence of board members is best assured through a structured and transparent nomination

process. In practice, nomination processes for board posts in the region are often based on criteria other than competence. The Hawkamah-IFC survey (2008) noted that 62% of the respondents surveyed believe that being a high-profile public officer remains a primary criterion for nominating a director to the board of an SOE; 52% of the respondents said that competency and skills are secondary requirements.

Oversight by state audit institutions

The state, as the owner of SOEs, needs to ensure that good corporate governance practices are embraced by companies in practice and do not simply stay in the realm of guidance or policies on the books. State audit institutions (SAIs) have an important role to play in the promotion of good governance practices in SOEs. Traditionally, the role of state audit bodies has been limited to ensuing financial probity. Recent years have seen the expansion of SAIs' powers, including in oversight of SOEs. This is consistent with the role of these institutions as guardians of public assets. The role of SAIs can go beyond the traditional boundaries of financial audit and should be extended to examining the corporate governance arrangements of SOEs.

The Hawkamah Institute has reached out to a number of SAIs in the region to help them incorporate corporate governance in their audit framework. We note, for example, that Omani, Moroccan and Emirates SAIs have already extended the remit of their audits beyond the financial performance of SOEs. The Moroccan SAI publishes a detailed annual report on its findings, including on board meetings, qualifications of board of directors and other relevant matters. A similar arrangement exists in Oman, whereby the state audit body reviews the governance practices of SOEs, in addition to the assurances provided by external auditors on the implementation of the corporate governance code (applicable to all listed companies).

Further adoption of internal best practices in this area would be useful. For example, the International Organisation of Supreme Audit Institutions (INTOSAI) in May 2010 issued recommendations on strengthening external public auditing. Hawkamah strongly endorses INTOSAI’s recommendations, especially the suggestion to include audits of corporate governance frameworks of SOEs in SAIs' audit plans. To develop this in practice, Hawkamah engaged with the SAI of the United Arab Emirates to expand the latter's role to include performance auditing.

Sovereign wealth funds

It is impossible to consider how to promote good governance of SOEs in the region without addressing the practices of sovereign wealth funds (SWFs). Although SWFs have existed for decades, they have been the subject of growing attention, and sometimes criticism, over the past five years. This has coincided with the growing role of these entities in the global economy as well as their investment in a variety of high profile international companies. The value of combined global assets held by SWFs – led by strong expansion of commodity-backed SWFs – is estimated to have exceeded USD 4.66 trillion in June 2011. With their growing assets, SWFs have invested not only domestically, but also abroad, in both developed and emerging markets, triggering some investment protectionism.

The protectionism spurred a debate focused on the transparency and governance of these vehicles. To address these concerns, the International Working Group of Sovereign Wealth Funds (IWG), with support from the International Monetary Fund (IMF) acting as a secretariat, published the *Generally Accepted Principles & Practices for SWFs* in October 2008. These guidelines consist of a set of 24 principles commonly known as the *Santiago Principles*. As can be seen in Table 2.3, Asian and European SWFs are judged to be more compliant in terms of disclosure and transparency than Middle Eastern ones according to the Linaburg-Maduell Transparency Index.[4] That said, the Abu Dhabi-based Mubadala has performed very well in this ranking.

The overall results of this ranking attest to the fact that typically SWFs remain largely exempt from public scrutiny and oversight mechanisms that may apply to SOEs. This is important for their own governance processes, but also because the governance impact of their investments in a range of private and state-owned companies has not been analysed. This is a significant gap because many SWFs in Gulf countries play an important role in the domestic economy and, if not governed properly, can present a systemic risk in the same way that large financial sector players have done in Europe and the United States.

Table 2.3. Sovereign Wealth Fund Rankings

Country	Fund name	Assets $Billion	Inception	Origin	Linaburg-Maduell Transparency Index
UAE – Abu Dhabi	Abu Dhabi Investment Authority	$627	1976	Oil	4
China	SAFE Investment Company	$567.9	1997	Non-Commodity	2
Norway	Government Pension Fund – Global	$560	1990	Oil	10
Saudi Arabia	SAMA Foreign Holdings	$472.5	n/a	Oil	4
China	China Investment Corporation	$409.6	2007	Non-Commodity	7
Kuwait	Kuwait Investment Authority	$296	1953	Oil	6
China-Hong Kong	Hong Kong Monetary Authority Investment Portfolio	$293.3	1993	Non-Commodity	8
Singapore	Government of Singapore Investment Corporation	$247.5	1981	Non-Commodity	6
Singapore	Temasek Holdings	$157.2	1974	Non-Commodity	10
China	National Social Security Fund	$134.5	2000	Non-Commodity	5
Russia	National Welfare Fund	$113.9	2008	Oil	5
Qatar	Qatar Investment Authority	$85	2005	Oil	5
Australia	Australian Future Fund	$73	2004	Non-Commodity	10
UAE – Dubai	Investment Corporation of Dubai	$70	2006	Oil	4
Libya	Libyan Investment Authority	$65	2006	Oil	2
UAE – Abu Dhabi	International Petroleum Investment Company	$58	1984	Oil	3
Algeria	Revenue Regulation Fund	$56.7	2000	Oil	1
South Korea	Korea Investment Corporation	$43	2005	Non-Commodity	9
US – Alaska	Alaska Permanent Fund	$40.3	1976	Oil	10
Kazakhstan	Kazakhstan National Fund	$38.6	2000	Oil	6
Malaysia	Khazanah Nasional	$36.8	1993	Non-Commodity	5
Azerbaijan	State Oil Fund	$30.2	1999	Oil	10
Ireland	National Pensions Reserve Fund	$30	2001	Non-Commodity	10

Country	Fund name	Assets $Billion	Inception	Origin	Linaburg-Maduell Transparency Index
Brunei	Brunei Investment Agency	$30	1983	Oil	1
France	Strategic Investment Fund	$28	2008	Non-Commodity	n/a
UAE – Abu Dhabi	Mubadala Development Company	$27.1	2002	Oil	10
US – Texas	Texas Permanent School Fund	$24.4	1854	Oil & Other	n/a
Iran	Oil Stabilisation Fund	$23	1999	Oil	1
Chile	Social and Economic Stabilization Fund	$21.8	1985	Copper	10
Canada	Alberta's Heritage Fund	$15.1	1976	Oil	9
US – New Mexico	New Mexico State Investment Council	$14.3	1958	Non-Commodity	9
New Zealand	New Zealand Superannuation Fund	$13.5	2003	Non-Commodity	10
Brazil	Sovereign Fund of Brazil	$11.3	2008	Non-Commodity	n/a
Bahrain	Mumtalakat Holding Company	$9.1	2006	Non-Commodity	9
Oman	State General Reserve Fund	$8.2	1980	Oil & Gas	1
Botswana	Pula Fund	$6.9	1994	Diamonds & Minerals	6
East Timor	Timor-Leste Petroleum Fund	$6.3	2005	Oil & Gas	6
Mexico	Oil Revenues Stabilization Fund of Mexico	$6.0	2000	Oil	n/a
Saudi Arabia	Public Investment Fund	$5.3	2008	Oil	4
China	China-Africa Development Fund	$5.0	2007	Non-Commodity	4
US – Wyoming	Permanent Wyoming Mineral Trust Fund	$4.7	1974	Minerals	9
Trinidad & Tobago	Heritage and Stabilization Fund	$2.9	2000	Oil	8
US – Alabama	Alabama Trust Fund	$2.5	1985	Oil & Gas	n/a
Italy	Italian Strategic Fund	$1.4	2011	Non-Commodity	n/a
UAE – Ras Al Khaimah	RAK Investment Authority	$1.2	2005	Oil	3
Nigeria	Nigerian Sovereign Investment Authority	$1	2011	Oil	n/a
Venezuela	FEM	$0.8	1998	Oil	1
Vietnam	State Capital Investment Corporation	$0.5	2006	Non-Commodity	4
Kiribati	Revenue	$0.4	1956	Phosphates	1

Country	Fund name	Assets $Billion	Inception	Origin	Linaburg-Maduell Transparency Index
	Equalization Reserve Fund				
Gabon	Gabon Sovereign Wealth Fund	$0.4	1998	Oil	n/a
Indonesia	Government Investment Unit	$0.3	2006	Non-Commodity	n/a
Mauritania	National Fund for Hydrocarbon Reserves	$0.3	2006	Oil & Gas	1
US – North Dakota	North Dakota Legacy Fund	$0.1	2011	Oil & Gas	n/a
Equatorial Guinea	Fund for Future Generations	$0.08	2002	Oil	n/a
UAE – Federal	Emirates Investment Authority	n/a	2007	Oil	2
Oman	Oman Investment Fund	n/a	2006	Oil	n/a
UAE – Abu Dhabi	Abu Dhabi Investment Council	n/a	2007	Oil	n/a
Papua New Guinea	Papua New Guinea Sovereign Wealth Fund	n/a	2011	Gas	n/a
Mongolia	Fiscal Stability Fund	n/a	2011	Mining	n/a
	Total Oil & Gas Related	$2 667.9			
	Total Other	$2 110.0			
	TOTAL	**$4 777.9**			

Source: Sovereign Wealth Funds Institute, December 2011 rankings.

In addition to preserving the wealth of GCC countries for future generations, SWFs underpin government creditworthiness, serving as a buffer against fiscal shocks and helping to generate revenues that are not dependent on natural resource prices. SWFs therefore need to act as responsible stewards of domestic wealth, and this role has to be formalised and clearly mandated. The introduction of stewardship codes is a relevant development and MENA SWFs, as well as other institutional investors, may benefit from adopting similar instruments. The experience of the UK with its Stewardship Code issued in July 2010 may be instructive for MENA countries wishing to introduce governance principles for institutional investors. In addition, the *Santiago Principles* might be further elaborated to give explicit support to existing stewardship codes.

Recommendations

Strengthening corporate governance of SOEs is an integral component of improving the overall public governance in the MENA region. Recent developments have highlighted the importance of building institutions and regulatory frameworks to reinforce corporate governance of SOEs. Establishing good governance of SOEs is an important part of structural reforms that need to the undertaken in the Arab world.

SOEs are, so to speak, "where the rubber hits the road" for citizens: where good governance can translate into efficiently-run enterprises delivering high quality goods and services on a competitive and non-discriminatory basis to citizens, businesses and other stakeholders. This chapter has made a number of recommendations, which can be summarised as follows:

- MENA countries should consider developing and implementing corporate governance standards for their SOEs. Privatisation is not the only answer to SOE sector reform.

- Defining the legal and ownership structure and objectives of SOEs is crucial. Explicitly defining SOE objectives allows for greater political autonomy, provides clarity for management and facilitates better monitoring of performance.

- There should be a clear separation of ownership from regulatory functions. This ensures a level playing field with the private sector and provides a healthy environment for competition.

- The ownership entities should be held accountable and therefore must report on the overall performance of SOEs to bodies representing the interests of the general public.

- The mandate of state audit institutions should be expanded to include audits of the corporate governance organs and practices of SOEs. SAIs should, where possible, make reference to national corporate governance principles in their review of individual SOEs.

- While the *Santiago Principles* are important in improving transparency and disclosure, they should be supplemented by national stewardship codes clearly setting out the mandate and responsibilities of SWFs as investors.

Finally, the economic and social transformation in the Middle East and North Africa has been nudged forward by the "Arab Spring" or the "Arab Firestorm". Reform of SOE sectors in the region is part and parcel of this transformation. The Hawkamah Institute will continue supporting the efforts of governments and enterprises to transform the governance frameworks and practices of state-owned enterprises.

Notes

1. See Nasser Saidi, "How Europe should douse the Arab firestorm", Europe's World, June 2011.
2. The World Bank, World Bank Institute Governance, Regulation and Finance and European Bank for Reconstruction and Development, Chief Economist's Office, "*Measuring Governance, Corruption, and State Capture: How Firms and Bureaucrats Shape the Business Environment in Transition Economies"* (April 2000).
3. The World Bank Privatisation Database, 2000-2008.
4. The Linaburg-Maduell Transparency Index was developed by the Sovereign Wealth Fund Institute and is a method of rating transparency in respect to sovereign wealth funds. This index is based on 10 essential principles that depict sovereign-wealth-fund transparency to the public. For additional information, see www.swfinstitute.org/tag/linaburg-maduell-transparency-index.

Bibliography

Arab Republic of Egypt, Ministry of Investment (2006), *The Code of Corporate Governance for the Public Enterprise Sector.*

Behrendt, Sven (2011), "Sovereign Wealth Funds and their Commitment to the Santiago Principles", *Geo Economica Political Risk Management*.

Bouton, Daniel (2002), "Promoting Better Corporate Governance in Listed Companies", Proceedings of a press conference.

Commonwealth of Australia (2003), *Review of the Corporate Governance of Statutory Authorities and Office Holders*.

Department of Public Enterprises (2002), *Protocol on Corporate Governance in the Public Sector*, Department of Public Enterprises, South Africa.

Economic and Social Commission for Western Asia (2008), "Foreign direct investment report", Presented in September to the United Nations.

Hawkamah and IFC (2008), *A Corporate Governance Survey of Listed Companies and Banks Across MENA.*

Hellman, Joel and Daniel Kaufmann (2001), *Confronting the Challenge of State Capture in Transition Economies.*

Hertog, Steffen (2010), "Defying the Resource Curse: Explaining Successful State-Owned Enterprises in Rentier States", *World Politics*, Issue 62.

INTOSAI (2010), "Conclusions and Recommendations", Conference on Strengthening External Public Auditing in INTOSAI regions, Vienna.

Lang Peter and Jan Lucassen, eds. (2008), *International and Comparative Social History, Global Labour History: A State of the Art*.

Lebanese Transparency Association and the Fares Foundation (2006), *The Impact of Corruption on Human Development in the Arab World.*

Linaburg, Carl and Michael Maduell (2011), *Linaburg-Maduell-Transparency-Index*, SWF Institute.

Lixin Colin Xu, Tian Zhu and Yi-min Lin (2001), *Politician Control, Agency Problems and Firm Performance: Evidence from a National Survey of Ownership Restructuring in China.*

Menozzi, Anna and Urtiaga María Gutiérrez (2005), *Board composition and performance in State-Owned Enterprises: Evidence from the Italian public utilities sector.*

Nadal, Nick (2010), "Stocktaking Report on Corporate Governance Practices of MENA SOEs", Presentation to the OECD Taskforce on Corporate Governance of State-Owned Enterprises.

Parker, Simon et al. (2010), *Shaping Up: A Whitehall For the Future,* Institute for Government, UK, Second edition.

Saidi, Nasser (2011), "How Europe should douse the Arab firestorm", *Europe's World*, June issue.

Saidi, Nasser and Fabio Scacciavillani (2011), "SWFs and the Ascent of Emerging Market Economies in Sovereign Asset Management for a Post Crisis World", *Central Banking Publications Series*.

Talbi, Abdelaziz (2010), "Corporate Governance of State-Owned Enterprises (SOEs) in Morocco", Presentation.

The Netherlands Code for Good Public Governance (2009), *Principles of Proper Public Administration.*

The World Bank Privatisation Database, 2000-2008.

The World Bank and the EBRD (2000), *Measuring Governance, Corruption, and State Capture. How Firms and Bureaucrats Shape the Business Environment in Transition Economies.*

UK Audit Commission for Local Authorities (2003), *Corporate governance: Improvement and Trust in Local Public Services.*

Chapter 3

How the GCC did it: formal and informal governance of successful public enterprise in the Gulf Co-operation Council countries

by

Steffen Hertog
Lecturer, the London School of Economics and Political Science

Like state apparatuses in the rest of the Middle East and North Africa, Gulf bureaucracies are not known as paragons of lean administration. This chapter explores the emergence of important "pockets of efficiency" in Gulf Co-operation Council countries' public sectors, namely in state-owned enterprises such as Saudi Aramco, Etisalat and others. In so doing, this analysis seeks to demonstrate that the success of Gulf-based state-owned enterprises can, to an extent, be explained by their adherence to some good corporate governance practices, but also to highlight that the way these principles have been implemented is often quite different than in other jurisdictions. Finally, this chapter seeks to isolate the elements that have contributed to the success of the state-owned enterprises and explore how these lessons can be extrapolated to other MENA jurisdictions.

Introduction

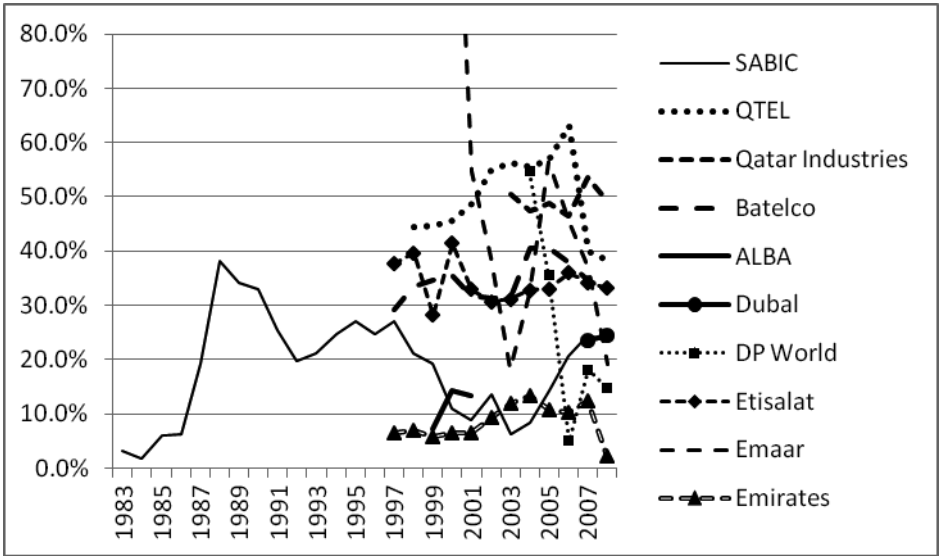
In the first chapter in this volume, Alissa Amico points out that 32 of the top 100 listed companies in the Middle East and North Africa (MENA) region are state-owned enterprises (SOEs). A full 29 of these are based in the Gulf Co-operation Council (GCC). To the extent that successful listings represent a vote of confidence in majority state-owned companies, GCC companies appear far ahead of the game in the region.

The size and prominence of Gulf SOEs can be explained by the availability of large capital surpluses that have made it easier to establish and maintain public enterprise. But there is also a genuinely different perception of public industries in the Gulf, many of which are seen as the best run national companies and the most attractive employers. In a poll that Ernst & Young conducted in 24 countries in 2010, 86% of Saudis agreed that big industry should remain in government hands – more than in any other country. Saudis also topped the list in agreeing that SOEs deliver better services and that SOE managers were better than their counterparts in the private sector (Ernst &Young, 2010).

Although the Gulf has seen its share of white elephants and failed investments, in comparison with the wider region and the developing world in general, the region stands out in having produced a number of profitable and, by most accounts, well-run public enterprises in a number of strategic industries. Players like the Saudi Basic Industries Corporation (SABIC), Emirates Airlines, Dubal and Etisalat have managed to make their mark not only domestically, but also in international product and service markets.

Figure 3.1 below provides a historical overview of the profit margins of some large Gulf-based SOEs.

Figure 3.1. Profit margins of successful Gulf SOEs



Notes:
1. Figure demonstrates operating margins as opposed to return on equity.
2. Series start in early 1980s to demonstrate SABIC's long-term track record.
3. In early 2000, Emaar was endowed with land grants, so the company had large initial profits on small operating expenditures in early years.
Source: Company reports, Markaz Financial Center, Kuwait.

Like state apparatuses in the rest of the MENA region, Gulf bureaucracies at large are not known as paragons of lean administration. What, then, explains the emergence of important "pockets of efficiency" (Evans, 1989; Geddes, 1996) in the GCC public sectors that seem to contrast with the struggling SOEs in many other Arab countries?

This chapter will show that the success of Gulf SOEs is explained by an adherence to some of the good practices of SOE governance as laid out by the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (OECD, 2005). The way these principles have been implemented is, however, often quite different from the specific governance mechanisms recommended by the OECD.

Absence of conventional governance mechanisms

In line with OECD principles, successful Gulf SOEs are insulated from politics and operate with clear mandates. Lines of command are clear, and most of the successful public enterprises are protected from the kinds of bureaucratic

interventions into operational management that have brought public sectors to their knees in other MENA countries.

The way that political insulation and performance orientation are guaranteed often has little to do with specific OECD recommendations such as the formal centralisation of ownership, an explicit ownership policy, the creation of independent boards or comprehensive disclosure requirements. Instead, insulation and performance incentives are generated on the basis of informal political patronage by senior regime players and the creation of regulatory enclaves and privileges that exist in parallel to the rest of the state apparatus.

The Gulf SOE model based on privileged "pockets of efficiency" has in some cases run its course, as the once underdeveloped private sector has caught up with public industry, and as separate regulatory regimes, as well as legal and financial privileges, have lost their developmental justification. In these cases, the GCC faces the challenge of transitioning to a more inclusive (and conventional) regulatory model in which all players, no matter their ownership structure, operate under the same rules. In several important cases, however, SOEs still act as trailblazers, developing infrastructure and business models that would never come into being without state intervention.

Parts of the Gulf SOE model are not readily exportable to other MENA countries, as the political conditions for the emergence of "pockets of efficiency" cannot be readily created through regulatory fiat. Nonetheless, the GCC holds some general lessons about the conditions under which effective public enterprise in MENA can thrive – conditions that are in large part analogous, but not necessarily identical, to the OECD's recommendations.

The GCC SOE story shows that the absence of conventional corporate governance mechanisms does not preclude good SOE performance or political accountability while, conversely, the formal presence of such mechanisms does not guarantee good performance. Sometimes informal politics and ingenuous incentive setting are as important as formal governance structures. It is generally accepted that in the long run, all SOEs should be centrally owned, publicly listed, independently regulated and supervised by independent boards. In the short- to medium term, however, much of this might not be politically feasible or, perhaps worse, could be implemented in a perfunctory way.

Every SOE's circumstances are unique, and the politically feasible solutions to achieve insulation and performance orientation will not be the same in all instances. In many cases, a pragmatic mixture will need to be found

between ideal principles derived from SOE governance in highly developed markets, and rules of thumb that take account of the informal nature and institutional imperfections of emerging markets in MENA.

A level playing field – but who wants to play?

The one area in which successful GCC SOEs deviate from the OECD rulebook even on the level of principle is that of the level playing field. Players like SABIC, Industries Qatar, Emirates or Emaar have benefitted from not only large initial capital injections, but also continued concessionary loans from the government, the provision of dedicated infrastructure and -- in the case of heavy industry -- privileged access to cheap feedstock.

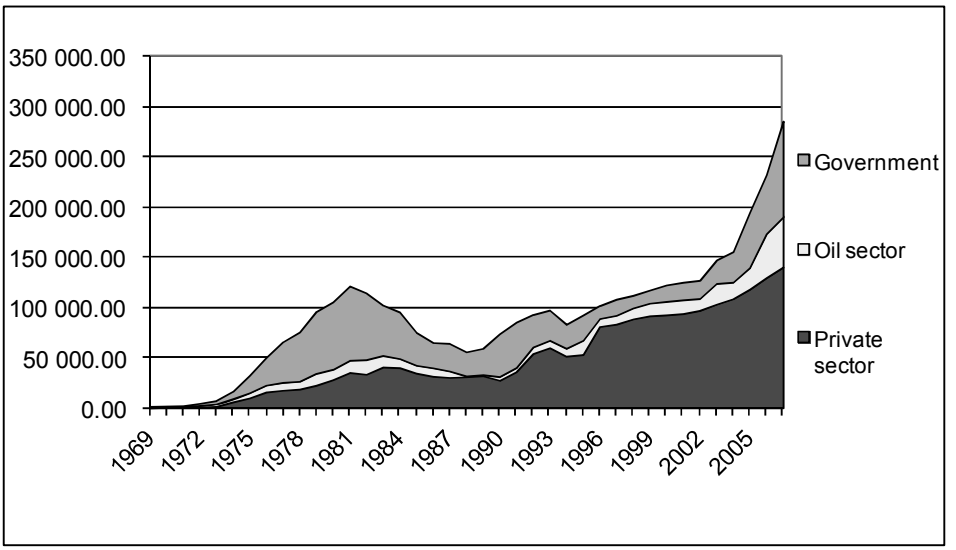
While this has become problematic in some cases, it was arguably a historical necessity to get new industries off the ground in the GCC. There would quite likely be no private aviation in the GCC had Emirates not shown that in principle this sector can be profitable, and no chemicals sector in Saudi Arabia had SABIC not shown the viability of heavy industry in the Arabian desert. Most breakthroughs into new sectors were led by public players, be it in heavy industry, aviation, international real estate, logistics or telecoms.

In contrast to most other countries in the world, GCC states are endowed with surplus capital, both financial and natural, that they need to put to productive use. Figure 3.2. below shows how capital formation in Saudi Arabia was almost by necessity dominated by government until the mid-1980s. Developing new sectors through privileged public enterprises has been a useful strategy for strategically injecting surplus public capital into a growing and diversifying local economy.

The GCC – like the wider MENA region – also remains in a different phase of economic development than leading Western economies, with a private sector that is less capable of leading diversification. Which tool(s) should be used to stimulate diversification depends on a country's specific circumstances and the sector at hand, but in the GCC public enterprise has repeatedly proved to be a powerful instrument in the process.

In terms of scale, planning capacity, time horizon, infrastructure investment and bargaining power with international counterparts, the public sector has often had a strategic advantage over private players. Arguably no private Saudi group could have negotiated the world-scale petrochemical joint ventures that SABIC set up with international partners in the late 1970s and early 1980s.

Figure 3.2. Saudi gross fixed capital formation since 1969 (SAR mil)



Source: Data from the Saudi Arabian Monetary Agency.

Private investors have shown that they are good followers, and despite inevitable tensions, the liberal economic environment in the GCC has generally allowed them to move into new sectors in the wake of SOEs. But private companies often wait for public industry to demonstrate what is feasible.

Conditions differ strongly from sector to sector, of course. In some, scale and long-term planning are more important than in others, notably in heavy industry, logistics and network-based industries. In network-based industries in particular, it has proved advisable to maintain public rather than private monopolies. Especially in emerging markets, SOEs tend to be easier to regulate and control in terms of their developmental and social mandates than the private sector at large.

In other sectors like hospitality and real estate, commerce and distribution, finance, light manufacturing or road transport, there is less of a justification for large-scale state investment. With some exceptions (notably in finance, hospitality, real estate and road transport), GCC governments have largely abstained from creating SOEs in these areas, leaving ample opportunities for local merchant families. These sectors were never subject to the waves of nationalisations that other Arab states witnessed in the 1950s and 1960s and that created public holdings in sectors that had seen vibrant private development in the pre-revolutionary era (Springborg, 1993).

In the GCC, by contrast, "level playing field" was an irrelevant concept in areas that simply did not exist before states started investing there. Treating public enterprises and private investors the same in Gulf heavy industry or aviation in the early phase would arguably have stunted strategic development, leading to either misallocation or non-allocation of capital.

The legacy of state-led diversification is a set of impressive, but often privileged, SOEs whose relationship to a maturing private sector can be tense. Yet this outcome appears preferable to a counterfactual one in which new sectors would likely not have been developed at all. SABIC is in conflict with large local industrialists over feedstock access and local sales of bulk petrochemicals – but there probably would not be any private heavy industry players of note without SABIC's historical role as the sector's handmaiden.

In some new industries such as aerospace or energy technology, and in certain fields of infrastructure and transport, state leadership still appears justified. The challenge in more mature sectors, however, is to move to a next stage of development where SOE capacities are preserved, but where private investors have the same access to inputs and infrastructure, and have the same regulatory status. This stage has probably been reached in Saudi heavy industry as well as in the regional banking and telecoms sectors.

It is in such mature sectors with substantial private capacity that some of the *SOE Guidelines* become relevant, in particular the recommendations on independent sectoral regulators, on clear competition policy and a transparent ownership policy for state assets. Much of this has been achieved in the Gulf telecoms sector, whereas the track record in banking is mixed. In the Saudi heavy industry sector – the only one where there is world-scale investment by private local investors – the situation remains complicated. SABIC seems to resist pressure for further privatisation or equal feedstock access for private investors through joint ventures with local investors: an imperfect situation perhaps, but still vastly preferable to the state of heavy industry in many other OPEC countries, which is both monopolistic and loss-making.

The institutional context of GCC SOEs: governed well without good governance?

The fact that only government entities have the resources and will to invest in specific activities does not mean that the investments will be made well. SOEs can easily get trapped in a perennial "infant industries" circuit of protection, operate at a loss due to "soft budget constraints" (Kornai, 1979), or become tools of patronage or be immobilised by conflicts among their political

principals. The broader political context of GCC regimes, as well as the specific institutional framework chosen for new SOEs, explains why in a number of large and important cases this did not happen:

- SOEs have an arm's length relationship to the administration at large. Companies like SABIC, Saudi Aramco, Abu Dhabi's Mubadala or Emirates Airlines are not under the regulatory purview of sectoral ministries, or they enjoy high de facto autonomy from these ministries.

- Executives are usually handpicked by the political leadership, to whom they have direct and privileged access. While chairs of boards are often ruling family members, executives usually are highly skilled "commoner" technocrats.

- The highest level principals accord SOEs political protection against interference by other political players.

- Levels of corruption are generally lower than in the rest of the state apparatus. Corruption is more harshly prosecuted by political principals and incentives for it are weaker thanks to competitive hiring and remuneration.

- SOEs are autonomous in their recruitment and have separate salary and staffing systems that enable them to attract top national talent. These structures are often deliberately set up in contrast to more rigid, less meritocratic (and usually less remunerative) public service employment.

- SOE budgets and capital resources are protected through generous initial capital endowments and through financial autonomy (i.e. SOEs are taxed only on their net revenue and can expand through both retained profits and conventional corporate finance, both in theory and practice).

Some of these structures and practices are informal and difficult to re-create through formal legal instruments. They can come into being thanks to a leadership that is fairly autonomous in its allocation decisions and to the absence of the populist economic ideology that has made public industry a tool of social engineering and patronage in some other developing countries (Hertog, 2010a). Neither of these two background factors can be influenced easily by policy decisions.

Some of the aforementioned privileges now undermine a level playing field with private players, but they were necessary initial conditions for building insulated, efficient structures in an otherwise often mediocre administrative environment. Dag Detter (2009) points out that "political insulation" is one pre-condition of SOE efficiency. While in the OECD context, this is achieved through separate regulators, the concentration of ownership in a central agency and other formal accountability mechanisms, in the GCC countries institutional insulation is a result of a top-down decision to establish structures separate from the rest of the civil service and its administrative culture.

Accountability, however, is almost exclusively to the top, not to a broader public or an independent regulator, and formal ownership is often fragmented among different government entities. Vertical accountability is particularly easy to orchestrate in political systems where other, horizontally organised interests in state and society are weak, as is the case in most GCC countries.

Such centralisation (and often personalisation) meets its limits when regulatory tasks become more complex, but it can be an important substitute for formal regulation and accountability mechanisms when the state apparatus at large is not sufficiently equipped for such tasks. Top-down control can also lend itself to abuse, but this is remarkably limited in the Gulf SOE sector compared with public sectors in many other centralised states. Rent seeking, for example, happens mostly in other fields.

Legal status and regulation: measured privilege

That being said, the formal and legal structures of Gulf SOEs do evince some characteristics of Western corporate practices, mixed with local institutional traditions to produce a fairly distinctive hybrid. For instance, successful Gulf SOEs are all incorporated as companies. None of them is a public agency, as many of the traditional SOEs in Arab countries have been (and still are) in Iraq or Yemen. Their senior management is structured very similarly to those of major Western companies, their accounts are usually audited by international auditing firms (though not always published), and their financial management and corporate finance practices broadly follow international standards.

At the same time, they are not just large and autonomously managed companies that happen to be state-owned. Many of them are statutory corporations established through presidential decrees or other special statutes that give them a particular mandate and/or privileges, including that of not being regulated by line agencies like local ministries of commerce, industry,

labour, or electricity and water. Saudi Aramco had the particular extraterritorial privilege of being incorporated in Delaware until 1988, eight years after it had been fully nationalised by the Saudi government (Hertog, 2008). Publicly listed SOEs in the UAE are exempt from the country's corporate governance code for listed companies, to some extent moving them beyond the purview of the country's capital markets regulator, the Emirates Commodities and Securities Authority (see Chapter 1 in this volume).

SOEs often have access to separate infrastructure and public service providers, and to the extent that they are subject to dedicated regulators, these often function as specialised support agencies rather than enforcers of competition or transparency. For instance, in the mid-1970s, the Royal Commission for the Industrial Cities of Jubail and Yanbu in Saudi Arabia was given a dedicated mandate to bypass the rest of the Saudi bureaucracy in regulating SABIC's operations and creating enabling utility and other infrastructure. Similarly, the Dubai Civil Aviation Authority is at least as much a support agency for Emirates as a classical regulator. Industries Qatar is not subject to supervision by a sectoral regulator, but instead functions under the umbrella of its majority owner, Qatar Petroleum, which is a large institutional and infrastructural enclave of its own.[1]

Where sectoral regulators exist, they tend to be stronger than general competition authorities that often lack the official mandate or the practical powers to address SOE-related matters. Sectoral bodies often have a clearer, focused mandate and a more established relationship with the entities under their purview. Only in the telecoms and finance do they attend to issues of competition and market access in a systematic way. In all other sectors, they tend to be midwives of and service providers for SOEs as much as anything else. If there is a dedicated regulatory mandate, however, it is usually not held by the agency that exercises the ownership in a given SOE.

Generally speaking, entities with separate ownership functions are passive shareholders. For example, the Saudi Public Investment Fund (PIF), which controls most of the kingdom's large SOEs outside of aviation and the oil upstream sectors, is de facto a unit of the Ministry of Finance with no strategic mandate and circumscribed autonomy. It has a limited number of lower level representatives on the boards of the various entities it formally owns. It appears to be the default receptacle for SOEs of very different provenances and purposes; their actual political principals are arguably located on more senior levels than the PIF.

The situation of some of the funds formally holding UAE SOEs such as Emirates Airlines or Etisalat is similar. The Qatar Investment Authority (QIA), which holds stakes in Qatar Airways, Qtel and the large real estate SOE - Diar, is one of more active ownership, with direct involvement of the ruling family. That said, Industries Qatar, a heavy industry giant and a centrepiece of the country's diversification strategy, is not among QIA's assets.

The main function of most ownership bodies in the GCC does not seem to be active and coherent portfolio management or even consolidated analysis of SOE finances. Instead, their relationship to the assets formally owned tends to be passive and arm's length. Conversely from the supervision recommended by the *SOE Guidelines*, the main function of holding entities seems to be *negative*: that is, preventing other bodies, especially line agencies, from interfering with or claiming ownership of SOE assets, which has led to target conflicts and collusion in other countries.

The only holding that is fairly close to the model of active and consolidated financial and portfolio management is Bahrain's Mumtalakat Holding Company, established in 2006 with a view to create a more active and co-ordinated management of the country's non-oil assets.[2] Its board has senior political players, but also Bahraini nationals who appear to have been chosen because of their financial management experience – in contrast to many other boards, which simply often have a cross-section of senior technocrats and political players with no specialised expertise. Four out of five members of Mumtalakat's executive committee, moreover, are expatriates with specialised financial backgrounds.

Mumtalakat is trying to actively rebalance Bahrain's public enterprise portfolio through partial divestitures as well as the restructuring of less well-performing SOEs, pursuing a much more active and centralised strategy than its counterparts. Bahrain's small size and the increased fiscal pressure it has been under probably explain why it has consolidated governance structures at a time when SOEs in other GCC countries are often well-functioning, but operate in largely separate administrative pockets.

Do GCC boards matter?

As elsewhere in the region (see Chapter 1 in this book), SOE boards in the Gulf remain dominated by government representatives, although the role of line agencies is probably less pronounced. There are nuances between different SOEs, but few have independent directors with specialised expertise, and by and large they appear more passive than boards in OECD jurisdictions.

Saudi Arabia's SABIC is a representative example. The chairman is a member of the ruling family and is also chairman of the Royal Commission for the Industrial Cities of Jubail and Yanbu, while the other members of the board include SABIC's CEO, one current and one former deputy minister as well as three local private sector representatives (two industrialists with a variety of interests and board positions in the Saudi industrial and service sectors, and a financial services manager with tax and accounting expertise).[3] The board members, especially on the government side, appear to have been chosen to a large extent ex officio and on the basis of seniority.

The board of Saudi Telecom (STC) looks similar. It includes a number of local private sector representatives, several senior ministerial representatives and the governor of the Saudi central bank (SAMA), as its chairman. SAMA is historically affiliated with the powerful Ministry of Finance, which controls the PIF that formally holds a majority of STC's shares.[4] The Ministry of Finance hence appears to exert indirect control through a chairman with no background in the telecommunications sector and with extensive other obligations. As with SABIC, the PIF as a formal majority owner is not represented on the board.

Saudi Aramco is the one Saudi SOE that most closely approaches an ideal board with independent directors. Its 12 member board includes 5 executives of the company and a number of very senior Saudi technocrats (including the Minister of Finance), but also one former World Bank managing director and two former international oil executives chosen for their experience and networks in the sector. Aramco is the only major Saudi SOE whose operations are supervised by foreign board members.[5]

The composition of other GCC SOE boards is comparable to the patterns at SABIC and Saudi Telecom. Bahrain's large aluminium smelter Alba, one of the crown jewels in Mumtalakat's portfolio, has the deputy CEO of Mumtalakat as its chairman (with a background in both engineering and public finance); other directors include an under-secretary of the Ministry of Finance who is also a ruling family member, a number of senior representatives of the local private sector and three SABIC executives (SABIC holds a minority share in Alba).[6] One of the private sector representatives hails from a very prominent family, while the other is present on several dozens of company boards in Bahrain. Again, some members of the board seem to be chosen ex officio and on the basis of seniority, people with numerous other obligations and limited sectoral knowledge.

The board of Industries Qatar involves an even closer circle of players. Until 2010, it included a number of senior ministers and advisors around the

Emir of Qatar who have since retired, as well as executives of several units of Industry Qatar's main shareholder, Qatar Petroleum. Since January 2011, the board consists exclusively of the Minister of Petroleum, who is also managing director of Qatar Petroleum, and other senior executives of various Qatar Petroleum and Industries Qatar units. There are no outside or independent directors. Industries Qatar is managed as an enclave within Qatar's energy technocracy by individuals with numerous other obligations and with no industry specific knowledge (barring one board member).[7]

The board of Abu Dhabi's public holding company Mubadala, which has invested in diverse areas like real estate, aerospace and renewable energy, also involves a fairly closed group. The chairman is the emirate's crown prince, while other directors represent a cross section of Abu Dhabi's senior technocracy, several of whom are also members of the emirate's Executive Council and most of whom are also involved with other SOEs across a variety of sectors.[8] No one can be clearly identified as an outside or an independent director, and all members combine numerous other senior functions with their directorship. As in Qatar, some of this can be explained by the thin layer of qualified managers in a small national population. Nonetheless, the extent to which recruitment of directors is limited to a small slice of the official technocracy is striking.

The Gulf SOE with perhaps the most surprising governance structure is Emirates. Emirates is owned through the Investment Corporation of Dubai, one of the three core holding structures in the emirate, which appears to be a hands-off owner. It is not subject to regulations of the Ministry of Labour and reports directly to the ruler's court. It is an enclave in almost every sense, with few conventional accountability mechanisms. Although the company is rated as one of the world's most successful airlines and publishes its audited accounts, the political leadership in Dubai did not create a board for the company and it is still governed by its executive leadership.[9] Its chairman and CEO is an uncle of the ruler of Dubai, flanked by a president and executive vice-chairman who are both expatriates.

We have seen that most Gulf SOEs have boards that are recruited on the basis of seniority from a fairly small circle of elites, and are staffed with directors who often have little spare time and, despite wide general experience, limited specialised expertise. The one board that has a significant presence of independent and competent directors – Saudi Aramco – is arguably a legacy of Aramco's history as international joint venture. Apart from Aramco, Gulf boards are by and large known to be fairly passive; most successful Gulf SOEs are run by their senior management quite autonomously.

The success of public enterprise in the Gulf hence does not appear to be attributable to high performing boards. Similarly to the passive ownership structures of Gulf SOEs, the main function of boards might be not to exercise close supervision, but rather to act as a buffer against other government institutions and actors interfering with SOE operations. Against a background of meddlesome ministerial technocrats in some other MENA countries, perhaps the very passivity of Gulf SOE boards is their strength.

The actors who do in fact hold the management of SOEs accountable for their performance are by and large not their technocratic directors, but senior members of the ruling family under whose formal or informal patronage they operate and from whom they receive a clear and often delimited mandate to generate profit and, in many cases, compete internationally. In this context, a corporate culture and recruitment structures have come into being that separate SOEs from the rest of the bureaucracy and that seem more important in guaranteeing their performance orientation than conventional corporate governance mechanisms.

Evolution of SOE governance in the Gulf

We have argued that successful Gulf SOEs are politically insulated and held accountable for their results through clear performance metrics monitored by a limited number of powerful principals. While on this level of abstraction the set up sounds very similar to the type of arrangements advocated by the *SOE Guidelines*, the concrete mechanisms through which a clear mandate and performance orientation are achieved are in parts quite different from the canon of Western corporate governance.

Two closely related questions present themselves. First, to what extent are the peculiarities of SOE governance in the GCC a passing phenomenon? In other words, even if the original institutional design is decidedly coloured by local institutional traditions, do they converge on international governance standards as they mature and compete internationally? Secondly, is it a problem if there are aspects in which they don't converge?

Some elements of convergence are undeniable: since the late 1990s, partial stock market listings of Gulf SOEs, including Saudi Telecom, Qtel, Industries Qatar, Emaar, DP World, Etisalat and Alba, have forced them into more extensive (though often still limited) disclosure and have exposed them to some scrutiny by outsiders.[10] This has bolstered disclosure practices and has forced management to publicly justify major strategic decisions. Owing to a fairly weak and short-term oriented shareholder culture and a feeble presence or

complete absence of institutional investors, however, listings have not been a game-changer for SOEs. Some of the best performing SOEs, including Saudi Aramco, Dubal and Emirates, remain unlisted.

SOEs have also deepened their international integration through overseas investment and, where applicable, export of their services into overseas markets. Prominent examples include SABIC through its USD 11.6 billion acquisition of GE Plastics in 2007, DP World's acquisition of port assets and operating licenses all around the world, Etisalat's expansion into telecoms markets in the wider Middle East and sub-Saharan Africa, and Emaar's real-estate investments in the Arab world and South Asia.

The more such expansion occurs, the less central the issue of a level domestic playing field becomes, as SOEs abroad have to compete with, and often behave like, private multinational enterprises. Although governments might still illicitly support their SOEs overseas, channels for such support will be more limited. Perhaps more important, there is less of a rationale for such support if the objective of SOEs is simply to generate profits – which is usually the case with outward-oriented ones in the GCC. Expansion abroad also exposes at least parts of such SOEs to the disclosure and governance requirements of overseas jurisdictions.

Finally, Gulf SOEs also increasingly seek corporate finance in international markets, not only through bank loans but also through the issuance of corporate bonds, which requires at least one-off disclosures even from unlisted companies. In fact, during the crisis of 2008-2009, SOEs were practically the only entities active on regional bond markets. Dubai SOEs in particular, which since 2008 have had less generous financial backing from their government, have had to divulge important bits of previously unavailable corporate information to international investors, forcing SOEs to overcome their penchant for secrecy.

In several arguably more important ways, GCC SOEs continue to stand apart. First, and most problematically, most of them are not subject to effective competition regulation. In some sectors – for example, aerospace or renewable energy – this is not yet an issue, as SOEs stand alone as large scale investors, while private sector interest in new ventures is muted at best. In other sectors, like large scale tourism projects, heavy industry or aviation, SOEs started out as the only players in town but have now been joined by an active stratum of private investors inspired by the successes of public industry.

While their trailblazer status made dedicated state support and infrastructural privileges for SOEs justifiable or even necessary at an early stage, such treatment now arguably hampers further diversification and maturation of GCC markets. For instance, given that SABIC has been joined by a mature local class of industrialists in the petrochemicals market, it is not so clear anymore why it should get privileged feedstock access. Unfortunately, there is no independent industrial regulator that could effectively arbitrate such questions. The increasing number of joint ventures SABIC has initiated with local capitalists mitigates but does not resolve the issue.

The building of independent sectoral regulators – as regulators in a true sense, not as service providers for SOEs – is the next big challenge in the governance of public industry in the GCC. Telecoms and to an extent the financial sector regulators are ahead in this regard, and their experience should be studied closely. It will be important to build regulators on a sectoral rather than a cross-cutting basis, as attempts to set up transversal institutions like generic competition authorities have never gotten off the ground in the fragmented institutional landscape of GCC states (Hertog, 2010b).

These regulators will require the same kind of high-level backing and institutional privileges that SOE leaders currently enjoy, since the latter are unlikely to cede their exclusive entitlements without a fight. Given local human-resource constraints, it will be initially difficult to staff new regulators with personnel that have no links to the existing SOEs. The case of telecoms has shown, however, that a progressive social and institutional decoupling between the enterprise and its regulator over time is possible.

Access to state finance is a particularly complex issue in this regard. While in principle SOEs should compete for funds, the implicit sovereign backing they enjoy is difficult to abolish. First, it is worth noting that it was SOE investment that kept GCC economies going during the 2008-09 financial crisis when private investment collapsed. Second, thanks to sovereign backing, SOEs are capable of engaging in long-term strategic investments for which the private sector often still lacks the time horizon. Dedicated state support must be limited to exactly these kinds of projects however; anything that can be undertaken by private players should be financed privately or through state funds made available on a competitive basis.

Privileged finance for strategic investment is easier to justify for profitable Gulf SOEs than for public enterprise elsewhere, as leading SOEs in the region are generally not used for patronage purposes, and the "soft budget constraints" they are subject to have not led to the chronic losses generated by Syrian or

Algerian SOEs. Social patronage in the GCC does of course exist, but is rather channelled through bureaucratic over-employment, rules of national economic privilege and variety of subsidy and handout schemes. Important (though not all) segments of public industry have been insulated from it (Hertog, 2010a).

There are further ways in which Gulf SOEs remain different from the generally accepted view of a well governed SOE. Ownership is often still fragmented, and even where there is formal consolidation, the holding entities tend to be administratively weak. Against the background of clear de facto mandates and high bureaucratic insulation, however, this appears to be less of a pressing concern than the issue of the level playing field. As long as SOEs are well-protected and know what their task is, the challenge seems to be independent regulation rather than consolidated ownership.

Despite partial listings and bond issues, Gulf SOEs also remain fairly opaque by Western corporate standards. More often than not, disclosure is kept to the statutory minimum, and performance information is shared with political principals rather than with the broader public (or even other government institutions). While transparency is a value in its own right, its impact on SOE performance and accountability in the GCC for the most part is likely to be muted. As already alluded to above, the audience that could make use of greater disclosure is limited, especially in Oman, Qatar and the UAE, small countries whose civil society is not very active. In other cases, increased transparency might augment populist calls for employment generation, provision of subsidised goods to local business or consumers, or other demands that could dilute SOEs' mandate.

To some extent, the relative opacity of players like Saudi Aramco or SABIC has arguably helped them defend themselves against bureaucratic as well as other encroachments. Such defence should in the long run derive from formal legal guarantees rather than institutionalised secrecy. In the short run, however, if the primary aim is to guarantee SOE performance and market contestability, it will be more important that independent regulators rather than the public have full access to company information, both to maximise impact and guarantee political feasibility.

Similarly, stronger boards with more specialised and independent members along Western lines might on the margin help SOE performance. But they will do little to address the issues of market contestability which are probably the main challenge that Gulf public sectors are facing now. Given the relationship-based nature of doing business in the Gulf, truly independent boards will in any case take a long time to establish.

Lessons for non-GCC countries?

In the long run, as the local private sector matures, Gulf public enterprise could and should converge on best practices that have emerged in more advanced economies. In the meantime, there is much left to analyse and potentially learn from GCC SOEs, pockets of efficiency which have been set up according to their own rulebook and in response to a very different social and economic context.

Not everything that has worked in the GCC will travel easily to other countries. GCC lessons could be difficult to apply in nations with lower levels of rent and hence less spare funding to build institutional enclaves in parallel to the official bureaucracy, and in countries where levels of political mobilisation and societal demands are higher, thereby making informal strategies of institutional insulation harder.

There are nonetheless a number of general principles that would seem to apply also outside of the oil monarchies of the Gulf in other MENA or emerging market jurisdictions – even if they might be harder to act on and represent necessary rather than sufficient conditions for guaranteeing performance:

- In countries where informal relations are paramount, successful SOEs require senior figures to give them political support, protection from rival interests and a guarantee of operational autonomy. Senior management needs good access to the leadership and stable, though not guaranteed, tenure. This is a caveat about political preconditions for SOE success rather than an easily actionable technical recommendation – which makes it no less important.

- Successful SOE need to be separate from the rest of bureaucracy, not only in formal and legal terms, but also in their management and human-resource practices. Recruitment needs to be autonomous, and salary and promotion schemes must be based on private-, not public sector, standards. Corporatisation is a necessary but not sufficient step towards this.[11]

- Line ministries should have a minimal role in managing SOEs, even if no independent regulators are in place and technical expertise in the rest of the state apparatus is limited. Indirect control through holding structures or financial agencies seems preferable, as it tends to be more hands-off. Line ministers should not chair holding companies.

- Partial listings of SOE equity or debt can help to advance corporate governance by improving their disclosure practices and subjecting SOEs to external auditing. However, there should be strong supplementary mechanisms of accountability within the government, especially if the local shareholder culture is weak.

- Clear time horizons and sunset clauses should be established for SOEs' administrative, financial and infrastructural privileges, with a defined timeline by which first profits need to be generated and with a clear exit/bankruptcy option for failing SOEs.

- SOE privileges need to be limited to strategic areas where the private sector is not capable of investing. A clear strategy and public commitment is needed for rescinding such privileges, and for guaranteeing market contestability through independent regulation as soon as private investors are ready to follow SOEs into new sectors.

- There should be no SOEs in areas where private business is capable of doing the job in a competitive framework. The state should gradually divest such companies.

- Joint ventures with foreign and local capital should be encouraged in the SOE start-up phase to assure technology and skills transfer, diffusion of a performance-oriented corporate culture and local multiplier effects.

- Where feasible, SOEs should be exposed to foreign competition through a mandate to export their goods and services, and by being subject to domestic competition from foreign exporters. Measured expansion of operations into international markets can have a disciplining impact and generate performance signals that become valuable especially if the domestic playing field is not level.

- If it is politically not feasible to build powerful independent boards, it is better to staff boards with a cross-section of weak figures than with influential but meddlesome bureaucrats, especially if the latter are from the line agencies in charge of the sector at hand.

Broader political conditions for building successful SOEs have been uniquely apposite in the GCC, where political leaders have enjoyed autonomy in their use of incremental oil rents, where a generally pro-market economic ideology is dominant and where organised groups in bureaucracy and society that could interfere with SOEs' strategies and operations tend to be weak.

Nowhere else in the MENA region do all of these conditions appear to apply together, meaning that SOE-driven diversification is a more risky prospect in those countries. For them, the primary challenge remains reform of the existing SOEs.

Even under such less auspicious circumstances, many of the above-mentioned points are relevant, if only as a benchmark to understand local constraints. While the GCC experience of state-driven diversification cannot be easily reproduced wholesale, it provides valuable insights about institutional conditions of SOE success that go beyond formal corporate governance precepts. The latter are important, but they often need to be supplemented with design principles and "tweaks" that take into account the local political context and institutional limitations.

Notes

1. *www.industriesqatar.com.qa/IQ/IQ.nsf/en_Pages/en_AboutUs_GroupStructure*, accessed 30 August 2011.
2. For details, see the company's website at *www.bmhc.bh*.
3. *www.sabic.com/corporate/en/ourcompany/boardofdirectors/default.aspx*, accessed 24 August 2011.
4. *https://www.stc.com.sa/cws/portal/en/stc/stc-landing/stc-lnd-abtsaudtelc/stc-lnd-abtst-bodir* 24 August 2011.
5. The most recent board reshuffle occurred in August 2010 (Arab News, 22 August 2010).
6. *www.aluminiumbahrain.com/en/default.asp?action=article&id=33*, accessed 24 August 2011.
7. Industries Qatar, Annual Report 2010.
8. See *www.mubadala.ae/about/board_of_directors/*, accessed 24 August 2011.
9. As evident from May 2011 contract approval for Emirates' use of airport facilities in San Francisco: *www.sfethics.org/files/yyyymmdd_20100603_126_mayor_emirates_redacted.pdf*, accessed 23 August 2011.
10. SABIC already sold 30% of its shares in 1984, at the time an anomaly among public enterprises – and a practical impossibility in most of the other GCC states,

which did not have stock exchanges (Saudi Arabian Basic Industries Americas 2001: 76).

11. Algerian SOEs that have been formally corporatised have continued to follow public sector salary and promotion procedures (World Bank, 1994).

Bibliography

Detter, D. (2009), "Managing State-Owned Commercial Assets", *Beijing University Business Review.*

Ernst & Young (2010), *Government as Best in Class Shareholder: Featuring the Point of View of 12,000 Citizens in 24 Countries.*

Evans, P.B. (1989), "Predatory, Developmental, and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State", *Sociological Forum*, 4(4).

Geddes, B. (1996), "Politician's Dilemma: Building State Capacity in Latin America", New Ed., University of California Press.

Hertog, S. (2008), "Petromin: The Slow Death of Statist Oil Development in Saudi Arabia", *Business History*, 50(5).

Hertog, S. (2010a), "Defying the Resource Curse: Explaining Successful State-Owned Enterprises in Rentier States", *World Politics*, 62(02).

Hertog, S. (2010b), "Princes, Brokers, and Bureaucrats: Oil and the State in Saudi Arabia", Cornell University Press.

Kornai, J. (1979), "Resource-Constrained versus Demand-Constrained Systems", *Econometrica*, 47(4).

Organisation for Economic Co-operation and Development (2005), *OECD Guidelines on Corporate Governance of State-owned Enterprises*, OECD, Paris.

Saudi Arabian Basic Industries Americas (2001), *The SABIC Story*, Houston, Texas.

Springborg, R. (1993), "The Arab Bourgeoisie: A Revisionist Interpretation", *Arab Studies Quarterly*, 15(1).

World Bank (1994), *Algeria Country Economic Memorandum: The Transition to a Market Economy*, Washington, D.C.

Chapter 4

State-owned enterprises in Kuwait: history and recent developments

by

Mithqal Sartawi
Managing Director and President, Privatisation Holding Company of Kuwait

State-owned enterprises have been an important feature of the Kuwaiti economy since the establishment of the nation state. As highlighted in this chapter, their importance in the Kuwaiti economy has only increased over the years, and today they play an important role in the provision of basic services, employment and fiscal revenue. This analysis outlines the development of the state-owned sector in Kuwait, in order to situate the current structure of the sector and its governance practices in a historical context. Following the introduction of the privatisation legislation in Kuwait in 2010, the privatisation process, which until now has been slow, is expected to accelerate with the initial disposal of a stake in the Kuwaiti Airways Corporation.

Introduction

Kuwaiti society draws its roots from the mid-18th century, when the Al-Sabah family settled in what today is Kuwait. Although the population of neighbouring countries come from similar Arab tribes, the common history of those settled in Kuwait with the Al-Sabah family gave them elements of cohesion that have maintained the unity of Kuwaiti society to this day. Unlike most other countries of the Middle East and North Africa (MENA), Kuwait was never colonised. It was considered as a British Protectorate for about 60 years, although the involvement and impact of the British government on Kuwaiti society and politics was minimal.

The development of the hydrocarbons sector, beginning with the first oil shipment in 1946, marked the emergence of a modern economy in Kuwait. The fast development of the country's infrastructure, public services, institutions and welfare systems attracted professionals, entrepreneurs and private sector entities from abroad and contributed to the development of the Kuwaiti economy, within the framework and vision established by the ruler. At the same time, the influx of oil revenues increased public sector involvement in the economic sphere.

The priorities of the government at the time were oriented towards providing basic services such as water, electricity, health care and education to the population. For instance, the first water desalination plant was built in Shuwaikh area to replace the unsuitable and sporadic supply of water from Shatt Al-Arab, reducing the dependence of the population on the water wells (Ministry of Oil, 1983). The first public hospital was built in 1949, and several schools were built in subsequent years. In parallel, significant efforts were made to upgrade the country's infrastructure and to build homes for low-income Kuwaitis.

The ambitious industrial development agenda of the Kuwaiti government has to some extent resulted in the traditional activities of the private sector such as pearling, fishing and shipbuilding taking a secondary priority in the overall economic development of the country, and indeed with time some of these industries have disappeared. From 1946 until Kuwait's formal independence in 1961, the government's key priority was institution-building and the development of welfare-oriented programmes, with the state subsidising many enterprises that provided basic goods and services such as electricity, water, gasoline, education and health care. These subsidies were introduced in tandem with a generous housing scheme and social security system for Kuwaiti nationals.

During this period, private sector activity was focused primarily on trading, construction and banking. The largest Kuwaiti companies at the time were operating in the banking and hydrocarbons industries. For instance, the Kuwait Oil Company (KOC) was established as a joint venture between British Petroleum and the Gulf Oil Company as per the concession agreement signed with the ruler of Kuwait in 1934. The National Bank of Kuwait (NBK) was established in 1952 as the first private national bank in Kuwait and indeed in the Gulf region, following the refusal of the British Bank of the Middle East to grant credit to one prominent Kuwaiti merchant[1]. In 1957, the Kuwait Oil Tanker Company (KOTC) was established by a group of private investors who grasped the importance of maritime transport for the oil industry.

At this time, the Kuwaiti government started to involve the private sector in its ambitious infrastructure projects, mainly through public procurement. Foreign companies seeking to be involved in procurement for the Kuwaiti government were required to work through a local agent paid on commission. The laws of Kuwait at the time favoured involving Kuwaiti nationals in public sector activities as intermediaries. Nevertheless, this policy did not deter foreign private companies from the Kuwaiti market, where they were able to find business opportunities and execute profitable infrastructure contracts.

During the 15 years preceding Kuwait's independence, a welfare state emerged. All basic services were provided by the government at subsidised prices to make them affordable to every Kuwaiti, irrespective of income level. The state took a lead in almost all economic activities, while the role of the private sector was limited to trading and providing services that supported the objectives of the public sector. Oil revenues soared from $0.75 million in 1946 to about $500 million in 1961 (Khouja and Sadler, 1979). While there are no official figures on the magnitude of the economic activity at the time, it is estimated that the oil sector already represented more than 60% of Kuwait's GDP in the 1960s.

Historical background

The emergence of state-owned enterprises in Kuwait (1946-1961)

In considering the origins of the Kuwaiti state-owned enterprise (SOE) sector, it is important to keep in mind the social orientation of the government after it attained independence. The Constitution of Kuwait provides that the government is responsible for providing health care, education, water and electricity to the population. In its efforts to redistribute the oil wealth, the

government introduced a welfare system that has historically been, and remains, an important fiscal burden.

During this period, the state moved to strengthen the welfare system by adopting a number of subsidised programmes and services. For example, a housing scheme for newlywed Kuwaitis that did not cover the real cost of housing was introduced. In addition, the Credit and Saving Bank was established to provide loans to Kuwaitis planning to build their own homes, initially at concession interest rates and later with no interest.

The cost of the welfare system established in the early state-building years was initially prohibitive and has grown over the years. Subsidies provided by the government are currently estimated to reach 15%-20% of GDP (Central Statistical Office, 2010). The real cost of goods, whether produced by public or private Kuwaiti companies, is underestimated because of these subsidies. The government remains concerned about the high cost of subsidies across sectors and services; however, it has become politically difficult to reduce or abolish them. Several attempts to increase tariffs on water and electricity have been made over the years, but the necessary parliamentary approvals were not obtained.[2]

The dominant role of the public sector in the local economy was to some extent welcomed by the private sector, which saw it as an opportunity to obtain contracts without taking the corresponding economic risks. The private sector's position was further strengthened by the legislative framework that protected it from outside competition. Indeed, until recently, the local commercial law prevented the establishment of majority foreign-controlled enterprises in Kuwait. In addition, foreign and local companies were not subject to the same fiscal treatment.

The post-independence era witnessed the establishment of several enterprises with majority government ownership. The key objectives behind the establishment of these SOEs related to the lack of the financial capacity of the local private sector to establish large-scale business ventures. These SOEs were provided with incentives and benefits such as heavily subsidised utilities, land concessions and customs exemptions that were politically acceptable because these companies were majority government-owned. SOEs were also shielded from competition and bankruptcy, and many benefited from a monopoly in the local market, which could have been viewed as favouritism had similar protections been offered to a private sector firm.

In the petroleum sector, enterprises were established with a majority ownership of the state. This was the case of the Kuwait National Petroleum Company (KNPC) established in 1960 and the Petrochemical Industries Company (PIC) established two years later with a minority shareholding from the private sector (limited to Kuwaiti nationals). Similarly, the National Industries Company was established in the 1960 as a wholly state-owned company to set up large construction projects that could not, at the time, have been undertaken by the private sector. Kuwait Flour Mills Company (KFMC) and Livestock Trading & Transport Company (LTTC) were also established in the 1960s to provide subsidised food products.

Growing state presence in the economy (1961-1980)

During the 1970s, two major events led to a further increase of government ownership in the commercial sphere. The first was the nationalisation of the oil sector, which resulted in the state taking full control over the crude oil production and hence the determination of the price of crude oil, refined and petrochemical products. Efforts to bring the petroleum sector under government control began with negotiations between the state of Kuwait, British Petroleum and Gulf Oil to acquire 60% ownership in the KOC established in 1934 under their joint ownership. A year later another round of negotiations was initiated, resulting in a complete transfer of ownership of KOC to the state.

This was followed by the state's acquisition of a 40% stake in Kuwait National Petroleum Company (KNPC), then a 5% stake in the Petrochemical Industries Company (PIC) and then, in 1979, the full nationalisation of the Kuwait Oil Tankers Company (KOTC). By the end of 1970s, the entire hydrocarbons sector was nationalised with the result that KNPC, PIC and KOTC were all de-listed from the Kuwait Stock Exchange and became 100% state-owned enterprises. Despite government efforts to diversify the local economy, oil revenue continued to provide more than 90% of the government revenue, especially after the oil shock of 1973 that resulted in a tremendous rise in oil prices.

The second event was the crash of the stock market in Kuwait in 1976-1977. In response, the government sought to shore up the market by buying shares in listed companies, which resulted in wide-scale state ownership in the banking, insurance, and real estate sectors. At the same time, the ongoing development of state institutions and companies established for specific projects continued to expand the state's role in the commercial sphere. These years saw the establishment of a number of authorities (e.g. the Supreme Petroleum

Council, the Public Port Authority) as well as additional SOEs (e.g. Kuwait Finance House). Again, significant benefits were bestowed on these newly established enterprises and they created highly paid managerial jobs for Kuwaiti nationals.

These trends continued unabated in the 1980s, and government ownership in commercial enterprises increased further, especially after the second stock market crash of 1982 - this time not of the official stock market, but of the parallel market, Souk Al-Manakh.[3] Similarly to the previous crash, the government injected substantial funds into the market, purchasing shares in most listed companies. However, the local economic context during this crash was different from the previous one in some important respects. On the one hand, the rescue required was more extensive. On the other, oil prices were low and the government was facing a real fiscal deficit. The government was forced to tap into its fiscal reserves to salvage the stock market.

By that time, it was clear that the public sector was very much dominating local economic activity. The contribution of the public sector to GDP was already in 1980s estimated to be above 65% (Ministry of Oil, 1983). One policy that further increased the size of the public sector over the years was a decision to provide lifetime government employment for all nationals entering the labour force, irrespective of their qualifications. In addition, key infrastructure development projects such as building power and water desalination plants, airports, sea ports and roads, were executed only by the public sector.

In 1980, a law was issued to establish Kuwait Petroleum Corporation (KPC) with paid-up capital of KWD 1 billion paid in kind and in cash (Legislation and Fatwa Department, 2005). KPC was structured as a statutory corporation not subject to commercial legislation. Effectively, it was established as a holding company consolidating the state's ownership in all oil-related companies and projects, including concession contracts. KPC's capital was increased to KWD 2.5 billion in 1982 (Kuwait Al-Youm), and today its capitalisation represents more than 30% of the total capitalisation of all companies listed on Kuwait Stock Exchange.

Reduction of the state's role during post-war reconstruction (1991-2000)

The intensive reconstruction programme introduced after Kuwait's liberation from the Iraqi invasion in 1991 forced the government not only to use most of its financial reserves, but also to borrow on the international financial market for the first time. Oil revenues were low and could not cover all government expenditures due to the low oil production caused by the

destruction of oil wells during the war. At the same time, the state's financial obligations established post-independence, such as providing employment to Kuwaiti nationals, continued to weigh heavily on its budget.

In the early 1990s, the government had shares in 61 companies in a variety of sectors, with ownership ranging from as little as 1% to 100%. For a list of these companies, please see Table 4.1 below. All companies in this table were established pursuant to the Commercial Companies Law. Although the number of companies appears small, representing approximately 3% of the total number of commercial enterprises in Kuwait at the time (World Bank, 2001), they accounted for about 70% of the total capitalisation of the corporate sector (Kuwait Stock Exchange, 2010), without even including government authorities and statutory corporations.

Given the strain on the budget, the government took serious steps to divest some of the assets acquired during previous years and reduce its investment in the SOE sector, despite the losses suffered by SOEs during the war with Iraq and as a result of the subsequent economic slowdown. This period saw the introduction of various policies aimed at turning over the control and management of a significant number of SOEs to the private sector as well as at encouraging the private sector to employ Kuwaiti nationals.

The procedure that the government used to divest its holdings in these companies involved selling shares through a variety of methods, including auctions, initial public offerings (IPOs), direct sales to existing shareholders, or a combination of the above (Al Rifai, 2006). In some cases the government divested its ownership stake entirely, while in others the stake was reduced based on the relative importance of the sector and on future return expectations.

It bears mentioning that some government holdings were not divested either because the enterprises were loss-making or because the time frames set for divestment were unrealistic. In most cases, however, the rationale behind the continued presence of SOEs often related to the limited financial capacity of the private sector, to the need to deliver commercial activities that could not be performed profitably or to the state's wish to continue its presence in certain strategic sectors.

Table 4.1. Kuwait Investment Authority local holdings, 1993

Company Name	Government Ownership
National Industries Company	58.0%
Kuwait Cement	35.6%
Cold Storage Industries	28.8%
Gulf Cables	60.4%
Car Trading and Manufacturing Company	71.5%
Paper Trading and Manufacturing Company	30.0%
Kuwait Repair and Ship Building	56.4%
Steel Pipe Manufacturing Company	17.8%
Marine Works and Contracting Company	50.5%
Live Stock Transport and Trading Co.	54.5%
Poultry United Co.	56.4%
Agriculture Food Products Company	49.5%
United Agriculture Products Co.	16.6%
Agriculture Palm Company	87.4%
Flower Mill Company	100%
Boubyan Fishing Company	0.2%
United Fisheries Company	55.8%
Mobile Telecommunications Company	50.4%
Public Warehousing Company	53.0%
Kuwaiti Supply Company	97.5%
Kuwait Hotel Company	37.9%
Public Utilities Management Company	99.9%
Car Driving Teaching Company	98.1%
Kuwait International Exhibition Company	49.0%
Kuwait National Cinema Company	3.2%
Kuwait Touristic Enterprise	98.0%
Kuwaiti Commercial Markets Company	16.4%
National Bank of Kuwait	1.7%
Gulf Bank	17.5%
Burgan Bank	60.9%
Bank of Kuwait and Middle East	58.8%

Company Name	Government Ownership
Real Estate Bank	33.7%
Industrial Bank of Kuwait	31.4%
Commercial Bank of Kuwait	8.5%
Al-Ahli Bank of Kuwait	8.5%
Ahlia Insurance Company	20.3%
Kuwait Insurance Company	7.5%
Gulf Insurance Company	75.2%
Warba Insurance Company	55.8%
Commercial Facilities Company	56.3%
Kuwait Investment Projects Company	15.8%
Jawhara Investment Company	1.1%
Coast Development Company	2.7%
Kuwait Finance House	32.6%
Foreign Investment Company	99.6%
Kuwait Investment Company	70.0%
Financial Consulting Company	77.0%
Industrial Investment Company	33.0%
Financial Coupons Group	95.2%
Financial Coupons House	94.5%
Kuwait Consulting and Investment Company	30.0%
First Brokerage	23.2%
Financial Brokerage	14.6%
National Investment Company	14.6%
Real Estate Investment Consortium	98.9%
Real Estate Financing	57.8%
United Real Estate	40.0%
National Real Estate	13.7%
Kuwait Real Estate	13.7%
Kuwaiti Computer Company	4.8%
Kuwait Public Transport Company	100%

Source: World Bank, Energising the Private Sector in Kuwait, 1994.

Current composition and practices

Despite the privatisation activities conducted in the 1990s, the public sector dominates most economic activities, and its contribution to local GDP still exceeds 60%. The state's involvement in local economic activities is not declining, considering that the line ministries and various authorities continue to provide services through unincorporated entities. The state also has significant stakes in private companies, established in accordance with the Kuwaiti Commercial Companies Law, some of which are listed on the Kuwaiti Stock Exchange.

Consequently, the role of the state as an employer remains considerable. As of June 2010, the private sector employed only 72,000 from the national labour force of 348,000, while it employed more than one million of foreign workers (Central Statistical Office, 2010). Whereas KIA's local holdings have declined from 61 companies to 14 as of January 2011 (see Table 4.2), the state remains a shareholder in a number of large companies. It is important to bear in mind that Table 4.2 highlights only KIA's ownership stakes; other ministries exercise their ownership directly.

Table 4.2. Kuwait Investment Authority (KIA) local holdings, January 2011

Company Name	Government Ownership
National Technology Enterprises	100%
Kuwait Real Estate Investment Consortium	99.13%
Kuwait Investment Company	76.19%
Livestock Transport and Trading Company	51.55%
Kuwait International Investment Co.	30.10%
Kuwait Cement Company	29.36%
Mobile Telecommunications Company	24.61%
Kuwait Finance House	24.08%
Health Insurance Hospital Company	24.0%
Warba Bank	24.0%
National Mobile Telecommunications Co.	23.54%
Gulf Bank	16.08%
Kuwait China Investment Co.	15.0%
Kuwait Telecom Co.	6.0%

Source: Zawya.

As mentioned above, the oil sector in Kuwait was nationalised and de-listed in 1970s. Thus, for the past 30 years, the oil sector has been fully owned and operated by the public sector. During these years, it has experienced growth both in absolute terms and in relative importance in the local economy. In 2004 the sector was estimated to generate just over half of Kuwait's GDP - USD 60 billion. By 2008, it was contributing over 64% of the GDP, estimated at USD 140 billion. Likewise, in terms of government revenues, the oil sector's contribution was 88% in 2004; it increased to 94% in 2008.

Government control over SOE performance

Two main bodies were established to control the operation and performance of state-owned companies. The Central Tender Committee (CTC) controls the procurement processes in any SOE that makes purchases exceeding KWD 5000 (Legislation and Fatwa Department, 2005). Companies in the defence, security and hydrocarbons sectors are exempt from these procurement regulations, but they are generally subject to other procurement regulations and requirements.[4] The Audit Bureau - the state audit body of Kuwait - is responsible for auditing all government bodies, including companies in which state ownership exceeds 25% (Legislation and Fatwa Department, 2005). The Bureau reports directly to the Parliament[5], while the Central Tender Committee reports to the Council of Ministries.

The audit procedures and rights of the Audit Bureau are different for majority- and minority-owned companies: the state naturally has more powers in the case of the former. The Bureau conducts pre- and post-audits and has the right to request any relevant information from the management. Even for minority-owned companies with an ownership stake exceeding 25%, the Audit Bureau is allowed to conduct pre-audits of SOEs, as is the case of other GCC jurisdictions (e.g. Oman). Companies falling into this category must also seek approval from the Audit Bureau before they make any financial commitments if the latter go beyond the annual budget approved by the board of directors at the beginning of the fiscal year.

The Audit Bureau's mandate is to ensure that the appropriate funds are collected and channelled to the public treasury, to ensure that SOEs are adhering to their by-laws and internal regulations, and to examine the by-laws and other founding documentation to determine their appropriateness to the enterprise in question. In instances where the Bureau has comments or objections to any activity undertaken by majority-owned SOEs, it has the right to request that management take corrective action. In most cases, SOEs abide by the Audit Bureau's recommendations during the course of the year. If any

comments are not dealt appropriately, the management is notified officially by the government entity with which ownership rights are vested and is requested to take action.

This procedure is necessary because the Audit Bureau has no legal powers to enforce its decisions, though it can inform management of its recommendations. The line ministries and authorities are, on the other hand, responsible for implementing comments of the Bureau. The Audit Bureau does not interact with the SOE's external auditor. However, the Ministry of Commerce and Industry (responsible for the administration of the Commercial Companies Law) reviews the work of the external auditor and attends general assembly meetings. It is also customary for the Audit Bureau to send a permanent representative, who can review any major expenditures and decisions taken by the management, to majority-owned SOEs.

SOEs and the budget process

Each year, the Minister of Finance presents a budget to the Council of Ministers. Once approved, it is sent to the Parliament for the final approval. Commercially oriented SOEs, established in accordance with the Commercial Companies Law No.15 of 1960, even if they are wholly owned by the state, are not included in the fiscal budget. The financial reports of these companies are usually approved by their board and are not presented to the Ministry of Finance for further reporting to the Parliament. The Kuwait Petroleum Corporation is especially important in the budget process since the government budget forecast is prepared on the assumption of an average price of oil per barrel put forth by the KPC.[6]

The government budget is split into three categories: (1) budgets of ministries and departments, (2) independent entities and (3) dependent entities. Independent budget entities (see Table 4.3) are institutions, authorities and statutory corporations that are wholly owned by the state, such as Kuwait Airways Corporation (KAC) or the Kuwait Port Authority (KPA). Entities considered as independent for the purposes of the budget are generally those that generate a profit and do not depend on the state for their operating expenses. The legal framework underlying the establishment of these entities stipulates that such agencies must have independent budgets and must operate on a commercial basis.

Dependent budget entities are government entities established for a specific, non-commercial purpose. The legal framework underlying the establishment of these agencies essentially provides that their budgets are

dependent on another government entity and that the government is committed to subsidising or financing their operations. For example, KAC was originally formed as a publicly listed company with majority state ownership. Subsequently, the state acquired the company, de-listed it and changed its legal status in 1965. The 1965 law forming the company stated that KAC would continue to operate as a commercial entity, noting however that the state would cover losses if necessary. For the last four years, KAC has incurred KWD 30-35 million of losses that have been covered by the state.

Table 4.3. Independent and dependent budget SOEs

Independent Budget SOEs	Dependent Budget SOEs
Central Bank of Kuwait	National Assembly
Kuwait Fund for Arab Economic Development	Kuwait Municipality
Saving of Credit Bank	Kuwait University
Kuwait Airways Corporation	Public Authority for Housing
Public Authority for Industry	Public Authority for Civil Information
Kuwait News Agency	General Fire Department
Public Institution for Social Security	Kuwait Investment Authority
Kuwait Port Authority	Public Authority for Applied Education and Training
Kuwait Institute for Scientific Research	Public Authority for Minors Affairs
Zakat House	Public Authority for Agriculture and Fisheries
Public Authority for Environment	Public Authority for Assessment of Compensation for Damages Resulting from Iraqi Aggression
Kuwait Petroleum Corporation	Public Authority for Youth and Sports

Source: Central Statistical Office.

The ownership function

The government of Kuwait has established two funds, the General Reserve Fund (GRF)[7] and the Future Generations Fund (FGF)[8] in order to invest the surplus funds domestically and abroad (Legislation and Fatwa Department, 2005). In 1978, the scope of operation of both funds was defined by law, which limited the FGF's operations to developed countries and mature stock markets, while the GRF's investment activity was limited to the Middle East and some less developed markets. All government assets and investments were registered either under the GRF or the FGF, both managed by the Ministry of Finance.

The sources of these funds were defined by Law No.31 of 1978, which stipulated that 10% of the total annual state revenues were to be allocated to the FGF, while the remainder was to be managed by the GRF. In addition, the Law stipulated that annual expenditures of the government would be drawn from the GRF. This situation was altered in 1982 with the passage of legislation establishing the KIA and giving it the responsibility of managing the assets of Kuwaiti government under the supervision of the Ministry of Finance. As a result, KIA became fully responsible for managing GRF and FGF, as well as any other funds entrusted to it by the Minister of Finance. That said, KIA itself does not own any assets and its budgets are presented to the Parliament as part of the Ministry of Finance's reporting procedure.

KIA is entrusted with exercising the ownership function in a number of Kuwaiti SOEs. In some instances, this function is vested entirely with KIA; in others, a dual ownership function prevails. The centralised model is applicable to all SOEs established in accordance with the Commercial Companies Law. In those cases, KIA has the entire ownership and supervision responsibility, and the owner is considered to be the Ministry of Finance and/or KIA.

The dual model, on the other hand, applies to all SOEs not subject to the Commercial Companies Law. For example, the KPC and all of its subsidiaries are officially owned by the Ministry of Finance/ KIA, but the supervision of their operations is entrusted to the Ministry of Oil. Although the Ministry of Finance is represented on the board of directors, the Minister of Oil appoints all the other board members. Likewise, the Ministry of Finance owns the KPA, but the operational responsibilities are in the hands of the Minister of Communication.[9]

Corporate governance of Kuwaiti SOEs

This section of the paper will address specific elements of the corporate governance framework applicable to state-owned enterprises in Kuwait, whether the SOEs are subject to the Commercial Companies Law or special regimes created for statutory corporations or authorities.

The general assembly

Each SOE established in accordance with the Commercial Companies Law must hold a general assembly at least once a year to discuss and approve the financial statements, the management report, and the selection and remuneration of the external auditor. The composition and the quorum of the board are specified in the Commercial Companies Law, unless the company was created

as a statutory corporation or an authority. The general assembly must elect the board every three years.

For the most part, entities that are considered as having an independent budget hold no general assembly meetings.[10] However, oil companies established in accordance with the Commercial Companies Law before the KPC was established have general assemblies. In these companies, the KPC, as a holding entity, represents the ordinary general assembly. The Supreme Petroleum Council, chaired by the prime minister and including the Ministers of Oil and Finance and other ministries and government agencies, represents the extraordinary assembly of these companies.

The chairperson of the board heads the general assembly meetings in the presence of an external auditor and a representative of the Ministry of Commerce. An invitation to the general assembly and its agenda is usually published in the local newspapers two weeks before the meeting. Although in principle, the general assembly is the highest governance organ, in practice it is often the weakest, since most decisions and discussions are usually taken outside its meetings. In majority-owned SOEs, general assembly meetings can often be considered a formality.

The weakness of the general assembly as a governance organ derives from the fact that the management of the enterprise usually has continuous contact with its major shareholders. In some cases, shareholders have signed a blank proxy, in others, shareholders do not even take an interest in attending general assembly meetings or voting by proxy. In practice, when management collects enough proxies to achieve a quorum, the remaining shareholders are often not directly notified of the meeting. Even the nominees for board posts are usually agreed upon between the major shareholders beforehand and the assembly is simply presented with the names for approval.

The minutes of general assembly meetings are prepared by the management and sent to the Ministry of Commerce for approval. The external auditor and the Audit Bureau are given copies of the approved minutes and subsequently, the Ministry of Commerce works with the management to implement the decisions of the general assembly. The effectiveness of this process is questionable. During the recent financial crisis, many commercial enterprises, both state-owned and private, suffered significant losses; however, very little criticism of management was expressed in general assemblies and no action was taken against the management of any SOE.

The board of directors

As in other jurisdictions, the board is generally considered as the second "line of command" after the general assembly. In the case of government authorities and the KPC, the board of directors is in fact the highest corporate organ. Typically, the board is comprised of an odd number of directors (minimum 5, maximum 11) and is led by an executive chair. Individual board nominations and board size are usually decided by major shareholders and endorsed by the general assembly. The directors can hold their membership for an indefinite number of terms, though the length of each term is limited to three years.

For statutory corporations, the by-laws define the size and structure of the board. There are no specific criteria for nominating board members, and it is not uncommon for them to be based on personal recommendations and political considerations. For instance, the founding documents of Kuwait Airways establish the size of the board at eight members and give the line minister the authority to appoint the entire board as well as the CEO. In case of KPA, another statutory corporation, the founding law states that the board shall be chaired by the Minister of Communication and shall be comprised of eight additional members from both public and private sectors, including the general manager. In practice, the remaining board members are nominated through a decree of the emir based on the recommendation of the line minister.

An emiri decree also specifies KPC's board size and composition. This decree appoints the Minister of Oil as the chair of the board, as well as 13 other board members from specific government entities. Another decree of the emir usually provides the exact names of the directors and appoints the vice-chair based on the recommendation of the Minister of Oil. The first KPC board was composed of the Minister of Oil, three directors representing the Ministry of Finance, the Ministry of Commerce and Industry and the Ministry of Planning, and six full-time outside directors. The same decree specified that the vice-chair of the board would act as the CEO.

Generally speaking, the appointment of directors in statutory corporations and companies in which the government has a majority stake is quite political. Even the appointments to fill management posts are sometimes politicised, especially in companies not perceived to be of strategic value. In companies of strategic economic value, such as KPC, management posts are usually filled based on professional credentials. Experience shows that some board members appointed on SOE boards have had conflicts of interest, despite the prohibition of such by the Commercial Companies Law. This is not a trivial point

considering that Kuwait's commercial legislation places legal responsibility with the chair of the board, the vice chair and/or the members of the management team.

In enterprises in which the government owns a minority stake, the Ministry of Finance or KIA appoints its directors and co-ordinates with other major shareholder(s) when it comes to the appointment of the chair, vice chair and CEO. In newly established enterprises, the board is entirely appointed by the Ministry of Finance/ KIA, even if the government share is less than 50%, provided that the remaining shares are allocated equally to all Kuwaiti nationals and no major shareholder exists. For example, the Council of Ministers recently took a decision to establish a fifth Islamic Bank with paid-up capital of KWD 100 million. The articles of association stipulate that KIA will own 24% of the capital and that the remaining capital shall be allocated among Kuwaiti nationals. The first slate of board of directors was appointed entirely by KIA for a three-year term, after which directors will be elected under the Commercial Companies Law.

In all SOEs, whether established by specific legislation or in accordance with the Commercial Companies Law, the board is given full legal authority and responsibility over the operations. In statutory companies, the board of directors is granted even greater powers than in those enterprises subject to the Commercial Companies Law. The legal responsibility rests with authorised signatories like the chair of the board, the vice chair and the CEO. Legal proceedings against the enterprise are usually brought against the chair unless otherwise specified in the founding documents, which results in many SOEs' having insurance policies for its chair and board members.

The Commercial Companies Law gives broad powers to the board, including approval of the by-laws. In SOEs with majority government shareholding, the chair and/or the CEO may choose to co-ordinate with either KIA or the line minister before taking major decisions. The board is required to hold at least four meetings a year. It can form committees composed of directors and outside experts as it sees suitable to help monitor the operations. The CEO can sit on the board; in this case s/he is given the title of managing director. In fact, Kuwaiti SOEs have a history of combining the role of the chair with that of the CEO; however, this practice has been changing in recent years.

In terms of remuneration policies and practices, the board can usually approve a different salary scale for an SOE than that established by the Civil Services Commission (CSC), a regulatory body that establishes guidelines for civil servants' pay. If an SOE board approves remuneration higher than that

established by the CSC, the amount is usually submitted to the Audit Bureau and the CSC for monitoring and control. Nonetheless, remuneration arrangements in the private sector are typically more competitive than those in the public sector, even in commercial SOEs. To compensate, members of SOE management are sometimes provided with generous health insurance as well as housing and schooling allowances.

Transparency and disclosure

The Commercial Companies Law outlines the disclosure requirements for enterprises, including for SOEs, subject to it. Additional requirements for SOEs are sometimes stipulated in company by-laws or in other founding documents. When additional reporting requirements (for example, on the frequency of reporting) apply, they are approved by the board of directors when it approves the by-laws. Where reporting requirements are outlined in company by-laws, they are not standardised. For instance, the legislation forming the KAC stipulates that the board of directors is responsible for overseeing the preparation of the annual report and must submit it to the Parliament after obtaining approval from the line minister and the Council of Ministers.

For listed SOEs, quarterly reporting is required by virtue of the listing requirements of the Kuwait Stock Exchange. SOEs are subject to the same listing procedures as are private sector companies, including providing the stock exchange with annual unaudited financial statements for the previous three years and one audited financial statement. The summary of the financial statements is usually posted on the stock exchange website; however, the details are generally not publicly disclosed.

Generally speaking, more emphasis is given to financial reporting, not only in SOEs but in all Kuwaiti enterprises. This is consistent with the situation of other MENA countries. Non-financial reporting is usually limited to information on the nomination and operation of the board of directors. Financial reports are generally circulated to the board of directors and are very seldom disclosed to other shareholders. KIA has the right to request additional reporting, financial or non-financial, beyond what the stock exchange or the securities regulator requires.

At the annual general assembly meetings, shareholders have the right to question management. Nevertheless, management has often refused to provide detailed financial reporting to the shareholders or to discuss the particular details of financial or operational performance. Most of the reporting is circulated only to the board of directors. The general public tends to be unaware

of SOEs' financial or operational performance. On the other hand, the Audit Bureau has the right to request complete financial reporting.

SOE performance and prospects

Assessing SOE performance

Studies show that Kuwaiti SOEs are inefficient, both in terms of their use of human and financial resources. For instance, the KPC appears inefficient when benchmarked against similar private sector enterprises – in fact, government investments in KPC have not realised a financial return higher than investing in bonds (World Bank, 1994). Additional evidence of the inefficiency of Kuwaiti SOEs is that some of them are not able to compete successfully with private sector entrants. This was the case with both the Kuwait Airways Corporation and the Kuwait Public Transport Company, which were unable to compete when their respective sectors were liberalised and opened to competition. Both have been loss-making since then, in spite of the various direct and indirect subsidies made available to them. Similarly, some SOEs in the food sector appear profitable only because of the subsidies they receive.

Over the past decade, the government of Kuwait has been rethinking its role in some sectors of the economy, previously seen as strategic (e.g. airline transport). At the same time, while the Parliament recently passed antitrust legislation to prevent market monopolies by the private sector, some SOEs continue to enjoy monopoly or oligopoly positions. For instance, the KPA has total monopoly on seaport services. That said, although some SOEs benefit from an uneven playing field, they are subject to sectoral regulation. For example, their fee structure must be approved by the Council of Ministers. If the price of refined oil products in Kuwait is to be raised by KNPC, a decision from the Council of Ministries is required.

The reasons for Kuwaiti SOEs' low productivity and weak performance are numerous. First, management incentives and accountability structures are not in line with international good practices. Line ministries seldom hold SOEs accountable for their performance, and SOE managers have almost never been dismissed for inadequate performance. Even when SOEs incur losses, the state usually covers any deficits, in part to protect employment of nationals. Since SOEs are not required to report publicly on their performance, public scrutiny is not a consideration for the management. Last but not least, SOE management does not face market pressures to improve company performance considering that many SOE operate in non-competitive sectors.

Recent privatisation effort

During the past decade, the government of Kuwait has moved to divest some of its holdings in commercially oriented SOEs in order to energise the private sector and reduce the financial burden on the state. The first step was the sale of some stakes in SOEs owned by the Ministry of Finance/KIA and not part of the government budget. The privatisation methods varied from IPOs limited to Kuwaiti nationals to open auctions, closed bidding contests and combinations of the above. For instance, the Ministry of Finance/KIA stake in the Kuwaiti Mobile Telephone Company (now Zain) was diluted from 51% in the early 1990s to 24%. Mobile telephony is now entirely controlled by private operators. Some government stakes managed by the Ministry of Finance/KIA were divested completely (e.g. Kuwait Facilities Company, Gulf Cable Company).

In the oil sector, the government divested its interests in the refined product distribution segment. The Lube Oil plant part of the Kuwait National Petroleum Company, wholly owned by KPC, was sold to the private sector. Similarly, the Salt and Chlorine Plant of Petrochemical Industries Company (PIC), wholly owned by KPC, was also entirely privatised. Nevertheless, government ownership in the KPC or in its associated companies remained at 100%. In addition, none of the basic services such as electricity or water has been privatised so far.

The privatisation process in Kuwait can be described as rather slow despite progress in certain sectors, such as mobile telecommunications. State ownership in some sectors continues to be a heavy burden on the fiscal budget. For instance, both public and private companies provide health related services. The cost of publicly provided health care is estimated to be approximately USD 3 billion annually and is rising. Water and electricity are provided at heavily subsidised tariffs and are therefore also costly for the state.

During the past decade, the government has made a serious effort to pass the privatisation laws. In June 2010, Parliament passed the first Privatisation Law in the history of Kuwait, establishing the Higher Council for Privatisation. The law mandates the creation of a public shareholding company for each privatisation deal and requires the retention of two consulting companies, one with international experience, to evaluate each privatisation transaction.

The Law also requires that the share capital of each privatised company be allocated as follows: no less than 35% to be auctioned among interested investors, no more than 20% to be retained by the state, no more than 5% to be sold to the employees and no less than 40% to be sold to nationals through an IPO. The state will retain a golden share in each of the privatised companies.

This legislation also makes generous provisions with regard to treatment of SOE employees in transition. Specifically, the law provides that Kuwaiti nationals employed by an SOE prior to privatisation are to be transferred to the newly established company and must be given an employment contract of no fewer than five years, with the same salary and benefits as before the privatisation. Also, the state retains the responsibility for finding employment for Kuwaiti nationals who are unwilling to work for the privatised company.

Thus far, the largest recent experiment with privatisation is the case of the Kuwait Airways Corporation, described in further detail in Box 4.1.

Box 4.1. Privatisation of the Kuwait Airways Corporation

The Kuwait Airways Corporation (KAC) was previously owned by the Ministry of Finance/KIA and regulated by the Ministry of Communication. Until five years ago, KAC had a monopoly on airline services in Kuwait and was granted benefits in the form of facilities, fuel discounts, etc. KAC has been loss-making ever since other airline companies were permitted to enter the market. In February 2008, the Parliament passed a law to privatise KAC.

The Council of Ministers was charged with nominating a government agency to establish a shareholding company within two years from the date of this law. KIA was designated as the appropriate entity. KAC's assets and liabilities will be transferred to a newly established company, the capital of which will be determined based on the results of an evaluation. KIA has retained two international companies, selected through a transparent competitive bidding process, to evaluate the assets. The evaluation results were reviewed by KIA, provided to the Audit Bureau for comments and then presented to the Council of Ministers.

In February 2010, the Council of Ministers passed a decision adopting the evaluation results and entrusted KIA to establish a Kuwaiti Public Shareholding Company under the name of Kuwait Airways Company with paid-up capital of KWD 220 million (approximately USD 787 million) in accordance with the Commercial Companies Law.

The shares of the new company will be allocated as follows: a bloc of 35% to be auctioned to strategic investors, 20% of capital to be allocated to KIA, 5% to be allocated equally among the current employees of KAC (who will be not allowed to trade shares for three years), and 40% to be offered to Kuwaiti nationals through an IPO. Local airline companies are not allowed to participate in this auction. Government income from the divestment proceeds will be divided equally between the General Reserve Fund (GRF) and the Future Generation Reserve Fund (FGF).

An application was submitted to the Ministry of Commerce to incorporate the new company in accordance with the Commercial Companies Law, with the capital specified in the Council of Ministers' decision and per the allocation of share capital as described above. Technical experts are currently working with KAC management and the Civil Service Commission to deal with issues concerning Kuwaiti nationals employed by the company. In the near future, it is expected that strategic investors will be solicited regarding acquiring 35% of the new company's capital.

The success of the KAC's privatisation is crucial to the overall privatisation process in Kuwait. If completed, it will be the second full privatisation in the country. At this point, it is early to judge the success of this experience. KIA has already succeeded in divesting many of its smaller holdings in listed companies, and the oil sector has seen limited privatisation as well. It is hoped that the KAC transaction will pave the way for future privatisation deals in Kuwait and to an eventual reduction of the state's role in commercial activities. This might be a challenge considering that the state is continuing to establish SOEs in certain sectors.

Notes

1. National Bank of Kuwait website (nbk.com).
2. In 1995, the Kuwaiti Parliament prevented the government from changing the tariff on these services without special legislation.
3. The Souk Al Manakh market was established in 1979 as an unofficial over-the-counter stock market, specialised in the trade of highly speculative unregulated Kuwaiti incorporated foreign companies, principally from Bahrain and the United Arab Emirates. The regulated official stock market became less popular considering that after the 1976-1977 crash it became subject to heavier regulation.
4. For example, refer to Resolution 7 of 2009 of the board of directors of the Kuwait National Petroleum Company "on material purchase, entrusting services, contracting, consultancy services and sale of surplus material items."
5. At the end of each financial year, the Audit Bureau conducts complete financial and operational audit and submits its report, covering all SOEs under its audit jurisdiction, to the Speaker of the Parliament.
6. Historically, this price has been on the low side, resulting in a very conservative budget presented by the government in order to avoid potential questioning from the Parliament at the end of the year.
7. The GRF was established as a main treasury for the government. It receives all revenues (including oil revenues), and all budgetary expenditures are paid out of it.
8. At the outset, the Future Generation Fund was created by transferring 50% of the GRF capital. No assets can be withdrawn from the FGF unless sanctioned by law.
9. The operational responsibility can be shifted from one ministry to another by a decision from the Council of Ministers, but the ownership is centralised in the Ministry of Finance. For example, Kuwait Airways Corporation was under the

operational responsibility of the Ministry of Finance, but recently this was shifted to the Minister of Communication.

10. An exception to this is Kuwait Airways Corporation, for which the law specifies the Minister of Finance in the general assembly.

Bibliography

Ahmed Al-Rifai, (2006), *Privatisation: the Kuwaiti Experience,* Dar Atlas Book Store, Damascus, Syria.

Central Statistical Office (2010), *Annual Statistics Abstract for 2008*, Edition 45, Issue 32.

Fryer, Jonathan reviewed by Abdel Malek Al-Tamimi (2009), *The Oil and Development in Kuwait*, Stacey International, London, UK.

Khouja, M.W. and P.G. Sadler (1979), *The Economy of Kuwait,* Macmillan Press London, UK.

Kuwait Al-Youm, The Official Gazette of The Government of Kuwait, Issues 64, 857, 979, 982, 998 and 987.

Kuwait Legislation and Fatwa Department (2005), *Legislation*, Vol. 11, Kuwait City, Kuwait.

Kuwait Ministry of Oil (1983), *Naft of Kuwait – Facts and Numbers*, Kuwait City, Kuwait.

Kuwait Stock Exchange (2010), *Data on Listed Companies – Capitalization & Shareholder Structure*.

World Bank (1994), *Privatisation Strategy in Kuwait.*

World Bank (2001), *Energising the Private Sector in Kuwait.*

Chapter 5

Transparency of Egypt's public-private joint ventures

by

Jennifer Bremer
Associate Professor of Public Policy
and Chair, Public Policy and Administration Department,
School of Global Affairs and Public Policy, American University in Cairo

This chapter examines a part of the state-owned enterprise sector that has been relatively unexplored to date, whether in Egypt or in the wider Middle East and North Africa region, namely, public-private joint ventures. Such ventures are a major feature of state-owned sectors across the region and are indeed the most common corporate form in Egypt's oil and gas sector. They deserve greater attention for their importance within the overall role of the state in the economy, but also for the special challenges they pose in terms of corporate governance. The analysis presented here constitutes an initial effort to close the information gap on corporate governance of joint ventures with public participation, specifically focusing on transparency and disclosure practices. To assess performance in this area, this paper first explores the governance environment in which these firms operate, with particular attention to disclosure. It then analyses disclosure of key governance information on corporate websites for a sample of 12 holding companies and 100 public-private joint ventures.

Introduction

The Government of Egypt has made a considerable effort to introduce standards of corporate governance in both public and private sector firms, as discussed elsewhere in this book. The Egyptian Institute of Directors (EIOD) was launched in 2003 by the Ministry of Investment (MOI)[1] with a mandate to promote better corporate governance. Although responsibility for the EIOD was transferred in June 2011 to the Egyptian Financial Supervisory Authority (EFSA, Egypt's financial market supervisor), the Institute is expected to continue working on governance in both the public and private spheres.

To date, the Institute has done substantial work in trying to promote good governance in Egyptian state-owned enterprises (SOEs), and indeed it is notable that Egypt was the first country in the region to issue a corporate governance code for SOEs in 2006. The EIOD also sought to promote good governance of SOEs on a regional level, and hosted one of the meetings of the OECD Taskforce on Corporate Governance of SOEs in Cairo in June 2010.

While much attention has focused on state-owned companies, improvement of governance in joint ventures (JVs) between the state and private investors also deserves serious consideration. First, such ventures are very common in Egypt and more generally in the Middle East and North Africa (MENA) region. Although relatively few new SOEs are now being formed in countries committed to market based approaches, the formation of new JVs with state participation remains common.

Second, public-private joint ventures face special governance challenges that differ in important respects from those of firms that are entirely state-owned or entirely private. The state's ownership objectives may diverge substantially from the objectives of the private partners. The two classes of owners may hold very different views on such critical governance issues as risk appetite, disclosure and transparency, and commitments to social and environmental standards.[2]

Third, as further discussed below, such firms may also be subject to complex and unclear reporting regimes, in part because their different classes of owners must comply with different regulatory constraints and reporting requirements depending on whether they are listed firms, government agencies, state-owned firms, privately held firms, other joint ventures, or even individuals. Arm's length relations between the regulator and the regulated are impossible to achieve if the government is on both sides of the table.

This chapter examines corporate governance practices in a sample of private-public JVs and in public sector holding companies that are most directly responsible for overseeing them. It focuses on transparency and disclosure, providing an analysis of disclosure practices through company websites. By definition, public-private JVs have both public and private ownership. Private investors vary widely in the nature and scope of their investment. Some are strategic partners exercising considerable managerial control, while others are passive or minority institutional or private investors that have little impact on the governance arrangements of a given joint venture.

The ownership structure within the government can be equally complex. It may include ministries, public sector firms (including government-owned or JV banks), intergovernmental organisations (jointly owned by multiple Arab governments) and other stakeholders such as unions. Annex 5.A.1 illustrates the complexity of public sector ownership, providing two examples of how different government stakeholders may have a role in the ownership of public-private JVs, both directly and indirectly. An important point is that some, but not all, of these ownership shares may be reflected in board positions.

A major theme of this chapter is that this dispersion of government ownership complicates oversight, given that public owners differ in their mandates, ownership objectives and perceptions of their role as shareholders. The following considerations support the importance of addressing governance of public-private JVs in Egypt and elsewhere:

- Joint ventures constitute an important and, in at least in Egypt, a growing segment of SOEs. Whereas the Ministry of Investment (before its dissolution in 2011) oversaw fewer than 150 firms classified as public enterprises in mid-2011, JVs under Ministry oversight numbered 662 and are continuing to increase.
- Overall, JVs between Egyptian firms and the government constitute an important part of the publicly traded corporate sector: an analysis of 50 most active firms trading on the Egyptian Stock Exchange in 2006 found that, on average, about a quarter of the shares of these companies were held by public sector firms (Bremer and Elias, 2007).
- In the rapidly growing petroleum and petrochemicals sector, all foreign investment must be made through joint ventures in which the state retains at least a 50% ownership. This sector merits special attention to ensure good governance, not only because the investments tend to be very large but also because it is widely recognised as being subject to particular governance challenges.

In light of these considerations, it is surprising that corporate governance of public-private JVs has not received more attention. A possible explanation is that the topic has simply fallen between the cracks, overlooked by both mainstream corporate governance analysts and those working on public sector governance.

Structure of the public joint ventures sector

Before its dissolution in October 2011, the Ministry of Investment's Asset Management Programme[3] database included 662 joint ventures (MOI official, personal communication). Of these, 386 were owned in part by one of the 9 holding companies under MOI's oversight, in addition to 276 JVs partially held by other Ministries and entities. Some of the shares in these firms are held by one or more public sector firms or other public sector entities; ownership by public sector banks and insurance firms accounts for the largest share of these non-holding company shares.

Table 5.1. Holding companies studied

Overseen by the Ministry of Investment
Drug Holding Company (D.H.C.) Holdipharma
Holding Company for Building and Construction
Holding Company for Chemical Industries
Holding Company for Food Industries
Holding Company for Insurance
Holding Company for Maritime and Inland Transport
Holding Company for Metallurgical Industries
Holding Company for Spinning and Weaving
Holding Company for Tourism, Hotels and Cinema
Overseen by other ministries
ACDIMA (pharmaceuticals)
Echem (energy)
Ganope (energy)

Source: Author's analysis.

Not all joint ventures are included in the MOI database, nor are the nine holding companies subject to MOI oversight the only public sector holding companies in Egypt (see Table 5.1 above). The five holding companies under the Ministry of Petroleum's oversight together hold a huge, but not publicly

disclosed, portfolio of public shares in ventures in this sector. The Egyptian Petrochemical Holding Company (ECHEM) and the Ganoub El-Wadi [South Valley] Petroleum Holding Company (Ganope), further discussed below, are two examples of such holding companies.

Similarly, the Arab Company for Drug Industries and Medical Supplies (ACDIMA), a holding company for pharmaceutical companies, is itself a JV of 11 Arab country governments, operating under the oversight of the Arab League and the ministries of health in its member countries. Several other ministries operate holding companies for the management of SOEs, such as the Ministry of Electricity and the Ministry of Housing, Utilities, and Urban Development. It is impossible to obtain even a listing of all of the holding companies overseen by the different line ministries in Egypt, much less their holdings.

This chapter does not seek to clarify this very complex situation, but instead focuses on the firms included in the MOI joint venture database and the holding companies in its oversight. Within this narrower scope, it concentrates primarily on the disclosure of corporate governance information through these firms' websites. The chapter examines a sample of 100 joint ventures and 12 holding companies (including nine under MOI and three others that have share ownership in one or more of the 100 JVs analysed). The 100 companies include all those listed on the MOI joint venture database in four sectors: chemicals, information technology, energy and pharmaceuticals. Table 5.2 below provides a summary of JVs examined by sector.

Table 5.2. Summary of joint venture firms studied

	Sample analysed	All firms studied
Sector		
Chemicals	14	38
Energy	21	32
Information technology	8	22
Pharmaceuticals	5	8
Listing status		
Listed	13	16
Not listed	35	84
Total	48	100

Source: Author's analysis.

A significant barrier to the effective oversight of Egypt's governmental ownership in joint ventures, and to assessing the quality of such oversight, is that no consolidated listing of JVs with state participation exists (author's communication with an MOI official). Even setting aside entities considered "strategic", held by the Ministry of Petroleum or Defence -- for which very limited information is available -- there has not been an effort to develop a consolidated listing of such ownership stakes.

The lack of consolidated information on SOEs in Egypt reflects the absence of a single government agency with oversight authority over the entire sector, including joint ventures with state participation. The 1991 reform that created the current ownership structure was designed primarily to support the privatisation programme, consolidating only companies that were targeted in that effort under the oversight of a single governmental entity (the Ministry of Investment). In the intervening 20 years, there has been a continuing expansion in the JV sector, as state entities have entered into new partnerships with foreign and domestic partners. Thus, even the holding companies under MOI supervision do not necessarily cover all of the public-private JVs in their sector, and many holding companies were not under MOI supervision (before its dissolution).

The absence of aggregate statistics on the size and composition of the state-owned sector, including JVs with state participation, precludes an effective analysis of the performance and governance of the sector as a whole or its constituencies, therefore lowering the quality of overall oversight. Available information makes it clear that both forms of enterprise continue to constitute an important element of the business sector in Egypt, despite the privatisation programmes carried out over the past 20 years and the increased emphasis on attracting private investment in Egypt since 2004.

This situation also makes it impossible to create a single consolidated report on the state-owned enterprise sector in Egypt, a practice employed in some countries to promote transparent communication to the public. The MOI last produced a consolidated report for companies that it was responsible for in 2009. This may be attributable to the sharp fall off in all types of regulatory compliance, both within and outside the government, since the recent revolution. In any event, the MOI's report fell short of a consolidated report on the SOE sector as a whole.

The remainder of this analysis is organised into three parts. The first briefly summarises the governance environment for public-private JVs, with an emphasis on transparency and disclosure. The second provides a comparison of

online governance disclosure for a sample of 100 JVs and 12 state-owned holding companies under the overall jurisdiction of the MOI. The third part draws conclusions and recommendations from this analysis regarding measures to improve transparency and disclosure in particular and the governance of public-private JVs overall.

Corporate governance of public joint ventures

Legal and regulatory environment

The governance of any corporation is shaped by the rules and standards that define what is required or expected, by the specific characteristics of the firm (notably its shareholding structure) and by the environment in which it operates. Two companies operating under an identical set of rules but in two different countries with highly divergent enforcement regimes may thus vary greatly in the way they are governed. Similarly, a company controlled by activist institutional investors in a heavily regulated sector is likely to display a very different style of governance than one with a single dominant owner, passive minority shareholders and limited government scrutiny.

To fully appreciate the environment in which Egyptian public sector joint ventures operate, it is necessary to consider the ownership context and the regulatory framework in which they operate, a task far beyond the scope of this chapter. Instead, the discussion in this section will examine the legal environment; that is, the laws under which the firms' reporting requirements were established. It will also aim to clarify the shareholding structure of public JVs in Egypt. This section will not examine the overall environment shaping corporate governance and public sector transparency in the region, which has been addressed elsewhere in this book (see Chapter 1 in this book).

Disclosure respects the citizens' right to know how public funds are used and what companies having full or partial government ownership do in the name of their ultimate owners, the citizens. The Government of Egypt has officially recognised the importance of improving transparency and disclosure as a key feature of improving corporate governance of private- and public sector enterprises. This has led it to create the Egyptian Institute of Directors and to develop a corporate governance code and guidance specific to SOEs.

The Ministry of Investment issued a Code of Corporate Governance for the Public Enterprise Sector in July 2006. The Code recommends that "[t]he State…should ensure the adoption of good practices of corporate governance in a manner that is grounded in transparency, responsibility and accountability…"

(MOI, 2006). Although its recommendations are not mandatory, this document remains the most recent specific guidance on governance in the SOE sector.

In terms of disclosure practices, the code recommends: "Regardless of whether or not public enterprises are listed in the stock market, they should disclose their financial and non-financial information in the same manner as the private sector. They should also adhere to the accepted international accounting standards; and their financial auditors should perform their duties in accordance with international auditing standards"(ibid).

Furthermore, the code suggests that "it is also useful for the holding companies to request their affiliated companies to establish electronic websites where their periodical reports and all the information that requires disclosure can be posted to facilitate their review by individuals and institutions alike". Whereas this guidance does not mandate use of web-based disclosure *per se*, the requirement to follow private sector good practices indirectly supports such use, as web-based disclosure has become nearly universal for publicly traded firms in international markets.

In addition to this code, in 2008 the Ministry of Investment issued general procedures and guidelines as part of its Asset Management Programme, which replaced the Privatisation Programme as the mechanism for managing SOEs and JVs under MOI responsibility. This document calls on SOEs to disclose their performance and financial information and to provide general assembly meeting minutes through the MOI website, in addition to making printed documents publicly available.

Beyond these general recommendations, the legal requirements bearing on disclosure practices of joint ventures with state participation differ based on the laws according under which they were formed. Of those for which the governing law is shown, about two-thirds are governed by Investment Law 230. An MOI official interviewed for this study indicated that a company established under the Companies Law 159 should be subject to the Investment Guarantees and Incentives Law 8 if the share of public sector ownership is below 50%, but there appears to be no clear pattern distinguishing which firms are governed by which law. Table 5.3 provides a summary of the founding legislation of the 100 joint ventures examined as part of this study.

Table 5.3. Laws governing joint ventures examined

Governing law	Joint ventures established under the law (among the 100 JVs studied)				Title	Relevant authority
	No. of firms	Public shareholding (%)				
		Average[1]	Minimum	Maximum		
Law no. 8 for 1997	25	44.8	0.13	100.00	Investment Guarantees and Incentives Law	General Authority for Investment and Free Zones (GAFI)
Law no. 43 for 1974	10	37.9	7.32	98.00	Arab and Foreign Capital Investment and Free Zones Law as amended by Law No. 32 of 1977	General Authority for Investment and Free Zones
Law no. 95 for 1992	1	8.5	NA	NA	Capital Markets Law	Egyptian Financial Supervisory Authority (EFSA)
Law no. 159 for 1981	14	37.9	0.07	84.83	Business Public Companies Law (public sector companies)	Ministry of Investment (MOI) or successor
Law no. 203 for 1981	1	36.3	NA	NA	Public Business Sector Law [2]	Ministry of Investment or successor
Law no. 230 for 1989	23	49.6	0.30	100.00	Investment Law	(Replaced by Law no. 8 for 1997)
Not specified	26	29.7	0.10	99.70		
	100	39.9				
o/w Law 230 and Law 8	48	47.1				

Notes: [1]55 of the 100 firms in the sample have at least 25% of their shares held by the public sector, which is the threshold for audit by the Central Audit Authority.
[2] Applies to holding companies under the privatisation/asset management programme and their subsidiaries ("affiliated companies", as per the law's terminology).

Source: Ministry of Investment joint venture database and author's analysis.

The share ownership structure in public-private ventures

The analysis presented in this section uses the same set of 100 joint venture firms used for the website disclosure discussion below. It is impossible to ascertain whether the firms selected for this exercise are representative of the entire universe of 600 or so JVs that the MOI tracks, much less the larger population of JVs. The MOI joint venture database provides information on the year of establishment and the governing law applicable to each JV.

Table 5.4 shows the distribution of ownership of the 100 public-private joint ventures examined in this study. Sixteen the 100 companies in the sample are themselves listed firms, and thus also fall under the regulation of the Egyptian Stock Exchange and the Egyptian Financial Supervisory Authority (formerly the Capital Market Authority). If more than 25% of their shares are held by the public sector, they are further subject to the regulation and audit of the Central Audit Authority.

Table 5.4. Distribution of public sector ownership in the 100 firm sample

Percentage of public ownership[1]	Number of firms
0-10%	23
11-25%	24
26-50%	24
51-75%	9
76-90%	9
91-100%	11
Total	100
Average	40%

Note: Includes all public sector entities for which information is available, including public sector companies, ministries, authorities and syndicates.

Source: Ministry of Investment website and author's analysis.

Although the data presented in Table 5.5 below suggest that the pace of establishment of JVs has increased, this cannot be stated with confidence, as no equivalent data are available on firms established in earlier periods that are no longer in operation, were merged with other firms or privatised.

Table 5.5. Year of joint venture establishment

Period	Number in period	Number/year
Before 1952	3	NA
1952-1975	3	0.1
1976-1995	26	1.3
1996-2011	41	2.6
Not in database	27	NA
Total	100	

Source: Ministry of Investment joint venture database and author's analysis.

Tables 5.6 and 5.7 summarise the distribution of shares for the 100 joint ventures examined by ownership class. Fifteen institutional investors, notably public sector banks and insurance companies, but also ministries, control 63% of the public sector holdings and 25% of all shares in the 100 joint ventures studied.

Table 5.6. Ownership of the 100 JVs by public sector institutional investors

Holdings by class of investor				Holdings by class of investor	
Class of investor	**No. in class**	**Number of investments by class**	**Average investment (% of shares)**	**Percentage of public sector shareholdings**	**Percentage of all shares**
Bank	9	104	10	25	10
Insurance firm	4	53	9	12	5
Ministry	10	32	32	26	10
Company	28	57	16	23	9
Syndicate	4	9	19	4	2
Holding company	7	22	18	10	4
Total	62	277	14	100	40

Note: The "number of investments by class" column indicates the total number of blocks of stock held in one of the 100 companies by members of the investor class. For example, if three banks each hold a block of shares in two different companies, this would count as six shareholdings. The "average holding" is the average percentage of the target company's shares held in a single block. Thus, on average, a ministry holds a 32% share *in a company in which it is invested,* but this translates to only 10% of the total shares in all 100 companies because the ministry holdings are concentrated in comparatively few companies.

Source: Ministry of Investment website and author's calculations.

The data presented in this section refer to the number of shares, not to their value, and this is an important distinction. Information on share value or total shareholders' equity is available only for the 16 companies traded on the stock exchange and for the very few unlisted companies that provide balance sheets on their websites (2 out of 35 in the sample of 48 JVs studied). MOI information shows only share value when issued, which is not useful for a comparative analysis.

Table 5.7. Control of joint ventures studied by public sector investors

Percentage of JV companies with shares held by at least one		Average % of shares held in company by all members of the class
Public bank	50	20
Public insurance company	37	13
Public bank and/or public insurance company	63	23
Public company	33	28
Ministry or authority	28	37

Note: For example, 50 of the 100 companies have one or more banks among their shareholders and banks hold on average 20% of the shares in these companies. Altogether, 63 of the 100 companies have a bank and/or insurance company among their owners and the latter have an average combined shareholding of 23% in such companies. Average shareholdings do not add up to 100% because not all classes of investor hold shares in all companies. Not shown in this table are holding companies or syndicate shares: these classes of investors each hold less than 10% of the total company shares.

Source: Ministry of Investment joint-venture database and author's analysis.

Holding companies are by no means the main public sector investors in the JVs, accounting for only 10% of the public sector shares and 4% of all shares in the 100 companies studied. The holdings of any one among the largest public sector bank and insurance company investors (e.g. the National Bank of Egypt, Banque Misr, Misr Insurance[4]) are almost as large as the combined ownership of all 12 holding companies in these ventures. The largest public sector institutional investor in the sample is the Egyptian General Authority for Petroleum, with 18 holdings averaging 45% of the shares of target companies.

The MOI assembles the information on public sector shareholding in joint ventures from information provided by the public sector investors themselves, not by the target firms. In principle, these firms submit annual reports to the General Authority for Investment and Free Zones (GAFI)[5], but the MOI did not have enough staff to compile information on private investments in these companies from this or other sources. The remaining 60% of shares are held by

private sector companies -- both foreign and domestic -- and individuals, either as private investors or through ownership of shares listed on the stock exchange. Information on the distribution of ownership among these classes of investors is not available.

To illustrate how these shareholdings translate into the ownership structure of a public JV, Annex 5.A.1 presents the shareholding structure of two firms. It highlights the diversity of shareholder interests in many JVs. In each of these cases, the owners are themselves regulated or controlled by four ministries, each of which is subject to different laws and may seek different objectives. For example, the Ministry of Labour regulates the public sector syndicates (unions), which own shares in many of the JVs as well as representing the workforce in negotiations with management.

Assessment of the disclosure provided

In order to explore the level of disclosure and transparency practiced by public-private JVs, an analysis was undertaken to determine the degree to which key information on their performance and governance is disclosed on JVs' and holding companies' websites. As further discussed in Annex 5.A.2 on methodology, analysis of Internet-based disclosure has become a standard approach in recent years for assessing disclosure practices. This approach has been adopted here for both theoretical and practical reasons.

On the theoretical side, disclosure of information on the Internet maximises its availability to all stakeholders, including ordinary citizens and civil society organisations, in addition to shareholders and capital market institutions. As such, it is the "gold standard" of disclosure and transparency from a policy standpoint, with near-zero information cost. On the practical side, analysis of Internet-based disclosure is less costly and time-consuming than obtaining paper copies of annual reports, security filings and other corporate documents. In a country such as Egypt, where government documents are often difficult to obtain, the advantages of an Internet-based study are self-evident.[6]

The twelve holding companies analysed include nine established as part of the privatisation process under Law 203 of 1991, the Public Business Sector Law, and overseen by the Ministry of Investment (originally established as the ministry of public sector companies) and 3 additional holding companies in the same sectors. A group of 100 JVs was selected for analysis, including all those listed on the MOI's joint venture database for four sectors: chemicals, energy (mainly petroleum-related firms), information technology and pharmaceuticals.

A reduced set of 48 joint ventures was then identified, after eliminating 34 JVs because no website for them could be located (functional or otherwise) and 18 firms because the combined public sector shareholding was below 10% (10 firms, with an average public sector shareholding of 3.8%) or exceeded 98 percent (8 firms with an average public sector holding of 99.5%). Firms in the latter two categories were excluded as not being truly joint ventures because of the predominance of one sector or the other in their shareholding structure. A full listing of the 48 JVs analysed and their websites is provided in Annex 5.A.2.

In order to assess and compare the level of disclosure of governance-relevant information on JV and holding company websites, a methodology was developed based on the presence or absence of a selected set of key information elements. This methodology is summarised in Annex 5.A.2. The standards developed were then applied to assess the websites of the 12 holding companies and the 48 JV firms for which websites could be found. A much more limited analysis, focusing on the links among web presence, listing and public sector ownership, was completed for the full set of 100 firms.

The analysis is presented in two parts. The first part examines the overall governance environment for these 100 firms, beginning with the structure of ownership and the legal bases under which they operate. The second part of the analysis measures the disclosure of basic governance-related information on public-private JVs' and holding companies' websites. It assesses the presence or absence of 20 information items or operational features on the holding companies' websites and 15 items on JV websites. Each measure examines only whether the information is substantially present on the website; information quality is not assessed.

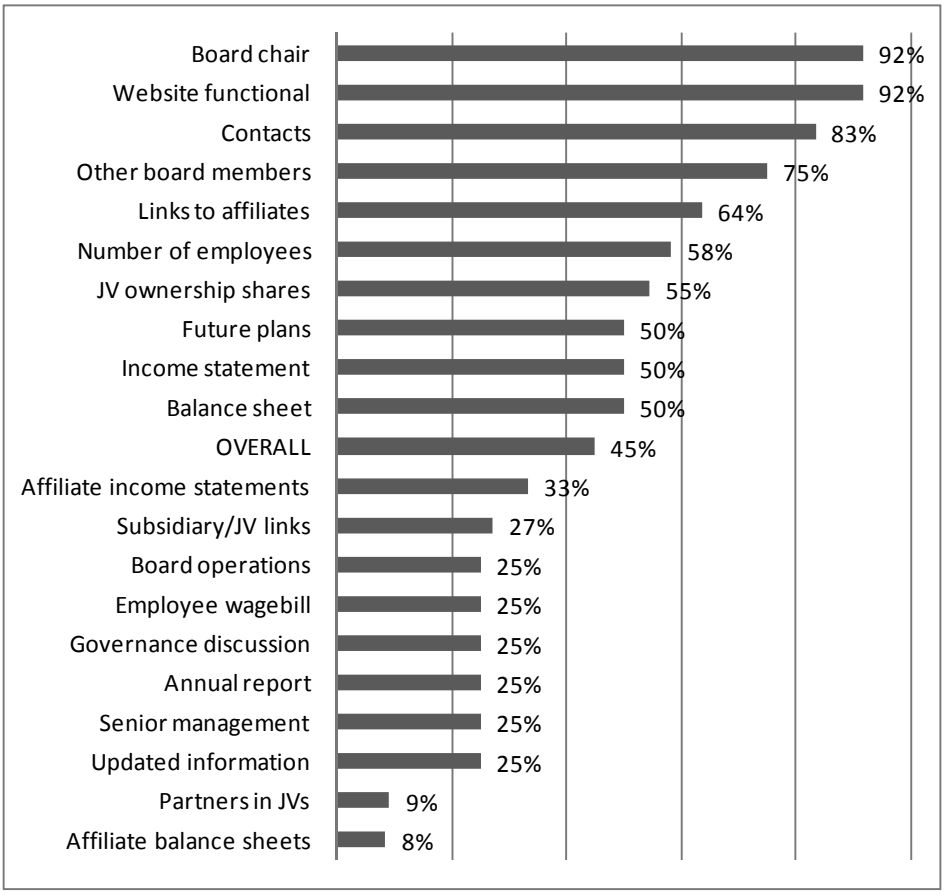
The analysis of the resulting data explores whether share ownership by public sector banks and insurance companies, listing on the Egyptian Stock Exchange and total public sector ownership influence disclosure levels. The assessment found serious deficiencies in the level of reporting for both the holding and JV companies. While listed companies in the sample provided better disclosure of key governance related information, on average, it was still found to be lagging behind international standards.

Disclosure on holding company websites

Figure 5.1 presents findings of the website-disclosure analysis for the 12 holding companies studied. 11 of the 12 websites were found to be functional, with only that of the Holding Company for Building and Construction failing to

open. All of the functioning websites provided the name of the board chair, but other basic information was absent on at least a quarter of all the websites, with an overall average of only 44% of all 20 information variables found. Only half of the websites provided a balance sheet and income statement for the holding company and only a third provided income statements for affiliates.

Figure 5.1. Disclosure of information on holding company websites
(percent of sample companies meeting standard)



Source: Author's calculations.

Key information on the governance features and processes at the level of the holding company, such as discussion of governance frameworks and practices, provision of an annual report or information on board structure and activities, was absent from three-quarters of the websites. Many of the annual

reports included only highlights of financial performance. Where income statements and balance sheets were provided, they rarely included the auditor's statement or notes, making them extremely difficult for an interested citizen or potential partner to interpret with confidence.

The holding company websites generally did not provide a substantive discussion of the affiliates or joint ventures. For example, partners in joint ventures were identified only by one holding company. Although the quality of information provided was not formally assessed in this study, comparison of the different websites found a wide variety of disclosure practices in each area. For example, only three websites provided biographical information for the chair and/or board members. Half of the websites provided some type of discussion of future plans, but these were often vague or outdated.

Several of the holding company websites provided graphs with revenues and profits in place of income statements and balance sheets. These were not counted for purposes of assessing the presence or absence of income statements and balance sheets. Some gave more detailed information, which, if providing a substantial summary of balance sheet/income statement information, were counted as meeting this criterion. The lack of consistency in content and design among the websites indicates a lack of guidance or quality control, giving the impression that it is up to each company to do what it wants.

Overall, areas of strength for disclosure by holding companies included provision of contact information and information on the board chair and other board members, all areas where at least three-quarters of the companies met the standard. Areas of weakness surrounded financial disclosure, with only three companies providing an online version of the annual report; only one company, Echem, disclosing the partners in its JVs; and only one company, the Holding Company for Insurance, providing balance sheets for its affiliates.

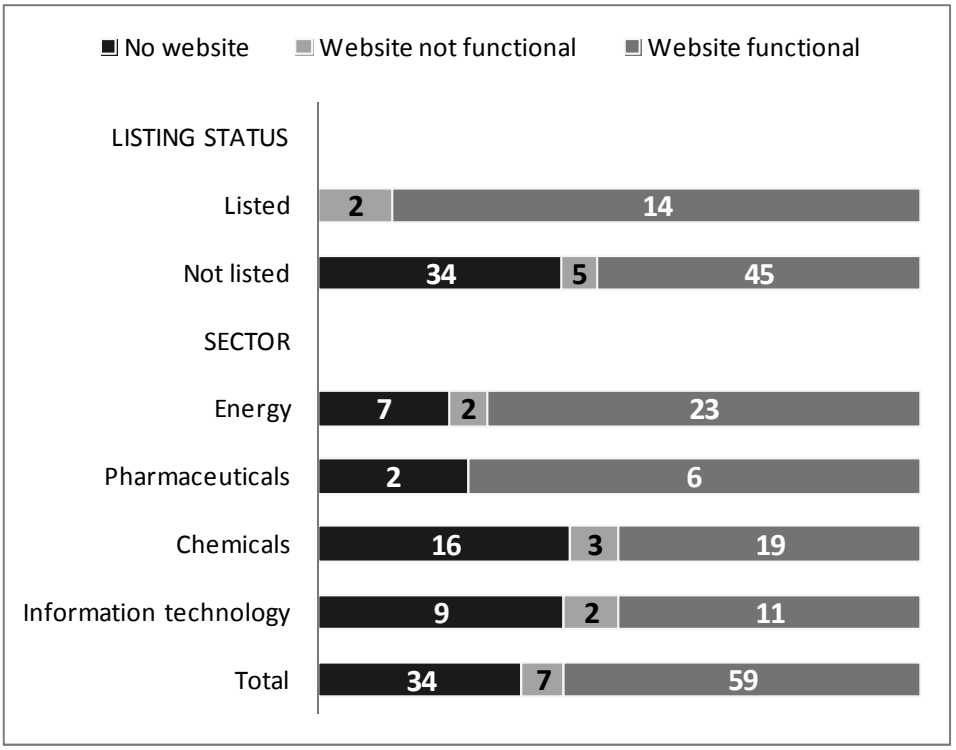
A few notable exceptions should be highlighted. For instance, the Chemical Industry Holding Company provided a very good discussion of the industry restructuring process. In addition, the website of the Holding Company for Insurance presented extensive financial information on the performance of the company and the industry restructuring process, including consolidated financial statements for the past four years and regular newsletters indicating progress made in implementing its plans. The experiences of these holding companies may be instructive for other sectoral holding companies, and competitive dynamics among holding companies may help raise the disclosure bar for all.

Disclosure on joint venture websites

A review of JV websites found an overall level of disclosure even lower than that of the holding companies, indicating a commensurately greater need for improvement. An initial examination of 100 companies found that only 59 had functioning websites (not all of which were fully functional). Thirty-four companies had no website that could be identified after a diligent search[7], and seven had a website that would not open at all despite repeated attempts.

Figure 5.2 provides further detail on this initial screening. Somewhat surprisingly, the information technology sector tied the chemicals sector as the worst-performing in terms of disclosure, while the energy and pharmaceuticals sectors performed at a somewhat higher level. Listed firms were more likely to have functional websites than non-listed ones, although 2 of the 16 listed firms failed to meet this requirement.

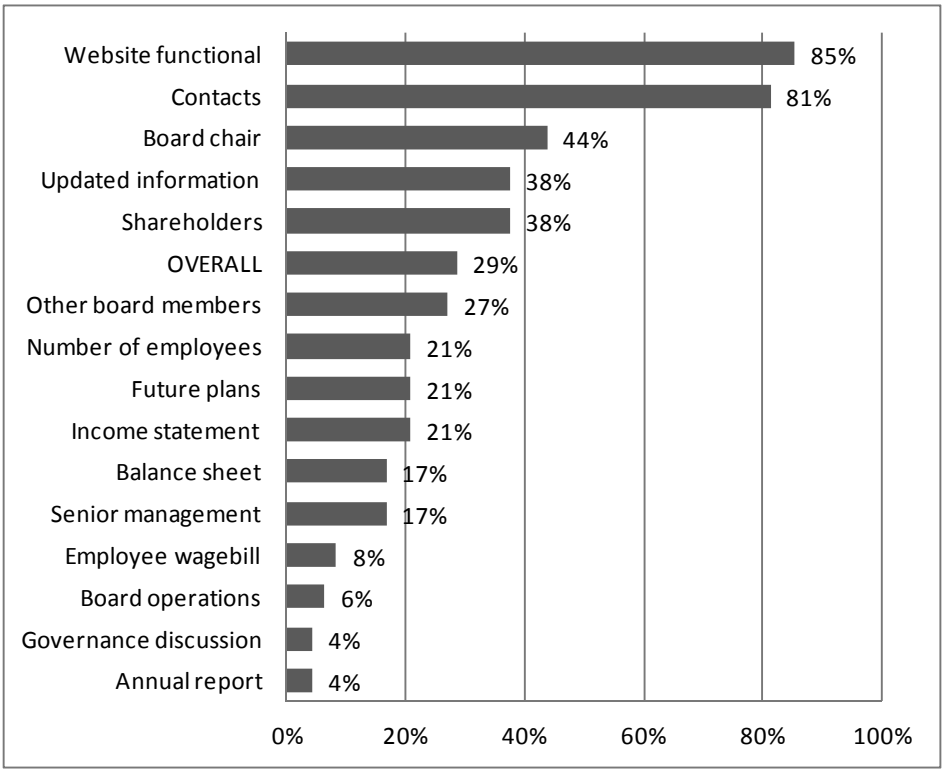
Figure 5.2. Distribution of all JV firms studied by web presence and functionality
(number of firms)



Source: Author's calculations.

A set of 48 companies was identified for further analysis by excluding those with state ownership of less than 10% or 98% or more, as well as those for which no website could be identified. The results of the more detailed analysis of these firms' websites are summarised in Figure 5.3.

Figure 5.3. Disclosure of information on joint venture websites
(percent of companies meeting standard)

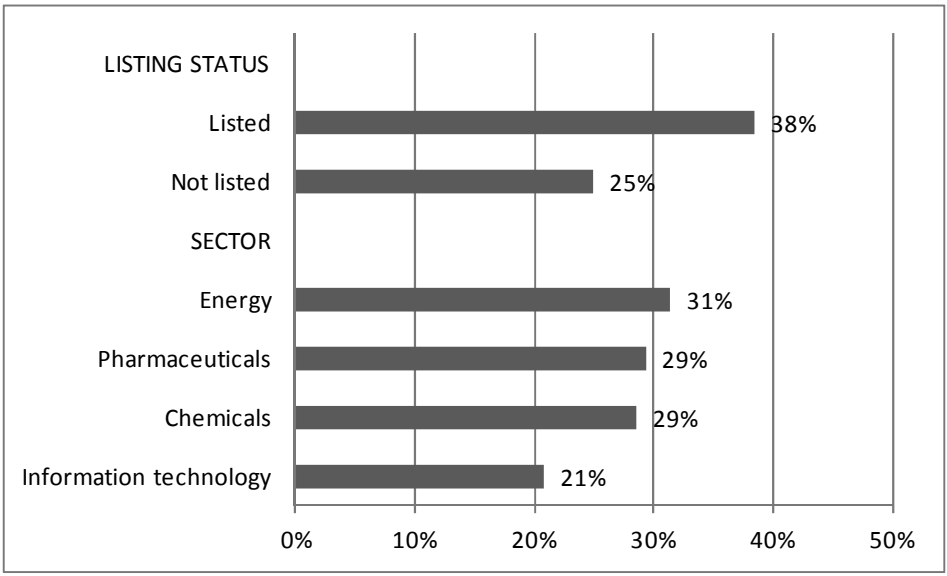


Source: Author's calculations.

The overall standard of performance did not reach a level that can be considered acceptable. Roughly one in seven websites could not be opened at all. Other than contact information, which was available on almost all of the functional websites, no criterion surpassed the 50% compliance mark, resulting in an overall average score of only 29%. Performance was very low on financial disclosure, with only about a fifth providing a balance sheet and income statement and a mere 4% making an annual report available on the site.

Disclosure on governance issues was worse, with only 4% discussing governance beyond the basics and only 6% giving any information on board operations (such as a mention of board committees). Nearly three-quarters failed to name their board members. As can be seen in Figure 5.4, performance was somewhat better for listed firms, with 38% of standards met, as opposed to unlisted firms with only 23%. Given the minimal standards used in this compliance test, one would have hoped to find near full compliance on the set of disclosure variables measured, at least among listed firms.

Figure 5.4. Overall JV disclosure level by sector and listing status
(sample average compliance with the 15 standards)



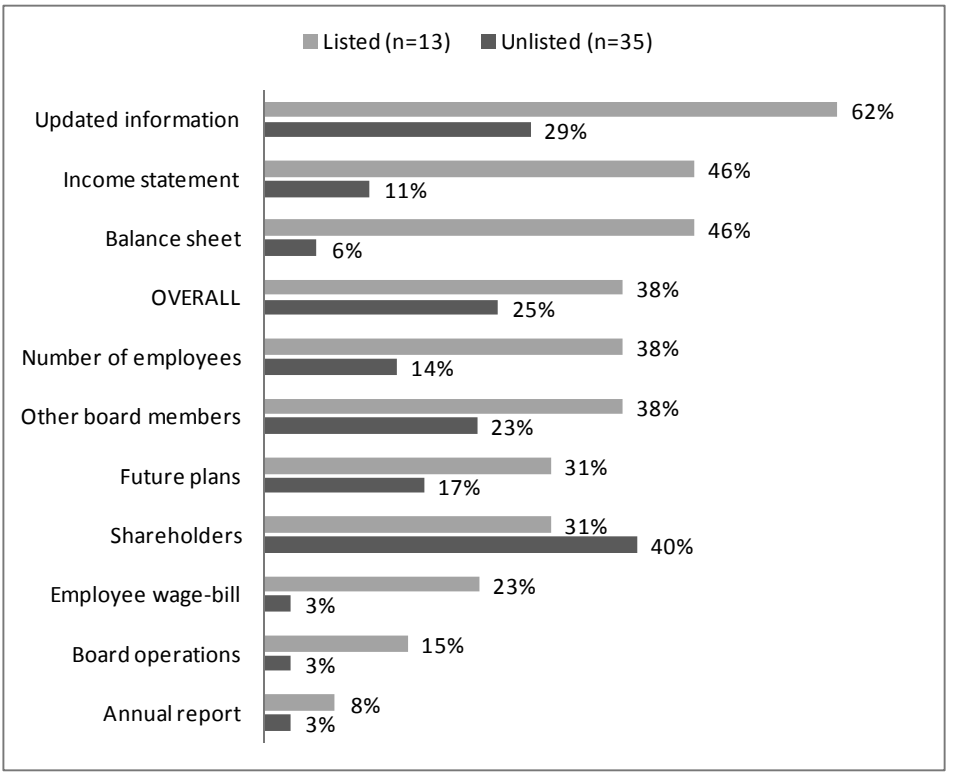
Source: Author's calculations.

The petroleum companies had the best average performance among all sectors studied, although the pharmaceutical and chemical companies were nearly as good. The information technology firms were the worst performers, meeting just over a fifth of the standards on average. Given that two of these firms are specifically dedicated to capital market and regulatory transparency, the deficiency of their own transparency is regrettable.

Figure 5.5 compares listed and unlisted firm disclosure, presenting measures where the difference between the two was at least five percentage points. Disclosure of shareholders is the only area where non-listed firms ranked above listed firms, but this may reflect in part a lack of consistency on how

shares traded on the exchange are shown (whether identified as free float, individual shareholdings, private sector or otherwise). On the positive side, this evidence suggests that capital market supervision is leading to better disclosure on the part of listed firms. It also suggests, however, that there is insufficient pressure on unlisted companies to disclose their performance to Egyptian citizens.

Figure 5.5. Comparison of disclosure by listed and unlisted JVs
(variables for which difference > 5%)



Source: Author's calculations.

Only one company, Telecom Egypt, earned a perfect score indicating compliance with all 15 criteria. The quality of its web-based disclosure stood out from the rest not only for the completeness of the information (only partially captured by the scale used) but also for the clarity and professionalism with which it was provided. This was the only website that would withstand comparison to international peers. A second Egyptian company, Alexandria Metallurgical Oils (AMOC), also performed well, with a score of 73%.

A final question explored in this analysis is the relationship between JVs' ownership structure and their level of disclosure. Three ownership variables were considered: the total percentage of shares held by the public sector, the ownership stake held by public banks and insurance companies, and listing on the stock exchange.

In sum, the analysis found that firms with a higher share of public ownership and those listed on the stock exchange were more likely to score well on both measures of disclosure; that is, on having a website and, for those with a website, on providing comparatively complete disclosure. Similarly, analysis of the full sample of 100 firms found that all three variables were associated with a higher probability of having a working website. Conversely, a high proportion of bank and insurance company ownership was associated with a lower level of disclosure (although this relationship was not as strong, statistically).

Overall, it is evident that the Internet is not the preferred means for public-private JVs' to communicate with their investors or the Egyptian public at large. Many of the websites devote the greatest share of their efforts to serving current or potential customers, while others give the appearance of a box-checking project, showing little evidence of thought devoted to using the website as an effective communication tool with stakeholders.

Considerations for future improvements

This concluding section draws on the foregoing analyses to identify possible measures to improve governance and disclosure. The analysis demonstrates deficiencies in both the level of information that public-private JVs disclose and in how and to whom the information is made available. In post-revolutionary Egypt, the previous pattern of limited, paper-based disclosure to governmental oversight bodies, which often made little use of this information, is no longer sufficient. The Egyptian government's approach to disclosure has worn out its welcome: young Egyptians of the "Facebook generation" are demanding the information needed to judge government performance.

The Government of Egypt has a long way to go to improve the disclosure of key corporate governance information on public sector JVs. Greater levels of transparency and overall accountability are required to enable the public to determine whether the companies in which their funds are invested are well governed, whether these are yielding an appropriate return and whether they are complying with their legal, social and environmental responsibilities. Our

analysis of website disclosures found that public-private JVs' performance in this area falls far short of international standards.

The first step is therefore to upgrade the websites of these JVs, to standardise the way that governance (and other information) is provided and to monitor website performance to ensure that information is available and up to date. This information should also appear on the websites of public organisations charged with overseeing these investments. The dissemination of paper documents that disappear into government files and are not made available to the public, even if such submissions in fact occur regularly and are carefully reviewed by the recipients, is no longer sufficient.

The lack of a single entity with the responsibility for oversight of all government holdings, including in JVs with public participation, is a major barrier to achieving this standard. Even if operational oversight remains with a diverse set of ministries or holding companies, consolidated oversight of financial performance, reporting and governance is urgently needed. This consolidation should be reflected in the preparation and publication of financial reports covering the performance of public-private JVs, both online and through traditional means. The publication should go beyond financial reporting to provide information on major developments, such as the formation of new companies, large investments made and the identity of local and international partners.

Several additional measures to improve oversight and disclosure practices for Egypt's public sector joint ventures merit consideration. First, the capacity of the ministry or entity responsible for the oversight of government investments needs to be augmented. The resources available for JV oversight in the MOI were too limited for the magnitude of the task. Only four people were assigned to monitor more than 600 entities. Their task was made more complex by their lack of authority to play more than a co-ordinating role. For example, they were not empowered to impose reporting standards for Internet disclosure or to impose penalties on companies that did not provide adequate reporting.

Online disclosure of financial reporting and other material information should be required. Regulations regarding the presentation of information should set clear and consistent standards based on international practice, since standardisation of websites was found to be critical. In addition, such regulations should reinforce freedom of information legislation that seeks to make information truly available to citizens. In this regard, countries such as Brazil and Chile provide examples that could be useful to Egypt.

Finally, more information should be made available on key central websites, including those of the Egypt Stock Exchange and the Egyptian Financial Supervisory Authority, as well as of public banks and insurance companies. The format in which information is presented should be standardised and structured so that it is possible to obtain access to blocks of information rather than having to look up information individually by company. Further development of the stock exchange website would be particularly important.

An area needing further analysis is how to maximise the role of the state-owned banks and insurance companies in the oversight of public-private JVs. As noted above, these entities are prominent among state shareholders, with each of the 3 largest holding a larger percentage of the total shares in the 100 firms studied than the consolidated stake of all holding companies. As major public sector institutional investors, these companies are in a position to exercise the type of oversight and pressure for good governance as Europe and the United States- based institutional investors (e.g. California-based CALPERS, Norwegian and U.K. pension funds).

The overall management of these key financial institutions has demonstrably improved in recent years. The insurance sector has been completely restructured, and public banks have been made more transparent and subject to fewer political directives regarding their investments. The next step would logically be to professionalise the role of these investors in corporate governance of public-private JVs through further training of their board representatives and development of consolidated reports on their performance as owners and trustees.

The ongoing opening up of the Egyptian government following the Arab Spring calls for a new, more open approach to providing information on public sector investments. At present, disclosure requirements target reporting to the ministries, rather than reporting to the public as the ultimate owner of the SOE sector. There is a need to review requirements to ensure that key information is made available to citizens. The current procedures require payment of EGP 200 (about USD 33) for each annual report obtained, which is beyond the means of most Egyptian citizens.

In general, the laws on oversight and governance in the public-private JVs should be updated to take into account the emergence of the Internet as a primary rather than incidental means for disclosure. Although the Internet was unavailable when most of the laws governing public sector companies were drafted, nearly 20 years have passed. With high and growing Internet use internationally and in Egypt, especially during the past five years, there is no

longer a valid reason for further delay in bringing Egypt's corporate reporting up to international standards.

Notes

1. The Ministry of Investment was officially dissolved in October 2011 and its technical dossiers were placed primarily under the supervision of the Ministry of Trade and Industry. Because further changes in the institutional structure in Egypt are likely and because many of the websites used in this study still refer to the Ministry of Investment, that designation (and the abbreviation MOI) will also be used here.
2. Such issues may also plague international joint ventures that are wholly within the private sector, but governmental joint-venture partners are likely to face additional pressures from political considerations, nationalistic attitudes on the part of some stakeholders and competing objectives among different government stakeholders.
3. In 2004, the government adopted the Asset Management Program to address the status of SOEs including the remaining public enterprises and joint-venture entities. The three pillars/components of the AMP were: restructuring of certain public sector enterprises; the introduction of principles of corporate governance, good management and disclosure to improve and revitalise management of public sector enterprises; and the sale of assets and shareholdings in public sector enterprises and joint-venture entities.
4. Misr Insurance, however, is itself owned by the Insurance Holding Company.
5. GAFI used to be also subject to oversight of the Ministry of Investment. Efforts to obtain annual reports from GAFI have not been successful to date.
6. The author is working with an Egyptian graduate student who is writing a thesis on governance in another set of joint ventures between the government and foreign investors. Copies of the annual reports were sought from the stock exchange, the General Authority for Investment and the companies themselves, among other sources. After months of effort, the student was not able to obtain 15 annual reports, only some of which are for the most recent year.
7. This included four companies under liquidation and one that had been acquired.

Bibliography

Arab Republic of Egypt Ministry of Investment (2011), *Public Enterprises Asset Management ,* www.masry.gov.eg/EN/JVsCompanies.aspx, accessed December 2011.

Arab Republic of Egypt Ministry of Investment (2008), *General Procedures and Guidelines for State-owned Enterprises Asset Management,* www.masry.gov.eg/content/docs/EN/AssetsCataloge.pdf, accessed December 2011.

Arab Republic of Egypt Ministry of Investment, Egyptian Institute of Directors (2006), *The Code of Corporate Governance for the Public Enterprise Sector*, in Arabic. www.masry.gov.eg/content/docs/EN/egyptsoecodeofcg.pdf, accessed December 2011.

Bremer, Jennifer and Nabil Elias (2007), "Corporate Governance in Developing Economies – The Case of Egypt", *International Journal of Business Governance and Ethics,* 3 (4).

Hegazy, Mohamed, and Karim Hegazy (2010), "Corporate Governance in the U.K: Audit Committees and Disclosure Arrangements – A Web-Based Analysis", *Journal of Business Studies Quarterly,* 1 (2).

Kelton, A. S. and Yang, Y. (2008), "The Impact of Corporate Governance on Internet Financial Reporting", *Journal of Accounting and Public Policy,* 27.

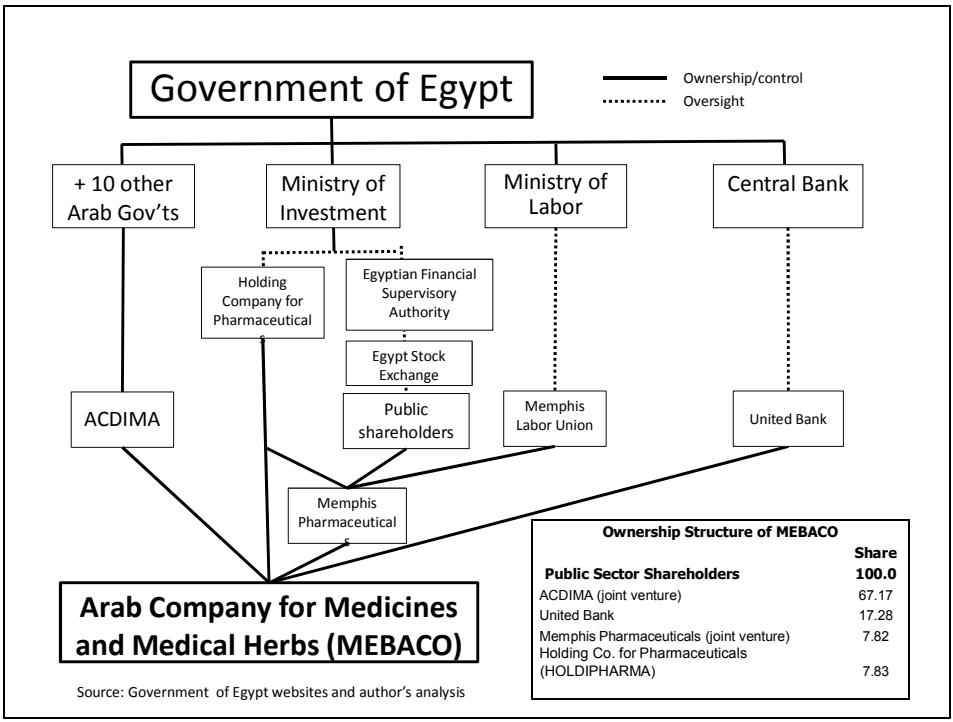
Samaha, Khaled and Sara Abdallah (2011), "Further Evidence on Web-Based Corporate Disclosures in Developed Versus Developing Countries: A Comparative Analysis of Nature and Determinants in Egypt and the United Kingdom", *International Journal of Disclosure and Governance*, advance online publication.

United Nations Conference on Trade and Development (2006), *Guidance on Good Practices in Corporate Governance Disclosure,* United Nations, New York and Geneva.

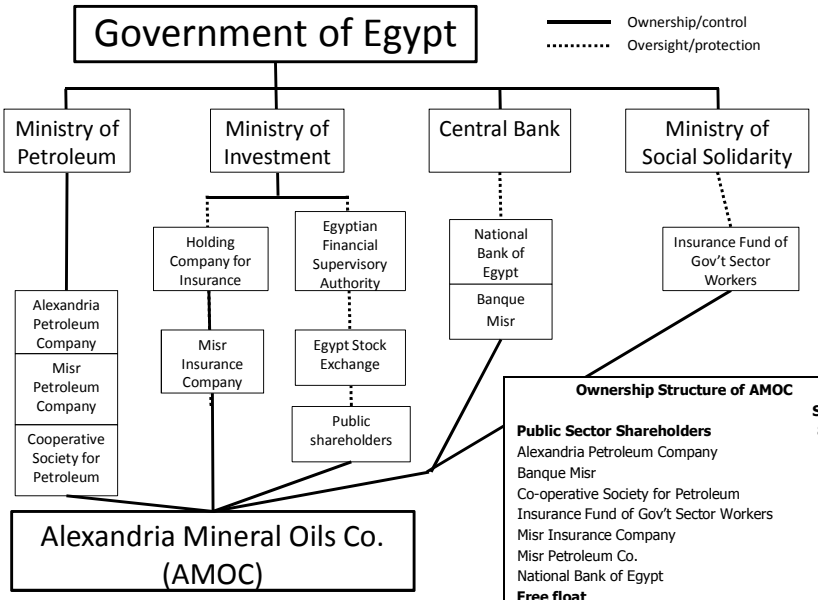
Xiao, J.Z., H. Yang and C.W. Chow (2004), "The Determinants and Characteristics of Voluntary Internet Disclosures by Listed Chinese Companies", *Journal of Accounting and Public Policy*, 23.

Annex 5.A.1

Ownership structure of two public-private JVs



Source: Government of Egypt websites and author's analysis



Ownership Structure of AMOC

	Share
Public Sector Shareholders	**80.0**
Alexandria Petroleum Company	20.0
Banque Misr	14.3
Co-operative Society for Petroleum	3.6
Insurance Fund of Gov't Sector Workers	10..0
Misr Insurance Company	9.7
Misr Petroleum Co.	3.6
National Bank of Egypt	18.8
Free float	**20.0**

Source: Government of Egypt websites and author's analysis

Annex 5.A.2.

Methodological notes

This annex provides a further explanation of the methodology employed in this chapter. It briefly considers the rationale for using an analysis of online disclosure and provides further information on how data was collected and analysed. The analysis in this chapter was based on the examination of Internet-based disclosure as a useful measuring stick to explore transparency and disclosure of public-private joint ventures in Egypt. Analysis of online disclosures has become increasingly common in recent years and has been used to explore disclosure in both developed and emerging markets. The use of this approach was based on three considerations.

First, company websites have become the primary means through which corporations trading in global markets communicate with shareholders and other stakeholders. In parallel to this development, assessment of corporate web-based disclosure has become a standard tool for measuring disclosure and other aspects of governance.[1] Second, given the spread of web-based disclosure, the presence or absence of information on corporate websites in emerging markets such as Egypt sends a powerful signal to international investors on local companies' commitment to transparency. Third, the resource requirements for an assessment of web-based information are more consistent with an exploratory study such as that undertaken here, particularly in view of the somewhat unsettled conditions prevailing in Egypt during the post-revolutionary period, when this study was undertaken.

The analysis carried out in this study relies on the information provided by the (former) Ministry of Investment, websites of the joint venture companies and numerous investment websites. The analysis began with the selection of variables to measure online disclosure and transparency. The majority of the variables selected measure whether information of primary relevance to governance disclosure is present on the website; additional variables measure the quality of online disclosure itself. These variables were selected with reference to the lists of variables used in previous studies, notably the United Nations Conference on Trade and Development's guidance on corporate governance disclosure.

Variables were selected with a view to capture whether the most essential information was provided, rather than looking at more sophisticated measures to capture variance among the companies examined. If the list of variables had been more demanding, most or all of the JVs examined would have been found to be non-compliant, reducing the utility of further analysis. All variables used in this study are binary (yes=1 and no=0); assignment of scores was based on the author's judgement.

For example, if a website included at least a telephone number, street address or e-mail address, it was counted as having contact information, even though some companies included much more detailed information. If a website included a list of its board members, it was counted as meeting this criterion, even if no further identifying or biographical information was provided. Conversely, if a company that provided only summary information on its income (such as a bar chart showing total revenues in different years), it was not counted as meeting the criterion on the availability of an income statement.

Some variables, taken together, provided a degree of scaling. For example, a number of variables tracked whether the website included an income statement, balance sheet and annual report. Most annual reports would include both an income statement and a balance sheet, so a company with an annual report that included an income statement and a balance sheet would receive three points. Not all annual reports posted included an income statement or balance sheet, and several companies posted income statements and balance sheets without providing an annual report. Companies received credit for any document that was present on the website, even if out of date, presented only in Arabic or only in English, or not accompanied by any notes, auditor's review or explanatory information.

Considerable effort was made to identify as many websites as possible from the list of 100 companies selected for analysis. This was attributable to the absence of website information on the MOI website or on most holding company websites. In addition to searching for the companies' names in Arabic and English, searches were also conducted on the Egyptian Stock Exchange (for listed companies), standard online business directories, investor websites and the websites of known investors such as the state-owned banks. If these failed, searches were also run using known trade names. The latter included trying variants of the companies' names, particularly reflecting variant spellings of place names in English (e.g. Abu Kir, Abu Qir, Abou Keer).This time-consuming process was necessary because neither the stock exchange nor the MOI provided links to company websites. Remedying this absence emerges as

both a simple measure and a priority for improved governance disclosure in Egypt.

Despite the effort made to identify websites, it is possible that some companies for which no site could be found in fact have a website. Many of the company names are similar or subject to translation into English in different ways. Egypt has yet to standardise translation of company names into English. Some companies that are not JVs have similar names to existing ones. Every effort was made to identify and exclude these.[2]

Finally, it should be noted that the Egyptian government websites go in and out of service regularly. While all websites were visited multiple times, it is possible that sites that were not functioning at the time of the analysis are now functional or vice versa. In all, websites were found for 66 of the 100 companies (of which 7 were not functional). Eighteen companies were excluded from the analysis because the government ownership was either below 10% or near 100% (98% or above). These firms were excluded as constituting joint ventures in name only. A full list of JV websites examined is reproduced below.

English name	Website	Sector	Listed/ not listed	Public share
Alexandria for Fertilizers - Abu Keer	www.abuqir.com/	chemicals	not listed	10.00
Universal for Manufacturing Packaging Materials and Paper – UNIPACK	www.universal-unipack.com/	chemicals	listed*	12.00
Middle East for Paper – SIMO	simo-eg.com/	chemicals	listed	16.20
Rubex for Plastic Manufacturing	www.rubexegypt.com/	chemicals	listed*	20.00
Al-Ahram Paper Factory – Flora	www.flora.com.eg/index.asp	chemicals	not listed*	25.00
Al-Mohandes - Jotun for Industrial and Maritime Paints	www.jotun.com/me	chemicals	not listed	30.00
Al-Amal for Manufacturing Plastic Pipes and Requisites	alamalplasticpipes.com/index.php	chemicals	not listed	31.06
Johnson Wax Egypt	www.scjohnson-egypt.com/nqcontent.cfm?a_id=2319	chemicals	not listed	35.00
Egyptian Financial and Industrial Co.	www.sfie.com.eg/	chemicals	listed	36.28
Paints and Chemical Industries - PACHIN	www.pachin.net/	chemicals	listed	44.30
Misr for Chemical Industries	www.mci-egypt.net/En/Index.aspx	chemicals	listed*	69.10
Helwan Fertilizers	www.hfc-egypt.com/cgi-sys/suspendedpage.cgi	chemicals	not listed	71.00

English name	Website	Sector	Listed/ not listed	Public share
Abu-Kir for Fertilizers and Chemical Industries	www.abuqir.com/	chemicals	listed	84.83
North Upper Egypt for Development and Agricultural Production-NUDAP	www.nudap.net/	chemicals	listed	5.00
Egyptian Banks for Technological Development	www.egyptianbanks.com/main	infotech	not listed	49.00
Egypt Telecom	www.telecomegypt.com.eg/	infotech	listed	80.00
National Holding for Communication (Al Ahly Holding)	www.ntcegypt.com/	infotech	not listed	14.30
Legislative Information Services and Development Information	www.tashreaat.com/help.asp	infotech	not listed	24.00
Misr for Construction and Building Information	www.misronet.com/	infotech	not listed	10.00
Misr For Information and Technology	www.egyfit.com.eg	infotech	not listed	63.75
Developing and Managing Intelligent Villages	www.smart-villages.com/docs/front.aspx	infotech	not listed	25.00
Stock Net Egypt	www.stocknetmisr.com/index.html	infotech	not listed	20.00
Regional for Transferring Gas and Oil Technology	femalite.com/	energy	not listed	10.00
National for Gas – NATGAS	www.natgas.com.eg/	energy	not listed*	10.00
Alexandria for Petroleum Maintenance - Petroment	www.petromaint.net/	energy	not listed	21.30
Middle East for Cistern and Pipelines - Medtab	www.midtap.com.eg/	energy	not listed	25.20
Petroleum Maritime Services	www.pmsoffshore.com/index.html	energy	not listed	32.50
Egyptian International Co. for Gas Technology	www.gastec-egypt.com/main.htm	energy	not listed	40.00
Petroleum Services for Safety and Environment - Petro Safe	www.petrosafe.com.eg/	energy	not listed	42.9
Egyptian Co. for Drilling	www.egyptian-drilling.com/	energy	not listed	50.00
Misr for Oil Maintenance - San Misr	www.emceg.com/	energy	not listed	50.00
Egyptian for Petroleum Services - EPSCO	www.epsco.com.eg/Home.html	energy	not listed	50.00
Middle East for Operating and Maintaining Oil Refinement Laboratory	www.midom.com.eg/aboutus.html	energy	not listed	60.00
Egyptian for Transferring and Connecting Gas – Potagasco	www.butagasco.com/pages/butagasco_arabic.html	energy	not listed	70.00
Egyptian Co. for Natural Gas - GASCO	www.gasco.com.eg/bod.html	energy	not listed	70.00
Oil Air Services	www.pas.com.eg/	energy	not listed	75.00

English name	Website	Sector	Listed/ not listed	Public share
Sidi- Krare For Petrochemicals - SIDPEC	/www.sidpec.com	energy	listed	76.90
Middle East for Oil Refinement – MEDOR	midor.com.eg/arabic/ Index.htm	energy	not listed*	78.00
Alexandria for Metallurgical Oils Company (AMOC)	www.amocalex.com/	energy	listed	80.00
Egyptian Co. for Machinery Maintenance	www.siancoeg.com/	energy	not listed	80.00
Gas Misr (Egygas)	www.egyptgas.com.eg/	energy	listed	80.50
Alexandria for Specialty Petroleum Products Company – ASPC	www.asppc.com.eg/	energy	not listed	84.40
Misr for Oil Production Company – MOPCO	www.mopco-eg.com/ar/ar_news-15.html	energy	not listed*	90.20
Medical Union Pharmaceutical Company	www.mupeg.com/aboutus. htm	pharma	listed	15.37
Arab co. for Medicines and Medical Herbs – Mebaco	www.mepaco-pharma.net/html/home-AR. html	pharma	not listed	17.61
Arab Co. for Medical Glass – EPIGYCO	www.apgglass.com/	pharma	not listed*	22.45
Arab Co. for Pharmaceutical Gelatin Capsules - Arab Caps	www.arab-caps.com/	pharma	not listed*	23.22
Upper Egypt for Pharmaceuticals - Cedeco	www.sedico.net/English/ Default_e.htm	pharma	not listed*	37.70

Source: Author's research.

The holding company websites were assessed on a 20-point scale that reflected the presence or absence of critical governance information on the company website. Joint venture websites were assessed on a similar 15-point scale, the difference driven by the exclusion of variables relevant only for holding company websites. No effort was made to assess the validity of the data provided, except one criterion that measured whether the site displayed any material information at all from 2010 or later. Where a category of information was represented only by a non-functioning link, the company was assessed as not meeting the criterion.

The variables assessed are shown in the table below. Overall, the bar for a positive assessment was set quite low. Other analyses have used much more stringent criteria for rating corporate disclosure on websites. The methodology can be seen as providing a baseline against which public enterprise web-based disclosure can be measured in the future as the availability of information in this format continues to improve, allowing the application of a higher standard of measurement.

Variables used to score holding company and joint venture website disclosure

Variable	Holding Companies	Joint Ventures	Explanation
Website functional	x	x	Homepage opens, but not necessarily all other pages
Company contacts provided	x	x	Address, phone, and/or e-mail provided
Chair of the board identified	x	x	Name of board chair, at a minimum
Other board members identified	x	x	Names of other board members, at a minimum
Senior management identified	x	x	Names and titles of selected senior managers
Annual report provided	x	x	Annual report downloadable and opens
Balance sheet provided	x	x	Balance sheet provided in standard format, with or without notes
Income statement provided	x	x	Income statement provided in standard format, with or without notes
Links to affiliates provided	x		Website links provided for most of the affiliates (as defined by the holding company)
Links to joint venture firms provided	x		Website links provided for most of the joint venture firms (as defined by the holding company)
Ownership distribution of JV shares provided	x		Ownership identified by percentages assigned to specific owners or at least to classes of owners (e.g. foreign private sector)
All partners in JVs identified	x	x	All investors in the joint venture are identified by name or, for listed firms, as publicly traded shares
Future plans discussed	x	x	Future plans are presented (excluding vague generalities, such as "maintain profitability") and refer to future, rather than past, dates
Income of affiliates provided	x		Income statements of affiliates and/or joint ventures provided in standard form
Balance sheets of affiliates provided	x		Balance sheets of affiliates and/or joint ventures provided in standard form
Governance discussed	x	x	More than a simple mention of governance is provided
Number of employees provided	x	x	The number of employees working in the firm is stated
Employee wage bill provided	x	x	The total wage-bill of the employees is stated
Website includes information from 2010 or later	x	x	Information (excluding copyright date) is provided for 2010 or later, such as news reports, financial statements, or events
Information on board operations provided	x	x	Specific aspects of board operations are discussed in any way, such as provision of minutes, mention of committees, invitations to meetings
Total	20	15	

Source: Author's research.

Notes to Annex 5.A.2.

1. For instance, Samaha and Abdalla (2011) compare online disclosure in the United Kingdom and Egypt, finding that Egypt both lags substantially behind the United Kingdom in this area and made little progress during the two-year period studied (2006-2008). Other recent studies using online disclosure to compare and explain performance include Kelton and Yang (2008), Xiao, Yang, and Chow (2004) and Hegazy and Hegazy (2010). Xiao et al. research is particularly relevant to this analysis in that it found that share ownership by government and, to a lesser extent, by other state-owned companies is negatively associated with disclosure (although the finding is statistically weak).
2. For example, although Unipaknile was originally identified as Unipack, comparison of addresses on the Unipaknile company website with documents posted on the stock exchange for Unipack demonstrated that these are two different Egyptian packing companies.

Chapter 6

Corporate governance of state-owned enterprises in Morocco: evolution and perspectives

by

Abderrahmane Semmar
Head of the Division of Programming and Restructuring,
Department of Public Enterprises and Privatisation,
Ministry of Economy and Finance of Morocco

Reform of the state-owned enterprise sector in Morocco has undergone three distinct phases: 1) structural reforms in the 1980s, 2) modernisation of their environment in the 1990s, and 3) the liberalisation of numerous industries in the 2000s. These measures have had a positive impact on the performance of SOEs, whose role has grown in the country's economic and social development over the years. This chapter outlines the experience of reform of the Moroccan SOE sector from the 1980s to today, focusing on the introduction of a corporate governance code specifically aimed at state-owned enterprises in 2011. The code is the second of its kind in the region and constitutes a major step towards enhancing governance practices, especially in commercially-oriented SOEs.

Introduction

Morocco has been undergoing a decade of major political, economic and social change. The government has launched a set of reform initiatives and significant projects, the latest of which - and one that will constitute a milestone in the country's history - is the new Constitution, adopted in July 2011. The Constitution seeks to consolidate the rule of law, enshrine the principles of separation of powers, bolster good governance and promote public accountability.

The considerable investment, rationalisation and restructuring efforts that the authorities have deployed to meet Morocco's needs and confront the challenge of globalisation are pursuing strategic goals that reach beyond 2020 with a view to provide the necessary impetus for the country's modernisation and further development. In this regard, state-owned enterprises (SOEs) play an important role in the development process given their multidimensional role in the delivery of basic services and their contribution to infrastructure development.

Morocco has pledged to improve the governance of its institutions, including its SOE sector, by introducing good governance mechanisms. These can bolster the country's development capabilities and lend further credibility to its actions in the eyes of its citizens and various international partners, including lenders, donors and rating agencies. The importance of these measures was underscored as the Moroccan economy showed resilience during the latest international financial crisis.

According to most observers, the resilience of the Moroccan economy is ascribable to sound macroeconomic policies adopted by the government. However, it can also to some extent be attributed to the various achievements of local SOE which have in recent years adopted a number of good governance mechanisms. In order to highlight these reforms and the progress in corporate governance of Moroccan SOEs, this chapter will focus on the following three aspects: (1) the current configuration of the sector and changes affecting the public portfolio; (2) progress in SOE governance by category of enterprises, with reference to the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*; (3) the main initiatives in progress, with emphasis on the implementation of the Moroccan Code of Good Governance Practices for Public Establishments and Enterprises.

The SOE landscape in Morocco

Composition of the sector

The public enterprise portfolio comprises 241 state-owned enterprises, 42% of which operate in productive sectors and 38% in the social domain, along with 44 companies in which the Treasury has direct equity interests, 43% of which operate in the infrastructure sector. This is a diversified portfolio in terms of size, legal status, type of activity, financial relations with the state and market position. In recent years, the portfolio has grown, in particular through additions of regional and local establishments and entities involved in infrastructure projects (e.g. Tanger Med, Nador West Med, development of the Bou Regreg Valley) or in charge of implementing sectoral strategies (e.g. Plan Maroc Vert , Plan Solaire).

The scope of the growth of the Moroccan SOE sector can indeed be seen from one statistic: 350 SOEs were created between 2001 and 2010. A significant portion of those additions stemmed from public groups, including the Caisse de Dépôt et de Gestion (CDG)[1]. This growth has been offset, to some extent, by the reduction in the SOE portfolio made through divestments of state equity holdings and public-private partnerships.

Act No. 69-00 on State Financial Control of Public Enterprises, adopted in December 2003, defined categories of Moroccan SOEs for the first time, making a distinction between public establishments and public companies subject to private law and, within the latter category, making distinctions by level of public ownership. By virtue of this Act, SOEs are classified into three categories: (1) state companies are those in which public bodies hold all the equity[2], (2) public subsidiaries are companies of which public bodies hold more than half the equity, and (3) semi-public companies are companies of which public bodies hold no more than half of the equity.

Certain entities have migrated from one legal form to another as successive sectoral reforms have entailed conversions of statutory corporations to limited liability companies (*sociétés anonymes*), privatisation programmes and buy-in strategies (e.g. Maroc Telecom, OCP SA).

The Moroccan SOE sector regroups public enterprises and subsidiaries around a limited number of groups. It has a strong presence throughout the kingdom, as well as footholds abroad. Overall, the ownership structure of the SOE sector can be characterised by the following features:

- 48% of the firms are affiliated with three public holding companies[3] (CDG, OCP SA and Banque Centrale Populaire),
- 119 are local or regional in scope,
- 34 are wholly or partially owned by local authorities,
- 53 have subsidiaries or affiliates abroad, and
- 11 are publicly traded.

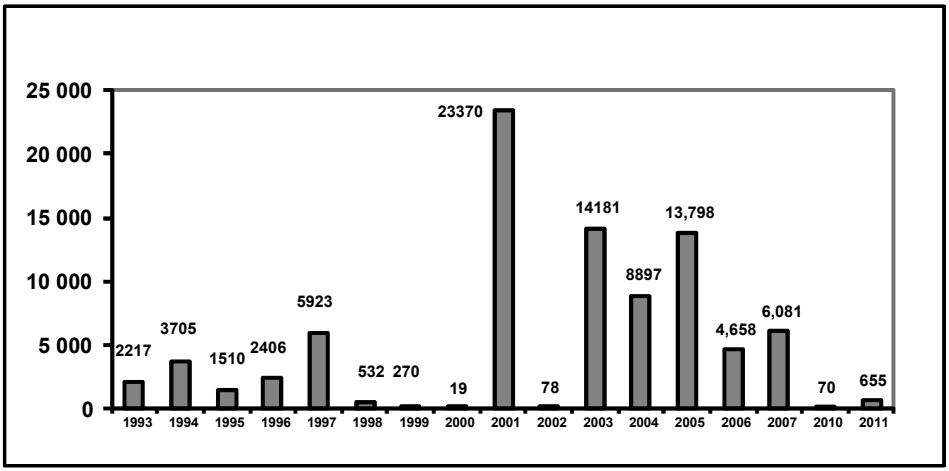
Overview of privatisation activity

"The objective of the structural reforms undertaken by the Moroccan government since the early 1980s was to re-establish and stabilise macroeconomic equilibrium and liberalise the economy. The result of that policy was to lift the monopoly on foreign trade, liberalise prices, open the national economy to foreign investment and reform the tax system. At the same time, a vast programme of privatisation was put in place" (UNCTAD, 2008).

Between the start of the transfer programme in 1993 and its end in August 2011, total revenue from the divestment of state-owned enterprise shares and the granting of telecom licences totalled approximately MAD 107 billion. Of that amount, the divestment of publicly owned shares governed by Act No. 39-89 totalled MAD 88 billion and transfer operations governed by specific provisions and granting of telecom licences totalled MAD 19 billion.

Revenues from the divestment of publicly owned shares governed by Act No. 39-89 are illustrated in the Figure 6.1 below; however, it should be noted that revenue from the divestment of shares in Crédit Populaire du Maroc is not included in this Figure since the privatisation of this bank was governed by a separate law (Act No. 12-96).

Figure 6.1. Breakdown of privatisation revenue by year (MAD mil)



Source: Ministry of Finance, 2011.

Over the years, the privatisation activity has given a great boost to the Casablanca Stock Exchange, where the privatised SOEs' market capitalisation accounts for a very substantial share of the total market size. The success of the privatisation effort in Morocco is also evident from the state's ability to use this instrument to attract foreign direct investment (FDI). Very recently, Morocco was elected "African Country of the Future 2011/12" by FDI Intelligence, a division of the Financial Times Group specialised in FDI. Privatisation has also had the positive effect of attracting well known operators to Morocco in a number of rapidly growing sectors such as telecommunications, automobiles, tobacco, ocean shipping, electricity, water, sanitation, petroleum products and the hotel trade.

For enterprises that have first discovered Morocco through the privatisation process, the country has become their development base for activities in the region, in particular in their outreach to Africa. Privatisation revenues, channelled through the Hassan II Fund for Economic and Social Development, have clearly contributed to the country's development. Created in March 2000 as a special allocation account, the Fund was transformed in January 2002 into a public establishment with legal personality and financial autonomy. During the Fund's first 10 years, 123 financing agreements were signed, confirming its role as a powerful lever for development and a major player in large projects.

It should be noted that each privatisation operation was conducted in accordance with a phased procedure offering full guarantees of transparency and professionalism. The first step of each privatisation entailed an audit, evaluation and advisory missions carried out by internationally reputed independent firms. As a second step, each privatisation entailed the establishment of a Transfer Board assisting the minister in charge of the transfer and comprising five senior officials appointed by royal decree (dahir) and chosen by virtue of their competency in economic, financial and social matters. As a last step, for each significant privatisation transaction undertaken, an independent body comprising seven members appointed by dahir and meeting the same criteria as members of the Transfer Board established a minimum selling price.

Generally speaking, transfers of state assets have taken form of an association with a renowned strategic partner, an initial public offering, a sale to employees or formation of a pool of reference shareholders. Most privatisations were carried out either through a public offer or a call for tender on the basis of concrete parameters, and aimed to consolidate assets and develop the activities of the enterprise concerned. This entire process takes a minimum of a year, with the assistance of established investment banks and lawyers.

Main achievements

Since the mid-2000s, the public portfolio's main economic and financial indicators point to remarkable achievements in the SOE sector that are the fruit of a reform process undertaken in previous decades, as well as of the significant infrastructure and development projects that SOEs have helped carry out. Table 6.1 gives a snapshot of the evolution of various performance indicators from 2005 to 2010.

As can be seen from this Table, the greatest achievement so far is SOEs' volume of capital investment, which has reached unprecedented levels in recent years. This investment, covering virtually all sectors of economic and social activity, amounted in 2010 to MAD 70.9 billion, versus only MAD 18 billion in 1999, an increase of 294%.

Figure 6.2 demonstrates the evolution of capital investment by Moroccan SOEs from 2004 to 2010. Over this period, capital investment increased by 120%. In the latter half of the 2000s, it reached a new plateau of 6%-10% of GDP versus under 6% of GDP in 2001-2005. Overall, and as compared with the capital investment by other economic agents, SOE investment in 2010 represented the equivalent of 30.3% of gross fixed capital formation in Morocco.

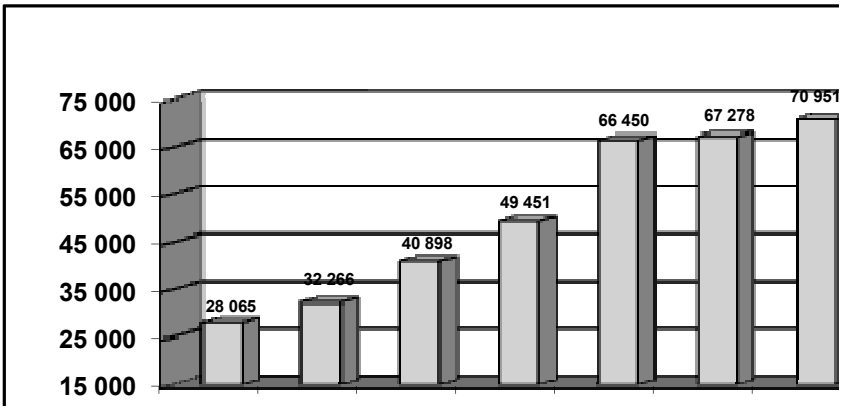
Table 6.1. Performance of the Moroccan SOE sector (MAD bil)

Indicator	2005	2006	2007	2008	2009	2010
Turnover	109.3	121.4	133.3	175	142.2	169.3
Value added	40.2	44.8	54.2	82.2	51.9	70.0
Self-financing capacity	14.9	18.4	24.6	24.9	28.2	32.4
Dividends and income paid to the state	5.5	7.7	7.7	7.8	10.5	8.9
Net income/equity	6.3	5.0	11.7	15.5	5.5	8.5
Net income/turnover	6.8	6.8	16.3	19.0	8.9	13.2

Note: The exceptional achievements of 2008 were affected by the results of the OCP group, stemming from a sharp rise in prices for phosphates and their derivatives.

Source: Ministry of Finance, 2011.

Figure 6.2. Capital investment by SOEs (MAD mil)



Source: Ministry of Finance, 2010.

The remarkable growth in the volume of capital investment consolidates SOEs' role as important and proactive players in the dynamic that the authorities set in motion with the objective of maintaining public investment at a higher level and making it a lever for growth, economic modernisation and the emergence of regional development clusters. Moreover, this capital investment is part of a clearly identified sectoral strategic vision and infrastructure projects aiming to develop parts of the country.

In addition to the investment support of the Hassan II Fund for Economic and Social Development, which receives 50% of its revenues from privatisation, the 2011 Budget Act introduced a National Investment Support Fund in the form of a specially funded account that essentially replaces the support provided by the Hassan II Fund. The new fund is also endowed with 50% of privatisation proceeds. The revenue from future privatisations will be used for capital investment, in addition to existing sectoral and regional strategies. These Funds enshrine the autonomy of the general state budget vis-à-vis proceeds from privatisations.

Changes in the governance framework and environment

Modernisation of the legal and regulatory framework of Moroccan enterprises in general, and of SOEs in particular, has been a major area of reform. The overall governance framework, based on the principles of transparency, accountability and ethics, has been updated and modernised repeatedly over the past decade in order to strengthen the rights of shareholders and the role of governance bodies, to ensure fair treatment of all stakeholders, and to increase the transparency and reliability of information.

The overall business environment is being modernised and improved continuously. In October 2011, Morocco achieved the greatest improvement in the "Doing Business 2012" ratings, gaining 21 places and ranking 94th for business climate out of 183 countries surveyed. The efforts of the National Business Environment Committee were instrumental in this regard by improving the delivery of government services to citizens and economic agents, simplifying administrative procedures, and taking measures to protect national and international investors.

Important strides have also been made in modernisation of the legal framework, including the Commercial Code; the Limited Liability Companies *[sociétés anonymes]* Act; the Competition Act; the public procurement framework; the Banking Act; the Labour Code; the Government Claims Recovery Code; the law on the liability of authorising officers, auditors and public accountants; the Financial Jurisdictions Code; the Securities Ethics Council; the law on financial control of SOEs; and the law on delegated management of public services.

In addition, the general management model of SOEs has been modernised and streamlined via three major types of undertakings; namely, institutional and strategic restructuring, operational and financial restructuring, and contractualisation. As a start, institutional and strategic restructuring has been

carried out in high-priority sectors such as transport, ports, airports, postal services, telecommunications, audiovisual media, housing, social affairs, agriculture, energy and water.

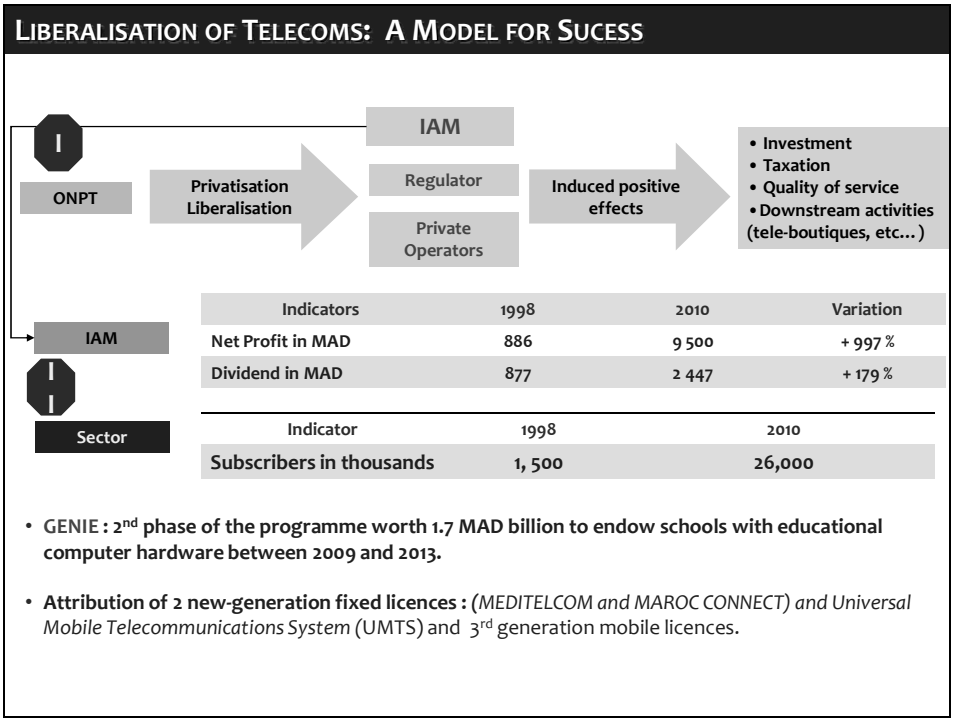
This restructuring has been accompanied by the creation of regulatory agencies such as the National Telecommunications Regulation Agency (ANRT), the National Ports Agency (ANP), the securities regulator (CDVM), the High Authority on Audiovisual Communication (HACA), and others. The creation of specialised sectoral regulators was a part of the plan to separate commercial activities from regulatory functions before allowing the private sector to buy shares in these commercial companies.

A number of sectors have been restructured successfully, including telecommunications, agriculture, housing, ports and the postal sector. The telecommunications sector has truly boomed, with the number of subscribers soaring from 1.5 in 1999 to 26 million to 2010, raising the per capita share of telephone access to nearly the same level as in developed countries. Also, call centres, which were virtually non-existent a decade ago, have grown considerably, to number 512 at the end of 2010.

Restructuring is also continuing in the postal sector, following the launch of a modernisation strategy in 2007, and in the financial services sector according to the vision set out in the Moroccan Banking Act. For example, Act No. 07-08, transforming Barid Al Maghrib (a public sector bank) from a public establishment to a limited liability company, was published in the Moroccan Official Journal in February 2010. As a result, Barid Al Maghrib can improve its governance, modernise its services and restructure its activities in order to cope with an increasingly competitive environment.

Its Al Barid subsidiary constitutes the first cornerstone of the emerging Banque Postale, which will enable Barid Al Maghrib to manage the cash flow of postal checking accounts and money orders and launch an overdraft service. The actual launch of the postal bank took place in June 2010, with the goal of improving the rate of access to banking services nationwide. The 2009 creation of two subsidiaries of Barid Al Maghrib – Barid Media in direct marketing and Barid e-Services in electronic publishing – is enabling the bank to develop new competitive services and reposition its offers to adjust to market demands.

Figure 6.3. Liberalisation of the telecommunications sector: a model for success



Source: Author's research.

In the agriculture sector, the restructuring and consolidation of assets of SOGETA and SOGEA – the two entities that manage state-owned farmland – has enabled creation of the Agricultural Development Agency (ADA). The agency aims to present the government with action plans to support the Green Morocco Plan (PMV), which seeks to foster high value-added agricultural activities and promote inclusive agriculture by setting up economically viable projects to increase farmers' income. By July 2011, this restructuring had attracted capital investment worth approximately MAD 22 billion, involving a total area of 100,400 hectares of land.

In response to demographic pressures and a rising urbanisation rate, the housing sector has also undergone significant institutional restructuring, which – following several mergers in the industry and the transformation of existing operators into companies – has led to the creation of a public holding company called Holding Al Omrane (HAO). The establishment of this group gave the state a powerful lever to increase home production and to combat substandard

housing conditions. Today, the holding company is carrying out a number of programmes including "Cities without Slums", which provides economical housing and seeks to enhance the diversity of the housing supply. In recent years, the group has intensified its activities and is making substantial achievements in providing affordable housing.

The ports sector has also been subject to significant restructuring. The purpose was to introduce competition among the 34 ports that handle 98% of Morocco's foreign trade. The restructuring, achieved through the introduction of the Ports Act in December 2005, resulted in significant liberalisation of the sector, the division of the former Port Operations Office (ODEP) and the separation of the marketing function – which has now been devolved to the Marsa Maroc company (which is competing with other operators) – from regulatory functions, which now lie with the Port Regulatory Agency (ANP).

In parallel, operational and financial restructuring of the SOE sector has sought to restore the financial soundness of some enterprises as well as consolidate the situation of certain SOEs that play a pivotal role in economic development. This restructuring has been carried out through a set of measures such as converting certain public establishments into limited liability companies, outsourcing the management of pension funds, controlling SOE staffing levels and improving management-to-staff ratios.

A number of public enterprises operating in diverse economic sectors that were previously organised as statutory companies have been converted to limited liability companies (e.g. OCP converted to OCP SA, ODEP to SODEP, ERAC to HAO). The purpose of transforming the legal status of certain public establishments to limited liability companies was, inter alia, to provide an opportunity to review their governance structures and processes as well as to improve their ability to compete with private sector operators in the wake of the liberalisation of certain sectors.

In many cases, the transformation has taken place in the context of an overall restructuring of a given public enterprise in order to consolidate its financial base, allowing it to speed up the implementation of its industrial strategy but also to promote its growth and international development. A prime example is the Office Chérifien des Phosphates (Office of Phosphates) whose transformation took effect in April 2008, bringing its governance practices in line with international standards, at the same time allowing for the establishment of strategic partnerships and cross-shareholdings (with the Banque Centrale Populaire).

With regard to outsourcing the management of certain SOE retirement funds, the main objective was to restore their financial equilibrium and refocus them on their core activities. This exercise involved 5 large enterprises with more than 31,000 employees, representing a quarter of aggregate SOE sector employees and 49,000 pensioners. The amount of pension obligations that was restructured reached nearly MAD 50 billion.

Another structural reform initiative undertaken by the government was the contractualisation of relations between the state and SOEs, which was enshrined in Act No. 69-00. Multi-year performance contracts between the state and contracting SOEs were introduced to stipulate the parties' respective commitments and the technical, economic and financial objectives assigned to each SOE, along with the means to attain these. The objectives of these contracts commonly include reconciling the state's role as a shareholder, auditor, and regulator; strengthening SOEs' management autonomy; and improving SOEs' technical, economic and financial performance.

Contractualisation of mutual obligations has unquestionably helped clarify the relations between the state and individual SOEs. Among other things, this makes it possible to streamline SOE management models, improve information and management systems and, last but not least, send positive signals to SOEs' various funding sources. Performance contracts have also been a useful preliminary step to both optimising budgetary transfers from the state to SOEs and to accompanying SOEs on the path towards liberalisation, restructuring and even privatisation.

Performance contracts can also be geared towards particular commitments such as optimising the remuneration of the state as shareholder; optimising pricing to bolster an SOE's cash flow; adjusting the size of an SOE's capital investment or debt; helping to manage tax, legal or foreign exchange risks; and helping to introduce requirements to enhance the economic and social contributions of SOEs, including respect for the environment and introduction of quality processes, and other objectives.

Contractualisation has been a constant theme of the government's policy to improve management of the public portfolio and its earnings and today it extends to the entire SOE sector. While all of these actions and measures have helped improve SOE governance, the programme of transferring SOE management to the private sector has also made a contribution by modernising the governance framework and the management practices of these entities, calling upon experienced investors and international expertise. The Moroccan corporate governance code for SOEs (discussed below) provides further

guidelines on the structures of SOE governance that are not outlined in these performance contracts.

Nonetheless, a fundamental leap in SOE governance was consolidated by the contractualisation of the relationship between the state and individual SOEs. The latter empowered boards of directors, gave managers better visibility on long-term strategies and enabled achievements to be evaluated objectively. The multi-year contractualisation provides an opportunity for regular strategic dialogue between the state and the SOE including, when necessary, a possibility to revise an SOE's mission and strategic objectives.

Progress in the governance of public enterprises

The progress towards better governance of Moroccan SOEs has been achieved through a number of mechanisms involving a review of the role of the state an owner of SOEs, streamlining of practices at the level of SOE boards and management, improving transparency and disclosure of SOEs and fostering better relations with stakeholders. The following section provides more information on the progress achieved.

Role of the state as the owner

While the state as the ultimate owner of SOEs has a clear impact on the development of this sector, changes in the portfolio of SOEs inevitably affect the state's role with respect to them. In this regard, the state's gradual withdrawal from enterprises operating in competitive sectors has had a positive impact on the economy insofar as this divestment has not been equated with abandonment. Instead, the role of the state has evolved to focus more on functions of regulation, providing incentives for better governance and tighter supervision through sectoral agencies and the Competition Council.

Likewise, the 2003 reform of the state's financial control over SOEs adopted a number of important governance principles and codified the contractualisation of state-SOE relations with a view to enhance their performance and corporate governance. The state as auditor, by virtue of Act No. 69-00, wields financial oversight over SOEs, and other forms of internal and external auditing are in place. Act No. 69-00 also reinforced the role of the state as shareholder. Section 20 of this Act stipulates that the Minister of Finance wields the rights and powers lying with the state as the shareholder in companies subject to its financial control.

The reform of the state's financial control over public enterprises, which took effect in 2003 through the repeal of 1960 legislation, contributed to reinforcing the accountability of SOE management and to increasing the relevance of the state's control by gearing it to *ex-post* evaluation of management, performance and earnings, replacing the previous mechanism focused on regularity and *ex-ante* approval. The reform of the state's financial control over SOEs was based on the following guidelines:

- Extension of the state's control to all SOEs, except public bodies invested with specific missions and control procedures;
- Focus of control on *ex-post* measures, depending on the entity's legal status as well as the quality of its information, management and internal control systems; and
- Clarification of powers of governance organs within each SOE, with reference to good corporate governance principles.

The role of SOE governance organs

Moroccan SOEs are overseen by boards of directors (in single-tier boards) or supervisory boards (in dual-tier boards) that play a paramount role in their governance systems. These bodies are governed by, among others, the Financial Control Act and the Limited Liability Companies Act in respect of state companies, public subsidiaries and semi-public companies. Significant regulatory reform through circulars from the Head of Government and the Minister of Finance was introduced in order to strengthen the operation of governance bodies and allow them fully to play their strategic orientation and control role.

The operation of SOE governance organs is monitored regularly by the Ministry of Economy and Finance's Department of Public Enterprises and Privatisation (DEPP). DEPP has a staff of more than 300 professionals with multidisciplinary backgrounds in economics, engineering, law, information technology and others. This unit has 60 auditors and government commissars. The gender balance in this unit is well respected, with 40% of the staff being female. DEPP's recommendations sometimes prompt circulars by the Head of Government. In the past, these have covered a wide range of issues, such as the scheduling of meetings, the role of the board of directors, reporting practices and other matters.

Transparency, auditing and financial disclosure

SOEs are required to keep accounts based on which it is possible to prepare certified financial statements that are audited by one or more external auditors licensed to practice as statutory auditors. Pursuant to Act No. 69-00, the annual accounts of all public establishments are published. Publication must be in accordance with the conditions and in the format stipulated by a government decree. Public groups are required to submit consolidated accounts, according to the accounting standards in force, or else according to internationally accepted accounting standards. Publicly traded SOEs publish their accounts according to the same standards applicable to other listed companies.

A special effort was recently made to support the practice of introducing an audit committee of the board. A model operating charter for audit committees was formulated and made available to SOEs. With regard to the external audit of SOEs, the main achievements include the extension of financial audits to include performance, strategy and organisational issues; and the development of follow-up on auditors' recommendations. This follow-up can lead to significant actions in the areas of improving governance and transparency and in combating corruption.

Under Act No. 62-99, constituting the Financial Jurisdictions Code, and more particularly Sections 75 to 85 thereof, the Court of Accounts and the Regional Courts of Accounts audit the management of a number of public enterprises as part of their yearly work plans. These entities' reports generally contain an assessment as well as recommendations for, among other things, improving corporate governance and the financial, technical and commercial performance of SOEs.

Recommendations of the Court of Accounts tend to bear on making boards of directors more effective; bolstering internal control systems, organisation and management information systems; rationalising expenditure and increasing revenue; and exercising better oversight over human resources and inventory management. To foster better implementation of the Court's recommendations, circulars and memoranda were sent in 2008 to chief executives of many SOEs, as well as to directors representing the Ministry of Finance and audit committees of the SOEs so that the recommendations would be put on the agendas of the boards meetings.

Pursuant to the Budget Act, an annual report on the SOE sector is submitted along with the draft budget to the Parliament. This report informs the

Parliament about the public portfolio inventory and changes to it over the past year, the performance of the SOE sector, SOEs' capital investments, their completed or ongoing restructuring, progress in the realm of corporate governance and outcomes of privatisation transactions conducted during the year. Annexes to the report contain fact sheets on the main SOEs and provide detailed snapshots of their financial performance.

Relations with stakeholders

One important avenue for increasing SOEs' transparency towards their stakeholders is better communication of their objectives. In Morocco, this has been accomplished through performance contracts as well as through the presentation of a multi-annual plan and the main scheduled investment projects, all of which can be found in an annex to the proposed annual budget of each SOE submitted for approval to the Minister of Finance. These budgets are developed according to the budgetary regulation mechanism proposed by the annual circular to SOEs prepared by the Ministry of Finance, which in turn refers to the Prime Minister's annual instructions setting forth the guidelines for preparation of the draft budget.

These mechanisms aim to increase transparency within the overall framework that encourages, *inter alia*, the adoption of practices to fight corruption and facilitate access to public procurement. With regard to conditions for access to public procurement, Section 9 of Act No. 69-00 requires SOEs to purchase competitively in order to ensure transparency, equal access to public procurement and efficient spending. Efforts are continuing in order to harmonise the contract rules of certain SOEs with the new public procurement provisions and ensure that SOEs advertise on the Moroccan public procurement portal.

Progress in the realms of governance and transparency has also been spurred by various initiatives to assist enterprises, carried out in partnership with international institutions and organisations. Notable examples include annual consultations with the International Monetary Fund under Section 4; World Bank assessments of the system of public finances; SOE governance seminars and workshops in partnership with the Organisation for Economic Co-operation and Development; and a Morocco/European Union institutional twinning programme, which includes an SOE governance aspect. One example of such a twinning programme was the co-operation between the Moroccan Ministry of Finance, the German Ministry for Economic Affairs and the Public Sector Enterprise Group of Northern Ireland.[4]

Ongoing initiatives

Today, the SOE sector is striving to do a better job of helping to raise Morocco to new heights of economic growth, wealth creation and employment. Structural reforms such as liberalisation, privatisation and more governance-specific reforms aiming to foster transparency and accountability, bolster the prerogatives of boards of directors and generalise the operation of specialised committees are enabling SOEs to visibly improve their results and affirm themselves as genuine players in the country's development.

The state has been able to redefine its role in the economic fabric in a tangible manner, essentially as a regulator but also as a driving force behind capital investment in strategic sectors. Contractualisation of state-SOE relations has had a major impact on capital investment and the transformation of governance bodies so that these can be sufficiently empowered to approve strategy and review risk-management procedures. In this regard, the reinforcement of reporting practices such as the consolidation of public groups' accounts and the adoption of internationally accepted accounting standards has been mutually reinforcing.

Currently, a number of governance-related initiatives are considered of priority. These include an initiative that aims to help SOEs contribute to the emergence of regional development clusters. The initiative will clearly have an impact on SOE governance through their involvement with regional authorities and through the contractualisation of their relationship with the state and private sector partners.

Second, a reform of the Budget Act was introduced with the objective of consolidating the progress in SOE reporting practices and multi-year planning, along with an upgraded reporting to the Parliament on the SOE sector. Finally, the Code of Good Governance Practices for Public Establishments and Enterprises was introduced in 2011, as a result of the work of the National Commission on Corporate Governance (CNGE). Additional details on the past work of the Commission can be found in Box 6.1.

This code, at least in the first instance, is aimed at SOEs keen to enhance their overall performance. It allows for diversity of governance structures of SOEs and recommends a series of good practices that are likely to improve their governance. The code addresses a wide range of issues, including the establishment of specialised committees of the board and their charters, inclusion of independent directors, contractualisation of objectives and performance targets, dividend policy, board evaluations, transparency and disclosure.[5]

Box 6.1. Moroccan National Commission on Corporate Governance

The Moroccan National Commission on Corporate Governance was established in 2007. It is led by the General Confederation of Moroccan Enterprises and by the Ministry of Economic and General Affairs, and also includes representatives of the Ministry of Economy and Finance, Bank Al Maghrib (the central bank), the Casablanca Stock Exchange and a few other national corporate governance experts.

This Commission prepared the first Moroccan Code of Good Corporate Governance Practices in 2008, based on the *OECD Principles of Corporate Governance*, aiming it at private- and public sector enterprises alike. This code was subsequently complemented by guidelines specifically for small and medium-size enterprises and for financial sector establishments. Recognising the specific features of the SOE sector, the Commission decided to draft a code dedicated to state-owned enterprises.

This specific code draws on the *OECD Guidelines on Corporate Governance of State-Owned Enterprises* and was formulated with the input of the OECD, other international experts and national stakeholders who discussed a preliminary version of the code on the occasion of the meeting of the OECD's *MENA Taskforce on Corporate Governance of SOEs* held in Rabat in April 2011. It also benefited from feedback from the World Bank and from the extended consultation with more than 100 SOEs, including subsidiaries of some large public groups.

This code is the fruit of a participative approach, reflecting views of private- and public sector participants, and extends to a set of public establishments and enterprises as well as to employer organisations, regulators and specialists sitting on a Working Group assigned to prepare the code. This Working Group has decided to continue its activities by supervising the code's implementation, assessing its impact and updating it in association with the National Commission on Corporate Governance.

The code applies to SOEs on a comply-or-explain basis. It is hoped that it will be complied with and implemented by the largest number of public entities, and that its current structure will enable it to evolve over time. This code is a call for making all members of governance bodies (i.e. directors and executives) and their partners (i.e. government auditors, external auditors, control officers) accountable, given the scope of their mission and the need for each of them to adopt a philosophy of systematic accountability.

The document is intended especially for market-oriented public establishments, be they state-controlled companies, public subsidiaries, or semi-public companies. It will also be highly useful for non-market establishments. The text was finalised by the National Commission on Corporate Governance on 10 October 2011, and the government is currently considering measures and steps to enhance its implementation. The Moroccan Institute of Directors, established in 2008, will help to train SOE board members on their duties and responsibilities.

Conclusions

Reform of the state-owned enterprise sector in Morocco has undergone three distinct phases: (1) structural reforms in the 1980s, (2) modernisation of their environment in the 1990s, and (3) liberalisation of numerous industries in the 2000. These measures have had a positive impact on the performance of SOEs, whose role in the country's economic and social development has grown over the years. It is therefore logical that the focus of the Moroccan government in recent years has been on improving corporate governance of SOEs in order to enhance their financial performance and their role in providing basic services, as well as develop rural areas of the country.

The government has pursued reform of the SOE sector with the view to forge firmer links between Moroccan companies and their international counterparts, align management standards of SOEs with those of their private sector competitors and adopt better corporate governance practices to improve transparency and financial performance of SOEs. In this dynamic of propelling Moroccan SOEs towards internationally recognised standards, the involvement of national and international partners – who have played a crucial role in promoting good practices such as transparency and accountability – has been important.

Notes

1. Caisse de Dépôt et de Gestion is a public holding company with 153 subsidiaries and affiliates as of 2010. It is a public financial establishment with a certain number of particularities compared with the conventional governance arrangements in other public establishments: a supervisory board (supreme supervisory body), general management and a general fund (institutional external control).
2. Equity holdings should be construed to mean direct or indirect interests, exclusive or joint, held by the state, local authorities or public establishments.
3. The three large public holding companies, *i.e.* Caisse de Dépôt et de Gestion, OCP SA and Banque Centrale Populaire, together own 46% of the number of the said companies.
4. The purpose of this twinning, which began in May 2011, is to bolster DEPP's institutional capacities in the realms of public-private partnerships and SOE governance. The European Union has provided EUR 970 000 over a 24-month period. Among other components of this twinning arrangement, the one on governance focuses on assisting DEPP to implement mechanisms inspired by European good practices in terms of operations of boards of directors, helping

with publication and dissemination of the Moroccan Code of Good Governance Practices for SOEs, and assisting with the Code's implementation at 10 pilot SOEs.

5. The text of the Code is structured, in line with the *SOE Guidelines*, under the following broad themes: clarification of the roles of the state, strengthening the role and responsibilities of governance bodies, clarifying the roles and responsibilities of management; strengthening ethics and transparency, and promoting equitable treatment of stakeholders.

Bibliography

Commission on Corporate Governance (CNGE) (2008), *Code of Good Corporate Governance Practices in Morocco.*

CNGE (2011*), Code of Good Governance Practices for Public Establishments and Enterprises in Morocco.*

FDI Intelligence (2011), *South Africa has been knocked off the top spot this year with Morocco awarded the African Country of the Future 2011/12.*

Ministère de l'Economie et des Finances du Royaume du Maroc (2012), *Rapport sur le Secteur des Etablissements et Entreprises Publiques accompagnant le Projet de Loi de Finances (Report on State-Owned Enterprises to accompany the Draft Budget).*

Ministère de l'Economie et des Finances du Royaume du Maroc (2010), *Rapport sur la Gouvernance des Etablissements et Entreprises Publiques et de la Privatisation (Report on Corporate Governance of State-Owned Enterprises and Privatisation).*

Organisation for Economic Co-operation and Development (OECD) (2004), *OECD Principles of Corporate Governance,* OECD, Paris.

OECD (2005), *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, OECD, Paris.

United Nations Conference on Trade and Development (2008), *Examen de la Politique de l'Investissement du Maroc (Study of the Investment Policy of Morocco).*

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

OECD PUBLISHING, 2, rue André-Pascal, 75775 PARIS CEDEX 16
(26 2012 02 1 P) ISBN 978-92-64-11090-8 – No. 59879 2012

Towards New Arrangements for State Ownership in the Middle East and North Africa

Contents

Chapter 1. Priorities for improving governance and performance of state-owned enterprises in the Middle East and North Africa
by Alissa Amico, Manager, Middle East and North Africa, Corporate Affairs Division, Directorate of Financial and Enterprise Affairs, OECD

Chapter 2. The Arab Spring emphasises better corporate governance of state-owned enterprises
by Nasser Saidi, Executive Director, Hawkamah Institute for Corporate Governance with the assistance of Jahanara Ahmad, Manager, Hawkamah Institute for Corporate Governance

Chapter 3. How the GCC did it: Formal and informal governance of successful public enterprise in the Gulf Co-operation Council countries
by Steffen Hertog, Lecturer, London School of Economics and Political Science

Chapter 4. State-owned enterprises in Kuwait: History and recent developments
by Mithqal Sartawi, Managing Director and President, Privatisation Holding Company of Kuwait

Chapter 5. Transparency of Egypt's public-private joint ventures
by Jennifer Bremer, Associate Professor of Public Policy and Chair, Public Policy and Administration Department, School of Global Affairs and Public Policy, American University in Cairo

Chapter 6. Corporate governance of state-owned enterprises in Morocco: Evolution and perspectives
by Abderrahmane Semmar, Head of the Division of Programming and Restructuring, Department of Public Enterprises and Privatisation, Ministry of Economy and Finance of Morocco

Please cite this publication as:

OECD (2012), *Towards New Arrangements for State Ownership in the Middle East and North Africa*, OECD Publishing.
http://dx.doi.org/10.1787/9789264169111-en

This work is published on the *OECD iLibrary*, which gathers all OECD books, periodicals and statistical databases. Visit ***www.oecd-ilibrary.org***, and do not hesitate to contact us for more information.

ISBN 978-92-64-11090-8
26 2012 02 1 P

OECD*publishing*
www.oecd.org/publishing