OECD Guidelines on the Governance of SOEs

Purpose: Information
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OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES

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Definition of an State-owned Enterprise (SOE)

- Differ from country to country

- Any corporate entity recognized by national law, in which the state exercises ownership

- “enterprises where the state has significant control through full, majority, or significant minority ownership” – OECD definition which is used for the guidelines

Policy Dialogue on Internalizing OECD Guidelines for Governance of SOEs
August 26, 2017

IFC International Finance Corporation
APEC Asia-Pacific Economic Cooperation
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SOEs are increasingly prominent actors in international markets

- SOEs remain significant in many key Asian economies, especially in China and Vietnam.
- In Asia, SOEs are prevalent in a wide variety of manufacturing and services industries such as electricity & gas, transportation and finance sector.
- Considerable and increasing number of listed SOEs on both domestic and international stock exchanges.

Source: “State-owned enterprises: Catalysts for public value creation?” - April 2015, PwC

…but their performance is hindered by governance challenges.

- Complex chain of accountability
- Passive ownership by the State
- Undue political interference/ State intervention
- SOE related law and regulations are outdated
OECD Guidelines on Corporate Governance of SOEs

- Previous edition: 2005
- This revised edition: 2015

- The Guidelines are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner.

- They are the internationally agreed standard for how governments should exercise the state ownership function to avoid the pitfalls of both passive ownership and excessive state intervention.

OECD Guidelines on Corporate Governance of SOEs

The Guidelines aim to:

(i) professionalize the state as an owner;

(ii) make SOEs operate with similar efficiency, transparency and accountability as good practice private enterprises; and

(iii) ensure that competition between SOEs and private enterprises, where such occurs, is conducted on a level playing field.
OECD Guidelines on Corporate Governance of SOEs

Defining an SOE:

“For the purpose of the Guidelines, any corporate entity recognized by national law as an enterprise, and in which the state exercises ownership, should be considered as an SOE. This includes joint stock companies, limited liability companies and partnerships limited by shares.”

“The Guidelines apply to enterprises that are under the control of the state, either by the state being the ultimate beneficiary owner of the majority of voting shares or otherwise exercising an equivalent degree of control.”

“The Guidelines are generally not intended to apply to entities or activities whose primary purpose is to carry out a public policy function.” (Page 14)

Contents of the Guidelines

I. Rationales for state ownership
II. The state’s role as an owner
III. State-owned enterprises in the marketplace
IV. Equitable treatment of shareholders and other investors
V. Stakeholder relations and responsible business
VI. Disclosure and transparency
VII. The responsibilities of the boards of state-owned enterprises
   Annotations to all chapters
I. Rationales for state ownership

- The state exercises the ownership of SOEs in the interest of the general public. It should carefully evaluate and disclose the objectives that justify state ownership and subject these to a recurrent review.
  - The ultimate purpose of state ownership of enterprises should be to maximize value for society, through an efficient allocation of resources.
  - The government should develop an ownership policy.
  - The ownership policy should be subject to appropriate procedures of political accountability and disclosed to the general public. The government should review at regular intervals its ownership policy.
  - The state should define the rationales for owning individual SOEs and subject these to recurrent review.

II. The state’s role as an owner

- The state should act as an informed and active owner, ensuring that the governance of SOEs is carried out in a transparent and accountable manner, with a high degree of professionalism and effectiveness.
  - Governments should simplify and standardize the legal forms under which SOEs operate.
  - The government should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management.
  - The state should let SOE boards exercise their responsibilities and should respect their independence.
  - The exercise of ownership rights should be centralized in a single ownership entity, or, if this is not possible, carried out by a coordinating body. This “ownership entity” should have the capacity and competencies to effectively carry out its duties.
  - The ownership entity should be held accountable to the relevant representative bodies, including the state supreme audit institutions.
II. The state’s role as an owner (continued)

The state should act as an informed and active owner and should exercise its ownership rights according to the legal structure of each enterprise. Its prime responsibilities include:

1. Being represented at the general shareholders meetings and effectively exercising voting rights;
2. Establishing well-structured, merit-based and transparent board nomination processes in fully- or majority-owned SOEs, actively participating in the nomination of all SOEs’ boards and contributing to board diversity;
3. Setting and monitoring the implementation of broad mandates and objectives for SOEs, including financial targets, capital structure objectives and risk tolerance levels;
4. Setting up reporting systems that allow the ownership entity to regularly monitor, audit and assess SOE performance, and oversee and monitor their compliance with applicable corporate governance standards;
5. Developing a disclosure policy for SOEs that identifies what information should be publicly disclosed, the appropriate channels for disclosure, and mechanisms for ensuring quality of information;
6. When appropriate and permitted by the legal system and the state’s level of ownership, maintaining continuous dialogue with external auditors and specific state control organs;
7. Establishing a clear remuneration policy for SOE boards that fosters the long- and medium-term interest of the enterprise and can attract and motivate qualified professionals.

III. State-owned enterprises in the marketplace

Consistent with the rationale for state ownership, the legal and regulatory framework for SOEs should ensure a level playing field and fair competition in the marketplace when SOEs undertake economic activities.

• Clear separation between the State’s ownership function and other state functions that may influence the conditions for SOEs, particularly regarding market regulation.
• High standards of transparency & disclosure where SOEs combine economic activities & public policy objectives.
• Costs related to public policy objectives should be funded by the state & disclosed.
• Law and regulations should not unduly discriminate between SOEs & their market competitors (e.g. exempt of laws, tax codes and regulations).
• SOEs’ economic activities should face market consistent conditions.
• The procedures for SOEs’ public procurement should be competitive, non-discriminatory and transparent.
IV. Equitable treatment of shareholders and other investors

Where SOEs are listed or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders’ equitable treatment and equal access to corporate information.

- Full implementation of the OECD Principles of Corporate Governance (equal treatment, high transparency, active communication, facilitating minority shareholders in board election, transactions on market consistent terms).
- National CG code should be adhered to by all listed SOEs & unlisted SOEs (where practical).
- Adequate information about the SOE’s pursue public policy objectives should be available to non-state shareholders at all time.
- When SOEs engage in co-operative projects, the contracting party should ensure that contractual right are upheld and that disputes are addressed in a timely and objective manner.

V. Stakeholder relations and responsible business

The state ownership policy should fully recognize SOEs’ responsibilities towards stakeholders and request that SOEs report on their relations with stakeholders. It should make clear any expectations the state has in respect of responsible business conduct by SOEs.
VI. Disclosure and transparency

SOEs should observe high standards of transparency and be subject to the same high quality accounting, disclosure, compliance and auditing standards as listed companies.

• SOEs should report material financial & non-financial information in line with high quality internationally recognized standards for corporate disclosure.

• Annual financial statements should be subject to an independent external audit based on high quality standards.

• The ownership entity should develop consistent reporting on SOEs and publish annually (use of web-based communications).

VII. The responsibilities of the boards of state-owned enterprises

The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

• The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the enterprise’s performance.

• SOE boards should effectively carry out their functions of setting strategy and supervising management, based on broad mandates and objectives set by the government, have the power to appoint and remove the CEO, set executive remuneration levels that are in the long term interest of the enterprise.

• SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications and have equivalent legal responsibilities.

• Independent board members, where applicable, should be free of any material interests or relationships with the enterprise, its management, other major shareholders and the ownership entity that could jeopardize their exercise of objective judgement.
VII. The responsibilities of the boards of state-owned enterprises (continued)

• Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties and to limit political interference in board processes.

• The Chair should assume responsibility for boardroom efficiency and act as the liaison for communications with the state ownership entity, and to be separate from the CEO.

• If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

• SOE boards should consider setting up specialized committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.

• SOE boards should, under the Chair’s oversight, carry out an annual, well-structured evaluation to appraise their performance and efficiency.

• SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent corporate organ.

International examples – The State as the Shareholder: The Case of Singapore

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<thead>
<tr>
<th>Investment Performance</th>
<th>Active Investor</th>
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<tbody>
<tr>
<td>Growth</td>
<td>Temasek's portfolio market value increased 300% over the past 20 years.</td>
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<td>Temasek invested S$159 billion and divested S$100 billion over the last decade.</td>
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<th>Shareholder Return</th>
<th>International Portfolio</th>
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<tr>
<td>Temasek’s 20-year Total Shareholder Return (TISR) was 2.5 times MSCI Singapore in 2012.</td>
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<td>Non-Domestic Ownership of Assets increased 22% over the last decade.</td>
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The State as the Shareholder: The case of Singapore
(Chartered Institute of Management Accountants & Centre for Governance, Institutions and Organizations (CGIO), National University of Singapore)
International examples – The State as the Shareholder: The Case of Singapore

Comparison of Governance Practices: GLCs vs NON-GLCs

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<tr>
<th>Category</th>
<th>GLCs</th>
<th>NON-GLCs</th>
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<tr>
<td><strong>Board Independence</strong></td>
<td>64%</td>
<td>40%</td>
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<td>Board Membership</td>
<td>GLCs have higher percentage of independent directors on their boards.</td>
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<tr>
<td><strong>Chairman Independence</strong></td>
<td>74%</td>
<td>20%</td>
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<tr>
<td>Chairman Position</td>
<td>GLCs have higher percentage of Chairs led by an independent/non-executive chairman.</td>
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<tr>
<td><strong>External Board Appraisal</strong></td>
<td>12%</td>
<td>10%</td>
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<td>GLCs hire more external consultants to conduct board appraisals.</td>
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<tr>
<td><strong>Risk Governance</strong></td>
<td>65%</td>
<td>7%</td>
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<td>GLCs are more likely to have a Board Level Risk Committee.</td>
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For more information about IFC's Corporate Governance services and publications, please refer to:

IFC.org/CorporateGovernance

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THANK YOU!