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KEF-2016: Reforms for Inclusive Growth

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SOEs reform: Public finance perspective

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Belarus

Management and Oversight of State Owned Enterprises

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Outline

I. Why Management and Oversight of SOEs is Important

II. SOEs in Belarus

III. Fiscal Risk Management

IV. Legal framework and Institutional Architecture

V. Improving Governance Arrangements

VI. Priority Reforms

I. Why Management and Oversight of SOEs is Important

They constitute a large proportion of many countries' economies

**Figure 1. Market Capitalization of Listed SOEs
(in percent of GNI)**

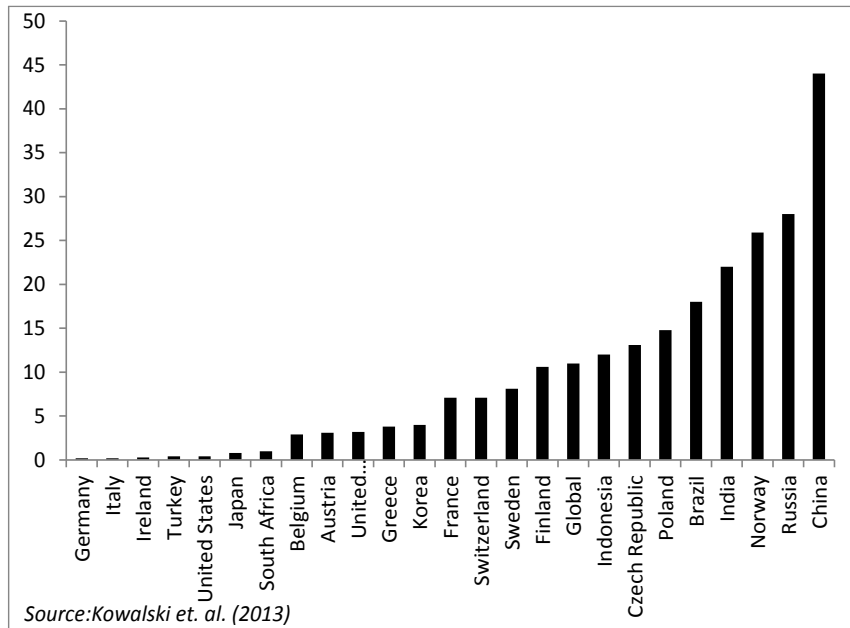
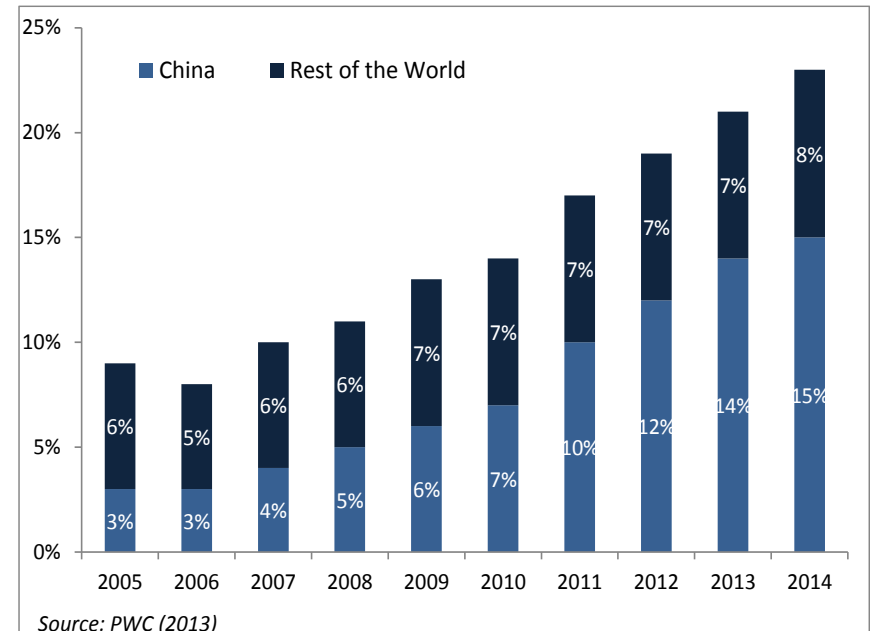
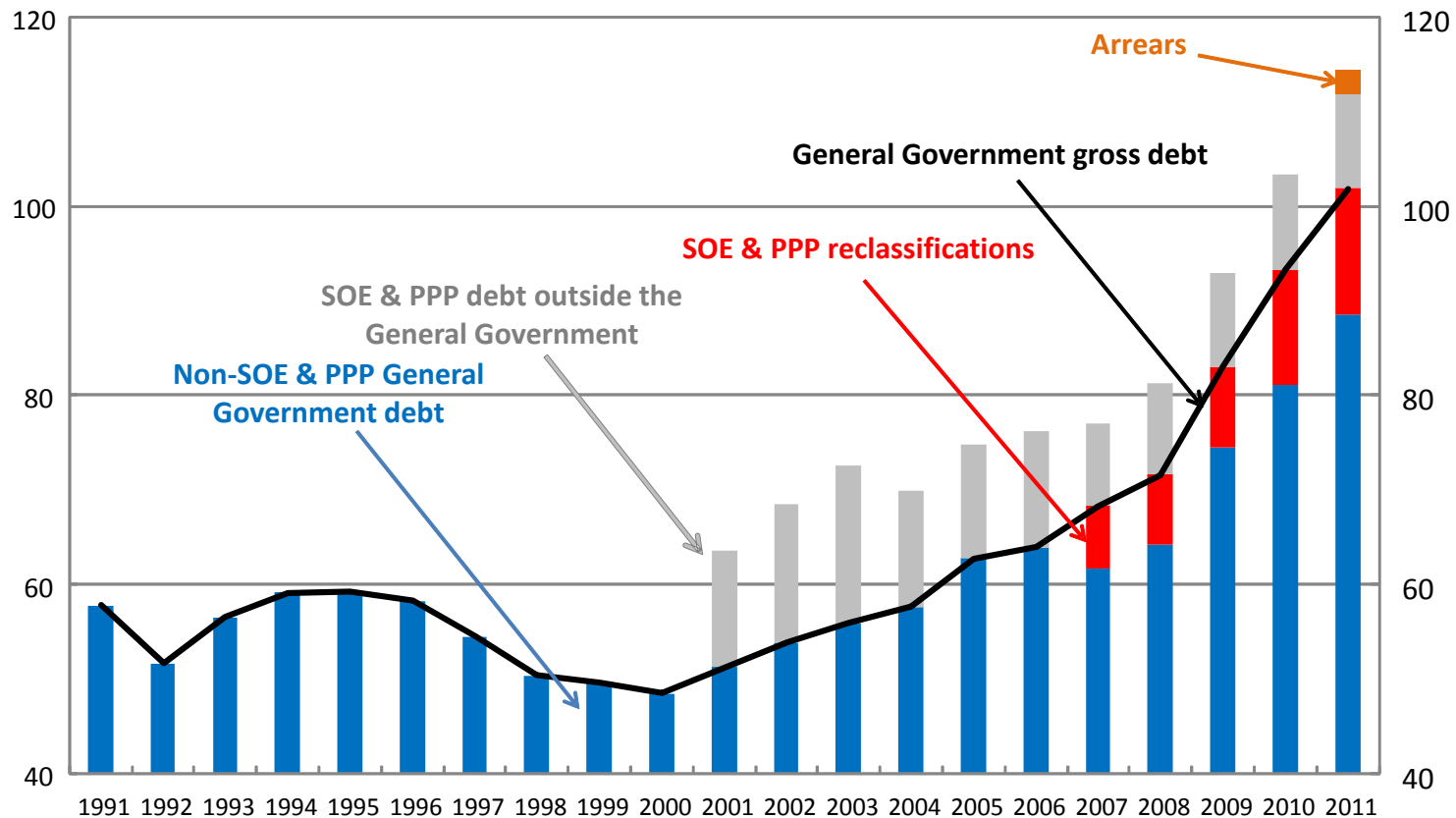


Figure 2. SOEs as a Percentage of Global 500



I. Why management and oversight of SOEs is important

They can significantly impact on Government Finances



I. Why Management and Oversight of SOEs is Important

They can be used for the wrong reasons!

- Use of bonds issued by State Tuna Company (Ematum) to illegally finance purchase of military vessels (Mozambique)
- Poor oversight of SOEs (Guinea)
- Management capture – abuse and corruption by vested interests (Ukraine)

Failures reflect lack of controls on establishment of SOEs, and issuance of loans and guarantees, as well as weak enforcement and oversight

II. SOEs in Belarus

- Represent a large proportion of the economy
 - 1,900 functioning joint stock companies and 1,800 unitary enterprises¹
 - Two thirds share of Employment²
 - Over 50 percent of value added to the economy²
- Many SOEs in financial difficulty and source of significant fiscal risk
 - Large percentage of SOEs are loss making
 - Arrears are sizable and increasing
 - Government Guarantees to SOEs are significant
 - SOEs have accumulated debts, including foreign currency denominated
 - Subsidies from the budget are relatively sizable
 - Directed lending has been a feature of SOE financing
 - Government lending to SOEs also relatively significant

1/ Estimate (unverified)

2/ Source: WB 2012

III. Fiscal Risk Management for SOE sector

Current situation

- Coverage of public sector
 - Size and value of commercial SOE sector subject to uncertainty
 - Determining size essential in determining size of fiscal risks
- Range of fiscal risks
 - direct budget costs of shrinking dividends and increasing subsidies
 - contingent fiscal risks from the outstanding stock of state guarantees
 - Reduced directed lending puts further strain on balance sheets as borrowing costs rise or access reduces
 - Effects of deviations of key macroeconomic variables (e.g., FX risk or interest rates)
 - Other obligations which could eventually fall on the budget
 - *implicit guarantees*
 - *pressure to recapitalize strained balance sheets*
- Existing capacity to analyze potential cost and sensitivity of budget to risks emanating from SOEs is limited

III. Fiscal Risk Management for SOE sector

How to improve disclosure and mitigate risks

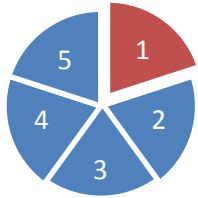
- Expand and improve coverage of information on public sector institutions
- Separate commercial from non-commercial activities
- Review rationale for existence of public enterprises where a private market exists or for non-commercial activities
- Strengthen safeguards for provision of state guarantees on public enterprise loans
- Prepare fiscal risk statement to include quantification of size and probability of realization
- Strengthen capacity in the economic ministries to identify and assess fiscal risks through the use of specific analysis tools
- Define risk mitigation actions in budget documentation

IV. Legal Framework and Institutional Architecture

- Fragmented legal provisions and overlapping oversight arrangements for different categories of SOEs (see below)
- No clear criteria to create new SOEs (as opposed to retaining functions within line ministry)
- Legal framework applicable to SOEs is fragmented
- Diverse information requests from numerous bodies strains reporting capacity and results in potentially conflicting data and analysis
- Mixture of commercial and social policy objectives for SOEs, with no clear prioritization

	Ministry of Economy	Ministry of Finance	Council of Ministers	Line Ministries	State Property Commission
Oversight of SOE sector	◀	◀	◀	◀	◀
Regulation/ Policy	◀	◀	◀	◀	
Performance Monitoring	◀	◀		◀	◀
Day-to-Day Management	◀	◀		◀	

V. Improving Governance Arrangements



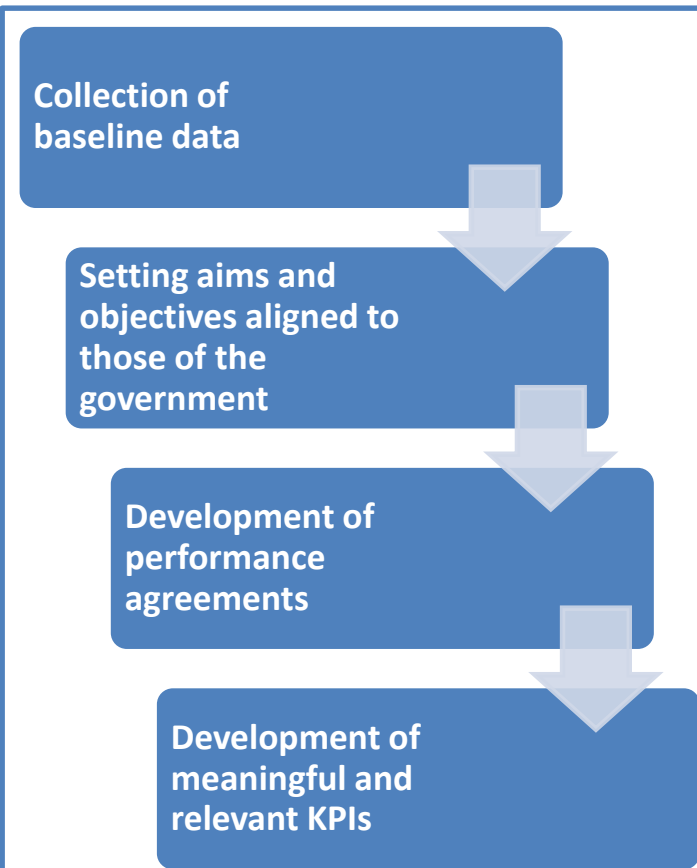
State ownership function

- **Different forms of SOE ownership can create dualistic approach to exercise of ownership function**
- **This adversely impacts on the quality of governance and the competitive environment**

A clearly articulated and consistently implemented state ownership policy needed:

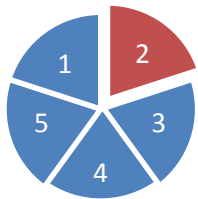
- Defining the objectives of the state
- implementing checks and balances to maintain independence from government
- setting lines of accountability and detailing performance monitoring requirements

Components of performance monitoring systems

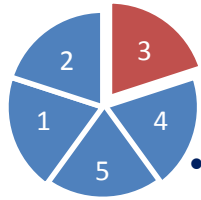


Performance monitoring

- **SOE performance management framework needs significant development to be fit for purpose**
- Focus should be on value maximization for the owner
- Effective performance monitoring helps drive operational efficiencies and incentivizes management to meet owners objectives
- Effective performance monitoring relies on assurance that SOEs will be held accountable for poor performance

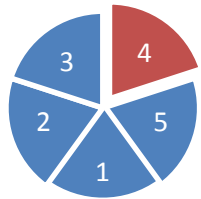


V. Improving Governance Arrangements



Financial and fiscal discipline

- Financial and fiscal discipline ensures competitive neutrality within the SOE sector and the wider economy, which is a component of good governance
- Lack of financial and fiscal discipline:
 - Undermines achievement of value for money
 - runs counter to maximisation of returns
 - Generates fiscal risks for the government



Board of Directors



Diagnostic review

- Critical role of an independent and effective board of directors
- Unitary SOEs lack the political insulation provided by a board of directors
- Boards of directors perform a crucial stewardship and oversight function for both public and private sector entities and in doing so are considered to be a prerequisite to achieving good governance

Good practice on SOE Boards of Directors

Nomination

Composition

Training

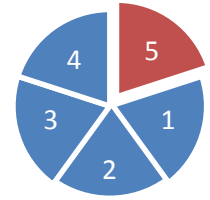
Remuneration

Efficiency

Evaluation

V. Improving Governance Arrangements

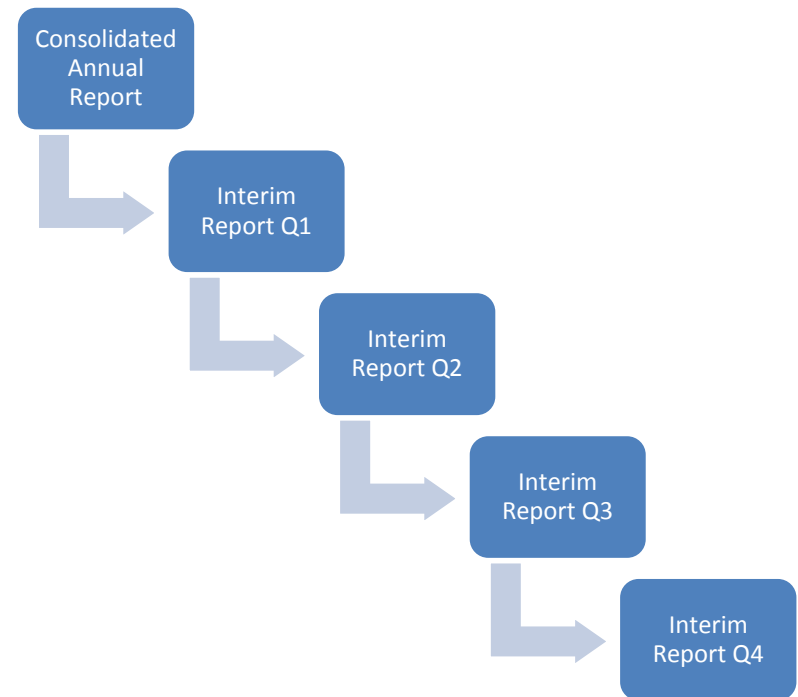
Transparency, reporting and disclosure



International good practice

- High standards of transparency and disclosure fundamental to achievement of good governance
- Help to address information asymmetries and support effective oversight by stakeholders
- Key recipient of disclosure by SOEs is the legislature as it represents the interests of the owners (i.e. the general public)

Lithuania's transparency policy for SOEs



Transparency guidelines require SOEs to present a range of financial and non-financial information in their interim and annual reports.

V. Improving Governance Arrangements

SOE Monitoring Reports

Content of Sweden's 2014 Annual Report of SOEs

1. **Financial overview**
2. **Events in brief**
3. **Ownership issues**
 - a. Ownership model
 - b. Company cases
 - c. Nominations to company boards
 - d. Financial targets
 - e. Sustainability business models
 - f. Public policy targets
 - g. Remuneration and terms of employment
 - h. SOE portfolio, including its valuation
 - i. Effect of company divestments and dividends in government finances
4. **Individual company data**
 - a. Description of company's mandate and operations
 - b. Summary of activities in 2014
 - c. Targets (financial, sustainability, and public policy)
 - d. Performance review
 - e. Summary financial information (abridged income statement and balance sheet, key ratios, reporting performance)
 - f. Panel charts (state ownership, gender distribution, and one performance indicator)
5. **General information**
 - a. State's ownership policy
 - b. Accounting principles and definitions
 - c. Legislation
 - d. Summary of changes in executive boards
 - e. Assessment of reporting practices
 - f. Guidelines for reporting
 - g. Guidelines for terms of employments for senior executives
 - h. Management responsibility for SOEs

Source: Sweden, Department for Innovation and State-Owned Companies, 2015.

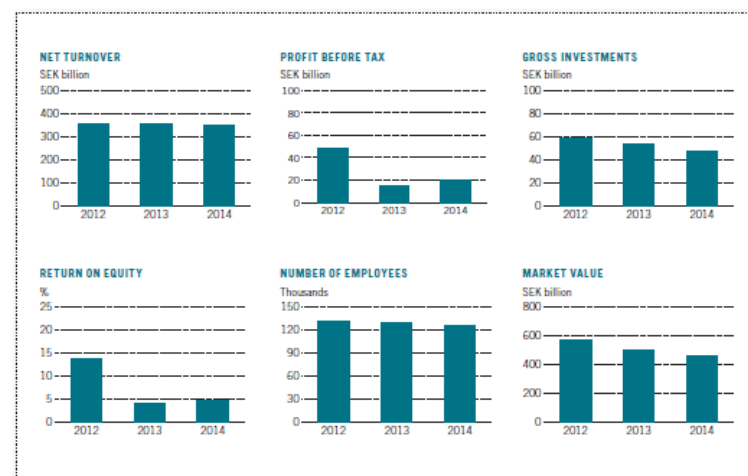
Financial overview

STATE-OWNED COMPANIES, TOTAL

SEK billion	2014	2013	Change, %
Net turnover	350.1	357.8	-2.2
Net turnover, including associated companies	396.5	405.4	-2.2
Profit before changes in value	23.0	24.9	-7.5
Changes in value	5.0	2.1	136.1
Operating profit (EBIT)	28.1	27.0	3.8
Profit before tax	20.6	17.3	19.4
Net profit	16.5	14.3	15.9
Gross investments	47.5	52.8	-10.0
Cash flow from operating activities (excluding SEK and SBAB)	65.2	65.0	0.3
Total equity	363.8	358.7	1.4
Total assets	1,539.4	1,489.0	3.4
Number of employees, excluding associated companies (thousands)	125.1 ¹⁾	128.6 ¹⁾	-2.7
Number of employees, including associated companies (thousands)	163.3 ²⁾	168.9 ²⁾	-3.4
Dividend	18.1	17.7	1.9
Estimated value	460	500	-8.0
Return on equity (%)	4.8	4.0	
Equity/assets ratio (%)	23.6	24.1	

1) Of whom women accounted for 34 (34) per cent and men for 66 (66) per cent.

2) Of whom women accounted for 36 (36) per cent and men for 64 (64) per cent.



VI. Priority Reforms

Issues to Consider

- 1- Strengthen fiscal risk management
- 2- Prepare inventory of SOEs
- 2- Separate commercial and policy objectives and assets
- 3- Separate ownership and regulation
- 4- Legal reform
- 5- Incorporate and move towards equity culture
- 6- Reform state ownership structure and management of portfolio

