

# OECD Guidelines on Corporate Governance of State-owned Enterprises



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# **OECD Guidelines on Corporate Governance of State-Owned Enterprises**



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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## Foreword

*Corporate governance of state-owned enterprises is a major challenge in many economies. But, until now, there has not been any international benchmark to help governments assess and improve the way they exercise ownership of these enterprises, which often constitute a significant share of the economy. These OECD Guidelines on Corporate Governance of State-Owned Enterprises fill this important gap, and their development has attracted global interest from a variety of different stakeholders. The strong support that OECD has enjoyed for this work, and the broad endorsement of the Guidelines themselves, makes me convinced that they will be widely disseminated and actively used in both OECD and non-OECD countries.*

*The demand for these Guidelines should not come as a surprise to anyone who has followed policy developments in this field. The shared experience of countries that have started to reform corporate governance of state-owned enterprises is that this is an important but also complex undertaking. A major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company. Another important challenge is to ensure that there is a level-playing field in markets where private sector companies can compete with state-owned enterprises and that governments do not distort competition in the way they use their regulatory or supervisory powers.*

*Building on practical experience, these Guidelines provide concrete suggestions on how such dilemmas can be solved. For example, they suggest that the state should exercise its ownership functions through a centralised ownership entity, or effectively coordinated entities, which should act independently and in accordance with a publicly disclosed ownership policy. The Guidelines also suggest the strict separation of the state's ownership and regulatory functions. If properly implemented, these and the other recommended reforms would go a long way to ensure that state ownership is exercised in a professional and accountable manner, and that the state plays a positive role in improving corporate governance across all sectors of our economies. The result would be healthier, more competitive and more transparent enterprises.*

*Experienced policy-makers and practitioners from a large number of OECD and non-OECD countries have contributed to the development of these Guidelines. Their input, through an open consultative process, is responsible for the quality and the*

relevance of these Guidelines. I extend my sincere appreciation to all members of the OECD Working Group on Privatisation and Corporate Governance of State-Owned Assets, whose constructive efforts made it possible to develop these Guidelines, and to their Chair, Mr. Lars-Johan Cederlund, whose dedication and leadership helped to bring this work to a successful conclusion. I also thank the organisations and individuals who participated in the consultations, thereby influencing successive drafts of this document. Your expertise has been indispensable and your contributions are greatly appreciated and acknowledged.\*

Looking ahead, these Guidelines should be widely disseminated and actively used. Their implementation in individual countries should be supported by a process of dialogue and exchange of experience among peers from many countries. The OECD will therefore continue to convene fora including OECD and non-OECD countries in order to promote good corporate governance of state-owned enterprises.



Donald Johnston  
Secretary-General

\* Please see my acknowledgements on page 7.

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## Preamble

In several OECD countries, State-Owned Enterprises (SOE) still represent a substantial part of GDP, employment and market capitalisation. Moreover, State-Owned Enterprises are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunication, whose performance is of great importance to broad segments of the population and to other parts of the business sector. Consequently, the governance of SOEs will be critical to ensure their positive contribution to a country's overall economic efficiency and competitiveness. OECD experience has also shown that good corporate governance of State-Owned Enterprises is an important prerequisite for economically effective privatisation, since it will make the enterprises more attractive to prospective buyers and enhance their valuation.

A number of non-OECD countries also have a significant state-owned sector, which in some cases is even a dominant feature of the economy. These countries are in many cases reforming the way in which they organise and manage their state-owned enterprises and have sought to share their experiences with OECD countries in order to support reforms at national level.

It is against this background that the OECD Steering Group on Corporate Governance in June 2002 asked the Working Group on Privatisation and Corporate Governance of State-Owned Assets to develop a set of non-binding guidelines and best practices on corporate governance of state-owned enterprises. The Working Group, which comprises representatives from OECD member countries and the World Bank and IMF as observers, has undertaken comprehensive consultations during the development of these Guidelines. It has consulted with a wide range of interested parties, such as board members and CEOs of state-owned enterprises, state audit bodies, unions and Parliamentarians, and has conducted extensive consultations with non-member countries. A draft version of the Guidelines was posted on the OECD website for public comment and resulted in a significant number of useful and constructive comments, which have also been posted on the site.

These Guidelines should be viewed as a complement to the OECD Principles of Corporate Governance<sup>1</sup> on which they are based and with which they are fully compatible. The Guidelines are explicitly oriented to issues that are specific to corporate governance of State-Owned Enterprises and consequently take the perspective of the state as an owner, focusing on

policies that would ensure good corporate governance. Nonetheless the Guidelines are not intended to, nor in their effect should they, contradict or discourage OECD countries or non-OECD countries from undertaking any privatisation policies or programmes.

Over the years, the rationale for state ownership of commercial enterprises has varied among countries and industries and has typically comprised a mix of social, economic and strategic interests. Examples include industrial policy, regional development, the supply of public goods and the existence of so called “natural” monopolies. Over the last few decades however, globalisation of markets, technological changes and deregulation of previously monopolistic markets have called for readjustment and restructuring of the state-owned sector. These developments are surveyed in two recent OECD reports that have served as input to these guidelines.<sup>2</sup>

In order to carry out its ownership responsibilities, the state can benefit from using tools that are applicable to the private sector, including the OECD Principles of Corporate Governance. This is especially true for listed SOEs. However, SOEs also face some distinct governance challenges. One is that SOEs may suffer just as much from undue hands-on and politically motivated ownership interference as from totally passive or distant ownership by the state. There may also be a dilution of accountability. SOEs are often protected from two major threats that are essential for policing management in private sector corporations, i.e., takeover and bankruptcy. More fundamentally, corporate governance difficulties derive from the fact that the accountability for the performance of SOEs involves a complex chain of agents (management, board, ownership entities, ministries, the government), without clearly and easily identifiable, or remote, principals. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge.

As the Guidelines are intended to provide general advice that will assist governments in improving the performance of SOEs, the decision to apply the Guidelines to the governance of particular SOEs should be made on a pragmatic basis. The Guidelines are primarily oriented to state-owned enterprises using a distinct legal form (i.e., separate from the public administration) and having a commercial activity (i.e. with the bulk of their income coming from sales and fees), whether or not they pursue a public policy objective as well. These SOEs may be in competitive or in non-competitive sectors of the economy. When necessary, the Guidelines distinguish between listed and non-listed SOEs, or between wholly owned, majority and minority owned SOEs since the corporate governance issues are somewhat different in each case. The Guidelines can also be applied to the subsidiaries of these aforementioned entities, whether listed or not.

While the Guidelines are primarily intended to cover commercial enterprises under central government ownership and federal ownership, authorities could also promote their use by sub-national levels of governments that own enterprises. They are also useful for non-commercial SOEs fulfilling essentially special public policy purposes, whether or not in a corporate form. It is in the governments and the public's interest that all these categories of SOEs are professionally run and apply good governance practices.

Throughout the Guidelines, the term "SOEs" refers to enterprises where the state has significant control, through full, majority, or significant minority ownership. However, many of the Guidelines are also useful in cases where the state retains a relatively small stake in a company, but should nevertheless act as a responsible and informed shareholder. In the same vein, the term "ownership entity" refers to the state entity responsible for executing the ownership rights of the state, whether it is a specific Department within a Ministry, an autonomous agency or other. Finally, as in the OECD Principles, the term "board" as used in this document is meant to embrace the different national models of board structures found in OECD and non-OECD countries. In the typical two tier system, found in some countries, "boards" refers to "supervisory board" while "key executive" refers to the "management board".

The following document is divided into two parts. The Guidelines presented in the first part of the document cover the following areas: I) Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises; II) The State Acting as an Owner; III) Equitable Treatment of Shareholders; IV) Relations with Stakeholders; V) Transparency and Disclosure; VI) The Responsibilities of Boards of State-Owned Enterprises. Each of the sections is headed by a single Guideline that appears in bold italics and is followed by a number of supporting sub-Guidelines. In the second part of the document, the Guidelines are supplemented by annotations that contain commentary on the Guidelines and are intended to help readers understand their rationale. The annotations may also contain descriptions of dominant trends and offer alternative implementation methods and examples that may be useful in making the Guidelines operational.

## Notes

1. OECD Principles of Corporate Governance, 2004.
2. "Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries", OECD, 2005 and "Privatising State-Owned Enterprise, An Overview of Policies and Practices in OECD Countries", OECD, 2003.

## I. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises

***The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.***

- A.** There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.
- B.** Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.
- C.** Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.
- D.** SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.
- E.** The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.
- F.** SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.

## II. The State Acting as an Owner

***The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.***

- A.** The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy.
- B.** The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.
- C.** The state should let SOE boards exercise their responsibilities and respect their independence.
- D.** The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a co-ordinating entity or, more appropriately, by the centralisation of the ownership function.
- E.** The co-ordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.
- F.** The state as an active owner should exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include:
  - 1. Being represented at the general shareholders meetings and voting the state shares.
  - 2. Establishing well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs' boards.
  - 3. Setting up reporting systems allowing regular monitoring and assessment of SOE performance.
  - 4. When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.
  - 5. Ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals.

### III. Equitable Treatment of Shareholders

***The state and state-owned enterprises should recognise the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.***

- A.** The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.
- B.** SOEs should observe a high degree of transparency towards all shareholders.
- C.** SOEs should develop an active policy of communication and consultation with all shareholders.
- D.** The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.

## IV. Relations with Stakeholders

***The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.***

- A.** Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.
- B.** Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.
- C.** The board of SOEs should be required to develop, implement and communicate compliance programmes for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.



## V. Transparency and Disclosure

***State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.***

- A.** The co-ordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.
- B.** 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 company organ.
- C.** SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.
- D.** SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.
- E.** SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public. Examples of such information include:
  - 1. A clear statement to the public of the company objectives and their fulfilment.
  - 2. The ownership and voting structure of the company.
  - 3. Any material risk factors and measures taken to manage such risks.
  - 4. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE.
  - 5. Any material transactions with related entities.

## VI. The Responsibilities of the Boards of State-Owned Enterprises

***The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.***

- A.** The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.
- B.** SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.
- C.** The boards of SOEs should be composed so that they can exercise objective and independent judgement. Good practice calls for the Chair to be separate from the CEO.
- D.** 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.
- E.** When necessary, SOE boards should set up specialised committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.
- F.** SOE boards should carry out an annual evaluation to appraise their performance.

## Annotations to Chapter I:

### Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises

***The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.***

The legal and regulatory framework within which SOEs operate is often complex. If it is not consistent and coherent it can easily result in costly market distortions and undermine the accountability of both management and the state as an owner. A clear division of responsibilities among authorities, a streamlining of legal forms together with a coherent and consistent regulatory framework will facilitate the improvement of corporate governance in SOEs.

***A. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.***

The state often plays a dual role of market regulator and owner of SOEs with commercial operations, particularly in the newly deregulated and often partially privatised network industries. Whenever this is the case, the state is at the same time a major market player and an arbitrator. Full administrative separation of responsibilities for ownership and market regulation is therefore a fundamental prerequisite for creating a level playing field for SOEs and private companies and for avoiding distortion of competition. Such separation is also advocated by the *OECD Principles of Regulatory Reform*.

Another important case is when SOEs are used as an instrument for industrial policy. This can easily result in confusion and conflicts of interest between industrial policy and the ownership functions of the state, particularly if the responsibility for industrial policy and the ownership functions are vested with the same branch or sector ministries. A separation of industrial policy and ownership will enhance the identification of the state as an owner and will favour transparency in defining objectives and

monitoring performance. However, such separation does not prevent necessary co-ordination between the two functions.

In order to prevent conflicts of interest, it is also necessary to clearly separate the ownership function from any entities within the state administration which might be clients or main suppliers to SOEs. General procurement rules should apply to SOEs as well as to any other companies. Legal as well as non legal barriers to fair procurement should be removed.

In implementing effective separation between the different state roles with regard SOEs, both perceived and real conflicts of interest should be taken into account.

***B. Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.***

SOEs may have a specific, and sometimes different, legal form from other companies. This may reflect specific objectives or societal considerations as well as special protection granted to certain stakeholders. This particularly concerns employees whose remuneration may be fixed by regulatory acts/bodies and whom are given specific pension rights and protection against redundancies equivalent of those provided to civil servants. In a number of cases, SOEs are also to a large extent protected from insolvency or bankruptcy procedures by their specific legal status. This is sometimes due to the necessity to ensure continuity in the provision of public services.

Where this occurs, the SOEs often differ from the private limited liability companies through: i) the respective authority and power of the board, management and ministries; ii) the composition and structure of these boards; iii) the extent to which they grant consultation or decision making rights to some stakeholders, more particularly, employees; iv) disclosure requirements and, as mentioned above, the extent to which they are subjected to insolvency and bankruptcy procedures, etc. The legal form of SOEs also often includes a strict definition of the activity of the SOEs concerned, preventing them from diversifying or extending their activities in new sectors and/or overseas. These limits have been legitimately set to prevent misuse of public funds, stop overly ambitious growth strategy or prevent SOEs from exporting sensitive technologies.

In some countries, SOEs' specific legal forms have evolved significantly in recent years in response to the deregulation and an increased scrutiny of state aid and cross subsidisation. Limitations on the type of activities that SOEs are allowed to carry out according to their legal form have been relaxed. In some countries, changes in the legal form have been accompanied by the state taking on commitments regarding employees' protection, more particularly regarding pension rights.

When streamlining the legal form of SOEs, governments should base themselves as much as possible on corporate law and avoid creating a specific legal form when this is not absolutely necessary for the objectives of the enterprise. Streamlining of the legal form of SOEs would enhance transparency and facilitate oversight through benchmarking. It would also level the playing field with private competitors in increasingly deregulated and competitive markets.

The streamlining should target SOEs having a commercial activity and operating in competitive, open markets. It should focus on making those means and instruments usually available to private owners, also available to the state as an owner. Streamlining should therefore primarily concern the role and authority of the company's governance organs as well as transparency and disclosure obligations.

If the change of the legal forms of SOEs is too difficult, other options could be to streamline SOEs' operational practices, make some specific regulations more inclusive, i.e. extending their validity or coverage to SOEs with specific legal forms, or ask SOEs to voluntarily fulfil requirements from these specific regulations, particularly concerning disclosure requirements.

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

In some cases SOEs are expected to fulfil special responsibilities and obligations for social and public policy purposes. In some countries this includes a regulation of the prices at which SOEs have to sell their products and services. These special responsibilities and obligations may go beyond the generally accepted norm for commercial activities and should be clearly mandated and motivated by laws and regulations. They should also preferably be incorporated in the company by-laws.

The market and the general public should be clearly informed about the nature and extent of these obligations, as well as about their overall impact on the SOEs' resources and economic performance.

It is also important that related costs be clearly identified, disclosed and adequately compensated by the state budget on the basis of specific legal provisions and/or through contractual mechanisms, such as management or service contracts. Compensation should be structured in a way that avoids market distortion. This is particularly the case if the enterprises concerned are in competitive sectors of the economy.

**D. SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.**

Experience has shown that in some countries SOEs may be exempt from a number of laws and regulations, including in a few cases, from competition law. SOEs are often not covered by bankruptcy law and creditors sometimes have difficulties in enforcing their contracts and in obtaining payments. Such exemptions from the general legal provisions should be avoided to the fullest extent possible in order to avoid market distortions and underpinning the accountability of management. SOEs as well as the state as a shareholder should not be protected from challenge via the courts or the regulatory authorities, in case they infringe the law. Stakeholders should be able to challenge the state as an owner in the courts and be treated fairly and equitably in such case by the judicial system.

**E. The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.**

The rigidity of the capital structure sometimes makes it difficult for an SOE to develop or fulfil its objectives. The state as an owner should develop an overall policy and provide mechanisms that allow appropriate changes in SOEs' capital structure.

These mechanisms could include the capacity, for the ownership function, to adjust the SOEs' capital structures in a flexible way but within clear limits. Within certain limits, this could, for example, facilitate the indirect transfer of capital from one SOE to another, such as through some reinvestment of dividends received, or the raising of capital on competitive market terms.

These mechanisms should respect the Parliament decision making power regarding the budget or the appropriate level of state ownership as well as the overall transparency in the budgetary system. Any change in the capital structure of an SOE should be clearly consistent with the state ownership objective and the SOE's specific circumstances. Decisions should be adequately documented to allow effective accountability through audits or scrutiny by the Parliament. Finally, such mechanisms should be limited and subject to careful oversight in order to avoid any form of cross-subsidisation via capital transfers.

**F. SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.**

Creditors and the board often assume that there is an implicit state guarantee on SOEs' debts. This situation has in many instances led to excessive indebtedness, wasted resources and market distortion, to the detriment of both creditors and the taxpayers. Moreover, in some countries, state-owned banks and other financial institutions tend to be the most significant if not the main creditor of SOEs. This environment leaves great scope for conflicts of interest. It may lead to bad loans by state-owned banks as the enterprise might feel itself under no obligation to repay the loan. This may shelter SOEs from a crucial source of market monitoring and pressure, thereby distort their incentive structure.

A clear distinction is necessary between the state and SOEs' respective responsibilities in relation to creditors. The state often grants guarantees to SOEs to compensate for its inability to provide them with equity capital, but this facility is often widely abused. As a general principle, the state should not give an automatic guarantee in respect of SOE liabilities. Fair practices with regard to the disclosure and remuneration of state guarantees should also be developed and SOEs should be encouraged to seek financing from capital markets.

Mechanisms should be developed to manage conflicts of interests and ensure that SOEs develop relations with state-owned banks, other financial institutions as well as other SOEs based on purely commercial grounds. State-owned banks should grant credit to SOEs on the same terms and conditions as for private companies. These mechanisms could also include limits and careful scrutiny on SOEs' board members sitting on the board of state-owned banks.

## Annotations to Chapter II:

### The State Acting as an Owner

***The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.***

In order to carry out its ownership functions, the government should refer to private and public sector governance standards, notably the OECD Principles of Corporate Governance, which are also applicable to SOEs. In addition to the OECD Principles of Corporate Governance, there are specific aspects of SOE governance that either merit special attention or should be documented in more detail in order to guide SOE board members, management and the state entity responsible for executing the ownership rights of the state in effectively performing their respective roles.

***A. The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy.***

It is often the multiple and contradictory objectives of state ownership that lead to either a very passive conduct of ownership functions, or conversely results in the state's excessive intervention in matters or decisions which should be left to the company and its governance organs.

In order for the state to clearly position itself as an owner, it should clarify and prioritise its objectives. The objectives may include avoiding market distortion and the pursuit of profitability, expressed in the form of specific targets, such as rate-of-return and dividend policy. Setting objectives may include trade-offs, for example between shareholder value, public service and even job security. The state should therefore go further than defining its main objectives as an owner; it should also indicate its priorities and clarify how inherent trade-offs shall be handled. In doing so, the state should avoid interfering in operational matters, and thereby respect the independence of the board. A clear ownership policy will help in avoiding the situation where



SOEs are given excessive autonomy in setting their own objectives or in defining the nature and extent of their public service obligations.

Moreover, the state should strive to be consistent in its ownership policy and avoid modifying the overall objectives too often. A clear, consistent and explicit ownership policy will provide SOEs, the market and the general public with predictability and a clear understanding of the state's objectives as an owner as well as of its long term commitments.

In developing and updating the state's ownership policy, governments should make appropriate use of public consultation. The ownership policy and associated company objectives should be public documents accessible to the general public and widely circulated amongst the relevant ministries, agencies, SOE boards, management, and the legislature.

It is also important that relevant civil servants endorse the ownership policy and that the SOE General shareholders meeting, the board and senior management endorse the corporate objectives statements.

***B. The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.***

The prime means for an active and informed ownership by the state is a clear and consistent ownership strategy, a structured board nomination process and an effective exercise of established ownership rights. Any involvement in the day-to-day management of SOEs should be avoided.

The ownership or co-ordinating entity's ability to give direction to the SOE or its board should be limited to strategic issues and policies. It should be publicly disclosed and specified in which areas and types of decisions the ownership or co-ordinating entity is competent to give instructions.

Along the same lines, strict limits should also be put on the ability of any other government bodies to intervene in day-to-day management of SOEs.

***C. The state should let SOE boards exercise their responsibilities and respect their independence.***

In the nomination and election of board members, the ownership entity should focus on the need for SOE boards to exercise their responsibilities in a professional and independent manner. As stated in the OECD Principles, it is important that individual board members when they carry out their duties do not act as representatives for different constituencies. Independence requires that all board members carry out their duties in an even-handed manner with respect to all shareholders. Except when this is compatible with the company charter or the explicit objectives of the company, this means that board members should not be guided by any political concerns when carrying out their board duties.

When the state is a controlling owner, it is in a unique position to nominate and elect the board without the consent of other shareholders. This legitimate right comes with a high degree of responsibility for identifying, nominating and electing board members. In this process, and in order to minimize possible conflicts of interest, the ownership entity should avoid electing an excessive number of board members from the state administration. This is particularly relevant for partly owned SOEs and for SOEs in competitive industries. Some countries have decided to avoid nominating or electing anyone from the ownership entity or other state officials on SOE boards. This aims at clearly depriving the government from the possibility to directly intervene in the SOE's business or management and at limiting the state responsibility for decisions taken by SOE boards.

Employees of the ownership entity, professionals from other parts of the administration or from the political constituencies should only be elected on SOE boards if they meet the required competence level for all board members and if they do not act as a conduit for undue political influence. They should have the same duties and responsibilities as the other board members and act in the interest of the SOE and all its shareholders. Disqualification conditions and situations of conflict of interest should be carefully evaluated and guidance provided about how to handle and resolve them. The professionals concerned should have neither excessive inherent nor perceived conflicts of interest. In particular this implies that they should neither take part in regulatory decisions concerning the same SOE nor have any specific obligations or restrictions that would prevent them from acting in the company's interest. More generally, all potential conflicts of interests concerning any member of the board should be reported to the board which should then disclose these together with information on how they are being managed.

It is particularly necessary to clarify the respective personal and state liability when state officials are on SOE boards. The state officials concerned might have to disclose any personal ownership they have in the SOE and follow the relevant insider trading regulation. Guidelines or codes of ethics for members of the ownership entity and other state officials serving as SOE board members could be developed by the co-ordinating or ownership entity. These Guidelines or codes of ethics should also indicate how confidential information passed on to the state from these board members should be handled.

Direction in terms of broader political objectives should be channelled through the co-ordinating or ownership entity and enunciated as enterprise objectives rather than imposed directly through board participation. SOE boards should not respond to policy signals until they are authorised by the Parliament or approved by specific procedures.

***D. The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a co-ordinating entity or, more appropriately, by the centralisation of the ownership function.***

It is critical for the ownership function within the state administration to be clearly identified, whether it is located at a central ministry such as the finance or economics ministries, in a separate administrative entity, or within a specific sector ministry.

To achieve a clear identification of the ownership function, it can be centralised in a single entity, which is independent or under the authority of one ministry. This approach would help in clarifying the ownership policy and its orientation, and would also ensure its more consistent implementation. Centralisation of the ownership function could also allow for reinforcing and bringing together relevant competencies by organising “pools” of experts on key matters, such as financial reporting or board nomination. In this way, centralisation can be a major force in the development of aggregate reporting on state ownership. Finally, centralisation is also an effective way to clearly separate the exercise of ownership functions from other activities performed by the state, particularly market regulation and industrial policy as mentioned in guideline I.A above.

If the ownership function is not centralised, a minimum requirement is to establish a strong co-ordinating entity among the different administrative departments involved. This will help to ensure that each SOE has a clear mandate and receives a coherent message in terms of strategic guidance or reporting requirements. The co-ordinating entity would harmonise and co-ordinate the actions and policies undertaken by different ownership departments in various ministries. The co-ordinating entity should also be in charge of establishing an overall ownership policy, developing specific guidelines and unifying practices among the various ministries.

Centralisation of the ownership function in a single entity is probably most relevant for SOEs in competitive sectors and is not necessarily applicable to SOEs that are mainly pursuing public policy objectives. Such SOEs are not the primary target of these Guidelines, and in their case, sector ministries may remain the most relevant and competent entities to exercise ownership rights which might be indistinguishable from policy objectives.

When centralisation of the ownership function is considered, it should not give rise to a new and overly powerful bureaucratic layer.

When the ownership function can not be handled by a single entity, some key functions could nevertheless be centralised in order to make use of specific expertise and ensure independence from individual sector ministries. One example when such partial centralisation can be useful is the nomination of board members.

The clear identification of the ownership function should be sought at different levels of government depending on where ownership is located, for example national, regional, federal or sub-federal levels. These Guidelines do not give direction to determine the appropriate level of SOE management in this respect within a state or a federation. They merely indicate that, regardless of the level of authority, the ownership function would be better centralised in or co-ordinated by a single entity. Moreover, if there are different administrative levels of ownership, harmonisation of ownership practices should be looked for. Finally, centralisation of the ownership function does not imply the centralisation of the legal ownership.

**E. The co-ordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.**

The relationship of the co-ordinating or ownership entity with other government bodies should be clearly defined. A number of state bodies, Ministries or administrations have different roles *vis-à-vis* the same SOEs. In order to increase the public confidence in the way the state manages ownership of SOEs, it is important that these different roles are clarified and explained to the general public.

In particular, the ownership entity should maintain co-operation and continuous dialogue with the state supreme audit institutions responsible for auditing the SOEs. It should support the work of the state audit institution and take appropriate measures in response to audit findings, following in this regard the INTOSAI Lima Declaration of Guidelines on Auditing Precepts.

The co-ordinating or ownership entity should also be held clearly accountable for the way it carries out the state ownership function. Its accountability should be, directly or indirectly, to bodies representing the interests of the general public, such as the Parliament. Its accountability to the legislature should be clearly defined, as well as the accountability of SOEs themselves, which should not be diluted by virtue of the intermediary reporting relationship.

Accountability should go beyond ensuring that the exercise of ownership does not interfere with the legislature's prerogative as regards budget policy. The ownership entity should report on its own performance in exercising state ownership and in achieving the state objectives in this regards. It should provide quantitative and reliable information to the public and its representatives on how the SOEs are managed in the interests of their owners. Specific mechanisms such as *ad hoc* or permanent commissions could be set up to maintain the dialogue between the co-ordinating or ownership entity and the legislature. In the case of Parliament hearings, confidentiality issues

should be dealt with through specific procedures such as confidential or closed meetings. While generally accepted as a useful procedure, the form, frequency and content of this dialogue may differ according to the constitutional law and the different parliamentary traditions and roles.

The accountability requirements should not restrict unduly the autonomy of the co-ordinating or ownership entity in fulfilling their responsibilities. For example, cases where the co-ordinating or ownership entity needs to obtain the legislature's *ex ante* approval should be limited and include significant changes in the overall ownership policy, significant changes in the size of the state sector and significant transactions (investments or disinvestment).

More generally, the ownership entity should enjoy a certain degree of flexibility *vis-à-vis* its responsible ministry in the way it organises itself and takes decisions with regards to procedures and processes. The ownership entity could also enjoy a certain degree of budgetary autonomy that can allow flexibility in recruiting, remunerating and retaining the necessary expertise, including from the private sector.

***F. The state as an active owner should exercise its ownership rights according to the legal structure of each company.***

To avoid either undue political interference or passive state ownership, it is important for the co-ordinating or ownership entity to focus on the effective exercising of ownership rights. The state as an owner should typically conduct itself as any major shareholder when it is in a position to significantly influence the company and be an informed and active shareholder when holding a minority post. It would be well advised to exercise its rights in order to protect its ownership and optimise its value.

As defined by the OECD Principles of Corporate Governance, four basic shareholder rights are: i) to participate and vote in shareholder meetings; ii) to obtain relevant and sufficient information on the corporation on a timely and regular basis; iii) to elect and remove members of the board; and iv) to approve extraordinary transactions. The co-ordinating or ownership entity should exercise these rights fully and judiciously, as this would allow the necessary influence on SOEs without infringing on their day-to-day management. The effectiveness and credibility of SOE governance and oversight will, to a large extent, depend on the ability of the ownership entity to make an informed use of its shareholder rights and effectively exercise its ownership functions in SOEs.

An ownership entity needs unique competencies and should have professionals with legal, financial, economic and management skills that are experienced in carrying out fiduciary responsibilities. Such professionals must also clearly understand their roles and responsibilities as civil servants with

respect to the SOEs. In addition, the ownership entity should include competencies related to the specific obligations that some SOEs under their supervision are required to undertake in terms of public service provisions. The co-ordinating or ownership entity should also have the possibility to have recourse to outside advice and to contract-out some aspects of the ownership function, in order to exercise the state's ownership rights in a better manner. They could, for example, make use of specialists for carrying out evaluation, active monitoring, or proxy voting on its behalf where deemed necessary and appropriate.

***Its prime responsibilities include:***

**1. Being represented at the general shareholders meetings and voting the state shares**

The state as an owner should fulfil its fiduciary duty by exercising its voting rights, or at least explain if it does not do so. The state should not find itself in the position of not having reacted to propositions put before the SOEs' general shareholder meetings.

For the state to be able to express its view on issues submitted for approval at shareholders' meetings, it is necessary that the co-ordinating or ownership entity organises itself to be able to present an informed view on these issues and articulate it to SOE boards via the general shareholders meeting.

It is important to establish appropriate procedures for state representation in general shareholders meetings. This could be achieved for example by clearly identifying the co-ordinating or ownership entity as representing the state's shares.

**2. Establishing well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs' boards**

The co-ordinating or ownership entity should ensure that SOEs have efficient and well-functioning professional boards, with the required mix of competencies to fulfil their responsibilities. This will involve establishing a structured nomination process and playing an active role in this process. This will be facilitated if the ownership entity is given sole responsibility for organising the state's participation in the nomination process.

The nomination of SOE boards should be transparent, clearly structured and based on an appraisal of the variety of skills, competencies and experiences required. Competence and experience requirements should derive from an evaluation of the incumbent board and the demands aligned

with the company's long term strategy. These evaluations should also take into consideration the role played by employee board representation when this is required by law or mutual agreements. To base nominations on such explicit competence requirements and evaluations will likely lead to more professional, accountable and business oriented boards.

Where the state is not the sole owner, the co-ordinating or ownership entity should consult with other shareholders ahead of the general shareholders meetings. SOE boards should also be able to make recommendations to the ownership entity based on the approved board member profiles, skill requirements and board member evaluations. Setting up nomination committees may be useful, helping to focus the search for good candidates and in structuring further the nomination process. In some countries, it is also considered to be good practice to establish a specialised commission or "public board" to oversee nominations in SOE boards. Even though such commissions or public boards might have only recommendation powers, they could have a strong influence in practice on increasing the independence and professionalism of SOE boards. Proposed nominations should be published in advance of the general shareholders meeting, with adequate information about the professional background and expertise of the respective candidates.

It could also be useful if ownership entities maintain a database of qualified candidates, developed through an open competitive process. The use of professional staffing agencies or international advertisements is another means to enhance the quality of the search process. These practices would help in enlarging the pool of qualified candidates for SOE boards, particularly in terms of private sector expertise and international experience. The process may also favour greater board diversity, including gender diversity.

### **3. Setting up reporting systems allowing regular monitoring and assessment of SOE performance**

In order for the co-ordinating or ownership entity to make informed decisions on key corporate matters, they should ensure that they receive all necessary and relevant information in a timely manner. They should also establish means that make it possible to monitor SOEs' activity and performance on a continuous basis.

The co-ordinating or ownership entity should ensure that adequate external reporting systems are in place for all SOEs. The reporting systems should give the co-ordinating or ownership entity a true picture of the SOE's performance and financial situation, enabling them to react on time and to be selective in their intervention.

The co-ordinating or ownership entity should develop the appropriate devices and select proper valuation methods to monitor SOEs' performance in respect of established objectives. It could be helped in this regard by developing systematic benchmarking of SOE performance, with private or public sector entities, both domestically and abroad. This benchmarking should cover productivity and the efficient use of labour, assets and capital. This benchmarking is particularly important for SOEs in non-competitive sectors. It would allow the SOEs, the co-ordinating or ownership entity and the general public to better assess SOE performance and reflect on their development.

Effective monitoring of SOE performance can be facilitated by having adequate accounting and audit competencies within the co-ordinating or ownership entity to ensure appropriate communication with relevant counterparts, both with SOEs' financial services, external auditors and specific state controllers.

#### **4. When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs**

Depending on the legislation, the co-ordinating or ownership entity may be entitled to nominate and even appoint the external auditors. Regarding wholly-owned SOEs, the co-ordinating or ownership entity should maintain a continuous dialogue with external auditors, as well as with the specific state controllers when these latter exist. This continuous dialogue could take the form of regular exchange of information, meetings or *ad hoc* discussions when specific problems occur. External auditors will provide the co-ordinating or ownership entity with an external, independent and qualified view on the SOE performance and financial situation. However, continuous dialogue of the ownership entity with external auditors and state controllers should not be at the expense of the board's responsibility.

When SOEs are publicly traded or partially-owned, the co-ordinating or ownership entity must respect the rights and fair treatment of minority shareholders. The dialogue with external auditors should not give the co-ordinating or ownership entity any privileged information and should respect regulation regarding privileged and confidential information.

#### **5. Ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals**

There is a strong trend to bring the remuneration of board members of SOEs closer to private sector practices. However, in a majority of OECD countries, this remuneration is still far below market levels for the competencies and experience required, as well as for responsibilities involved.





## Annotations to Chapter III:

### Equitable Treatment of Shareholders

**The state and state-owned enterprises should recognise the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.**

It is in the state's interest to ensure that, in all enterprises where it has a stake, minority shareholders are treated equitably, since its reputation in this respect will influence its capacity of attracting outside funding and the valuation of the company. It should therefore ensure that other shareholders do not perceive the state as an opaque, unpredictable and unfair owner. The state should on the contrary establish itself as exemplary and follow best practices regarding the treatment of minority shareholders.

**A. The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.**

Whenever a part of an SOEs' capital is held by private shareholders, institutional or individual, the state should recognise their rights. It is in the interest of the co-ordinating or ownership entity and SOEs themselves to refer to the OECD Principles of Corporate Governance with regard to minority shareholders' rights. The Principles state that "*Minority shareholders should be protected from abusive action, by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress*". The Principles also prohibit insider trading and abusive self-dealing. Finally, the annotations to the OECD Principles suggest pre-emptive rights and qualified majorities for certain shareholder decisions as an *ex-ante* means of minority shareholders protection.

As a dominant shareholder, the state is in many cases able to make decisions in general shareholders meetings without the agreement of any other shareholders. It is usually in a position to decide on the composition of the board of directors. While such decision making power is a legitimate right that follows with ownership, it is important that the state doesn't abuse its role as a dominant shareholder, for example by pursuing objectives that are

not in the interest of the company and thereby to the detriment of other shareholders. Abuse can occur through inappropriate related party transactions, biased business decisions or changes in the capital structure favouring controlling shareholders. The measures which can be taken include better disclosure, a duty of loyalty of board members, as well as qualified majorities for certain shareholder's decisions.

The co-ordinating or ownership entity should develop guidelines regarding equitable treatment of minority shareholders. It should ensure that individual SOEs, and more particularly their boards, are fully aware of the importance of the relationship with minority shareholders and are active in enhancing it.

As stated in the OECD Principles of Corporate Governance, *“the potential for abuse is marked when the legal system allows, and the market accepts, controlling shareholders to exercise a level of control which does not correspond to the level of risk that they assume as owners through exploiting legal devices to separate ownership from control”*. Therefore governments should, as far as possible, limit the use of Golden Shares and disclose shareholders' agreements and capital structures that allow a shareholder to exercise a degree of control over the corporation disproportionate to the shareholders' equity ownership in the company.

#### **B. SOEs should observe a high degree of transparency towards all shareholders.**

A crucial condition for protecting minority and other shareholders is to ensure a high degree of transparency. The OECD Principles of Corporate Governance *“support simultaneous reporting of information to all shareholders in order to ensure their equitable treatment. In maintaining close relations with investors and market participants, companies must be careful not to violate this fundamental principle of equitable treatment.”*

Minority and other shareholders should have access to all the necessary information to be able to make informed investment decisions. Meanwhile, significant shareholders, including the co-ordinating or ownership entity, should not make any abusive use of the information they might obtain as controlling shareholders or board members. For non-listed SOEs, other shareholders are usually well identified and often have privileged access to information, through board seats for example. However, whatever the quality and completeness of the legal and regulatory framework concerning disclosure of information, the co-ordinating or ownership entity should ensure that all enterprises where the state has shares put mechanisms and procedures in place to guarantee easy and equitable access to information by all shareholders.

Any shareholder agreements, including information agreements covering board members, should be disclosed.

**C. SOEs should develop an active policy of communication and consultation with all shareholders.**

SOEs, including any enterprise in which the state is a minority shareholder, should identify their shareholders and keep them duly informed in a timely and systematic fashion about material events and forthcoming shareholder meetings. They should also provide them with sufficient background information on issues that will be subject to decision. It is the responsibility of SOEs' boards to make sure that the company fulfils its obligations in terms of information to the shareholders. In doing so, SOEs should not only apply the existing legal and regulatory framework, but are encouraged to go beyond it when relevant in order to build credibility and confidence. Where possible, active consultation with minority shareholders will help in improving the decision making process and the acceptance of key decisions.

**D. The participation of minority shareholders' in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.**

Minority shareholders may be concerned about actual decisions being made outside the company's shareholder meetings or board meetings. This is a legitimate concern for listed companies with a significant or controlling shareholder, but it can also be an issue in companies where the state is the dominant shareholder. It might be appropriate for the state as an owner to reassure minority shareholders that their interests are taken into consideration.

As underlined in the OECD Principles of Corporate Governance, the right to participate in general shareholder meetings is a fundamental shareholder right. To encourage minority shareholders to actively participate in SOEs general shareholder meetings and to facilitate the exercise of their rights, specific mechanisms could be adopted by SOEs, in the same vein as those recommended for listed companies in the OECD Principles. These could include qualified majorities for certain shareholder decisions and, when deemed useful by the circumstances, the possibility to use special election rules, such as cumulative voting. Additional measures should include facilitating voting *in absentia* or developing the use of electronic means as a way to reduce participation costs. Moreover, employee-shareholder participation in general shareholders meetings could be facilitated by, for example, the collection of proxy votes from employee-shareholders.

It is important that any special mechanism for minority protection is carefully balanced. It should favour all minority shareholders and in no respect contradict the concept of equitable treatment. It should neither prevent the state as a majority shareholder from exercising its legitimate influence on the decisions nor should it allow minority shareholders to hold-up the decision-making process.



## Annotations to Chapter IV:

### Relations with Stakeholders

***The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.***

In some OECD countries, legal status, regulations or mutual agreements/contracts grant certain stakeholders specific rights in SOEs. Some SOEs might even be characterised by distinct governance structures as regard the rights granted to stakeholders, principally employee board level representation, or other consultation/decision making rights to employees' representatives and consumer organisations, for example through advisory councils.

SOEs should acknowledge the importance of stakeholder relations for building sustainable and financially sound enterprises. Stakeholder relations are particularly important for SOEs as they may be critical for the fulfilment of general service obligations whenever these exist and as SOEs may have, in some infrastructure sectors, a vital impact on the economic development potential and on the communities in which they are active. Moreover, some investors increasingly consider stakeholder related issues in their investment decisions and appreciate potential litigation risks linked to stakeholder issues. It is therefore important that the co-ordinating or ownership entity and SOEs recognise the impact that an active stakeholder policy may have on the company's long term strategic goal and reputation. They should thus develop and adequately disclose clear stakeholder policies.

However, the government should not use SOEs to further goals which differ from those which apply to the private sector, unless compensated in some form. Any specific rights granted to stakeholders or influence on the decision making process should be explicit. Whatever rights granted to stakeholders by the law or special obligations that have to be fulfilled by the SOE in this regard, the company organs, principally the general shareholders meeting and the board, should retain their decision making powers.

**A. Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.**

As a dominant shareholder, the state may control corporate decision making and be in a position to take decisions to the detriment of stakeholders. It is therefore important to establish mechanisms and procedures to protect stakeholder rights. The co-ordinating or ownership entity should have a clear policy in this regard. SOEs should fully respect the rights of stakeholders, as established by law, regulations and mutual agreements. They should act in the same way as private sector listed companies and refer to the OECD Principles of Corporate Governance regarding relations with stakeholders.

Implementation of the OECD Principles of Corporate Governance implies full recognition of the contribution of various stakeholders and encourages active and wealth-creating co-operation with them. To this end, SOEs should ensure that stakeholders have access to relevant, sufficient and reliable information on a timely and regular basis to be able to exercise their rights. Stakeholders should have access to legal redress in the event their rights are violated. Employees should also be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing that.

Performance enhancing mechanisms for employee participation should be permitted to develop when considered relevant with regard to the importance of stakeholder relations for some SOEs. However, when deciding on the relevance and desired development of such mechanisms, the state should give careful consideration to the inherent difficulties in transforming entitlement legacies into effective performance enhancing mechanisms.

**B. Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.**

Good practice increasingly requires listed companies to report on stakeholder issues. By doing so, SOEs will demonstrate their willingness to operate more transparently and their commitment to co-operation with stakeholders. This will in turn foster trust and improve their reputation. Consequently, listed or large SOEs should communicate with investors, stakeholders and the public at large on their stakeholder policies and provide information on their effective implementation. This should also be the case for any SOE pursuing important public policy objectives or having general services obligations, with due care to the costs involved related to their size. Reports on stakeholder relations should include information on social and environmental policies, whenever SOEs have specific objectives in this regard.

To this end, they could refer to best practice and follow guidelines on social and environmental responsibility disclosure, which have been developed in the past few years.

It might also be advisable that SOEs have their stakeholder reports independently scrutinised in order to strengthen their credibility.

The co-ordinating or ownership entity could in turn strengthen disclosure on stakeholder matters by having both a clear policy and possibly developing aggregate disclosure to the general public.

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

The OECD Principles of Corporate Governance recommend that boards apply high ethical standards. This is in the long term interest of any company as a means to make it credible and trustworthy in its day-to-day operations and with respect to its longer term commitments. In the case of SOEs, there may be more pressures to deviate from high ethical standards given the interaction of business considerations with political and public policy ones. Moreover, as SOEs might play an important role in setting the business tone of the country, it is also important for them to maintain high ethical standards.

SOEs and their officers should conduct themselves according to high ethical standards. SOEs should develop internal codes of ethics, committing themselves to comply with country norms and in conformity with broader codes of behaviour. This should include a commitment to comply with the *OECD Guidelines for Multinational Enterprises*, which have been adopted by all OECD states and reflect all four principles contained in the *ILO Declaration on Fundamental Principles and Rights at Work*, and the *OECD Anti-Bribery convention*. The ethical code should apply to the SOEs as a whole and to their subsidiaries.

The ethical code should give clear and detailed guidance as to the expected conduct of all employees and compliance programs should be established. It is considered as a good practice for these codes to be developed in a participatory way in order to involve all the employees and stakeholders concerned. These codes should also be fully supported and implemented by the boards and senior management.

The code of ethics should include guidance on procurement processes, as well as develop specific mechanisms protecting and encouraging stakeholders, and particularly employees, to report on illegal or unethical conduct by corporate officers. In this regard, the ownership entities should ensure that SOEs under their responsibility effectively put in place safe-harbours for complaints for employees, either personally or through their



representative bodies, or for others outside the company. SOE boards could grant employees or their representatives a confidential direct access to someone independent on the board, or to an ombudsman within the company. The codes of ethics should also comprise disciplinary measures, should the allegations be found to be without merit and not made in good faith, frivolous or vexatious in nature.

## Annotations to Chapter V:

### Transparency and Disclosure

***State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.***

***A. The co-ordinating or ownership entities should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.***

Co-ordinating or centralised ownership entities should develop aggregate reporting that covers all SOEs and make it a key disclosure tool directed to the general public, the Parliament and the media. This reporting should be developed in a way that allows all readers to obtain a clear view of the overall performance and evolution of the SOEs. In addition, aggregate reporting is also instrumental for the co-ordinating or ownership entities in deepening their understanding of SOE performance and in clarifying their own policy.

The aggregate reporting should result in an annual aggregate report issued by the state. This aggregate report should primarily focus on financial performance and the value of the SOEs. It should at least provide an indication of the total value of the state's portfolio. It should also include a general statement on the state's ownership policy and information on how the state has implemented this policy. Information on the organisation of the ownership function should also be provided, as well as an overview of the evolution of SOEs, aggregate financial information and reporting on changes in SOEs' boards. The aggregate report should provide main financial indicators including turnover, profit, cash flow from operating activities, gross investment, return on equity, equity/asset ratio and dividends. Information should also be provided on the methods used to aggregate data. The aggregate report could also include individual reporting on the most significant SOEs. It is important to underline that aggregate reporting should not duplicate but complement existing reporting requirements, for example, annual reports to Parliaments. Some ownership entities could aim at publishing only "partial" aggregate reports, i.e. covering SOEs active in comparable sectors. Finally, publishing bi-annually aggregate reports would further improve transparency of state ownership.

In some countries it has proven useful for the co-ordinating or ownership entity to develop a website, which allows the general public easy access to information. Such websites could provide information both on the organisation of the ownership function and the general ownership policy, as well as information about the size, evolution, performance and value of the state sector.

**B. 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 company organ.**

As in large public companies, it is necessary for large SOEs to put in place an internal audit system. “Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.” Internal auditors are important to ensure an efficient and robust disclosure process and proper internal controls in the broad sense. They should define procedures to collect, compile and present sufficiently detailed information. They should also ensure that company procedures are adequately implemented and be able to guarantee the quality of the information disclosed by the company.

To increase their independence and authority, the internal auditors should work on behalf of, and report directly to the board and its audit committee in one-tier systems, to the supervisory board in two-tier systems or the audit boards when these exist. Internal auditors should have unrestricted access to the Chair and members of the entire board and its audit committee. Their reporting is important for the board’s ability to evaluate actual company operations and performance. Consultation between external and internal auditors should be encouraged. Finally, it is also recommended as good practice that an internal control report is included in the financial statements, describing the internal control structure and procedures for financial reporting.

**C. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.**

SOEs are not necessarily required to be audited by external, independent auditors. This is often due to specific state audit and control systems that are sometimes considered sufficient to guarantee the quality and comprehensiveness of accounting information. These financial controls are

\* Definition of the Institute of Internal Auditors ([www.theiia.org](http://www.theiia.org)).

typically performed by specialised state or “supreme” audit entities, which may inspect both SOEs and the co-ordinating or ownership entity. In many cases they also attend board meetings and are often reporting directly to the Parliament on the performance of SOEs. However, these specific controls are designed to monitor the use of public funds and budget resources, rather than the operations of the SOE as a whole.

To reinforce trust in the information provided, the state should require that, in addition to special state audits, at least all large SOEs are subject to external audits that are carried out in accordance with international standards. Adequate procedures should be developed for the selection of external auditors and it is crucial that they are independent from the management as well as large shareholders, i.e. the state in the case of SOEs. Moreover, external auditors should be subject to the same criteria of independence as for private sector companies. This generally includes limits on providing consulting or other non-audit services to the audited SOE, as well as periodic rotation of audit partners or audit firms.

***D. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.***

In the interest of the general public, SOEs should be as transparent as publicly traded corporations. Regardless of their legal status and even if they are not listed, all SOEs should report according to best practice accounting and auditing standards.

All SOEs should disclose financial and non-financial information, and large and listed ones should do so according to high quality internationally recognised standard. This implies that SOE board members sign financial reports and that CEOs and CFOs certify that these reports in all material respects appropriately and fairly present the operations and financial condition of the SOE.

To the extent possible, a cost-benefit analysis should be carried out to determine which SOEs should be submitted to high quality internationally recognised standard. This analysis should consider that demanding disclosure requirements are also both an incentive and a means for the board and management to perform their duties professionally. SOEs under a certain size could be excluded, provided that they do not pursue important public policy objectives. Such exceptions could only be decided on a pragmatic basis and will vary among countries, industrial sectors and the size of the state sector.

A high level of disclosure is also valuable for SOEs pursuing important public policy objectives. It is particularly important when they have a significant impact on the state budget, on the risks carried by the state, or when they have a more global societal impact. In the EU, for example, companies that are entitled to state subsidies for carrying out services of general interests are required to keep separate accounts for these activities.

**E. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public.**

The OECD Principles of Corporate Governance describe what the main elements of disclosure for a public company should be. SOEs should at least comply with these requirements, including financial and operating results, remuneration policies, related party transactions, governance structures and governance policies. SOEs should disclose if they follow any code of corporate governance and, if so, indicate which one. With regards remuneration of board members and key executives, it is viewed as good practice to carry this out on an individual basis. The information should include termination and retirement provisions, as well as any specific facility or in kind remuneration provided to board members. SOEs should be particularly vigilant and improve transparency in the following areas.

**Examples of such information include:**

**1. A clear statement to the public of the company objectives and their fulfilment**

It is important that each SOE is clear about its overall objectives. Regardless of the existing performance monitoring system, a limited set of basic overall objectives should be identified together with information about how the enterprise is dealing with trade-offs between objectives that could be conflicting.

When the state is a majority shareholder or effectively controls the SOE, company objectives should be made clear to all other investors, the market and the general public. Such disclosure obligations will encourage company officials to clarify the objectives to themselves, and could also increase management's commitment in pursuing these objectives. It will provide a reference point for all shareholders, the market and the general public for considering the strategy adopted and decisions taken by the management.

SOEs should report on how they fulfilled their objectives by disclosing key performance indicators. When the SOE is also used for public policy objectives, such as general services obligations, it should also report on how these are being achieved.

## **2. The ownership and voting structure of the company**

It is important that the ownership and voting structures of SOEs are transparent so that all shareholders have a clear understanding of their share of cash-flow and voting rights. It should also be clear who retains legal ownership of the state's shares and where the responsibility for exercising the state's ownership rights are located. Any special rights or agreements that may distort the ownership or control structure of the SOE, such as golden shares and power of veto, should be disclosed.

## **3. Any material risk factors and measures taken to manage such risks**

Severe difficulties arise when SOEs undertake ambitious strategies without clearly identifying, assessing or duly reporting on the related risks. Disclosure of material risk factors is particularly important when SOEs operate in newly de-regulated and increasingly internationalised industries where they are facing a series of new risks, such as political, operational, or exchange rate risks. Without adequate reporting of material risk factors, SOEs may give a false representation of their financial situation and overall performance. This in turn may lead to inappropriate strategic decisions and unexpected financial losses.

Appropriate disclosure by SOEs of the nature and extent of risk incurred in their operations requires the establishment of sound internal risk management systems to identify, manage, control and report on risks. SOEs should report according to new and evolving standards and disclose all off-balance-sheet assets and liabilities. When appropriate, such reporting could cover risk management strategies as well as systems put in place to implement them. Companies in extracting industries should disclose their reserves according to best practices in this regard, as this may be a key element of their value and risk profile.

Public Private Partnerships should also be adequately disclosed. Such ventures are often characterised by transfers of risks, resources and rewards between public and private partners for the provision of public services or public infrastructure and may consequently induce new and specific material risks.

## **4. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE**

To give a fair and complete picture of an SOE's financial situation, it is necessary that mutual obligations, financial assistance or risk sharing mechanisms between the state and the SOEs are appropriately disclosed. Disclosure should include details on any state grant or subsidy received by the SOE, any guarantee granted by the state to the SOE for its operations, as well

as any commitment that the state undertakes on behalf of an SOE. Disclosure of guarantees could be done by SOEs themselves or by the state. It is considered good practice that Parliaments monitor state guarantees in order to respect budgetary procedures.

#### **5. Any material transactions with related entities**

Transactions between SOEs and related entities, such as an equity investment of one SOE in another, might be a source of potential abuse and should be disclosed. Reporting on transactions with related entities should provide all information that is necessary for assessing the fairness and appropriateness of these transactions.

## Annotations for Chapter VI:

### The Responsibilities of the Boards of State-Owned Enterprises

***The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.***

In a number of countries, SOE boards tend to be too large, lack business perspective and independent judgment. They may also include an excessive number of members from the state administration. Moreover, they may not be entrusted with the full range of board responsibilities and can therefore be overruled by senior management and by the ownership entities themselves. Moreover, their function may also be duplicated by specific state regulatory bodies in some areas.

Empowering and improving the quality of SOE boards is a fundamental step in improving the corporate governance of SOEs. It is important that SOEs have strong boards that can act in the interest of the company and effectively monitor management without undue political interference. To this end, it will be necessary to ensure the competency of SOE boards, enhance their independence and improve the way they function. It is also necessary to allow them clear and full responsibility for their functions and ensure that they act with integrity.

***A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.***

SOE boards should, in principle, have the same responsibilities and liabilities as stipulated in company law. However, in practice, board members may have a reduced liability, particularly the ones nominated by the state.

The responsibilities of SOE boards should be articulated in relevant legislation, regulations, the government ownership policy and the company



charters. It is essential and should be emphasised that all board members have the legal obligation to act in the best interests of the company and to treat all shareholders equitably. The collective and individual liability of board members should be clearly stated. There should not be any difference between the liabilities of different board members, whether they are nominated by the state or any other shareholders or stakeholders. Training should be required in order to inform SOE board members of their responsibilities and liabilities.

To encourage board responsibility and in order for boards to function effectively, they should follow best practices adhered to in the private sector and be limited in size. Experience indicates that smaller boards allow for real strategic discussion and are less prone to become rubberstamping entities.

To underline the board's responsibilities, a Directors' Report should be provided along with the annual statements and submitted to the external auditors. The Directors' Report should give information and comment on the organisation, financial performance, material risk factors, significant events, relations with stakeholders, and the effects of directions from the co-ordinating or ownership entity.

***B. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.***

In many instances, SOE boards are not granted full responsibility and the authority required for strategic guidance, monitoring of management and control over disclosure. SOE boards may see their roles and responsibilities encroached from two ends; by the ownership entities and by management. The co-ordinating or ownership entity, if not the government itself, may be tempted to become too involved in strategic issues, although it is their responsibility to define the overall objectives of the company, particularly since the difference between defining objectives and setting strategies can be rather unclear. SOE boards may also encounter difficulties in monitoring management as they do not always have the legitimacy, or even the authority, to do so. Furthermore, in certain countries, there is a strong link between the management and the ownership function or directly with the government. SOE senior management tends to report to the ownership function or the government directly and thereby circumvent the board.

In order to carry out their role, SOE boards should actively i) formulate, monitor and review corporate strategy, within the framework of the overall corporate objectives; ii) establish appropriate performance indicators and identify key risks; iii) monitor the disclosure and communication processes, ensuring that the financial statements fairly present the affairs of the SOE and

reflect the risks incurred; iv) assess and follow management performance; v) develop effective succession plans for key executives.

One key function of SOE boards should be the appointment and dismissal of CEOs. Without this authority it is difficult for SOE boards to fully exercise their monitoring function and feel responsible for SOEs' performance. In some cases, this might be done in concurrence or consultation with the ownership entity. In some countries, a full owner can directly appoint a CEO and this possibility extends to SOE. This may also occur when the state is a dominant owner in SOEs that are assigned important public service purposes. To ensure that the integrity of the board is maintained, good practice would require consultation with the board. Regardless of the procedure, appointments should be based on professional criteria. Rules and procedures for nominating and appointing the CEO should be transparent and respect the line of accountability between the CEO, the board and the ownership entity. Any shareholder agreements with respect to CEO nomination should be disclosed.

It follows from their obligation to assess and follow management performance that the SOE boards should also have a decisive influence over the compensation of the CEO. They should ensure that the CEO's remuneration is tied to performance and duly disclosed.

**C. The boards of SOEs should be composed so that they can exercise objective and independent judgement. Good practice calls for the Chair to be separate from the CEO.**

A central prerequisite in empowering SOE boards is to structure them so that they can effectively exercise objective and independent judgement, be in position to monitor senior management and take strategic decisions. As underlined in the Principles, *"in order to exercise its duties of monitoring managerial performance, preventing conflicts of interest and balancing competing demands on the corporation, it is essential that the board is able to exercise objective judgement"*. All board members should be nominated through a transparent process and it should be clear that it is their duty to act in the best interests of the company as a whole. They should not act as individual representatives of the constituencies that appointed them. SOE boards should also be protected from undue and direct political interference that could detract them from focusing on achieving the objectives agreed on with the government and the ownership entity.

A central requirement to enhance the objectivity of SOE boards is to nominate a sufficient number of competent non-executive board members who are capable of independent judgement. These board members should have the relevant competence and experience and it is advisable that they be recruited from the private sector. It will help in making boards more business-oriented,

particularly for SOEs that operate in competitive markets. Their expertise could also include qualifications related to the SOE's specific obligations and policy objectives. In some countries, diversity in board composition is also an issue and it includes gender consideration. All board members should disclose any conflicts of interest to the board which must decide how they should be managed.

Mechanisms to evaluate and maintain the effectiveness of board performance and independence should be developed. These include, for example, limits on the possible number of reappointments and resources granted to the board to have access to independent information or to carry out independent expertise.

For enhancing board independence, the OECD Principles of Corporate Governance also consider that it may be regarded as a good practice that the Chair person is separated from the CEO in single board structures. Separation of the Chair from the CEO helps in “*achieving an appropriate balance of power, increasing accountability and improving the board's capacity for decision making independent of management*”. An adequate and clear definition of the functions of the board and of its Chair would prevent situations where the separation might give rise to inefficient opposition between the two company officers. In the case of two-tier board systems, it is similarly considered good practice that the head of the lower board (management board) does not become the Chair of the Supervisory Board on retirement.

Separation of the Chair from the CEO is particularly important in SOEs, where it is usually considered necessary to empower the board's independence from management. The Chair has a key role in guiding the board, ensuring its efficient running and encouraging the active involvement of individual board members in the strategic guidance of the SOE. When the Chairman and the CEO are separate, the Chairman should also have a role in agreeing with the ownership entity on the skills and experience that the board should contain for its effective operation. The separation of the Chair from the CEO should therefore be considered as a fundamental step in establishing efficient SOE boards.

***D. 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.***

When employee representation on SOE boards is mandated by the law or collective agreements, it should be applied so that it contributes to the SOE boards' independence, competence and information. Employee representatives should have the same duties and responsibilities as all other board members, should act in the best interests of the company and treat all shareholders

equitably. Employee representation on SOE boards should not in itself be considered as a threat to board independence.

Procedures should be established to facilitate the professionalism and the true independence of employee board members, and to make sure that they respect their duty of confidentiality. These procedures should include adequate, transparent and democratic election procedures, training and clear procedures for managing conflicts of interest. A positive contribution to the board's work will also require acceptance and collaboration by other members of the board as well as by the SOE management.

***E. When necessary, SOE boards should set up specialised committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.***

The use of specialised board committees in SOEs has increased, in line with practices in the private sector. The type of special committees that boards make use of can vary between companies and industries and includes: audit committees, remuneration committees, strategy committees, ethics committees, and in some cases risk and procurement committees. In some countries, an equivalent body to the audit committee performs a similar function.

The setting up of specialised board committees could be instrumental in reinforcing the competency of SOE boards and in underpinning their critical responsibility in matters such as risk management and audit. They may be also effective in changing the board culture and reinforcing its independence and legitimacy in areas where there is a potential for conflicts of interests, such as with regards to procurement, related party transactions and remuneration issues.

When board committees are not mandated by law, the co-ordinating or ownership entity should develop a policy to define in which cases specialised board committees should be considered. This policy should be based on a combination of criteria, including the size of the SOE and specific risks faced or competencies which should be reinforced within SOE boards. Large SOEs should at least be required to have an audit committee or equivalent body with powers to meet with any officer of the company.

It is essential that specialised board committees are chaired by a non-executive and include a sufficient number of independent members. The proportion of independent members as well as the type of independence required (e.g. from management or from the main owner) will depend on the type of committee, the sensitivity of the issue to conflicts of interests, and the SOE sector. The audit committee, for example, should be composed of only independent and financially literate board members.

The existence of specialised board committees should not excuse the board from its collective responsibility for all matters. Specialised board committees should have written terms of reference that define their duties, authority and composition. Specialised board committees should report to the full board and the minutes of their meetings should be circulated to all board members.

SOE boards could also establish a nomination committee to co-operate with the ownership entity with regards to the board nomination process. In some countries it is the practice that nomination committees can also be set up outside the board structure, particularly including several main owners. Regardless of who establishes the nomination committee, it is important to involve the board in thinking about its own composition and succession planning, through its involvement in the search process and its ability to make recommendations. This can contribute to making the nomination process focused on competence.

***F. SOE boards should carry out an annual evaluation to appraise their performance.***

A systematic evaluation process is a necessary tool in enhancing SOE board professionalism, since it highlights the responsibilities of the board and the duties of its members. It is also instrumental in identifying necessary competencies and board member profiles. Finally, it is a useful incentive for individual board members to devote sufficient time and effort to their duties as board members.

The evaluation should scrutinise both the overall board performance and could also include the effectiveness and contribution of individual board members. However, the evaluation of individual board members should not impede the desired and necessary collegiality of board work.

Board evaluation should be carried out under the responsibility of the Chair and according to evolving best practices. The board evaluation should provide input to the review of issues such as board size, composition and remuneration of board members. The evaluations could also be instrumental in developing effective and appropriate induction and training programmes for new and existing SOE board members. In carrying out the evaluation, the SOE boards could seek advice from external and independent experts as well as by the ownership entity.

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# OECD Guidelines on Corporate Governance of State-owned Enterprise

The new *OECD Guidelines on the Corporate Governance of State-owned Enterprises* provide an internationally agreed benchmark to help governments assess and improve the way they exercise their ownership functions in state owned enterprises. They build on a wealth of concrete experience from a large number of OECD and non-OECD countries around the world and offer concrete advice on corporate governance challenges that need to be addressed when the state is a corporate owner.

Good corporate governance of state-owned enterprises is becoming a reform priority in many countries. Improved efficiency and better transparency in the state owned sector will result in considerable economic gains especially in countries where state ownership is important. In addition, creating a level-playing field for private and state owned enterprises to compete will encourage a sound and competitive business sector. The *Guidelines* thus provide a tool for national and international efforts to improve corporate governance of state owned enterprises.

For any question or information concerning the *OECD Guidelines on the Corporate Governance of State-owned Enterprises*, please contact the Corporate Affairs Division of the OECD at: [corporate.affairs@oecd.org](mailto:corporate.affairs@oecd.org). For more information for OECD's work in the area of privatisation and corporate governance of state-owned assets and the *Guidelines*, visit: [www.oecd.org/daf/corporate-affairs/soe/](http://www.oecd.org/daf/corporate-affairs/soe/).

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