The board is usually where these dramas play out. Mixing ownership and regulatory roles can cause conflicts of interest, as can the appointment of government bureaucrats, such as the energy or finance minister who sits on the board of the state-owned electrical utility. This minister may make decisions based on the political desirability of his party rather than on the best interests of the SOE or what makes operational sense.

While SOE boards may lay claim to having independent directors, it may be in name only. Where undue political influence is involved, such directors might be given a place on the board by virtue of their political connections, rather than for their professional skills and industry expertise. If they are reliant on the political-powers-that-be for their position they may not want to challenge bad decisions. Plus, being in the minority on the board makes it a bit awkward to challenge the majority. Even if this is not the case, they may lack understanding of the issues associated with governing the SOE in question, since they may not have experience of the particular industry and its dynamics. Layered on to this are the political nuances implicit in the decisions-making process. The combination of all of these factors can make it far more difficult for these independent directors to provide informed contributions.

Board continuity is another issue. Without any protections to curb such behavior, the SOE may be treated as a political instrument of the ruling party, operating at the whim of the government. The leader of the ruling party may suddenly decide to ‘clean house’ and remove long-serving board members and creating an experience void that could get in the way of good governance. Or, the leader may use the SOE to accommodate other tricky political decisions, such as where to place a minister who has fallen out of favor but still warrants considerable influence.

These governance challenges affect performance, resulting in poor quality products or unreliable service delivery and causing enterprises to bleed money. Given the dominant role many SOEs play in some emerging markets, the risk is that poor performance could severely impact a critical industry sector, such as banking or power, thereby impairing the national economy.

Fixing SOEs: improving governance as part of a holistic approach
At IFC we have worked with SOEs in emerging markets around the world on a variety of governance-related issues, often in preparation for privatisation. Recently, we partnered with our colleagues at the World Bank to develop a corporate governance toolkit for SOEs, offering comprehensive guidance on ways to address the tough challenges that impede effective governance and efficient operations.

In this context, we have seen that attending to SOE governance issues can contribute to improved performance of state-owned companies as part of a comprehensive and contextually relevant approach to tackling policy reforms, restructurings, external incentives, such as increased competition, and more, as well as fiscal discipline.

Governance changes often begin with identifying what ownership function is required, followed by a decision-making process around the selection of directors. For instance, in Hungary and the Czech Republic, board directors of SOEs now must hold relevant professional degrees in finance, economics or law, or bring to the table corporate governance experience. In Chile, Israel and Lithuania, boards of large SOEs are required to demonstrate proficiency in good governance practices and appropriate strategic planning.

The creation of autonomous holding companies to focus on asset management is another reform that has yielded positive results in countries such as Singapore. This model prohibits government officials from direct participation in the SOE. It follows the Nordic approach, which is generally regarded as the international good practice standard. Here, existing company functions like a shareholder, with the expectation that the SOE will report to parliament on a regular basis and will be held accountable for its effectiveness and other measures. The autonomy allowed to SOEs may lead to a more transparent decision-making process by holding it to tight performance criteria, in recognition that the SOE is a valuable asset with an obligation to deliver efficient and effective products and services.

Requiring SOEs to remain in international markets, rather than relying on the government, can also have a wide-ranging and positive impact, with a disciplining effect on governance. Financial statements and governance will be subject to lender scrutiny and the cost of capital will depend on credit rating. In countries such as South Africa, such market-driven pressures should help instil a measure of financial discipline in conjunction with governance enhancements through enabling legislation.

Other governance improvements that can make a difference include creating the ownership function from the regulatory function, which would allow decisions-making from the political exigencies of the moment and give the regulator some autonomy on how the market will operate.

Such actions are not easy and there is no standard template to follow, as in the private sector. Moreover, evidence suggests that the effort would be well worth the trouble – recent research by Dag Detter and Stefan Foekel reveals that better-governed state-owned enterprises around the world would enable central governments to generate an astonishing $3 trillion in annual returns – “more than the world’s yearly investment in infrastructure including transportation, power, water and telecommunications” they note in a recent issue of Foreign Affairs magazine.

Just imagine how such funds – and the associated product and service delivery improvements – could support emerging markets in their efforts to accomplish the economic growth and development goals.