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Synthesis of Review of Corporate Governance of State-Owned Enterprises in Burkina Faso, Mali, and Mauritania

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Abstract

This synthesis paper is based on a review of three countries in West Africa –Burkina Faso, Mali, and Mauritania- where SOEs continue to play an important role and Governments have embarked on a number of public sector reforms are intended to have a positive impact on SOEs. SOE governance practices and problems are have strong similarities in all of the countries reviewed. These commonalities can be ascribed to the fact that all of the countries are transitioning from centrally controlled economic and political traditions to more liberal economies and to a more democratic government. All are facing challenges with implementing the legal structures left behind from colonial times. The data that is available shows that wholly-owned and state controlled SOEs under perform. Many are technically insolvent and survive only through government support. Their performance is not only poor in the financial area but also in the provision of needed social services.

The country studies link the poor performance of SOEs, in particular wholly-owned SOEs, to their governance practices. Long-lasting reforms are not simply a matter of plugging holes in the legislative or institutional framework. Corporate governance is the result of a complex interplay of law, practice, institutions and culture. Action plans need to take into account incentives and the political, social and cultural context of corporate governance in the country in addition to the legal framework. Indeed, SOE governance is a system and making it work better requires a systems approach. Most reform plans in the past have focused on one or another element of SOE governance, which might explain why many have fallen short of hopes and expectations. Systems approaches, on the other hand, are important in complex organizations (such as SOEs) whose success depends upon the interaction and cooperation of other organizations and institutions.

This synthesis paper presents the objectives and the methodology used in carrying out the reviews followed by a discussion of the features and importance of SOEs in each of the countries studied. It then segues into a discussion on the performance of SOEs which is supplemented by case studies of both successful and unsuccessful SOEs and key lessons learned The paper then presents the current Government initiatives for reform and the remaining challenges and recommendations. The paper concludes with suggestions on how to implement the recommendations based on examples from other countries that have embarked on comprehensive governance reforms for the SOE sector.

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[1] The in-depth review of the framework and practice of SOE governance was only carried out in Burkina Faso, Mali, and Mauritania while preliminary analysis was conducted for Nigeria and Democratic Republic of Congo,

Synthesis of Review of Corporate Governance of State-Owned Enterprises in Burkina Faso, Mali, and Mauritania

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List of Acronyms

AFKED	Aga Khan Fund for Economic Development
AGM	Annual General Meeting
AFTFP	World Bank Africa Finance and Private Sector Development Department
BHM	Banque de l'Habitat du Mali
CEO	Chief Executive Officer
COPIREP	Comité de Pilotage de la Réforme des Entreprises du Portefeuille de l'Etat(DRC)
DGABE	Direction Générale de L'Administration des Biens de L'Etat (Mali)
DGPE	Direction Générale du Patrimoine de l'Etat (Mauritania)
DRC	Democratic Republic of Congo
DTF	The Direction de la Tutelle Financière (Mauritania)
EDM	Energie du Mali
FMAWR	Nigeria Federal Ministry of Agriculture and Water Resources
GA	General Assembly
GCMCG	World Bank Corporate Governance Unit
GDP	Gross Domestic Product
IEPP	Inspection Entreprises Publiques et Para-publiques
IFRS	International Financial Reporting Standards
IPS	Industrial Promotion Services
MAURITEL	Société mauritanienne de télécommunications
NACDRB	Nigerian Agricultural, Co-operative and Rural Development Bank
OECD	Organization of Economic Co-operation and Development
OHADA	L'Organisation pour l'Harmonisation en Afrique du Droit des Affaires
ONATEL	Office Nationale des Telecommunications (Burkina Faso)
ONEA	Office National de l'Eau et de l'Assainissement (Burkina Faso)
SNIM	Société Nationale Industrielle et Minière (Mauritania)
SOEs	State Owned Enterprises

Contents

Executive Summary

State owned enterprises continue to play a significant role in many sub-Saharan Africa countries. More often than not they are present in vital sectors of the economy such as utilities, infrastructure (transport/ telecommunications), energy, and natural resources. Though privatization has resulted in moving many state assets into the private sector, there are still a considerable number of SOEs that represent a significant portion of GDP. Some of the more successful SOEs provide much needed fiscal revenues for states with a narrow economic base and limited tax collections. In many countries where the informal sector dominates private sector activity, SOEs offer one of the few sources of formal and stable employment. Finally, SOEs continue to be seen as essential for achieving social and policy development goals. Given the continued importance of SOEs and the fact that many will remain publicly owned for the foreseeable future, it is important to assist countries in exploring avenues for improving the performance of SOEs. Corporate Governance refers to the way companies are directed and the means by which owners hold management accountable for achieving agreed goals. Improving corporate governance has been demonstrated to result in improved accountability, transparency, operational performance, and of course appeal to private investors.

This synthesis paper is based on a review of three countries in West Africa –Burkina Faso, Mali, and Mauritania[2]- where SOEs continue to play an important role and Governments have embarked on a number of public sector reforms that can have a positive impact on SOEs. These reforms have not been specific to SOEs; however, they can be built on through also working on enhancing the framework and practice of SOE Governance.

SOE governance practices and problems are strikingly similar in all of the countries reviewed. These commonalities can be ascribed to the fact that all of the countries are transitioning from centrally controlled economic and political traditions to more liberal economies and to a more democratic government. All are struggling with implementing the legal structures left behind from colonial times. The data that is available shows that wholly-owned and state controlled SOEs under perform. Many are technically insolvent and survive only through government support. Their performance is not only poor in the financial area, but also in the provision of needed social services.

The country studies link the poor performance of SOEs, in particular wholly-owned SOEs, to their governance practices. The fundamental problem is the politicization of decision making so that commercial objectives are either not taken into account, or are not assigned appropriate weight. Additional factors that had negative impact on governance includes lack of managerial and board-level skills, weak regulatory oversight, and insufficient checks and balances. Indeed,

[2] The in-depth review of the framework and practice of SOE governance was only carried out in Burkina Faso, Mali, and Mauritania while preliminary analysis was conducted for Nigeria and Democratic Republic of Congo.

SOEs that succeeded are those that had a non-political accountability element, which was introduced either through new investors, strategic partnerships, long term creditor relationship, or the granting of managerial autonomy by the state. These various approaches serve to mitigate political interference and provide the space for SOEs to perform according to established objectives.

Changes in corporate governance imply changes in business and political culture and public attitudes. Any changes in existing political/economic relationships, such as any significant SOE reform might imply, whether through privatization, the imposition of hard budget constraints or reductions of subsidies. Likewise, a change of the control structures of SOEs (i.e. their governance) might be met with resistance and could can easily result in social, political and economic tensions and vigorous resistance from those who benefit from existing practices. Any reform effort needs to pay attention to the reason why practices persist and to the disincentives for reform.

Long-lasting reforms are not simply a matter of plugging holes in the legislative or institutional framework. Corporate governance is the result of a complex interplay of law, practice, institutions and culture. Action plans need to take into account incentives and the political, social and cultural context of corporate governance in the country in addition to the legal framework. Indeed, SOE governance is a system and making it work better requires a systems approach. Most reform plans in the past have focused on a specific element of SOE governance. This narrow approach might explain why many have fallen short of hopes and expectations. Systems approaches, on the other hand, are important in complex organizations (such as SOEs) whose success depends upon the interaction and co-operation of other organizations and institutions.

This synthesis paper presents the objectives and the methodology used in carrying out the reviews followed by a discussion of the features and importance of SOEs in each of the countries studied. It then segues into the actual performance of SOEs and is supplemented by case studies of successful and unsuccessful SOEs and lessons learned from these experiences.. The paper then presents the current Government initiatives for reform and the remaining challenges and recommendations. The paper concludes with suggestion on how to implement the recommendations based on examples from other countries that have embarked on comprehensive governance reforms for the SOE sector.

I. Introduction

A. Factors that Prompted the Studies

Corporate governance is a critical element of sustainable private sector development. Promoting good corporate governance is an essential component of investment climate reforms. Better corporate governance would help improve the quality and transparency of companies and in turn help attract local and foreign investment. Furthermore, improved governance at leading enterprises can send a powerful signal to the rest of the marketplace and have an impact on other sectors, including small and medium enterprises.

The Private and Finance Sector Development Unit in the Africa Region of the World Bank undertook this review with the goal of strengthening corporate governance and improving the investment climate in Africa. Since state-owned enterprises (SOEs) are amongst the leading enterprises that continue to dominate key sectors of the economy in many African countries, the emphasis of the work was on improving the governance of SOEs. Studies were conducted both on the legal and institutional framework of SOE governance, as well as on the governance of specific SOEs.

This paper summarizes the results of studies conducted in Burkina Faso, Mali, and Mauritania. Two additional countries,the Democratic Republic of Congo and Nigeria, were initially targeted. However, the approach in these countries was modified due to local needs and conditions as well as resource constraints. Though the approach in DRC and Nigeria was different from that of the first three countries, circumstances there largely corroborate the findings of the structured reviews that were conducted.

The research was conducted under a grant provided by the Dutch government with complementary funding from the Africa Region Governance and Anti-Corruption Action Plan.

B. The Objectives of the Studies

In developed countries, SOEs tend to represent a relatively small part of the economy. On the other hand, SOEs represent a considerably larger portion of the economy in developing countries. Furthermore, SOEs in certain developing countries do a poor job of providing the basic infrastructure services needed for the economy to prosper. An improvement in SOE governance can have a significant impact on SOE performance, which could eventually have a knock-on effect on economic performance and poverty alleviation.

The studies aim at a variety of outcomes. These outcomes can be usefully divided into a timeframe that indicates when they could be expected to be achieved. The work that has been completed to date corresponds to the short-term goals of the project. The medium-term goals

are those that should be achieved in a next phase. The longer-term outcomes represent the ultimate outcomes.

Short term:

- Identify gaps in the governance framework for SOEs;
- Arrive at a better understanding of SOE corporate governance in the target countries;
- Inform officials in key ministries and leading SOEs and other stakeholders on good governance practices and provide them with some tools;
- Provide feedback to local contacts on findings of country reviews;
- Provide feedback to revise and refine the Methodology for Assessment of the Corporate Governance Framework for SOEs with the goal of improving it for similar reviews in other African countries.

Medium term:

- Encourage a movement of reform;
- Integrate the results into ongoing World Bank projects, future development policy credits, and the legal reform component of upcoming projects;
- Develop better SOE oversight by governments;
- Encourage more effective SOE boards.

Long term:

- Improve financial performance of SOEs;
- Improve the quality of basic services provided and social performance of SOEs;
- Improve the investment climate;
- Have an impact on long-term development and poverty reduction.

C. Problems Specific to the Governance of SOEs

The link between corporate governance and the performance of private enterprises has been the subject of extensive study and is well documented. The link between the corporate governance framework of a particular countries and the risk associated with doing business in that country is also well documented. With respect to SOEs, the incentive problems they suffer are well known and their underperformance well-documented in developed countries. Even if SOEs could, in principle, be able to perform as equally well as private companies, and though there are real examples of SOEs that do in practice, they generally do not.

This paper does not offer a statistical analysis of the link between SOE governance and performance in the countries under review. Rather, it illustrates how corporate governance of SOEs impacts their performance through a number of case studies. These case studies describe how weak governance practices of certain SOEs have led to decisions that are directly

detrimental to the SOE, to its shareholders (including the state) and generally to the public. The paper also includes case studies where changes in governance have induced better performance.

Unlike their private sector counterparts, SOEs are typically required to pursue both financial and social objectives. This mix of objectives often requires tradeoffs that result in inconsistent or un-economic decision making. Another difficulty SOEs face is that the costs of the social policies they are supposed to achieve are not fully recognized either by their financial disclosures or in the state budgets. The real costs of providing some social services are often difficult to calculate or go uncounted. Even when costs are well understood, fair compensation is not always forthcoming.

Furthermore, the close link to the state tends to subject the SOE to political influence. Political influence may sometimes work in the SOE's favor. However, more typically, political influence makes business objectives play a secondary role to political goals. This tends to lead to economic inefficiencies that, in turn, impede the achievement of social objectives. Inefficiencies often accumulate and resist resolution. Eventually they lead to financial problems and frequently bankruptcy.

In principle, state-ownership need not yield worse results than private owners so long as SOEs operate on a commercial basis. In practice, however, private sector incentives are difficult to copy and even enlightened state ownership tends to be associated with under performance. The recognition of this problem is at the origin of the privatization waves that occurred in Europe in the 1980s, and later the large scale privatizations in formerly centrally controlled economies. Full or partial privatization is often viewed as the most effective measure for reforming SOE governance and enhancing SOE efficiency. However, privatization is not a panacea; and many privatizations fail when improperly conceived.

In practice, many countries use a mix of approaches to address the SOE governance problematic including widening the shareholder base, bond issues to encourage creditor oversight, performance agreements/contracts between the government and the SOE, the use of private sector management techniques and incentives, and other corporate governance practices such as emulating private sector board practices. Even then, the mixed goals make issues difficult to fully resolve.

It is important to recognize that corporate governance and SOE governance in particular are complex systems for directing and controlling an enterprise that include a large number of factors and players including the legal framework, governments, the judiciary, ministries, regulators, public opinion, management, boards, shareholders and other stakeholders. The variety of parties involved in the governance of the SOE creates a complex system of interests and incentives. Reform efforts must take into account these complex incentive structures.

D. Approach and Methodology

The reviews were conducted with the assistance of local consultants with knowledge of the local corporate governance framework and with access to SOEs and key institutions. Over a period of months in 2007 and 2008 , consultants conducted a framework or "gap analysis" that compared local practices with best practices as described in the OECD Guidelines on the Governance of State-owned Enterprises.

The OECD Guidelines are the only recognized international benchmark for SOE governance. The OECD Guidelines presuppose the existence of a well-functioning judiciary and civil society institutions and adequate resources that are often lacking in the countries under review. Their prescriptions are designed for developed countries, and some of their recommendations clearly do not apply to the developing world.[3] Nevertheless, they represent a cohesive and well-reasoned set of principles that are well suited for a comprehensive country review of SOE governance. Their basic principles remain relevant and represent the longer-term goals even in a developing country context.

The framework analysis was supplemented by an assessment of the governance practices of a number of SOEs in each country. SOEs were selected for analysis based upon their size and relevance to the local economy. Electricity and telecommunications providers were examined in each country. Water and sanitation providers were reviewed in Burkina Faso and Mauritania. A mix of other enterprises was studied including banks, agricultural co-operatives, and petroleum and natural gas importers.

Both the framework and company analyses were followed by interviews with a broad range of stakeholders including government officials, SOE boards, SOE executives, regulators, government and private auditors, trade unions, corruption watchdogs and other institutions. These interviews helped capture what could not be reported on paper, and were crucial in gaining an understanding of how governance really works in practice. Wherever possible, the interviews were used to inform local counterparts of international best practices in corporate governance.

What constitutes a SOE is defined broadly in these studies. Any enterprise with a commercial activity in which the state holds an ownership interest, irrespective of the legal form of the enterprise, whether the state holds a majority interest, or whether the state exercises control, is taken to be a SOE. More restrictive definitions could have been chosen. However a broad definition was used in order to encourage the best governance of all commercial enterprises

[3]For example, the OECD Guidelines suggests that SOEs should consider establishing specialized board committees including: audit, remuneration, strategy, ethics, risk, and procurement committees. In fact, the establishment of a large number of committees is not recommended in a developing country context where SOEs are struggling to get one board to manage itself properly. A multiplicity of committees would be a recipe for confusion. This is one example of how some of the recommendations of the OECD Guidelines need to be tailored to the developing country context but, there are more.

that the state holds and manages on behalf of the people. Not included under the definition are state agencies whose primary mission is the achievement of social/public objectives.

II. SOEs remain a significant presence in the economies

A. The number of SOEs

The DRC has the most state ownership compared to the other countries reviewed in this study. It is emerging from a long period of internal conflict and is beginning to ramp up its privatization efforts. Contrasting DRC, the number of SOEs has declined considerably in Burkina Faso, Mali, Mauritania and Nigeria as a result of privatization. Despite differences, each country retains ownership in a considerable number of SOEs (See Table 1).

Table 1: Number of wholly-owned and partially-owned SOEs by country

Country	Total	Wholly-owned	Mixed-ownership	
			Majority-owned	Minority-owned
Burkina Faso	22	11	12[4]	
DRC	113	53	60	
Mali	36	10	6	20
Mauritania	31	14	7	10
Nigeria	65[5]	NA		
Total	267	88	179	

Though data are incomplete, approximately one-third to one-half of all SOEs are wholly-owned by the state. The remaining SOEs are mixed-ownership enterprises. For those countries where information was available for mixed ownership enterprises, it appears that the preponderance of mixed-ownership SOEs is minority owned by the state.

B. Sectors in which SOEs are active

SOEs are present in many sectors of the economy (see Table 2 below). The breakdown below applies only to SOEs in Burkina Faso, Mali and Mauritania, the countries from which information was available.

[4] Partially state-owned (both majority and minority)

[5] Figures apply only to Abia, Anambra, Enugu, Lagos and Ogun states and Abuja the federal capital. Source: African Institute for Applied Economics, 2008, prepared for World Bank Sub-national Investment Climate Program.

Table 2: Sectors of activity of SOEs

Sector	Wholly-owned	Partially- owned	Total
Services	8	1	9
Transportation	6	4	10
Agriculture	3	2	5
Postal	3	0	3
Water	2	1	3
Electricity	2	1	3
Industry	2	10	12
Public works	2	0	2
Lottery	1	1	2
Fishing	1	3	4
Energy/petroleum	1	2	3
Telecoms	1	3	4
Finance		10	10
Construction		2	2
Mining		9	9
Total	**32**	**49**	**81**

Note: Totals do not match Table 1 since sectoral definitions were not available for all of the companies cited above and since sectoral breakdowns were not available from DRC or Nigeria.

As Table 2 shows, wholly-owned SOEs are active in sectors traditionally associated with state ownership such as public works, transportation, postal services, water and sanitation, and electricity. Ownership is typically more mixed in other sectors such as industry, finance, construction telecommunications and mining.

The greater presence of the state in electricity and water, and postal services is presumably because of their strategic importance: some of these SOEs are natural monopolies; some due tothe social impact of the services they provide; and others because of the potential political impact that the liberalization of these services might suggest. The relatively smaller presence of the state in industry, finance and mining may be due to a combination of natural competition, the high level of technical expertise required in these fields, the level of risk associated with the activity, and/or the need for capital.

C. The Contribution of SOEs to the National Economy

A number of key items of information regarding the role of SOEs in the economy were sought during the studies: 1) the contribution of SOEs to the GDP in each country; 2) the value of assets that SOEs hold on behalf of the state; 3) the financial liabilities to which SOEs are exposed that could eventually encumber the state; and 4) information on the consolidated impact of SOEs on government budgets.

Unfortunately, aggregated information does not exist or is not easily accessible. National statistical agencies do not typically track SOEs as a group, and ministries of finance do not generally produce consolidated SOE reports (Burkina Faso is an exception). Sometimes the data available is outdated or incomplete. In Mali and Mauritania some efforts have been made to collect information, however, once collected there is no capacity to aggregate or analyze it.

Despite these gaps, one can piece together some general figures. Official statistics compiled in Mauritania suggest that, in 2005, the state sector (including public services) represented approximately 25% of GDP.[6] In Burkina Faso, a rough calculation shows that the total sales[7] of SOEs as a percentage of GDP are approximately 12%.[8] These figures are consistent with World Bank figures for Africa as a whole that indicate that the SOE sector contributes approximately 15% of GDP[9]. What is clear is that SOEs still form a significant portion of African economies. Indeed, beyond measures of GDP, SOEs operate in strategic sectors and supply much of the formal employment. Additionally, efforts at privatizations and public private investments have plateaud across the continent , and especially, with the recent global financial crisis, foreign private investments in SOEs is likely to diminish further. Therefore, SOEs will be a significant part of these countries' economic landscape for many years to come.

III. SOE Performance is Generally Poor

The financial data collected in the context of the reviews confirm that SOEs, in general, perform poorly in all of the countries considered, though there are important exceptions. Even when SOEs are not loss makers, there are indications that profitability is worse than comparable private sector enterprises. This might be considered a calculated cost of state ownership if SOEs were to help the state achieve its policy goals. But, there are also indications that SOEs do not achieve their policy goals either, at least not to the extent they should. In each country there were signs of public dissatisfaction with the services that SOEs provide to the public. What scant information is available on SOE performance on social/policy indicators suggests that well-regulated private sector and quasi-public enterprises do better at providing social goods than wholly-owned SOEs.[10]

A. Financial performance

The absence of reliable data prevents a comprehensive overview of SOE performance. However, some observations can be made based on the questionnaires that were administered to a group of SOEs that were examined in the context of the country reviews. A total of 14 SOEs (4 in Burkina Faso, 5 in Mali, and 5 in Mauritania) were asked to fill in detailed questionnaires on their governance. These questionnaires also covered basic financial indicators. The SOEs that

[6] National Statistics Office (ONS)
[7] A rough proxy for their contribution to GDP.
[8] Ministry of Economy and Development, Base de Données Socio-économiques-Medvev 2007.
[9] Mako, W., Governance of SOEs: Lessons from the Private Sector, World Bank, 2006
[10] AADFI (2008), Association of African Development Finance Institutions, Prudential Standards, Guidelines and Rating System for African Development Banks and Finance Institutions.

were reviewed were from sectors in which the government tends to maintain long-term ownership (telecoms, electricity and water). (See Table 3).

Table 3: Sectors of SOEs examined in the context of the reviews

Sector	Number of SOEs
Telecommunications	3
Electricity	3
Water and sanitation	2
Finance	2
Petroleum importation	1
Mining	1
Natural gas importation and distribution	1
Agriculture (cotton)	1
Total	14

In most cases, these were wholly-owned SOEs or SOEs in which the government had a controlling interest. Amongst the mixed-ownership SOEs, the state was the controlling shareholder in all except for two cases (see Table 4 below).

Table 4: Ownership of SOEs examined in context of review

Ownership of SOE	Number of SOEs
Wholly-owned	6
Mixed-ownership enterprises:	8
• State is controlling shareholder	6
• State is not the controlling shareholder	2

Thus, the sample differs slightly from the general population of SOEs described in Table 2 above. The financial performance described here thus corresponds more closely to that of wholly-owned or state-controlled SOEs, and not minority owned mixed-ownership SOEs.

Some interesting patterns emerge from the analysis. First, financial information was outdated and it proved difficult to draw conclusions regarding the current state of SOE performance. Of the SOEs contacted, the most recent financial statements were for fiscal 2005 in 9 out of 14 cases. Two SOEs made figures available for 2006, and one for 2007. Only one SOE made figures available for the financial year immediately preceding the review. Comparatively, wholly-owned SOEs appear less capable of producing timely financial reports than mixed-ownership SOEs with majority outside participations.

The financial data that is available reveals that the past financial performance of the sample is uniformly poor - even if there are some individual exceptions. Eight of the 12 SOEs that provided

information reported losses, and one SOE that did not provide full information was known to be technically insolvent. Four companies made profitsHowever, 3 of these were operating at or very close to break-even. The only company that reported significant profits during the reporting period was Mauritania's *Société Nationale Industrielle et Minière (SNIM).* SNIM, a majority state-owned mining company, was also the only SOE that produced timely financial reports (See mini-case on SNIM below).

B. Performance on social indicators

Financial indicators tend to receive more attention than social indicators from the financial markets, investors and even governments. Certainly, SOE boards in the countries that were reviewed focus almost exclusively on budgets and financial reports. Where reporting systems exist in SOEs, these typically cover only financial indicators. Yet, most of the justification for keeping SOEs under government control is that the state is assumed to be uniquely placed to ensure the provision of social services.[11]

The absence of reliable indicators on social performance is a serious impediment to understanding the costs and benefits of state ownership. Without them it is difficult to define SOE goals and hold SOEs and managers accountable. More information on the social performance of SOEs is needed irrespective of the view one takes on the role of state ownership.

C. The causes of poor performance

One of the important findings of the studies is that the causes of SOE underperformance are not principally exogenous factors, such as the inability to access raw materials, or fluctuations in the market price of end products, or unbridled competition. After all, many SOEs enjoy some form of protection and privileged access to factor inputs and finance. There are strong indications that the dysfunction of SOEs is most often directly related to the way that they are governed. In fact, the studies suggest that corporate governance is not just part of the problem of underperformance; they suggest that poor corporate governance is the problem.

More specifically, SOE under performance is attributable to: cumbersome decision making structures, mixed incentives for top managers, the quality of boards of directors, how managers are selected, and the lack of accountability of everyone ranging from executives to directors to governments. Further causes are the politicization of business decisions, excessive government involvement in the day-to-day decision making of SOEs, and the use of SOEs for political patronage and personal rent extraction. The case studies in the Section IV are provided to illustrate how governance practices affect SOE performance. Section V includes additional case

[11]Nor are the costs of services calculated. According to the African Association for Development Finance Institutions, there are indications that private companies—even when they pursue profitability—produce better social outcomes at lesser cost than the state.

studies to illustrate how governance problems have been addressed to improve some aspect of SOE performance.

IV. Case studies of dysfunctions in governance

This section illustrates how the particular governance characteristics of SOES can lead to performance problems. The cases are illustrative of common problems found in SOEs but the problems that are described are not comprehensive.[12]

Hard budget constraints and supports

SOEs are subject to different degrees of hard budget constraints and market competition. Some of the larger wholly-owned SOEs enjoy monopoly rights and do not operate in fully competitive markets. The SONABHY case from Burkina Faso illustrates how an SOE may receive subsidies and enjoy other advantages such as preferential tax or customs rates. In principle, this protects them from competition and gives them an advantage over private sector players.

On the other hand, SOEs that accumulate cash are natural targets for government intervention and may be used to subsidize the operations of other SOEs or to finance other government projects. It is often the case that cross-subsidization of government projects leaves the SOE unable to pursue its own investments.

Micro-management by the state and politicization of operating decisions

SOEs are often treated as extensions of the government and specifically of line ministries. There is clear evidence that the state's involvement in SOEs slows decision making, confuses corporate objectives, is subject to political influence, and lacks commercial orientation. In some cases micro-management can be positive. In Burkina Faso, for example, BUMIGEB, under the direction of the Prime Minister, was required to contract an insurance policy for its physical plant after an explosion destroyed part of its facilities. In this case, sound business sense may have prevailed by forcing the SOE to better manage its risks. But, more often than not, micro-management is deleterious to SOEs and ultimately to consumers as illustrated by the case of SOMAGAZ in Mauritania below.

[12] A more comprehensive and detailed listing of problems found in the corporate governance framework and SOEs can be found in the individual country studies that form the basis of this consolidated report.

Burkina Faso: The case of SONABHY: Monopolies, subsidies and supports

SONABHY is the state monopoly responsible for the purchase, importation and stocking of petroleum. It plays a central role in the Burkinabe economy. The principle objective of SONABHY is to prevent an inventory stock out that might cause the economy to grind to a halt. In addition to ensuring a steady flow of petroleum, SONABHY aims to do so at a "reasonable" price.

Additional objectives are to make a profit, pay dividends, collect taxes for the state, and be a good corporate citizen. As with many other SOEs in Burkina Faso, SONABHY provides medical services to its employees and assists in the treatment of those who have AIDS. SONABHY is effectively part of the system that supports public health. SONABHY thus operates under a different set of rules from private sector companies.

SONABHY is often the object of state intervention since it generates considerable financial resources. Some 71% of all SOE dividends paid to the state in 2006 came from SONABHY. Furthermore, SONABHY is Burkina Faso's centralized tool for collecting import duties on petroleum. Prior to the nationalization of SONABHY, Burkina Faso had difficulty collecting import duties on petroleum. After nationalization, all imports were required to pass through one central repository, making the collection of duties easier. When centralized stocking and customs control were first introduced, collections increased by a factor of ten.

SONABHY's importance is also underscored by the fact that it provides petroleum to SONABEL (the state electricity provider) with which to produce electricity. This relationship is not always in the commercial interest of SONABHY, since payment for petroleum products is not always received on a timely basis. Another example of the use of SONABHY's resources to achieve the state's policy goals was the creation of the SBIF[13] (a financial intermediary), whose principal activity is to conduct corporate bond offerings for SOEs. SBIF was created by the Central Bank with the participation of other banks, and through capital injections by SONABHY and SONAPOST among others.

Sometimes SONABHY takes significant losses in order to stabilize gas prices. Any attempt to liberalize petrol markets and reform SONHABY would be complicated by the fact that it is one of the state's principal revenue generating arms.

Mauritania: The case of SOMAGAZ: State micro-management

SOMAGAZ is a state importer of butane gas in Mauritania. Its principal activity lies in the importation, storage and distribution in pressurized bottles of butane for domestic use. Retail distribution of cooking gas is open to other competitors though they must purchase their butane from SOMAGAZ. Beyond providing a necessary product to households, the use of butane gas helps fulfill an important public policy goal by reducing deforestation (households have traditionally resorted to burning wood), and pollution from burning coal.

Despite strong demand for its products, SOMAGAZ is unable to operate effectively or service consumers. The principal reason is that it has little operational autonomy. The state fixes the sales price of butane and compensates SOMAGAZ for the difference between that and the market price. However, compensation is typically late, thus forcing SOMAGAZ to resort to private banks for short term lending. Banks continue to lend to SOMAGAZ despite the fact that it is technically insolvent because of implicit guarantees by the state. However, lending that is needed to make longer term investments that could help SOMAGAZ improve its capacity and economic position is not available.

Personnel problems dog the company. One is the constant turnover of CEOs. When new ministers are appointed, CEOs change. New CEOs, in turn, hire new management and employees—often friends, family and associates. Since it is difficult to build down the staff brought by a prior CEO, the company accumulates personnel. The board is viewed as a formality and the qualifications of board members are insufficient. There is also the perception that the board is not fully cognizant of the challenges facing the company or its own responsibilities.

[13] *Société Burkinabé d'Intermédiation Financière.*

Absence of board authority and managerial autonomy

In the SOMAGAZ case above, the board fulfilled a formal function and rubber stamped the decisions of ministers; it was unable to act autonomously or exercise any authority. In the case below, the board of the NACRDB, a Nigerian development finance institution, was considerably more pro-active and self-sufficient. However, it too suffered from the lack of authority to address fundamental business problems. The NACRDB case illustrates how the NACRDB board developed a restructuring plan to rescue the bank and how this plan was stymied by a line ministry that was unwilling to follow a needed more commercially oriented strategy for the bank.

Nigeria: The Case of NACRDB: Absence of board autonomy leads to protracted inaction

The NACRDB is a limited liability company wholly owned by the Federal Government of Nigeria. Its share capital is held to 60% by the Ministry of Finance Incorporated (MOFI) and to 40% by the Central Bank of Nigeria (CBN). All key decisions are made by the Federal Ministry of Agriculture and Water Resources (FMAWR). The policy goals of the FMAWR often conflict with the mission of the bank and hamper its ability to survive. Some of the specific factors that hinder NACRDB's are: [14]

- A directive of the Federal Executive Council that pegs 70% of NACRDB lending at a below market rate of 8%. NACRDB is not compensated for the gap in interest rate.
- The NACRDB was directed to absorb 4,600 employees from a merger with other banks, irrespective of their qualifications and experience.
- The NACRDB was supposed to be recapitalized with NGN 50 billion[15] (USD 560 million at 2000 exchange rates), of which the shareholders only paid in NGN 21 billion.
- The refusal of the Central Bank of Nigeria to fully pay in capital corresponding to its 40% ownership stake.
- The requirement to continue to meet pension payments of disengaged staff since the inception of the bank.

Difficult as these problems may be, a well-reasoned remedial plan was developed by NACRDB management and approved by the board. But, the bank's problems finally became intractable because of the unwillingness of the owners and the FMAWR to come to grips with the tradeoffs inherent between running a sustainable DFI and the pursuit of political and social goals.
The board and management never received approval from the Ministry of Agriculture to pursue the restructuring measures needed to make the NACRDB viable. No plan was presented by the state as an alternative. The result was that the bank—initially intended to help Nigeria's poor farmers—is effectively insolvent and an administrative burden to the state.

The NACRDB case is a specific example of a more general problem: SOE boards throughout the region do not have the ultimate responsibility for company performance, and do not have the basic characteristics of professional boards. It is often heard that SOE boards are hard working and fulfill their legal function of an annual check of the financial statements and the budget of the SOE. This is true in many cases. However, the tasks that boards fulfill typically fall far short of the classic functions of a board such as: overseeing and guiding strategy, selecting and replacing

[14] Board of Directors of NACRDB, Strategic Development Plan, 2007.
[15] NGN: Nigerian Naira. Exchange rate NGN 149/USD 1 as of 6/9/09. Source: http://www.corporateinformation.com/Currency-Exchange-Rates.aspx?c=566. Exchange rate in 2000: NGN 86/USD 1. Source: http://en.wikipedia.org/wiki/Nigerian_naira.

top executives, monitoring executive performance, overseeing the external audit and other key board functions.

The role of the external auditor

The external auditor should provide an external check on the SOE and help ensure financial accountability. The external audit and the assurance that it provides to shareholders and the public is a fundamental part of good governance. In each of the countries reviewed the external auditor is independent by law. At the same time, there are questions regarding the ability of the external auditor to come to truly independent opinions, and to have these opinions heard.

Mali: The case of the compromised external auditor

The *commissaires aux comptes* in Mali have broader responsibilities than an external auditor in the non-francophone world. In addition to auditing the financial statements, they also exercise a role of compliance monitoring, reporting related party transactions, alerting the judiciary of infractions, and ensuring the equitable treatment of shareholders.

In the event of the discovery of accounting irregularities, the *commissaires aux comptes* has the legal obligation to inform the general assembly of the enterprise. In the case of wholly-owned SOEs, a report is addressed to the board, which is the highest authority within the enterprise. Should illegal activities be discovered, the auditor is required to inform the *Procureur de la République* (public prosecutor).[16]

Despite these broad legal authorities and obligations, there is some question regarding the ability of the external auditor to fulfill in practice what is envisioned by the law. A great reticence to report wrongdoing now exists among auditors due to concern that they became the targets of reprisals. Now, as a rule, the *commissaires aux comptes* do not report corruption, and do not trust the judiciary to render fair judgment or protect them in the event that they do.

In practice, it is difficult for the Malian *commissaires aux comptes* to fully meet the ideal set out by the law. In the view of some, the *commissaires aux comptes* suffer an even more fundamental conflict of interest: they cannot afford to be overly critical of their clients for fear of losing business.

Lack of internal control and deficient oversight

The case above illustrates the weakness of a key external control. The BHM case below illustrates the weak internal controls in a bank and the impact of uncontrolled expansion.

[16] Article 716 Uniform Acts of OHADA.

Mali: The case of BHM: Dilution of minority shareholders interests due to poor oversight and poor performance

BHM (*Banque de l'Habitat du Mali*) was initially owned 65% by the state, 23% by individual investors and the rest by other shareholders. It experienced rapid growth from 1999 and 2002 but entered a period of crisis in 2003 due to excessive expansion. This crisis was characterized by an insufficient treasury, high levels of problem loans, a mismatch of funding, declining profitability and an insufficient capital ratio. These problems threatened the existence of the bank.

BHM identifies the principal causes of the crisis as: 1) dysfunctional governance; 2) uncontrolled growth; and 3) a lack of internal controls. However, responsibility for the bank's failure can also be assigned to a broad set of actors in the regulatory and governance chain including: the board; controls; management; auditors; and the central bank.

With respect to BHMs board, it was giving perfunctory endorsement of decisions without assessing the merits. Board members had limited commercial experience and no banking experience, and were largely ignorant of prudential norms. There was little understanding of risks, and there were inadequate controls. While ignoring warning signals of a larger impending disaster, the board was distracted by and prone to direct intervention in questions of detail.

In the end, BHM was considered too important to fail and the state stepped in. The reasons for the intervention were numerous. BHM had significant deposits from Malians living abroad who used the bank to remit money to locals. This made the issue politically sensitive and depositors were able to exert significant pressure on the state. BHM also managed state pensions and had a significant number of employees who risked losing their jobs. There was also some concern regarding the potential systemic impact of a bank failure.

Due to the number of small investors, BHMs problems became a national issue that were followed closely by the press and received considerable public attention. Today, the state holds 93% of the shares with former investors' shareholdings being diluted proportionally.

Ultimately, BHM was restructured and rescued due, in part, to concerns of systemic stability. The case is also interesting because of the presence of minority shareholders in its ownership. It may be indicative of the need for better minority shareholder protections and, in particular, better education of minority and other retail investors on the risks of investing.

V. Case Studies of Improvements in Governance

The previous section links common performance problems to the corporate governance practices of SOEs. This section illustrates how some of these problems can be addressed. Each of the success stories below is linked to the introduction of some level of external accountability to the SOE. Even if not all of the case studies are unmitigated success stories, the cases suggest that governance and performance improve significantly when SOEs introduce new external shareholders who demand greater accountability.

This is a strong argument for privatization. Even the privatization of a relatively small portion of the SOE can have a strong salutary effect. However, not all privatizations work. In the course of the research, a number of partially and wholly-privatized SOEs were found that continue to perform badly or fail after the introduction of external shareholders. Governance dysfunctions can persist when the state continues to exercise disproportionate influence, or where new owners do not bring the needed financial resources, or strategy, or management skills to the SOE.

Two further means of enhancing accountability are described below. One is accountability through stakeholder oversight coming from the introduction of external lenders. Arms-length lending relationships with banks as well as bond offerings can introduce greater accountability to SOEs. Another is through increased transparency. One of the reasons that weak governance practices are able to persist unchecked is that SOEs affairs often escape public scrutiny. Increasing reporting and transparency is an additional method for creating greater accountability and improving SOE performance.

Improving performance by broadening the shareholder base

The studies confirm the view that opening the capital of SOEs to strategic investors can significantly improve SOE financial performance and the services that SOEs provide to the public. With the influence of new owners, profitability, sustainability and a greater client orientation often move to the forefront of considerations. A number of SOEs in the region opened their capital to external shareholders, and reformed their governance structures. These reforms had an immediate and lasting effect on boards, information systems, reporting, operational decision making and, ultimately, on performance.

Burkina Faso: The case of ONATEL: Improved governance through a majority privatization to strategic investors

2006 was marked by the partial privatization of ONATEL, one of Burkina Faso's flagship SOEs. A controlling stake of 51% was sold to Maroctel, the Moroccan telecoms operator, for EUR 225 million. Maroctel is, in turn, controlled by Vivendi (a French communications and entertainment group). The new owners of ONATEL view corporate governance as fundamental to success.

Since the acquisition, the board was restructured and developed a new performance orientation. Of nine board members, five are now nominated by Maroctel. The new directors have much stronger business backgrounds than their government appointed predecessors. As a result, board discussions have become shareholder value oriented. Oversight by government departments was reduced to a minimum while strong operational oversight from the home office of Maroctel was introduced. A "management board" was created that is staffed entirely by telecommunications professionals who meet on a monthly basis to review all key performance indicators.

The responsibilities of the supervisory board changed. They shifted from a line by line cost checking exercise to an evaluation of strategic and financial performance. The company now uses International Financial Reporting Standards in its consolidated statements. ONATEL can now produce an accurate vision of the company's financial status on a monthly basis.

One of the fundamental contributions of the new owners was a change in attitudes. Public enterprises often wait for clients to appear. ONATEL now prospects for clients and a greater service mentality has emerged. ONATEL no longer views a telephone line as a privilege for which a client must stand in line. Staff now receive clients in open offices (rather than working in isolation behind closed doors) and aim to satisfy consumer needs. Currently, there are 1.3 million cell phone users in Burkina Faso, a number that is growing rapidly, partly as a result of the efforts of ONATEL to become more client driven, and as competition has resulted in better services at better prices for the consumer.

In summary, the opening of ONATEL's capital to a strategic investor, and the ensuing changes to corporate governance and management helped improve the telephony and internet services available to the public. They also helped improve ONATEL's financial performance, making it a healthier and more viable enterprise that has a greater capacity to invest for the future.

ONATEL is the case of a new majority owner who helped turn around an SOE principally through the introduction of technical expertise and better management. But, majority privatizations are not the only way to achieve better performance. Changes in governance and performance can also be obtained when the state remains the majority owner. In the case of SNIM in Mauritania, the state owns over 78% of the enterprise. Nevertheless, SNIM is a strong performer.

Mauritania: The case of SNIM: Strong performance through competition and the influence of outside investors

SNIM (*Société Nationale Industrielle et Minière)* mines iron ore deposits located in an inaccessible dessert in the northeast of Mauritania. SNIM is highly capital intensive. The remote location of iron mines in northwestern Mauritania requires SNIM to build and operate its own railway that runs 700kms through a baking desert between the site of production and the port of Nouadhibou. These factors do not favor the performance of the SOE. Nevertheless, SNIM is responsible for 40% of Mauritania's exports and approximately 12% of Mauritania's GDP.[17]

What explains SNIM's strong performance?

SNIM enjoys more decision making autonomy and less political interference than other SOEs. It is the only SOE in Mauritania that is specifically exempted from SOE legislation (Ordinance 90.09). SNIM has benefited from the know-how of foreign investors. SNIM resulted from the nationalization of a foreign company whose owners left an imprint on the corporate culture that continues to have an impact on the way the company runs today. It has a group of vocal and interested foreign shareholders that provide a balance of powers.

Another important distinguishing factor is that it operates in a competitive market. The principle clients of SNIM are major European buyers who purchase iron ore in competitive commodities markets.

SNIM is a case where the SOE performs well with the state as the majority owner. It also a case that illustrates how good governance practices, once embedded in an SOE, persist (just as poor governance practices have been shown to persist in dysfunctional SOEs).

Better accountability through creditor oversight

The presence of creditors appears to result in greater accountability. In developed countries, creditors are often bond holders. In the study region, few SOEs had conducted bond offerings. On the other hand, many SOEs resort to bank lending, and a good number appear to borrow from international financial institutions including the World Bank. The case below illustrates how creditor stakeholders helped professionalize the board and management of ONEA, and helped create a greater sense of responsibility and accountability.

[17] SNIM Vision and Strategy Document.

Burkina Faso: The case of ONEA: Improving accountability and performance in wholly-owned SOEs through creditor oversight

ONEA (*Office National de l'Eau et de l'Assainissement*) provides water and sanitation services in Burkina Faso. Like other SOEs it is subject to operational constraints related to the provision of services. It is required to provide services that are considered fundamental to the development of the country.

Whilst ONEA is still wholly-owned by the state, donor organizations are involved in its activities, and regularly hold ONEA to account. Outside creditors bring independent oversight and a rigor to decision making that is often lacking in other SOEs.

There are other factors that contribute to ONEA's success. The chairman, whilst coming from the Ministry of Economy and Finance, has a commercial background; he is not the typical political appointee and is able to understand the economic constraints under which ONEA operates.

The ONEA case suggests that the conditions under which wholly-owned SOEs are able to improve their performance are much the same as for mixed-ownership SOEs: shielding from political influence; commercial experience; autonomy; and accountability.

The lender in the ONEA case was an independent foreign bank. Anecdotal evidence suggests that lending from local state-owned banks may not be accompanied by the same insistence on accountability and repayment of loans. The determining factor could be lenders who are capable of maintaining a true arms-length lending relationship from the SOE.

The positive influence of committed strategic partners

One might assume that the greater the equity capital in private hands, the better the performance. This is, however, not always the case. It is entirely possible for the state to cede majority ownership but continue to exercise a negative influence over the SOE.

The EDM case shows how reducing government ownership to a minority stake may be an insufficient condition to promote better performance. A number of other conditions need to exist. The case suggests that a critical factor is how the government exercises its influence on the SOE after privatization. To the extent that the state continues to exert direct and/or informal decision-making control, or indirect control via regulators, and does so in an opaque fashion, the governance, decision making, and incentive structures do not change from the long-ingrained practices that have contributed to poor performance.

Mali: The case of EDM: Improved boards through strategic partnerships

Energie du Mali (EDM) is Mali's state electric and water company. It was initially created in 1960 with the help of The French State Agency for Development and *Electricité de France* the French state-owned electric company. The shareholding structure has fluctuated considerably over the years with EDM becoming 100% state owned in 2000 as foreign partners ceded their shares. EDM subsequently became majority private with 39% in the hands of Bouygues/SAUR and 21% held by Industrial Promotion Services (IPS) the West African affiliate of the Aga Khan Fund for Economic Development (AKFED).

In 2005, Bouygues/SAUR left EDM thus returning majority control (66%) to the state with the remaining 34% now in the hands of IPS. Despite what initially seemed an auspicious ownership structure, the short period of private ownership was a failure.

What caused the failure of the privatization? In the final analysis, the failure and renationalization of EDM was due to an inability to achieve consensus among the owners on electricity pricing. The state advocated low principles to comply with its political commitment to the people of Mali. The new owners wanted to either raise prices or be compensated for the shortfall in meeting real costs.

The board of EDM failed to achieve consensus. The governing structures of the enterprise were never able to achieve an agreement on what the correct pricing of services was, and on fair compensation for the costs of services provided.

The situation has changed dramatically recently. Today, the board of EDM is one of the best in Mali partly due to the strong commitment of IPS. Board deliberations are increasingly open and professional, and decisions are more often than not taken in the interest of the company. The different positions of the state and the outside investors are discussed actively and compromises are sought. The state representatives on the EDM board have become more professional, and an audit committee was introduced in 2008.

The special role of IPS is worth highlighting. IPS has contributed significantly to the operations and governance of EDM. It has also contributed to a better understanding of governance among state officials. The Bouygues experience suggests that outside investors who take a purely financial perspective would not have shown the same long-term commitment as IPS has.

Yet, despite the many positive changes visible at EDM, fundamental problems persist. The company continues to perform poorly as a result of differences over pricing and an inability to operate based on economic logic. Improved board performance cannot by itself address the more fundamental problems facing EDM, which are government decisions on investment and pricing.

The EDM case highlights the important of having a committed strategic partner who supports the SOE in the face of serious challenges. IPS the African affiliate of the Aga Khan Fund for Economic Development partnered with EDM after Bouyges found its partnership with EDM to be unsustainable. IPS was instrumental in professionalizing EDMs board practices and in ensuring that commercial objectives received consideration from the state and during board meetings.

Some of the immediate effects of IPS's involvement were: the introduction of directors with new qualifications; greater frequency of board meetings; greater consideration of strategic

issues at board meetings; better information provided to boards; the introduction of new management information systems; the introduction of a genuine internal audit function; the application of IFRS and IAS in the production of financial reports; and improved external reporting.

Improved governance through improved accounting and reporting

Reporting under best practice reporting standards is being done in a limited number of SOEs in the review countries. The Mauritel case below describes an accomplishment that was considered too difficult to achieve in the past—the use of IFRS in an SOE.

Mauritania: The case of Mauritel: Best practice accounting and information systems

Mauritel is Mauritania's principle fixed and mobile phone operator. The company resulted from the sale of the phone operations of the previous state phone and postal operator. A telecommunications regulator was created in parallel to its privatization.

Control of Mauritel was purchased by Maroctel, the principal telecommunications operator from Morocco. Maroctel brought not only its own expertise to Mauritel, but also that of its French parent Vivendi. Maroctel also brought a cultural affinity with its southern neighbors that helped avoid mistakes that would surely have occurred if Mauritel had been acquired by investors less familiar with local business culture.

Lines of accountability were completely changed as was the board of directors which received new members, new procedures and authorities, and commercial expertise. Mauritel was effectively forced to introduce best practice accounting systems and procedures because of the accounting consolidation requirements of its parent which is listed in France and reports under IFRS. The Maroctel office invested heavily in systems to oversee management and hold them to account.

While problems persist, Mauritel is an example of how SOEs can enhance their information a systems and reporting in support of more professional governance and management.

VI. Government-driven SOE reform initiatives

The case studies above paint a mixed picture of SOE governance in the region. On the one hand, there are serious performance problems that are directly linked to governance dysfunctions. On the other hand, there are examples of improved performance. In most cases, better performance resulted from the introduction of new stakeholders who demanded greater accountability and brought a needed commercial perspective to the SOE, and from the depoliticization of the SOE's decision making processes.

None of the countries studied had undertaken a comprehensive state-lead project aimed specifically at improving SOE governance. SOE reforms have not been viewed through the lens of governance reform, i.e. how the SOE is directed and how control is exercised. On the other hand, numerous discrete programs have been undertaken over the years to strengthen the

state's ability to control SOEs, in particular, the state's access to financial information and discover fraudulent practices. Some of the more recent initiatives are described below.

Burkina Faso

Burkina Faso distinguishes itself from some of the other countries in that it has political support for the reform of SOE governance. Political support has been spurred, in part, by public perceptions of mismanagement at some of the largest SOEs and also by the Prime Minister's office, which is the source of a 2007 decree seeking to improve the professionalism and qualification of CEOs.

Burkina Faso: The 2007 Decree on CEO qualifications

Burkina Faso recognizes the need for professional CEOs and directors at the helms of its SOEs. In 2007, a decree was issued by the Prime Minister specifying how the directors and executives of public enterprises and majority-owned enterprises are to be nominated.[18]

New requirements call for the post of chief executive to be subject to an open tender. The sought after profile for chief executives is to be set by the line ministry in charge of the SOE. The process yields three candidates whose names are submitted to the Council of Ministers for selection and approval.

The 2007 decree represents a significant change in approach, from a process based upon patronage to a selection based upon professional background. There is hope that it will yield more competent chief executives.

But there is also considerable skepticism regarding the ability of the decree to achieve its goals. A number of concerns have been raised regarding the potential for manipulating candidate profiles, and the independence and objectivity of the selection process.

Nevertheless, the decree appears to be a step in the right direction even though the Council of Ministers retains the power to bypass the new process.

The 2007 decree was being implemented at the time of writing. How far it goes to achieve its objectives remains to be seen. Questions remain regarding its implementation, in particular, the independence of the selection process. And, while its aim clearly goes in the right direction, it is uncertain if the newly hired and highly qualified CEOs will be able to solve profound governance issues.

If the performance problems of SOEs were due exclusively or in large part to CEO qualifications, then performance improvements could be expected. If, on the other hand, the governance problems of SOEs are due to a large number of interlinked factors, as this paper suggests, then the change in CEO profile may be insufficient to effect any change.

[18] No. 2007-724/PRES/PM/MEF/MCPEA. French title: *Portant modalités de désignation des membres des organes d'administration et de gestion des Établissements publics et des sociétés à participation majoritaire de l'État*.

Burkina Faso is also the source of one of the more innovative initiatives in the region. Indeed, though still weak, the IEPP (Inspection Entreprises Publiques et Para-publiques) enjoys notably better information systems and oversight than its counterparts in other countries. A General Assembly of SOEs, described below, is being used to better hold SOE management to account and subject SOE performance to public examination.

Burkina Faso: An innovative oversight structure: The combined AGM for all SOEs

The General Assembly of SOEs (*l'Assemblée Générale des Sociétés d'Etat*) [19] is a feature that is unique to Burkina Faso. It is a two-day meeting (typically held in June, six months after the end of the fiscal year) at which all SOEs present their results to the Council of Ministers and the Prime Minister. SOEs are represented by their chairman of the board, the external auditor, directors, and the CEO and his staff including the finance director. Participation in the GA is mandatory for wholly-owned SOEs.

The GA of SOEs is a recent and innovative structure that allows the state to publicly hold SOE executives to account. Problems are exposed, directives are issued and resolutions are taken during the meeting. Board member nominations, directors' fees, the remuneration of auditors, and the accounts are approved. The GA can result in fairly specific recommendations such as, for example, resolutions to pay arrears, decisions to contract insurance,[20] or changes in the place of an SOE's operations.

There has been a history of CEOs not taking the GA too seriously. This has changed in recent years, and meetings have become more effective. Company directors and chairmen are questioned on performance compared to plans and with respect to their adherence to prior year's resolutions. At times there is lively debate. It has occurred that a chairman receives a public dressing down from the Prime Minister and, though unusual, chief executives are replaced for management irregularities.[21]

The GA is one of the only ways to create public accountability for SOEs in Burkina Faso and for that matter in the region. The fact that participation is open to the public makes it a unique tool, and may explain in part its success. The full government typically attends the GA as do trade unions. It is covered by the press and is televised. While sometimes viewed as a formulaic exercise, the GA is broadly viewed as useful because CEOs are no longer able to ignore public scrutiny. The implication is that greater disclosure, public transparency and public shaming can impact SOE behavior.

Mali

Similar to Burkina Faso and Mauritania, SOEs are placed under the oversight of line ministries that are responsible for the sector in which the SOE operates. These line ministries are referred to as "technical oversight" ministries. The ministry responsible for technical oversight periodically notifies the SOEs under its control of their social and financial objectives within the context of the national plan for development (*Plan National de Développent Economique et Sociale*).[22]

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[19] Established under Article 20: Law No. 025/99/AN.
[20] See resolutions of BUMIGEB 2006/2007 in *Rapport du Secrétariat sur la Gestion des Sociétés d'Etat, Exercice 2006. Quinzième Session de l'Assemblée Générale des Sociétés d'Etat, Secrétariat Générale des Sociétés d'Etat*. June 2007.
[21] *Caisse Autonome Retraite Fonctionnaire*, 2007.
[22] Article 37, Ordinance 91 – 014 / P – CTSP, 18/05/1991.

SOES are also subject to financial oversight by the Ministry of Finance.[23] In the Ministry of Finance, the *Direction Générale de L'Administration des Biens de L'Etat* (DGABE) and a number of counselors to the minister collect information on SOEs and advise on decisions. The DGABE collects data from SOEs using unaudited questionnaires. At the time of writing, the DGABE did not have the capacity to analyze the data or otherwise make use of it since its 5-person staff lacked hardware and training. Systematic information sharing does not occur between ministries and, at present, it is not possible to produce a general overview of what assets are under control of the state.

Between the two oversight ministries, the line ministries tend to have closer contact with the SOE and exercise greater influence over its affairs. There is no single co-ordinating body or "ownership entity" that is able to exercise an ownership function that oversees SOEs and take decisions purely from a shareholder perspective, and there is no formal aggregate reporting.

Previously, there had been a central body (Bureau des Entreprises Publiques) under the Ministry of State Assets (Ministère des Domaine de l'Etat). It appears that the role of the bureau was to be actively involved in SOE operations. Both ministry and bureau were dissolved with the establishment of the democracy and as central control and industrial policy fell out of favor. Performance contracts, which were a feature of this period, were abandoned, and oversight functions were transferred to sectoral ministries and the Ministry of Finance.

Mauritania

Mauritania was, at the time of the review, restructuring its SOE oversight. Oversight is provided by the Ministry of Economy and Finance through the newly established *Direction Générale du Patrimoine de l'Etat* (DGPE), or General Directorate for State Patrimony. The *Direction de la Tutelle Financière (DTF*) the Directorate for Financial Oversight is under the DGPE and oversees SOEs and ensures compliance with regulation.

The DTF and the DGPE are trying to improve the state's ability to oversee and manage its extensive assets, principally by strengthening their limited capacity to track financial information. The main challenge the DTF faces is the lack of competent staff, hardware and budgets. Their efforts have focused on establishing institutional capacity and have not, as of yet, resulted in a comprehensive plan to improve SOE governance. Important in Mauritania was the growing commitment to change that was evident at the time of the review. Mauritania's reform initiatives were still in their infancy at the time of writing. With the new Government in place since the last election, there could be momentum for re-launching the reform efforts that were being considered prior to the coup d'état of 2008.

[23] Article 2, Ordinance 91 – 014 / P – CTSP, 18/05/1991.

Democratic Republic of Congo

The DRC has a well-funded government agency (COPIREP) tasked with private sector development and the disengagement of the state from SOEs. Though not an ownership entity as per the OECD Guidelines, improved SOE governance is clearly part of its mandate.

DRC: The case of COPIREP: *An example of government-driven reform*

COPIREP (*Comité de Pilotage de la Réforme des Entreprises du Portefeuille de l'Etat*) is the Steering Committee in Charge of the Reform of State Enterprises in the DRC. It is part of the ministry in charge of the management and reform of SOEs (*Ministère du Portefeuille*).

COPIREP has a broad mandate to encourage private sector development including restructuring, privatization and liquidation. In its role as an advisor to the government, it puts forward enabling legislation.

COPIREP also has an important mission to reform the governance of SOEs which it does principally by assisting line ministries by proposing directors and auditors, and conducting studies to inform the state's SOE strategy. Its specific mission is to:

- Assist line ministries in fixing the objectives of SOEs and evaluating their performance;
- Assist line ministries in the fixing performance criteria and evaluating performance contracts;
- Assist line ministries in follow-up missions to evaluate the management of SOEs and make recommendations;
- Propose board members and auditors;
- Evaluate the ownership position of the state and propose strategies on participations and dividends; and
- Undertake any necessary studies on SOEs.

COPIREP has considerable leeway in proposing reform initiatives. One that was recently completed was the establishment of a telephone hotline to allow whistleblowers to anonymously come forward and report fraudulent activities at SOEs.

As a primary vector for encouraging private sector development, COPIREP enjoys considerable financial support from the World Bank and other donor organizations. Among the countries surveyed, the DRC was the only one that had a website[24] that provided information on the state's portfolio of SOEs, reform projects, decrees and legislation, and extensive annual reporting on its own projects and performance.

The reform initiatives listed above have met with varying levels of success. Each targets one element of the reform of SOE corporate governance. None of them take a systemic approach to governance reform though, arguably, the broad mandate of the COPIREP in DRC could allow it to do so.

Part of the problem with piecemeal reforms is that they do not take into account the systemic nature of SOE governance and the political economy issues. For example, it is unlikely that a

[24] COPIREP website: http://www.ministereduportefeuille.org/entreprise.htm.

board professionalization program should yield any results in the absence of a reform of the way that ministers and ministries control enterprises. This, in turn, may require changes in law and at the very least, government procedures.

VII. Remaining challenges and recommendations

Much progress has been made in enhancing SOE governance in recent years. SOEs that were formally run directly by the government now enjoy greater autonomy with better oversight and more competent boards. However, despite a history of reform initiatives and some real improvements, the countries that were reviewed still face significant challenges. Addressing these challenges promises to be difficult. It is apparent from the studies that SOE reform and the reform of SOE governance practices are strongly resistant to change. Understanding why they resist change is important in developing actionable recommendations.

The principal reason can be summarized as strong vested interests. Changing SOE governance practices means altering people's access to power, prestige and money. Losses in any of these areas will, understandably, be opposed. Furthermore, in some cases, SOEs are used to fund important activities of the state such as the operations of political parties, government travel and investment projects. A long-term solution to the governance problems of SOEs means that viable solutions need to be found to financing legitimate government expenditures.

Another reason is that SOE governance is not merely a question of getting discrete elements of SOE governance (such as board composition, director profiles, board practices, regulation, competition, or board member nominations) right. SOE governance is a complex interaction of politics, economics and the legal framework, in which a large number of institutions and players are involved including government, boards, management, industry regulators, creditors, auditors, investors, the judiciary and more.

SOE governance is, ultimately, not just about a board of directors; it is a system and making it work better requires a systems approach. Most reform plans in the past have focused on one or another element of SOE governance, which might explain why many have fallen short of hopes and expectations. Systems approaches, on the other hand, are important in complex organizations (such as SOEs) whose success depends upon the interaction and co-operation of other organizations and institutions.

As a consequence, corporate governance should be seen as part and parcel of a broader SOE reform program, rather than in isolation, which includes policy reforms aimed at enhancing competition and creating a level playing field. The latter is needed to make SOEs more competitive and commercially-oriented thereby creating incentives and/or forcing SOEs and government to undertake reforms, and helping to maximize and sustain the gains from governance improvements. In turn, improving SOE governance can also make it easier to undertake policy reforms that create a more competitive environment. Doing one without the other is not likely to be effective or sustainable.

The following section summarizes the principal challenges that apply generally to all the countries in which framework reviews were conducted and makes a limited number of high priority recommendations for how to address them.

A. The state as an owner

Each country that was reviewed has units inside their ministries of finance that oversee the financial performance of SOEs. The actual control of SOEs, however, typically resides in line ministries that tend to direct the SOE. Line ministries typically focus first and foremost on policy (not ownership) objectives. Ministries of finance take more of an owner or shareholder view, but have limited authorities and suffer from capacity constraints. Broadly speaking, the countries do not have ownership policies to guide the state in its SOE strategy.

- ***Countries Reviewed do not tend to have consolidated SOE ownership policy statements to guide the government's SOE strategy****:* A country's SOE strategy needs to be guided by a structured ownership policy that defines: (i) the justification and purpose of state ownership; (ii) what institutions represent the interests of the state; (iii) expected outcomes of state ownership; and (iv) the methods by which the outcomes are to be achieved.

  The countries reviewed do not have unified written policies that define the shareholder objectives of the state or guide SOE oversight. General guidance on the goals of state ownership and the missions of SOEs is provided by law, with somewhat more specific guidance contained in legislation, procedures and performance contracts. In some cases, the law simply specifies what enterprises are to remain under state ownership and which do not. Such statements are, however, insufficient for guiding the state on fundamental questions of SOE ownership.

- ***All the countries surveyed separate the government's ownership function from its policy function:*** There tends to be a clear legal separation between the state's ownership function (its role as a shareholder of the SOE) and the state's public policy functions (policy goals that the state implements through SOEs). The state's shareholder function is typically fulfilled by the ministry of finance (and, in the case of a financial SOE, sometimes by a central bank).

  While ministries of finance may fulfill some classic shareholder functions, the control of the SOE tends to be heavily skewed in favor of line ministries. The dominance of policy goals and policy oriented oversight is, in fact, the norm. None of the countries has an "ownership entity" that takes a pure shareholder perspective on SOEs as recommended by best practice.

- ***Finance ministries may fulfill a financial oversight function but they lack capacity:*** Ministries of finance tend to lack the capacity to gather information, analyze information, and act upon it.

  In Mauritania, the *Direction de la Tutelle Financière (DTF*) within the Ministry of Economy and Finance is the "ownership entity" that oversees SOEs. The DTF is in the process of revamping its operations though it lacks the training, hardware and budgets to achieve its goals. At present, it has a relatively generous staff of approximately 20 people. The DTF needs better access to information and also needs to have the ability to analyze a broader spectrum of factors that impact SOE performance. The inability of governments to receive timely and accurate information on all material SOE matters, including financial performance, is a serious concern. This is particularly true in Mauritania.

- ***SOEs are treated as extensions of line ministries:*** Governments are typically deeply involved in SOE affairs and there is clear evidence that their involvement slows decision making, confuses corporate objectives, is subject to political influence, and lacks commercial orientation. Furthermore, there is a tendency for civil servants to bring a bureaucratic mentality to commercial operations and to micro-manage. Government may at times be simultaneously very present in SOEs and entirely absent. In some SOEs government is very involved in day-to-day issues but fails to consider important strategic issues. Alternatively, the government may be entirely absent from the governance of smaller, minority-owned SOEs meaning that a significant amount of state assets entirely escape oversight.

- ***States may be actively involved in the management of the SOE but, their role contrasts starkly from best practice:*** For example, countries do not generally fulfill the obligations of the state as suggested by best practice: 1) *Attending and voting at shareholder meetings:* there is a widespread perception that both boards and shareholder meetings give perfunctory approval to business decisions without consideration of the merits; 2) *Establishing clear and efficient nominations procedures for directors:* In practice the selection of directors can be far from transparent. Political patronage and the award of board positions based on factors other than competence are common; 3) *Having effective reporting systems that monitor performance:* Data gathering is weak as is the analysis of information (though Burkina Faso has comparatively stronger practices). In all countries, the content, reliability and timeliness of information can be improved. One of the major shortfalls of the state is that it pays limited attention to SOEs once they have been majority privatized; *4) Communicating with external auditors and state audit institutions:* Communications between state audit institutions and external auditors occurs, however, the end result does not appear to improve the quality of audits; 5) *Establishing effective incentive compensation in the long-term interest of the company:* Modern incentive compensation systems are not

generally in place. Nor are boards of directors actively involved in remuneration or incentive compensation decisions.

- ***SOE managers are often limited in their ability to make major business decisions:*** Restructuring decisions, adjustments to the capital structure of SOEs, and transactions over a certain monetary level generally require state approval. There are, thus, bright line limits on managerial authority. International best practice standards are principally concerned with providing executives sufficient managerial autonomy. They build on the assumption that systems of checks and balances prevent that autonomy from being abused. However, these same systems of checks and balances do not always exist in developing countries and managerial autonomy often leads to abuse. These local limits appear as a whole to be appropriate; they are imposed in order to prevent corruption, self-dealing and abusive related-party transactions.

- ***The accountability of the state to elected bodies is weak:*** Parliaments generally have the legal power to question governments on a broad range of issues and command the testimony of officials, particularly in a fraud investigation. But, in practice, the state answers only to itself for its performance in overseeing SOEs. There is limited or no public accountability for the oversight of SOEs and their performance.

Key recommendations

- ***Establish an experts group to raise awareness and guide SOE governance reforms:*** Governance reforms require influential and visible leadership. Experts groups can bring together influential and knowledgeable individuals to encourage SOE governance reform. Their task is to examine the needs of the country, develop an SOE governance reform strategy, bring together key players and support individual initiatives. An experts' group should benefit from the highest level political support possible such as that of the Prime Minister and/or President from whom it should receive its mandate. The work of the group should assist the state in developing a written ownership policy for SOEs.

- ***Draft an ownership policy:*** Both the state and the ownership entity need to be guided by clear policies. On the level of the state, the ownership policy should spell out the government's approach to the SOE sector as a whole, including for example: 1) the justification and criteria for state ownership; 2) the role of different reform options including privatization, restructuring, and better corporate governance; 3) the need for operation of SOEs on commercial grounds; 4) 4) what institutions represent the interests of the state; 5) expected outcomes of state ownership; 6) the methods by which the outcomes are to be achieved etc. The policy should define the different roles and responsibilities of the state, the ownership entity, boards, and management. The

ownership policy could be developed by the experts' group possibly in conjunction with an ownership entity.

- ***Develop an ownership entity:*** It is of fundamental importance to separate the policy interests of the state from the ownership function, and to provide sufficient authority to the ownership function. Creating an ownership entity can help achieve this objectives. An ownership entity: 1) collects and analyzes information on SOEs; 2) uses its knowhow to help the state craft better SOE policy; 3) shields SOEs from political interference; 4) demands accountability from boards; 5) encourages the development and application of detailed policies; 6) professionalizes monitoring and oversight; and 7) promotes better decision making (both from a shareholder and a policy perspective). An ownership entity can serve as the locus for an SOE reform effort.

  There are three principal approaches that can be considered for establishing an ownership entity: 1) establish a new ownership entity, possibly within a Ministry of Finance where similar functions already exist; 2) build the capacity of existing ministerial units or divisions so that they can take on new responsibilities; or 3) establish an independent agency. Variants of all three approaches have been used in developed countries. The advantages and disadvantages of the different approaches need to be considered in the local context.

  Whatever route is chosen, the main responsibilities of an OE are to:

  - **Collect and analyze data:** The state and the ownership entity need to insist on their information rights and oblige all companies with a state participation, irrespective of the level of state ownership, to provide annual reports and other relevant information on a timely basis. Data needs to be analyzed in order to generate a better view of individual and aggregate SOE performance, and serve as the basis for informed policy making.

  - **Ensure effective monitoring:** Data collection is insufficient. The ownership entity needs to be able to monitor SOE activities on an ongoing basis to ensure that its shareholder goals are being pursued. In order to do so it needs to have mechanisms in place to ensure accountability. The principal monitoring mechanism for the ownership entity is the board, recommendations for which follow below.

  - **Report on its own performance and of the SOEs that it oversees:** The ownership entity should produce annual reports that show SOE performance on an aggregate and individual basis. The reports should track key performance indicators, with special attention being paid to the cash flow and liquidity aspects of SOE activities. Additionally, performance measures should be established for the ownership entity. Ownership entity performance against

these measures should be reported on an annual basis. Reports should be made public and should also be addressed to parliaments.

B. The legal and regulatory framework

The legal and regulatory framework for SOEs has been increasingly liberalized in all of the countries reviewed allowing for greater competition between the private and public sectors. However, differences in the treatment of private sector companies and SOEs persist. The various ways in which SOEs are protected prevent them from feeling the salutary effects of competition and extending the benefits of competition to consumers. Furthermore, law and regulation suffer from weak implementation.

It bears mention that some countries in the review are part of OHADA,[25] a group of countries that have laws that are agreed at a regional level. Burkina Faso and Mali are members and the DRC is in the process of joining. In countries under OHADA law, both private companies and SOEs are typically subject to OHADA in their commercial relations. OHADA also determines certain governance practices of mixed-ownership enterprises such as, for example, the requirement that companies have nine directors and that board meetings take place twice a year to consider, specifically, the past year's accounts and the upcoming yearly budget.

The benefits of OHADA are economies of scale in developing legislation and the greater ease of regional legal integration. The principal drawback is that changes to OHADA are time consuming, require international consensus and make it difficult to keep OHADA and its local application up to date with best practice. Furthermore, individual countries are not able to adjust elements of their legal framework based on local needs.

An in depth review of OHADA was not undertaken in the context of this study. However, it is clear from the local application of the OHADA framework that OHADA lacks specificity with respect to good governance as well as related accounting and audit practices.

- ***SOEs are subject to the same law as private sector companies:*** In the countries under review SOEs are, in fact, subject to the same general law and regulation as private sector companies, such as competition and labor law, and do not generally benefit from explicit favorable treatment under law. In principle, they operate on a "level playing field" with private sector companies. There are, however, some exceptions. For example, some SOEs enjoy monopoly rights, and insolvency procedures are not applied to SOEs who appear to enjoy the implicit backing of the state. Some SOEs visited in the context of the reviews were technically insolvent, yet no note was taken by boards, and the enterprises continued to operate and produced financial accounts on a going concern basis.

[25] *L'Organisation pour l'Harmonisation en Afrique du Droit des Affaires.*

- ***Implementation is uneven, and considerable gaps exist between law and practice:*** Common to all of the countries is a significant divergence between the legal framework and practice. [26] The laws that are in place in the three countries in which framework analyses were conducted (Burkina Faso, Mali and Mauritania) are arguably sufficient for a reasonable standard of governance. But, the legal texts have, at times, little to do with the actual exercise of governance, which is as much, and possibly more, the result of business culture and traditions. A similar divergence can be observed in DRC and Nigeria even though their frameworks were not examined in detail. From the reformer's perspective, recommendations need to take into account practice and incentives in addition to the legal framework.

- ***Enforcement is lax and the capacity for redress is limited: laws and regulation rely on an effective judiciary for their enforcement.*** In a number of countries reviewed, there is widespread skepticism with respect to the capacity and independence of the judiciary and the courts.[27] Neither is seen as being able to enforce law or regulation, or provide recourse to shareholders or other stakeholders whose rights have been infringed. In practice, the courts are not used to as a tool to pursue violations of law, and legal disputes with SOEs are rare. Alternative channels and informal means for adjudicating conflicts are preferred such as approaching government or influential individuals or, sometimes, more formally through arbitration.

- ***Many of the larger wholly-owned SOEs do not operate in fully competitive markets:*** SOEs are subject to different degrees of market competition. Some sell their products such as cotton or iron ore in competitive international markets. Others face local competition by private sector players as often occurs in the mobile telephone sector where barriers to entry are low. A number of SOEs enjoy natural and/or legal monopolies. These are often in the water, sanitation, electricity and energy related sectors.

- ***SOEs are subject to hard budget constraints to varying degrees:*** SOEs, in particular the largest ones, tend to have access to a broad range of sources of finance. They may borrow from private and public banks, international financial institutions and bilateral lending agencies, and borrowing may be on easy terms, or not at arm's length.

[26]Cheung and Jang describe countries with strong frameworks and weak practices, and also countries with weak frameworks and good practices in East Asia. They conclude as follows: "…there is not a significant correlation between the rules and regulations pertaining to corporate governance… and how corporate governance is actually practiced…." Cheung, S and Jang H. (2006), Scorecard on Corporate Governance in East Asia, Working Paper No. 13, the Centre for International Governance Innovation. There appears to be a much stronger correlation between framework and practice in more developed countries in which law and legal institutions are more established and mature.

[27] The judiciary in Nigeria falls out of the norm with respect to the other countries. While similar concerns exist, the Nigerian judiciary appears to enjoy significantly greater capacity than that of other countries.

Governments may guarantee and/or approve borrowing, and some SOEs may receive direct subsidies or other indirect benefits such as subsidized fuel or electricity.

Even when SOEs receive some form of support, the supports do not generally cover the full costs of operations, and many SOEs find themselves in a situation of chronic cash shortage. Unable to generate sufficient funds from operations, many important SOEs such as electricity and water providers are technically insolvent.

The relations between SOEs and the state are often characterized by gamesmanship, *i.e.* tactical maneuvering. SOEs may use the threat of cessation of services as a way of putting political pressure on the state and negotiating better pricing or financial support. On the other hand, the state may decide not to compensate (or under compensate) SOEs for services because it works on the assumption that SOEs are operating inefficiently or that the state is being manipulated. Information asymmetries, particularly with respect to pricing and the cost of services provided, clearly favor SOEs in such negotiations though, ultimately, the state makes final and sometimes arbitrary decisions.

- ***Regulators are emerging but are not fully operational or independent:*** Regulators are emerging throughout the region. In some industries such as electricity generation and telecommunications, regulators were established at the same time as the privatization of SOEs. New regulatory bodies face challenges both to their independence and their powers. In Burkina Faso, for example, the regulator is hampered by the fact that pricing decisions are made directly between the state and the SOE in the process of fixing SOE performance contracts. In Mali, concerns have been raised regarding the independence of the electricity regulator.

  The creation of regulators in the countries under review has introduced a degree of rigor and transparency into decision making, particularly in Mali. But, generally, it has not achieved the goal of a fully independent mediator between state, the private sector and the public. The provision of basic services such as electricity and water remains a fundamentally political issue that often results in pricing decisions that make the operations of regulated SOEs uneconomical.

Key recommendations

- **Efforts to reform the regulatory framework need to focus on implementation and enforcement of existing legislation:** The legal framework is arguably well ahead of practice and could be considered sufficient for a reasonable standard of governance. Closing the gap between existing legislation and practice would be an important first step in improving SOE governance.

- **Greater efforts need to be made to subject SOEs to competitive pressures and to loosen the financial guarantees that tie SOEs to the state:** Efforts need to be made to enforce financial discipline and ensure that financing of SOEs occurs at arm's length. At the same time, SOEs must be compensated at fair prices for the services that they are required by the government to provide. The financial affairs of SOEs cannot be stabilized unless both occur simultaneously. Any subsidies to SOEs should be arrived at through negotiations with independent regulators and should be contractually set.

- **Regulators need to professionalize according to international best practice standards:** In principle, regulators should be able to act independently of the state and establish prices based upon a set of established regulatory principles. Regulatory institutions should be characterized by the *clarity* of roles and objectives, *autonomy* from political intervention, wide *participation* by (or consultation with) relevant stakeholders, *accountability* to outside agencies, *transparency* of decision making process and the *predictability* of decisions.[28] In developing countries there is often the expectation that the establishment of regulatory agencies will serve as a check on excessive state control and makes politics less important.[29]

C. SOE boards

Boards fulfill few of the functions of best practice boards though differences exist between the boards of wholly-owned and mixed-ownership SOEs. Among the boards considered for the reviews, almost all lacked authority, key competencies and the capacity to arrive at independent judgments. None saw themselves as responsible for guiding SOE strategy or as having the ultimate responsibility for the SOE's performance. The powers usually ascribed to best practice boards tend to reside with line ministries and the state. Case evidence suggests that majority privately owned SOEs have considerably better practices.

- ***Boards focus on examining and approving annual reports and budgets; they are neither responsible for the strategic guidance of the SOE nor its performance:*** Boards in Burkina Faso, Mali and Mauritania are legally able to consider virtually any issue that has an impact on the enterprise. In practice they focus almost exclusively on two issues: 1) the approval of the annual budget; and 2) the approval of the annual financial reports. In none of the three review countries do boards have (or see themselves as having) ultimate responsibility for performance.

  The precise nature of the board's work is usually to check line items to discern gaps between budgeted and actual performance. Little time is devoted to issues such as

[28] Stern and Holder (1999: 43).n

[29] Emergent Regulatory Governance in India: Comparative Case Studies of Electricity Regulation, Paper Presented at a Conference on "Frontiers of Regulation: Assessing Scholarly Debates and Policy Challenges", September 7-8, 2006, University of Bath, UK.

strategy, sales and marketing, research and development, incentives, internal and external audit, information systems, risk management, related party transactions, conflicts of interest and, of course, corporate governance. It would be inaccurate to imply that these issues are not treated at all. Each may come up during board deliberations, though they are not considered in sufficient depth.

- ***Boards are instruments to implement the will of ministers; they do not act autonomously or independently:*** While law seems to bestow significant scope of action and powers on boards, fundamental decisions are taken outside of the board room with the board often providing only *ex post* procedural approval. The ultimate decision making power over SOEs rests with the government and line ministries.

- ***Boards are unable to appoint or remove the chief executive or evaluate management performance*:** One of the primary responsibilities of a best practice board is to evaluate, appoint and remove top management. Boards are unable to do so in the countries that were reviewed. One of the reasons is that chief executives are typically influential, politically connected figures who are nominated by presidents or prime ministers. They cannot be appointed, removed or criticized by directors.

  With respect to monitoring management, boards may be required to report on the performance of top executives.[30] However, interviews suggest that: 1) boards do not perceive their role as providing critical assessments; 2) there are disincentives to criticism; and 3) critique of management is ineffective since business decisions are ultimately taken at a higher level.

- ***The nominations procedure for board members does not yield the needed board member profiles or the correct board composition:*** Political patronage and the award of board positions based on factors other than competence are perceived as serious problems. More often than not, nominations procedures do not yield the board member profile that is best suited for the governance of the SOE.

  In practice, board seats are assigned to ministries with an interest in the SOE, with the line ministry generally playing the lead role in selecting board members. Ministries of finance, who often take a less political and more financial perspective on SOE operations, may be involved in board member nominations; however, ministries of finance tend to play a secondary role to line ministries.

  Laws and procedures are often silent on the precise qualifications needed for board members. Often the written procedures for nominating board members are either imprecise or are not followed, with nominations determined by unwritten rules and traditions. For example, the texts may specify that board members be upstanding and

[30] Mauritania.

competent in overseeing SOEs (as is the case in Burkina Faso). However, this legal obligation is interpreted to mean a competent and upstanding bureaucrat—and not necessarily a competent board member as defined under best practice. At present, the gap between existing board skills and what is needed to govern a modern SOE is large. Specific industry expertise is uncommon and individuals with in-depth financial experience are rare.

Furthermore, independent board members are uncommon. There is little appreciation of the concept and utility of independence. In practice, the sought-after profile of a board member is not an individual who is independent of mind, but rather someone who can faithfully represent the state's views and interests, and report back to the relevant authorities.

- ***Few SOE boards have committees:*** The purpose and function of board committees is not well understood among executives or board members. Nor is there any appreciation of the conflicts of interest that committees are designed to help alleviate (particularly in the areas of audit, executive remuneration, director nominations and related party transactions).
  In most cases committees are not considered necessary given the limited scope of the work of the board. In cases where they have been established, there are indications that they do not fulfill expectations. The cases where successful committees have been introduced are usually audit committees in the context of a mixed-ownership SOE.

- ***Boards do not undergo any self appraisal:*** Other than attendance logs, boards have no mechanism for appraising their own activities and performance. Boards cannot identify a relevant benchmark against which they should measure themselves and have no way of objectively assessing if they are performing well or poorly.

Key recommendations

- ***A comprehensive board professionalization program should be put in place:*** The program should: 1) define the desired composition of boards and director profiles; 2) propose effective and transparent nominations procedures; 3); provide training for a professional corps of directors; 4) define the proper roles of the state versus boards versus management; 5) propose a considered devolution of power to boards; 6) assess the status of existing SOE boards; and 7) develop individual remedial action plans for SOEs.

- ***Board members need to be selected based on qualifications and not patronage:*** Board selection procedures need to be modified to reduce political patronage and the selection of board members or executives based on any factor other than competence. More commercial and technical expertise (particularly in the areas of finance and

accounting) are required of board members. Board members need to be selected on the basis of their ability to arrive at objective judgments that are in the interest of the SOE, and their ability to defend their views in the face of powerful executives. Procedures need to be written and enforced.

- ***Empower boards:*** Boards need to be invested with real authority to decide on the issues for which they are responsible under best practice. However, unless proper checks and balances accompany an increase in their authority, the devolution of powers from ministries to boards can result in their domination by powerful executives. Autonomy should only be granted when effective systems for controlling potential abuse are in place. This is not always the case in the region where political influence is pervasive, and internal and external controls and judicial enforcement are often lax.

- ***Conduct board assessments and develop remedial action plans:*** All SOE boards should undergo a formal assessment of their governance and board practices. This should be followed by the development of a governance improvement plan and an annual evaluation of progress against the plan. One outcome of the governance improvement plan is that SOE boards should adopt formal procedures.

- ***Conduct mandatory training for directors:*** Significant training is required to educate board members on their proper roles. All existing board members should undergo training, which should cover, first and foremost, the role and responsibilities of the board and that of individual board members. Similar training needs to be provided to government officials and executives.

D. Transparency and disclosure

SOEs have low standards of transparency. Though practices have improved significantly, reporting is rarely timely or complete and certain material matters appear to be absent from financial statements. Accounting and auditing standards are either incomplete or applied only in part, and external auditors are often viewed by the public as having their independence compromised. There is little or no reporting on the achievement of non-financial indicators such as performance on social objectives. Even where reporting is legally required and technically available to the public at SOE home offices, access is limited in practice; the internet is underutilized. With regard to reporting by the state, only limited aggregated information on SOEs is compiled. Virtually none of it is publicly available. On the other hand, the potential for better reporting exists; a limited number of mixed-ownership enterprises comply fully with international best practice.

- ***Good aggregate reporting exists in Burkina Faso. In other countries, aggregate reporting efforts have languished due to capacity constraints:*** Aggregate reporting is most developed in Burkina Faso where up to date performance indicators are tracked and made public. Burkina Faso's aggregate reporting also contains a qualitative

discussion of the performance of SOEs and makes recommendations for remedial action. In Mali and Mauritania aggregate reports have not been produced in the recent past. Aggregate information permits Burkina Faso to focus attention on oversight of SOEs as a group, which is not possible in the other countries.

- ***The independence of the external auditor is a concern:*** External auditors should be independent both "in fact" and "in appearance"; the public perception is that they are neither. This can be attributed to a number of factors. The primary interlocutor of the external auditor is generally the CEO, and issues that should be decided by independent board members (such as the selection, remuneration and interaction with the external auditor), are handled by management thus weakening the level of assurance provided by the audit. In many cases, the selection and remuneration of the external auditor of wholly-owned SOEs is performed directly by the state. Boards do not see managing the audit relationship as one of their responsibilities.

- ***Most countries state that they comply with International Standards of Audit (ISA):*** However, this claim needs to be treated with considerable caution and it was beyond the scope of this project to conduct an in-depth review of auditing standards for SOEs though some observations can be made. First, some countries adopt only selected standards or adopt ISA as of a particular date and then no longer update them. Secondly, the institutional and regulatory backing for audit standards is also missing, and compliance is ultimately a matter of discretion on the part of preparers and the external auditor. Only Nigeria has a professional accounting body that is a member of IFAC, the international body of professional accountants' organizations.

- ***Local accounting standards, including OHADA accounting standards, are likely to be materially different from IFRS:*** Many countries report that their national standards comply with IFRS (or IAS[31]). No comparisons of local standards to IFRS are available to substantiate or reject this claim. However, international studies suggest that one should expect significant differences between local standards and IFRS.[32] OHADA standards, which seek to emulate IAS, are out of date since they were fixed in 1998 and were never maintained.

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[31]IAS were produced by the International Accounting Standards Committee (IASC) up to 2001. Afterwards, IFRS were developed and maintained by the IASC's successor, the International Accounting Standards Board (IASB). IFRS integrate the former IAS.

[32]The only authoritative international comparison of IFRS to local GAAP was published in 2001 by the big accounting firms under the aegis of the International Forum for Accountancy Development. The only African country to be included in the comparison was South Africa, and OHADA was not a basis for comparison. Nevertheless, one can extrapolate from the conclusions of the report which found many and major differences from IFRS in a large number of countries. The principal accounting differences found were: 1) the recognition and measurement of financial assets and derivative financial instruments, impairment losses, provisions, employee benefit liabilities, and income taxes; 2) accounting for business combinations; and 3) disclosure of related party transactions and segment information. These differences could be expected to be found in the countries under review.

- ***Mandatory disclosure does not automatically translate into transparency:*** Most SOEs are legally obligated to disclose a variety of information. And, they do so in practice. Most often, they make information available at corporate offices or in the official gazette of the state. These legal obligations do not, however, translate into transparency. The financial information available from SOEs is generally out of date, and the information published in official gazettes is rarely complete. Some gazettes are only available as subscription services and are thus difficult to access for the public. Non-financial disclosure (a necessary complement to financial disclosure) is limited as is social impact reporting. SOEs have numerous public service obligations the costs of which are not generally disclosed, thus making it difficult to evaluate the SOE' s performance on social objectives. Though there are some exceptions, the usage of the internet for disclosure is limited.

- ***Real internal audit functions are not widespread:*** Virtually all SOEs have internal controls. But there appears to be confusion with respect to the difference between internal control and internal audit. In practice, it appears that most SOEs have an internal control function but no internal audit function. In no case did the internal control/audit function have direct access to the board as suggested by best practice.

Key recommendations

- ***The state's accountability needs to be enhanced:*** The state's oversight bodies need to be held more formally to account, including to the public and parliaments. The state and the ownership entity need to report on their own performance in the oversight and management of SOEs (and not just on the performance of individual SOEs).

- ***The state needs to enhance and enforce disclosure requirements and, in particular, ensure better access to information:*** SOE reports must be produced on a more timely basis. Disclosures need to be more complete and include non-financial performance indicators including performance against policy measures. Special efforts need to be devoted to making information easily available to the public at no cost and disclosure of key information on the internet should be mandatory. Better disclosure should encourage the development of civil society institutions, public debate, and better SOE and government scrutiny and accountability. It should also help the public better understand the value of the services they receive.

- ***Review and improve accounting standards:*** Even if IFRS may be too advanced for smaller SOEs, the largest SOEs, those of a particular public policy impact, and those with a significant impact on the state budget should move towards compliance with international standards. Better accounting standards should make SOEs more accountable and encourage better performance. Where SOEs use local accounting standard, these need to be applied in full.

- ***Enhance the external auditor's independence:*** A concerted effort should be undertaken to enhance the external auditor's independence and standing, beginning with creating a more direct reporting relationship to the board. Boards will need to recognize that the veracity of the accounts and safeguarding the auditor's independence are their responsibility. An additional step is to strengthen the audit profession by establishing professional bodies and/or other structures to exercise oversight of the audit profession.

- ***Establish real internal audit functions:*** SOEs need to have an internal audit function. In practice, most SOEs simply have systems of internal control. Boards will need to include oversight of the internal audit function as one of their responsibilities.

VIII. How to initiate a reform process and how donors can help

The countries that participated in this review would benefit greatly from the technical expertise that is available from bilateral and multilateral donors. Donors can play an important role as catalysts to SOE governance reform, since the political will to address SOE performance and governance problems rarely emerges spontaneously. Furthermore, some donor countries have unique technical expertise in overseeing and governing SOEs. This section presents a possible road for initiating the reforms:

9-step process for how to initiate reform[33]

1. Inform opinion leaders
2. Enlist support at the level of the president or prime minister and identify leaders for the reform effort
3. Generate home-grown solutions
4. Create local ownership, and defend reform
5. Train
6. Develop plans and roadmaps
7. Create institutions to carry reform forward
8. Provide direct assistance to SOEs
9. Take advantage of economies of scale through a regional approach

These steps are developed further as follows:

1. **Inform opinion leaders:** It is important for influential opinion leaders in government, SOEs , civil society , and the private sector to fully appreciate the link between SOE governance and SOE performance. Even if stories of dysfunctional SOEs abound throughout the region, few appreciate how closely linked SOE problems are to corporate governance, or how corporate governance can be used as a tool to improve the performance of SOEs. One of the principal

[33]Based on steps recently used in starting SOE reform in Baltic countries. Though the circumstances of the regions are quite different, basic reform steps are similar.

ways of informing influential opinion leaders is to conduct seminars and training on SOE governance and its link to performance. To the extent that a large number of stakeholders can be educated on standards of good governance and the outcomes of both good and bad governance, the easier it will be to get support for reform initiatives and develop tailored solutions.

2. **Enlist support at the level of the president or prime minister and identify leaders for the reform effort:** SOE governance can only succeed if there is a strong political will for change. Political will is important because of the many vested interests, so the higher the level of support for SOE reform, the better. It is only through high level support that the various aspects of SOE performance and governance can be co-ordinated, and the systemic nature of SOE governance be addressed. Leadership must also be identified to push the SOE reform agenda on a technical level. The tasks that need to be completed include, for example, the convening of working groups, commissioning of studies, drafting of plans and policies, etc. Reform process should to be guided by a high level and empowered task force that is answerable to the President and/or Prime Minister and provides reports of its progress to Parliamentarians and the general public.

3. **Generate home-grown solutions:** The individual country studies that were used to inform this synthesis report already give clear indications on the issues and potential solutions. However, the government or another local institution should conduct their own studies with the aim of: being more comprehensive; examining SOE performance/governance dysfunctions in-depth; setting their own agenda; and focusing on generating home grown solutions to problems. The process of encouraging local examination of the issues holds the promise of greater local ownership of the reform process and more adapted solutions.

4. **Create local ownership, and defend reform:** Reforms cannot be conducted from the outside. Local institutions must have ownership of reforms and carry reform programs forward. Ways of creating local ownership and consensus around the issues are to conduct: studies, training,organized discussions; and the local development of an action plan or recommendations. Full consensus on SOE reform is unlikely when power, prestige and money are at risk, and resistance is inevitable. Advocates for reform can include civil society, local communities where SOEs operate, the local media, and business associations. A high level political champion is crucial when resistance arises

5. **Technical training:** Technical training should become a central element of any awareness building and reform project. Training should visibly show the relationship between governance and performance. The outcome of training should be to clearly define the proper roles and responsibilities of the key stakeholders in the governance of the SOE since a poor understanding of these roles and responsibilities is one of the underlying causes of poor governance in all of the countries considered. All practicing government officials involved in the governance of SOEs, board members and high level executives should undergo training. Training should not just be given to mid-level bureaucrats; it needs to be

provided to ministers and political appointments, and could be expanded profitably to include individuals who could hold relevant positions in the future. University training and training for civil society institutions such as journalists also need to be developed.

6. Develop **plans and roadmaps:** A key element of reform is the development of a local action plan or roadmap, or a local code or recommendations on SOE governance. The drafting of a roadmap forces a rigorous consideration of the issues, serves to create awareness, educates a group of influential individuals on the fundaments of good governance, and helps build support for specific remedial actions.

7. **Develop the needed institutions to carry reform forward:** In the short term, awareness can be raised and greater technical knowledge can be transmitted through the establishment of experts groups, working groups or SOE governance reform committees. Small ad hoc groups may be able to act more flexibly and more rapidly in starting a reform initiative than existing institutions. Reform committees or working groups should be composed of respected and influential individuals. They should consider the contents of the country studies conducted by the World Bank as well as their own work in the development of tailored programs for reform. A longer term tool for SOE governance reform is an ownership entity. The utility of an ownership entity is that it can serve as the nexus for a whole series of technical reforms. The establishment of an ownership entity may take some time, but it should also yield longer term benefits.

   The establishment and management of an ownership entity is clearly an area where foreign technical assistance would be invaluable. Many developed countries have experience in establishing and running ownership entities and could easily share their accumulated knowledge. Francophone countries, such as Canada and France, in particular, have many years of experience with SOE governance and management. In addition, they share linguistic, cultural and legal traditions that could make their technical assistance particularly effective.

8. **Provide direct assistance to SOEs:** Starting a program of individual SOE evaluations would be an immediate and practical step to encourage change, and an ideal object for technical assistance. In order to conduct SOE governance evaluations, standard benchmarks or "scorecards" need to be adapted to the local context. After benchmarks are developed, assistance in their application would be required. It may be prudent to undertake an overall analysis of SOE governance (focusing on systems, disclosures and controls) before moving on to an analysis of board practices (which may be more sensitive). Self-evaluations of SOE governance need to be discussed at board meetings with the eventual goal of developing individual SOE improvement plans. A newly established ownership entity could be involved in commenting on plans and ensuring follow-up.
9. **Take advantage of economies of scale through a regional approach:** Assistance to the countries covered in this review could benefit from considerable economies of scale. Much training and technical support can be conducted on a regional level. Of course, regional

approaches have limitations; the more technical reforms get, the more country specific they become. Nevertheless, some of the areas for which regional workshops could be developed would be: 1) the establishment and operation of ownership entities; 2) the roles and responsibilities of government, directors and executives in the governance of the SOE; 3) how to run an SOE self-evaluation –lessons learned, peer reviews and comparisons. An additional valued-added of the regional approach is the potential for exchange of experiences and comparative international analysis. Peer learning and pressure have proven to be powerful motives for reforms and there's much to be learned through these exchanges. Regional meetings and training would also be an efficient way to encourage reform projects and would also help donors to efficiently identify the specific needs of individual countries.

The list above presents an approach to launching governance reforms. Obviously, there are different entry points to start SOE reforms and not everything needs or can happen at once. Indeed, in some countries, it may make more sense to start with SOE or sector specific reforms through direct assistance to SOEs. In others, a review of the legal framework may be the best starting point. In yet a third instance, it could be that training and awareness raising needs to be emphasized prior to any specific reforms being implemented. The one underlying principle though is that there has to be the desire and commitment to pursue the governance agenda. Indeed, it is important to keep in mind that corporate governance is not just about the "hardware" of systems, processes, procedures, and structures. It is also about the "software" of people's interactions with each other , their moral judgments, professional ethics, and personal accountability.

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