Experiences on Institutional Aspects of SOE Supervision in Latin America

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1. Regional Overview on Institutional Aspects of SOE Supervision
Ownership Function and Institutional Framework - (usually common features from LAC SOEs)

Ownership function

- In most cases decentralized, with sector ministries in charge of overseeing portfolio of SOEs within the sector; Ministry of Finance or Planning leading ownership function role; Regulatory Agencies

- Trend towards centralization in some countries… but dual model subsists
  - Centralized function through public holding company: Peru - FONAFE (1999)
  - Efforts towards centralization: Chile (2001), Brazil (2005), Paraguay (2008)

Corporate Structure

- Many SOEs under private sector law, with limited responsibility
- Mixed in terms of Public versus Private law for employment purposes
- 100% Public; Mixed Capital Corporation; Listed in intl and local markets
Corporate Governance - Boards (usually common features from LAC SOEs)

Boards:

- **Members**: Most of them composed by political appointees (Ministers, representatives from ministries) - Independent directors and executive members not a common practice yet, except for some listed SOEs (CODELCO, Chile; ECOPETROL, Colombia, etc.)

- One third of SOEs in LAC have specific technical profiles for board members (CAF, 2012). 2/3 don’t

- Remuneration for board members not comparable to private sector, some even *ad honorem*

- Very limited use of self-assessment or coaching of board members
Corporate Governance - Management
(usually common features from LAC SOEs)

Management

• Many countries have introduced merit-based recruitment policies for selection of CEO and high-level staff…

  …but discretionary and political appointments continue to be a common practice and SOEs tend to be a large source for patronage

• Remuneration for management and staff is competitive versus private sector, even for those SOEs whose employees are legally public servants…

  … but issues of pay inequality with larger public administration
Transparency and Accountability  
(usually common features from LAC SOEs)

- **Transparency and disclosure improved** through making info available on SOE websites, in particular for listed SOEs

- **External audits** of financial statements by private firms increasing in number and publication of results on the rise too

- **Public employment** in SOEs still not that transparent

- **Social, operational and economic objectives** of SOEs not always clear

- **Effective participation** from public institutions other than the executive branch – Congress, Judiciary, Comptroller General’s Office – common in some countries (Peru, Brazil, Chile)

- **Performance contracts** for enhanced accountability mixed results - discontinued in different countries (Brazil, Peru), on the rise in others (Paraguay)
2. Country Cases
Brazil - Federal Government

Overview

- **Portfolio**: 147 Federal SOEs despite privatization in 1990s
- **Size**: SOEs Budget = 30% of GDP; Employees: 0.5 million; SOEs Revenues = 3% of GDP (9% of Govt Revenues)
- **SOEs in Competitive and Non Competitive Markets**
- **Sectors**: Oil and Gas; Electricity; Finance; Services

Ownership Function and Institutional Framework

Dual oversight Model……with Trend Towards Centralization

- **Min. of Planning**: Dept SOE Coordination and Governance (DEST)
- **Min. of Finance**: Budget Approval; tariff setting
- **Sector Ministries**: planning and technical aspects
- **Congress**: Investment budget approval
- **SOE Governance Committee (2005)**: Finance, Planning, Presidency. Technical Secretariat: DEST.
Corporate Governance

- **Board of Directors**: composed by representatives from Finance, Planning and Sector Ministries. Since 2010 also 1 Staff representative. Period is unrelated to Government’s term.
- **No independent directors**. Technical experts can participate as *advisors*.
- **Management**: Directors chosen discretionary, suggested by Sector Ministry, approved by Casa Civil. Stability.

Accountability and Transparency

- Performance contracts not successful, discontinued
- Internal and external audits disclosed and sent to Congress

Challenges

- Separation of functions as owner and regulator
- Discretionary appointments of board members and CEOs; Independent Directors; transparency of remunerations
Peru – National Government

Overview

• **Portfolio:** 34 SOEs + 18 SOEs with minority participation
• **Size:** SOEs Budget 4% of GDP; 64,000 staff approx (2011) US$ 1.3 bn to govt revenues (2011)
• **SOEs in Competitive and Non Competitive Markets**
  **Sectors:** Energy Distribution, Water and Sanitation, Electricity generation, finance, infrastructure, communications

Ownership Function and Institutional Framework

Centralized Ownership Model through Public Holding Company

• **FONAFE (1999),** responds to Ministry of Finance
  – **FONAFE Board:** with participation of Ministers of Finance (Presides); Minister of Council of Ministers; Minister of Energy and Mining; Minister of Transport; and Minister of Housing, Construction and Sanitation
  – **FONAFE Management:** Executive Director appointed by Minister of Finance
  – Mandate includes: SOE regulation; ownership rights, budget process, corporate governance, appointment of board members and CEOs
Corporate Governance

• **SOE Boards**: members appointed by FONAFE’s board, proposed by Ministry of Finance and Sector Ministry, since 2010 at least 1 must be selected through Head Hunter or SERVIR
• **CEOs**: selection process through private sector head hunter, SERVIR (Civil Service Agency) or politically, minimum qualifications required. Appointed by FONAFE’s board (2010)
  • Appointments with no time limit but usually end with the govt mandate; FONAFE can dismiss at any time
  • [Good Corporate Governance Framework for SOEs](#) (2006)

Accountability and Transparency

• SOEs ➔ accountable to FONAFE and to lesser extent to sector ministries
• CEOs ➔ accountable to SOE board and to FONAFE
Accountability and Transparency

- Performance contracts introduced in 1999 but discontinued in 2006 (linked to variable pay)

- Oversight by Institutions outside the Executive
  - FONAFE reports to Congress on each SOE on an annual basis;
  - External audit carried out annually by private firm, process led by General Comptroller’s Office

- Code of Ethics and other Transparency Guidelines issued by FONAFE during 2006-2009 enhanced transparency mechanisms

Challenges

- Incorporate Independent Directors
- Market-based control through incorporating private capital
- Enhancing internal controls
- Framework for evaluation of Board members
Overview

- **Portfolio:** 37 national SOEs, Commercial; Public Utilities; Mixed Capital
- **Size:** 9% of GDP, 4% of govt revenues (2010)
- **Competitive and non Competitive markets.**
  - **Sectors:** Oil (ECOPETROL), Finance, Electricity, Transportation

Ownership Function and Institutional Framework

- **Decentralized setting, complex institutional framework**
  - Sector ministry: guides activities
  - National Planning Department: investments, finance, performance
  - Ministry of Finance: Ownership function - majority stakeholder
  - Regulatory commissions per service: tariffs, other (Public Utilities)
  - Superintendence of Public Utilities: compliance with regulatory commissions rules

- **Legal framework per SOE can vary substantially**
Corporate Governance

- No general rules for appointing board members or CEOs
  - Board Members - based on law creating each SOE, usually highly specialized
  - CEOs: President of the Republic appoints and dismisses
- Listed SOEs or those which issue debt in capital markets stricter rules (Law 964/2005 – follows OECD corporate governance guidance), crucial for accessing international and national capital markets
- Relatively broad use of Independent Directors at major SOEs

Accountability and Transparency

- MCC and incorporation of private shareholders improved transparency and performance.
- Specific code of ethics at the enterprise level

Challenges:

- Decentralized ownership structure, complex institutional framework
- Different reporting standards and rules per SOE
Paraguay

Overview
- **Portfolio**: 9 national SOEs, mostly monopolies, 100% public sector
- **Size**: 9% of GDP
- **Sectors**: Water, Electricity (generation and distribution), Oil, Transport, Telecommunications

Ownership Function and Institutional Framework
- **In transition**: from decentralized to centralized model (2008)
  - Creation of Council for SOEs (CEP). Multi-Ministry body, presided by the Minister of Finance, participation of line ministries
  - Creation of SOE Monitoring Unit within Ministry of Finance, Technical Support to CEP, professional cadre

Corporate Governance
- **Limited use of Boards.** Past experience led to politicization. CEOs appointed by President
Paraguay

Accountability and Transparency

• SOE Monitoring Unit established performance contracts with most SOEs, Balance Scorecard, Management Indicators
• External audits carried out and published for all firms for first time in 2010
• Broad use of public employment in SOEs for political purposes, including leadership positions

Challenges

• Consolidation of CEP and UMEP through legal framework (currently Decrees, Draft Law in Congress)
• Overcome resistance to centralized model of ownership structure
• Introduction of good Corporate Governance framework through establishment of Boards and professionalization of management
Institutional Aspects of SOE Supervision Challenges for LAC

Ownership Function
• Effective separation between State functions as owner and regulator, in particular for SOEs listed in capital markets;
• Formalization of centralized ownership function (Chile, Paraguay);
• Effective organizational approach to reach a good balance between autonomy and control

Corporate Governance
• Technical Boards, independent from the owner
• Participation of Independent Directors
• Defined selection criteria and minimum requirements to be appointed;
• Reduction of purely political appointments

Accountability and Transparency:
• Effective communication with shareholders; transparency of remuneration policies for board members and staff; preserve independence of external auditors
3. Examples - IDB projects supporting institutional aspects of SOEs
Supporting Institutional Aspects of SOEs

• **SOE level.** Loans and technical cooperation to strengthen institutional capacity within the enterprise; regulatory or governance framework within a sector:
  – Electricity
  – Water
  – Finance
  – Services
  – Telecommunications

• **Country level.** Technical cooperation aimed at:
  – Transparency and accountability in a particular sector involving SOEs
  – Addressing internal controls and fiscal risk

• **Demand** for addressing systemic coordination and management issues between the central government and decentralized entities, including SOEs
4. Institutional Aspects of SOE Supervision: Learning from Korea’s Experience
Learning from Korea’s Experience

- **Ownership structure – Supervision**
  - What are the lessons learned from Korea to reach a good balance between autonomy and control?
  - What are the lessons learned of introducing CPIM within MOSF for SOEs?
  - What mechanisms can be used to ensure that SOEs are acting in the best interest of their shareholders? (i.e. the citizens)

- **Corporate Governance**
  - How to reduce political influence and enhance board credibility?
  - Experiences with board and CEO evaluation and remuneration?

- **Accountability and Transparency**
  - What are the most effective mechanisms to ensure an SOE is accountable to its shareholders for the economic and social results it generates?
  - What incentives can be provided to ensure external audits are published?
  - How to involve the National Assembly and other actors to enhance accountability without politicizing SOE management?
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