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«МЕЃУНАРОДЕН ДИЈАЛОГ: ИСТОК - ЗАПАД»
(ЕКОНОМИЈА, БЕЗБЕДНОСНО ИНЖЕНЕРСТВО, ИНФОРМАТИКА)

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ИСТОК - ЗАПАД

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ИНФОРМАТИКА

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CORPORATE GOVERNANCE IN STATE-OWNED ENTERPRISES

ABSTRACT: The purpose of this paper is to examine the corporate governance in state-owned enerprices. State-owned enterprises (SOE) are still major players in economic development globally and have large investment accounts. Globally, according to the World Bank (2014): "State Owned Enterprises account for 20% of investment, 5% of employment and up to 40% of output in some countries." As the World Bank (2014) paper further discussed: State Owned Enterprises are not focusing on critical service sectors like utilities, finance, and natural resources only, but also competitive industries like large scale manufacturing and service sectors. The ownership of these enterprises by the state is in the interest of the general public as it is stipulated in OECD guideline OECD (2015). OECD guidelines on corporate governance of state-owned enterprise emphasize that: "Improved efficiency and better transparency in the state-owned sector will result in considerable economic gains, especially in countries where state ownership is important. In addition, creating a level playing field for private and state-owned enterprises will encourage a sound and competitive business sector."

KEYWORDS: corporate governance, public sector, state-owned enterprises, state ownership, transparency

INTRODUCTION

There has been limited literature on public sector corporate governance. Not only does the term corporate governance need to be clearly defined and understood, but a governance model should be developed for the public sector which has a consistency of approach across the public sector (NSW Audit Office 1997a, p7). Indeed, as Hodges et al (1996) observed, the challenge to the public sector as a whole is to devise systems of governance that can both provide assurance to stakeholders that the sector is in capable and honest hands, while at the same time, avoiding the negative effects of tight control and bureaucracy, to enable performance objectives to be achieved and improved.

The public sector and the private sector are two different entities with different responsibilities. Regarding corporate governance, despite this difference, there are corporate governance principles applicable to both entities: accountability, transparency, a focus on performance, commitment, and integrity. Some of the best guidelines on public sector corporate governance are developed in the UK based on The Cadbury Report. The most important thing in the public sector corporate governance is the performance aspect and conformance aspect. According to the findings of Ryan and Ng (2000), there has been increasing worldwide attention to corporate governance in the public sector. Mulyadi, Anwar, and Ikbal (2012) found control in public entities was secured by political interventions, often at the behest of trade unions and for the party political rather than commercial ends. Detailed systems of accounting for control and accountability were maintained but became marginal ritualistic and decoupled from operations.

Given the particular characteristics of state ownership, corporate governance of state-owned enterprises is an exceptional challenge in many economies. In many economies, state-owned enterprises still have a high share in GDP creation, in total employment, and market capitalization. In addition, state-owned enterprises are most present in the utility and infrastructure activities of industry, such as energy, transport, and telecommunications, whose activities are of great importance for the broadest segments of the population as well as for other activities (OECD, 2018). Therefore, quality corporate governance in state-owned enterprises is of utmost importance to enable their positive contribution to the competitiveness of an entire country's economy. On the other hand, viewed through the prism of privatization, quality corporate governance of state-owned enterprises is an essential prerequisite for effective privatization because it will increase their value, and companies will be more attractive to potential buyers (OECD, 2015).

CONTROVERSIES OF STATE-OWNED ENTERPRISES

The rationale behind state-owned enterprise as discussed in OECD (2018): it is commonly agreed and seen as good practice that the government should use its own policy to clarify and prioritize the reasons why the state should own any given enterprise. There are five reseons why the state should own any given enterprises (OECD, 2018):

1. supporting national economic and strategic interests;
2. ensuring continued national ownership of enterprises;
3. supplying specific public goods or services (after deeming the market cannot supply the same goods or services);
4. performing business operations in a "natural" monopoly situation; and
5. creating or maintaining a state-owned monopoly (or oligopoly)

Among the five reasons as OECD (2018) listed, the two most common in several countries are supporting national economic and strategic interests; and supplying specific public goods or services (after deeming the market cannot supply the same goods or services). In many countries as stated by the World Bank (2014): "State-owned enterprises in strategic industries are increasingly viewed as tools for accelerated development and global expansion."

However, in the contrary, there are fundamental problems in the governance that hinders the state-owned enterprises not to deliver the intended purpose. Some of these challenges is how to create a clear separation, as the World Bank (2014) said: in the underlying rules, processes, and institutions that divergence of political interests between ownership (by the government on behalf of the citizens of the country) and control (by the directors and managers that run the company). These governance problems manifested in a different form as further elaborated by the World Bank (2014): including "the absence of clearly identifiable owners, politicized board and management, lack of autonomy in day-to-day operational decision making, weak financial reporting and disclosure practice, and insufficient performance monitoring and accountability system."

The challenges listed above are real problems in state-owned enterprises, in most of the developing countries. In a country where democratization process is at stake and government accountability to its people is not matured, state-owned enterprises are a "milking-cow" to a few elites. In this situation state-owned enterprises highly monopolize the market and give little room for private enterprises to grow and become competitive in the marketplace. They always get the greater share of the market and use political platform and civil institutions to maximize control over the market. Corruption and nepotism are the prime manifestation of such enterprises. They cover up such ill systems by labeling it as a "developmental state" operation.

PROPER CORPORATE GOVERNANCE FOR STATE-OWNED ENTERPRISES

As it explained by OECD (2015) guideline: "The boards of State-Owned Enterprises should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions." Proper Corporate Governance requires a set-up of proper structure, policies, and processes to operate in a transparent way to benefit and support national economic and strategic interests of citizens through an effective and efficient operation. As the World Bank (2014) indicated: Good Corporate Governance system in a country is associated with a benefit for all whether private or state owned.

The state-owned governing body has five principal fiduciary duties when they are taking responsibility to manage public property. First, a duty of managing the enterprise based on rules and regulations and not favoritism. Second, a duty of loyalty and working to the best interest of the public. Third, duty of transparency, easy for others to see what is going on. Fourth, duty of belongingness and ownership, these cultivates a strong sense of connectedness. Finally, fifth, duty of professionalism, obey the law and put people first before personal interest.

PRIVATIZATION OF STATE-OWNED ENTERPRISES AND CORPORATE GOVERNANCE – THE CASE OF MACEDONIA

Each country has its history, culture, and legal and regulatory framework, which affect country-specific corporate governance models. Regarding the Macedonian corporate sector, its main characteristics may be summarized as follows:

- Gradual concentration of ownership. The majority of Macedonian socially-owned enterprises were privatized in the nineties, by models that favored employee ownership of companies. That resulted in a rather dispersed ownership structure of companies. The assessments refer to more than 300,000 individuals that have become shareholders through the privatization process (Apostolov, 2011). During the post-privatization stage, an ownership concentration process has got underway, leading to a decrease in the number of shareholders from over 255,000 in 2004 to 105,000 in August 2007 (Apostolov, 2011). In some instances, the ownership concentration was occurring under the pressure of companies' governing structures, given the weaknesses in the legal framework relating to minority shareholders' protection. In that respect, part of the 1996 Company Law provisions was actually in favor of companies' governing structures. In other cases, the concentration was a result of voluntary decisions of shareholders to sell their shares on the Macedonian Stock Exchange and make earnings in that way. The insider domination in terms of ownership, and the low level of investor protection during a lengthy period, were the possibly major impediments to developing the country's securities market. Even today, the number of companies listed on the Macedonian Stock Exchange is relatively small. Nevertheless, the legislation that regulates the areas of companies and securities and the presence of the Central Securities Depository – the state authority for securities registration have all led to the entirely new quality in this field.

- Twofold role of both company shareholder and company employee. As large numbers of companies' employees are at the same time companies' shareholders, it is common for these individuals to be incognizant of the rights and duties that derive from each of their two opposite roles. Below are several examples (Mihajlova Tikvarovska, Latif, Semenkova, & Lazarevski, 2007):

» Many of the employees that are at the same time company's shareholders believe that owning a certain number of the company's shares makes them absolute and unequivocal owners of the company, and as such resistant to layoffs on any grounds.

» It may occur that these individuals, when unsatisfied with the company's affairs, act merely in the capacity of employees and organize strikes or protests, without seeing that company's operations are as much their responsibility and that the general meeting of shareholders is the means through which they can initiate procedures for changes in company's governing bodies and policies.

» Occasionally, the concurrent positions of both a shareholder and an employee of the same company result in conflicting situations for such individuals. In contrast, the role of an employee presses for job protection, the position of a shareholder urges to cutting costs, downsizing, and increasing share value. Conflicts, as such, preclude effective decision-making in the company.

» Lack of separation of the company's ownership from the company's control. Despite the possibility of separation of the company's ownership from its control, as provided for by law14, the practice is showing something completely opposite. Majority vote shareholders most often hold companies' top positions (either the role of chief executive officer, or management board chairman, or both concurrently). They have a tremendous influence on the company's day-to-day operations. These companies suffer from a lack of control and oversight systems, as well as systems for regular and accurate information disclosure, needed by both existing shareholders and potential investors.

» Inadequate oversight of management's work. Very often, members of companies' supervisory boards are insufficiently competent or inexperienced individuals, close to the controlling shareholders or to the management, or individuals that are under the direct control of persons who are supposed to be controlled by them. That results in improper oversight of companies' top decision-making structures.

» Slow development of the auditing profession in the country. Although there has been progressing in the self-organization of auditors at the Institute of Certified Auditors of North Macedonia, it was granted an associate member of the International Federation of Accountants (IFAC) only in 2011. According to the Progress Reports of the Republic of Macedonia from the European Commission, the chapter on commercial law, which includes the issue of corporate accounting and auditing, is constantly pointed out as areas in which greater achievements are needed. The 2011 Report on the

Institute states that there is still insufficient administrative capacity, that international qualifications for auditors are not yet recognized (Mihajlovska et al., 2007). The provisions in the Law on Audit regarding the Audit Promotion and Supervision Council allow it to be established as an independent regulatory body, but this process is still ongoing.

PUBLIC SECTOR CORPORATE GOVERNANCE EXPECTATION

The public sector organizational governance system is geared towards welfare maximization, considering community interests, involving trade-offs and often deliberately vague to satisfy different stakeholders. Other performance indicators used, economic efficiency is often at cost of technical efficiency. Effectiveness often more important, community costs, including externalities, deadweight losses, dependent on policy – from free provision through to prohibitive Allocation often on welfare grounds.

The OECD Principles require that the corporate governance framework ensures the strategic guidance of the company by the board and its accountability to the company and its shareholders. The most common and recommended board format is the one-tier board system, which is favored in twice the number of jurisdictions that apply two-tier boards (supervisory and management boards). A growing number of jurisdictions allow both a one-tier board system. Independent directors have also become critical in the board of directors. The efficient board of directors requires a majority of directors to be non-executive of significant shareholders to be classified as independent (OECD, 2019).

RECOMMENDATIONS FOR GOOD CORPORATE GOVERNANCE IN STATE-OWNED ENTERPRISES

The basic principles for ensuring effective and good corporate governance in state-owned enterprises would be:

» Ensure an effective legal and regulatory framework for state-owned enterprises. The legal and regulatory framework for state-owned enterprises should ensure fair competition on markets where state-owned and privately-owned enterprises compete to avoid market anomalies. A clear division of responsibilities between bodies, simplification of legal norms, and a clear and consistent regulatory framework will facilitate the improvement of state-owned corporate governance (Daiser, Ysa, & Schmitt, 2017).

» The state as a responsible owner. The state should act as an informed and active owner and establish clear and consistent ownership policies, ensuring that state property management is conducted in a transparent and accountable manner with the necessary degree of professionalism and efficiency. In order to perform its ownership function, the state should rely on the best corporate governance standards applied in the private sector.

» Fair treatment of all shareholders. The state and state-owned enterprises should recognize the rights of all shareholders and ensure their fair treatment and equal access to business information. It is in the interest of the state itself as the owner that all minority shareholders in all state-owned companies have equal and appropriate treatment, as this will affect the ability to attract external sources of funding as well as the assessment of the value of the company itself. It should, therefore, be ensured that other shareholders do not perceive the state as a non-transparent, unpredictable, and unfair owner. On the contrary, the state should set itself up as an exemplary majority owner and follow best practices regarding the conduct of minority shareholders.

- Stakeholder relations. State ownership policy should fully respect the state's own responsibility as the majority owner to all interested stakeholders. State-owned enterprises need to recognize the importance of certain stakeholders in building a sustainable and financially healthy enterprise.
- Transparency. State-owned enterprises need to adhere to high standards of transparency. The government should develop a consistent and comprehensive report on state-owned enterprises and publish an annual report on the total portfolio of state-owned enterprises. All state-owned enterprises, especially large ones, should be subject to independent external audit, which is based on international standards. All state-owned enterprises should apply the same level of accounting and auditing standards as listed companies. Large and state-owned listed companies should disclose both financial and non-financial information according to highly recognized international standards (Grossi, Papenfuß, & Tremblay, 2015). State-owned enterprises should publish information on all issues, with a particular focus on areas important to the state as the owner as well as to the general public.
- Responsibilities of the supervisory board and management of state-owned enterprises. Supervisory boards and management boards of state-owned enterprises must have the necessary powers and competencies, and objectively perform the function of strategic and operational management of the enterprise. They should act with integrity and be accountable for their actions.

CONCLUSION

One of the key pillars of economic development and a clear indication of a healthy economy is corporate governance. Public sector governance has not received a significant degree of attention. Certain states have taken active steps towards the same, while others still lag behind, despite economic prosperity. This is perhaps a result of the lack of strategy and clear definition of expectations of the public sector and public service at large. Driving a shift in the mindset, a focus on the quality of services needs to be the target, laying the foundation on an overall strategy focusing on integrity, and transparency, as well as efficient and effective use of resources through: proper definition of strategy and purpose, including clear citizen and service users' quality of service measures, and defined key performance indicators; clear organizational structures, reporting lines and processes, defining clear roles and responsibilities, as well as governance oversight bodies, such as audit and risk committees; talent management, as the public sector should be regarded as a good attraction and development of talent; promotion of ethical conduct by establishing codes of conduct; clear definition of accountability for public wealth policies, transparent internal and external reporting, and use of appropriate accounting policies and standards, as well as clear performance measures; focusing on the Lines of Defense (internal audit, risk management, control and compliance); ensuring compliance with applicable laws, regulations and internal mandates; stronger internal controls; and, enhanced risk management (including business continuity and information security). The relationship between internal auditors, external auditors and the State Audit Bureau/ Regulators should also be integrated as applicable. Proper governance frameworks strengthen accountability mechanisms and open channels of communication within and across the various market players. Accordingly, the public sector can be more confident about delivering defined outcomes and being accountable for the way in which results are achieved. Good governance also leads to good management, good stewardship of public wealth, good public engagement and, ultimately, better outcomes for citizens and service users. All organizations should aim to meet the highest governance standards; as such, governance arrangements should not only be sound but also be seen to be sound.

Recommendations or requirements for the separation of the board chair and CEO have doubled in the last four years to 70%. Nearly all jurisdictions require an independent audit committee. Due to the expectations of the public sector board of directors, there are challenges the board face in the execution of their duty especially when it comes to controls in corporate governance systems in the state-owned enterprises. The public service is designed to look at welfare maximization and considering community interests rather than profit maximization. There is the need therefore to engage in thorough consultation in the selection and nomination of board members by the president and other institutions liable to do so. In the selection and nomination of board members, there is the need to consider the organizational core business and align board members to such mandate. There is the need for such an organization in this case the public sector organization to also consider some fundamental challenges in the organization to nominate board members which are equipped with such knowledge and experience to bring a solution to such challenges.

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