

# State Owned Enterprises and Corporate Governance in the Andes

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# Outline of the Presentation

- Main features of the Corporate Governance frameworks in the Andean region
- CAF Initiative on Corporate Governance and SOEs
- Specific Case Interventions in the Andes
- Lessons Learned

# Main Features of CG in the Andes

Often utilities are constituted by a specific law making the legal framework heterogenous

## SOEs Legal Status

No distinction is made (with the exception of Colombia) between ownership and regulatory agencies

## Bailout

Bailouts are common creating weak incentives for SOEs although in some countries rules are more strict (Colombia and Perú)



## Separation of Functions

Often State-owned enterprises have advantages over private-owned companies, such as easier and special access to finance.

## Equal Footing With Private Sector

# Main Features of CG in the Andes

Ownership Policy is limited.  
Few countries such as Colombia and Peru have written policies

## Ownership Policy

Only one country in the Andean Region (Perú) has created a Unified Ownership Entity

## Board Nomination

Regulations often indicate who appoints the board, but rarely how the nomination process for board appointments should be conducted



## Ownership Entity

General Assemblies sometimes do not exist (for legal reasons) and they are commonly managed informally

## Shareholder Assembly

# Main Features of CG in the Andes

In most countries special or local accounting standards for SOEs are in place. Often they don't respond to IFRS standards

## Accounting Standards

Only those SOEs that are governed by commercial and private law, are required to hold external audits

## Consolidated Reporting

Most States have a website where they disclose information about SOEs. None of them have consolidated reporting

## Internal Audit

Public Control Laws are in place in all countries, that shape required procedures for Internal auditing

## External Audit



# Main Features of CG in the Andes

Only few SOEs have issued a declaration protecting minorities' rights.  
Problems often arise when the nation and the cities coexist in one SOE

## Transparency

Risk Committees exist mainly in Financial Institutions.  
Audit committee are created in some SOEs.  
No N&R Committees are in place



## Minority Rights

Processes of consultation with stakeholders are informal but Citizen's participation laws are common

## Stakeholders

Most countries have laws related to accountability and transparency and disclosure

## Board Committies

# Main Features of CG in the Andes

Management can be and usually is subject to political influence

## Professional Management

Public officials or management are dominant in boards, except when private capital exists.

## Strategic Oversight

Rarely In SOEs the board has a strategic and monitoring function.

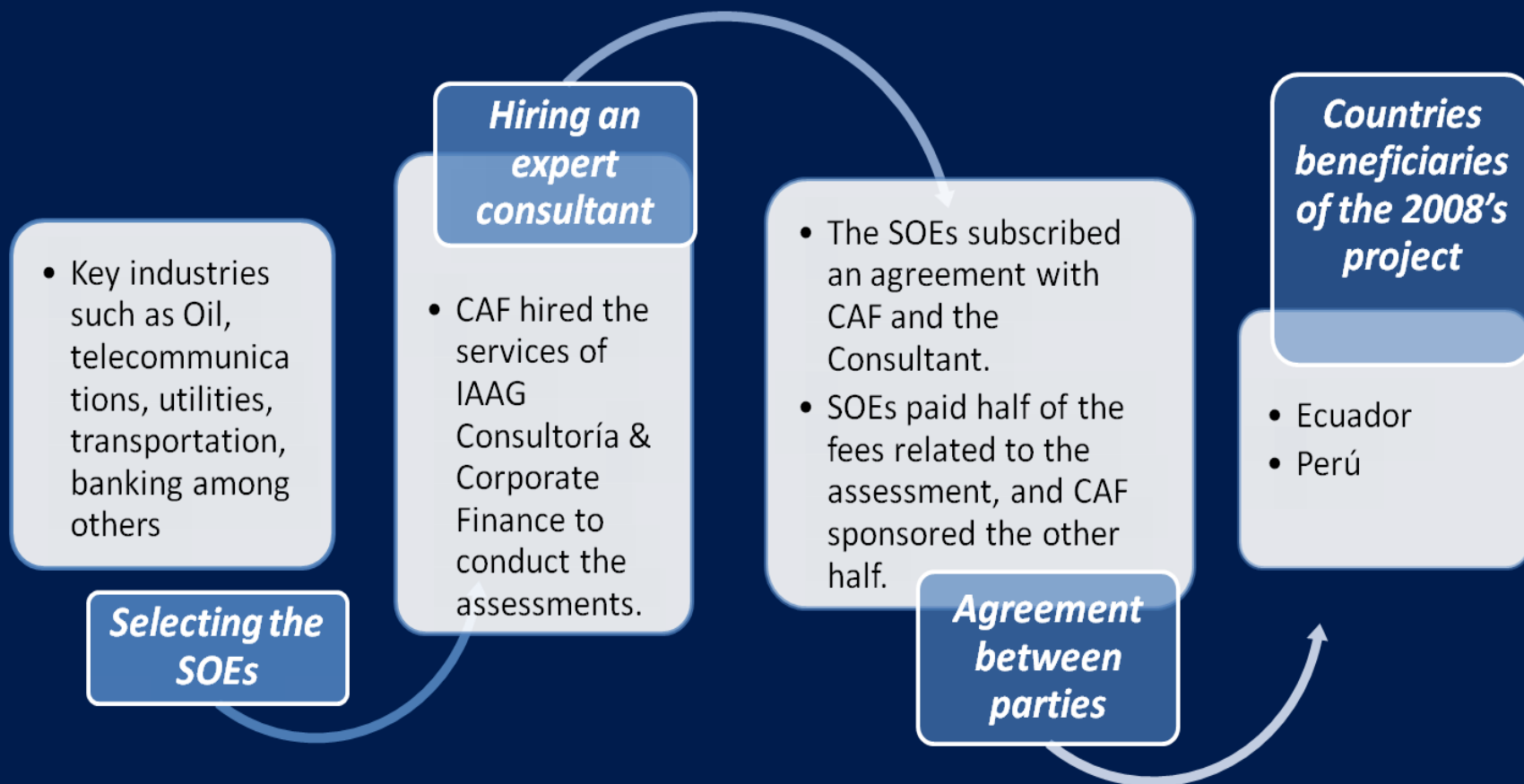
## Annual Assessment

No board evaluations are mandatory by law nor are conducted by the SOEs.

## Independent Directors



# CAF's SOEs Initiative



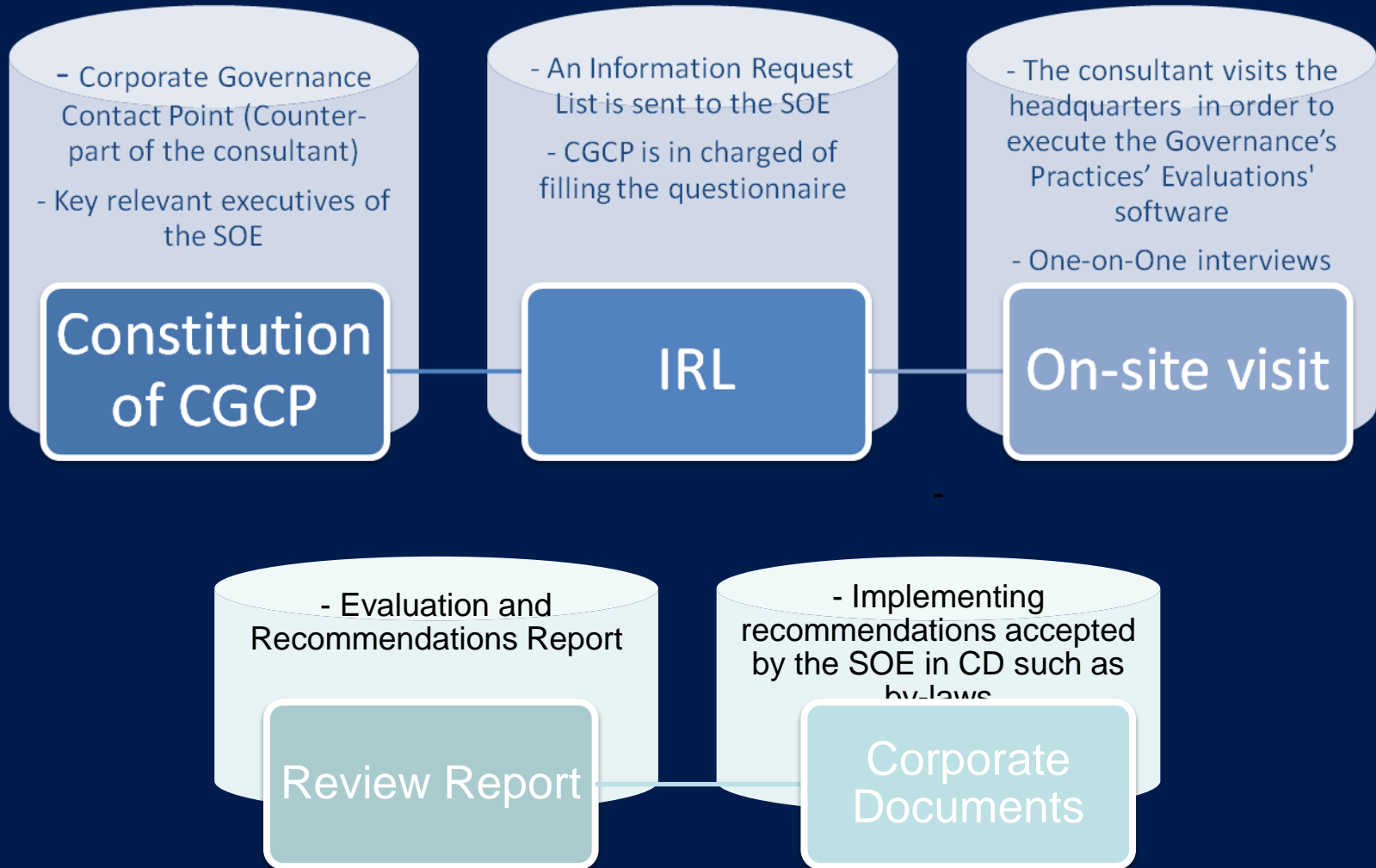
Colombian SOEs participated in the initiative under different conditions and no Venezuelan SOEs showed initial interest



# Cases Selected for Intervention



# The “Stepping In” Process



# The Case of EMCALI in Colombia

## Background

**2000**

- This utility was intervened by the Superintendency by initiating an insolvency procedure
- A special counsel of creditors was established.

## Agreement

**1st Q2008**

- CAF hired IAAG to undertake a corporate governance assessment on EMCALI.
- The main counter-part of the process was The Superintendency of Utilities and the Management of EMCALI.

## 1st Round

**2nd and 3rd Q2008**

- IAAG staff agreed with the counterparts to established a set of tools for the SOE to use, once it got out of the insolvency process
- CAF-IAAG delivered: i) Suggestions on the By-laws; ii) Agreement between the Municipality and the Superintendency; iii) Agreement between the Municipality and the SOE, iv) Declaration of the Owner.

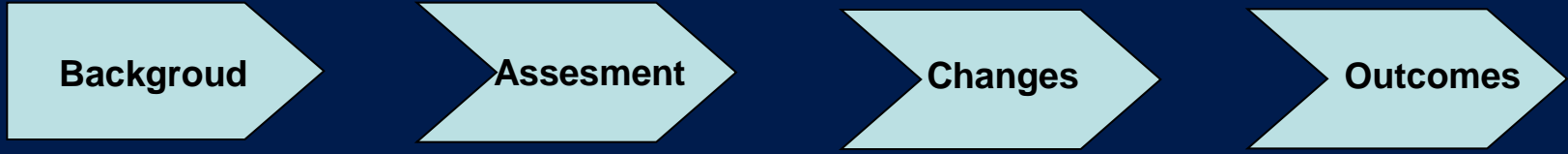
## 2nd Round

**2009**

- The new management refused to continue with the process



# Municipal SOEs in Quito (Ecuador)



**2008**

- Three SOEs of the municipality regulated by administrative law (Water, Sewer and garbage, public works)
- One SOE regulated by private law (Electricity)

**2009**

- All were subjected to the Due Diligence process
- One SOE regulated by private law (Electricity) followed a different assesment

**2009**

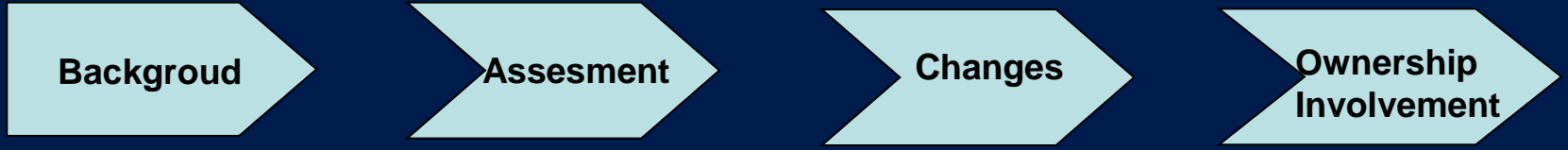
- New Bill for SOEs was approved by the National Assembly
- Change of Mayor in Quito

**2009 - 2010**

- Improvement Program
- Declaration of the controlling shareholder (owner)
- Suggestions on the new Act for SOEs and its regulation at the city level



# The Case of FONAFE in Perú



**2008**

- Four SOEs were included in the project
- Key industries such as Oil and Banking were included

**1S 2009**

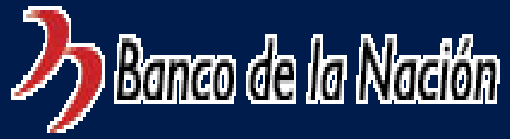
- Four due-diligences and assesments were conducted by IAAG's staff members under CAF's supervision

**2S 2009**

- A report with detailed recommendations was delivered to each SOE
- Lack of empowerment by the management to introduce changes was quickly identified and adequately addressed by parties

**2S 2009**

- A dialogue was established with the Ministry of Energy and the FONAFE to redirect the assesment's conditions.
- Both parties agreed on new products to improve the Governance's process. Interest in project gained salience.



# The Case of PetroPerú

## Decisions

## Actions

## Outcomes

### 2009

- Strong Commitment to introduce reforms

### 1S 2009

- Clear actions taken to improve Corporate Governance, particularly at the board level
- A steering committee was created within the SOE, that appointed a functionary which as a full-time job, has the responsibility of implementing all the actions required to improve the governance's practices of PetroPerú.

### 2S 2009 - 2010

- Decision to be listed in the stock market to improve CG requirements in route to issue shares in the future
- PetroPerú will be prepared to coexist in adequate terms of governance with private minority shareholders, as controlling shareholders (MEN) & (MEF) will be fully compromised throughout a Declaration of the State in regards the observance of best governance standards



- **Interventions need to address the heterogeneity of the legal status of SOEs**
  - The vast number of different legal structures under which the SOEs are created and governed brings a challenge to the intervention process and the team of consultants. Some of them have specific laws that regulate their activities and governance, while other are regulated by private and commercial law.
  - For the first segment of SOEs, methodology needed to be adjusted as most of them didn't have by-laws or relevant corporate documents related to the Owner. The changes included a draft for an Improvement Plan and declarations of the owner.

- **The Partnership is both with the Owner and the Management**
  - As difficult as it is to involve Ministers or Majors, this is a decisive step for the success of the process, particularly when there's not an Ownership Entity to create a strong partnership with the project
  - Senior Management of SOEs that aren't regulated by private or commercial law, are unable to take step further in terms of implementing corporate governance practices, due to their lack of empowerment and to legal limitations
  - Timing matters: It's crucial not to undertake efforts in this regard, when political changes are taking place. Demand for change should also be present both on the side of management and owner.



# Lessons Learned

- **There is a strong need to Depoliticize the Concept of Corporate Governance**
  - Multilateral organizations and Consultants must give away a clear message that the concept of Corporate Governance has no ties with any particular political view.
  - One incentive for governments to embrace the reform process, is that it could help them to increase transparency and accountability, particularly with regard to utility companies.

# Final Recommendations

- The elaboration and oversight of an Ownership Policy should be a mandatory process.
- The simplification of legal structures of SOEs is a very important step that can only be addressed by governments
- Building strong institutional capabilities for Ownership Entities is a necessary condition for good governance
- The unification of accounting standards, preferably under IFRS, should be strongly encouraged
- External audit, aside from controlling governmental agencies, should be mandatory for all SOEs

# Final Recommendations

- Ownership Entities should focus their attention in strengthening the policy and nomination procedures to build strong and independent boards
- Management in SOEs play a key role in the implementation of best practices in CG, and usually their tenure is longer than owner representative, and therefore can guarantee the sustainability of the changes. However, they can fear or even avoid reform without ownership backing.



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