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Corporate governance

REFORMING THE STATE-OWNED ENTERPRISES SECTOR

- State-owned enterprises (SOEs) are an important element of Lithuania's economy, often operating in sectors on which private businesses and the general public depend. Their performance is therefore crucial for the efficient functioning of the broader economy.
- Partly owing to shortcomings in their ownership, corporate governance and regulatory arrangements, SOEs tend to underperform and are sometimes perceived to compete on unequal footing with private firms.
- This puts a strain on public resources, crowds out private sector activity and reduces citizens' trust in the institutions tasked with overseeing SOEs.
- Top reform priorities for tackling these challenges include further separating the state's ownership and regulatory functions, improving board autonomy, streamlining SOEs' corporate and legal forms, and subjecting all SOEs to high standards of corporate disclosure.

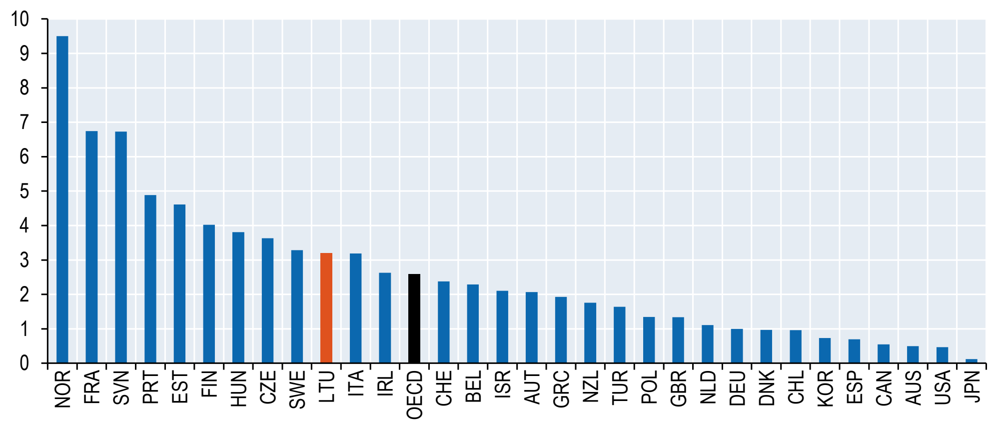
What's the issue?

SOEs are an important element of the Lithuanian economy, accounting for approximately 3.2% of national employment (see Figure). This is above the 2.4% average for all OECD countries. When the comparison is broadened to include state minority-owned enterprises – which are more prevalent in OECD countries than in Lithuania, which has none – Lithuania still remains above the average.

Although SOEs in some sectors of the Lithuanian economy have witnessed improved performance in recent years, even profitable SOEs post low rates of return by international comparison. Furthermore, a number of SOEs are outright loss-making to an extent that cannot be explained purely by the costs of under-funded public policy objectives. In a recent example of particularly poor performance, an SOE on the verge of bankruptcy was rescued by a loan from another SOE, provoking public perceptions of mismanaged resources and unfair competition.

Lithuania has a significant state-owned enterprises sector

Employees of SOEs relative to national employment (percentage)



Source: OECD (2014), The Size and Sectoral Distribution of SOEs in OECD and Partner Countries, OECD Publishing.

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Recognising that many of SOEs' performance woes stem from underlying weaknesses in state ownership and corporate governance arrangements, the Lithuanian authorities embarked on an ambitious SOE reform programme in 2010. This has led to significant progress in many areas, notably in developing a state ownership policy, clarifying SOEs' objectives and strengthening transparency through the regular publication of annual aggregate reports on the SOE sector.

However, several concerns remain. An overarching issue relates to the insufficient separation of the state's ownership and regulatory functions, with sectoral ministries being simultaneously responsible for regulating SOEs in a particular sector and ensuring their commercial success. Not only does this create conflicts of interest for the state bodies involved, it also exacerbates the risk for SOEs to become vehicles for political purposes. In some cases powerful line ministries are perceived as by-passing SOE boards of directors, resulting in key corporate decisions being driven by political motivations rather than performance objectives.

Furthermore, boards are often dominated by public officials – in some cases even acting politicians – rendering them ineffective in safeguarding an arms' length relationship with the state as shareholder. The decentralised manner in which ownership is exercised also means that the government's guidelines on SOE governance and reporting – although of a high standard – are not consistently respected by line ministries or SOEs. Finally, a number of SOEs operate under specific statutory legislation and are thus not subject to the same governance and disclosure requirements as privately-owned corporations.

Why is this important for Lithuania?

SOEs are important players in the Lithuanian economy and are active in sectors on which large parts of the corporate sector and the general public depend (e.g. electricity and gas, transportation and postal services). SOEs are often tasked with implementing strategic investment projects for the state or delivering public services, in some cases while simultaneously competing with private firms. SOEs also constitute an important revenue stream for the state, whether in the form of dividends or corporate taxes.

Ensuring that SOEs perform efficiently – and on a level playing field with private competitors – is crucial for allocative efficiency in the broader economy and sound management of public resources. Perhaps more fundamentally, making sure that SOEs operate in a clean and transparent manner is critical for maintaining citizens' trust in the institutions which have been tasked with overseeing SOEs on their behalf.

What should policy makers do?

- Ensure an effective separation of the state ownership and regulatory functions in SOEs by equipping the central state ownership entity with sufficient resources.
- Put in place mechanisms to promptly deal with cases in which line ministries do not respect state policies on SOE governance and reporting.
- Equip more SOE boards with a larger number of qualified independent directors selected through transparent and competitive nomination processes.
- Avoid having acting politicians serve on SOE boards.
- Convert state enterprises with primarily commercial activities to limited liability companies.
- Consider corporate consolidation in sectors with a multitude of small SOEs pursuing similar activities.
- Make government guidelines on corporate disclosure mandatory for at least the largest SOEs.

Further reading

OECD (2015), *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, OECD Publishing. http://www.oecd-ilibrary.org/governance/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015_9789264244160-en

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OECD (2010), *Accountability and Transparency: A Guide for State Ownership*, OECD Publishing. http://www.oecd-ilibrary.org/governance/accountability-and-transparency-a-guide-for-state-ownership_9789264056640-en