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SOE Reform: Time for Serious Corporate Governance

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Abstract

This policy paper is motivated by the Government's "Pakistan: Framework for Economic Growth (FEG) 2011" which places weak corporate governance at the top of the "software" constraints to growth. The efforts to reform the State-Owned Enterprises (SOEs) have stalled in Pakistan for almost five years—with significant negative implications not only in terms of fiscal losses, but also deteriorated and cost-ineffective service delivery. The paper suggests a number of urgent policy measures designed to improve the efficiency and effectiveness of SOEs. These include basic governance reforms, revamped commercialization processes and enhanced market regulations. The paper also provides some perspectives on international experience on SOE reforms combined with some suggestions on how the Government can move forward.

SOE Reform: Time for Serious Corporate Governance

John Speakman

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Background

1. Pakistan has a substantial investment in the SOEs[1], as they contribute approximately 10% to the Gross Domestic Product (GDP). These enterprises provide infrastructure services (power, transport etc.), economic development services (mining etc.), financial services and also spread across the manufacturing sector. According to State Bank of Pakistan (Central Bank) estimates there are around 100 SOEs at the federal and provincial levels.[2] The two decades of privatization reforms has reduced the number of SOEs—particularly in financial services and manufacturing sector. However, the ones that remain are significant and since 2007 no further privatization attempt has been successfully achieved. Table 1 lists some of the significant SOEs in Pakistan.

Table 1 **List of Prominent SOEs in Pakistan**

Sector	Examples of Significant Enterprises[3]
Power	Power Generation Companies, Distribution Companies, National Power Construction, National Transmission and Dispatch Company, Sui South, Sui North etc.
Transport	Pakistan International Airlines, Pakistan Railways, National Highway Authority, Civil Aviation Authority, Port Qasim Authority etc.
Mining and Hydrocarbons	Pakistan State Oil Company, Oil and Gas Development Corporation, Pakistan Petroleum, Lakhra Coal Mines etc.
Manufacturing	Pakistan Steel Mills, Heavy Electrical Complex, Pakistan Machine Tool Factory etc.
Financial Services	SME Bank, National Bank of Pakistan, Industrial Development Bank of Pakistan, First Women Bank, National Insurance Company, National Investment Trust, State Life Insurance Company, Pakistan Reinsurance Company, Bank of Punjab, House Building Finance Corporation etc.
Other	Trading Corporation of Pakistan, Utility Stores Corporation of Pakistan, Pakistan Agricultural Storage and Services Corporation, Cotton Export Corporation, Rice Export Corporation of Pakistan, National Fertilizer Corporation, Pakistan Post, Pakistan Tourism Development Corporation, National Engineering Services of Pakistan etc.

2. Moreover a small number of these SOEs produce a major negative fiscal impact (as a result of poor labor and capital productivity, wasteful management practices and inadequate tariffs).[4] They are a significant constraint to private sector growth as a result of poor service provision[5], crowding out of private provision and distortion of product and factor markets. They generate a strong negative image of the Government in terms of their general ineffectiveness and poor governance. A recent example of this negativity is the Government

[1] SOEs are often referred to in Pakistan as either Public Enterprises or Public Sector Enterprises (PSEs). Internationally SOE is the generally accepted name for institutions owned by the governments. The wider term "Government Assets" includes ownership positions in enterprises where the Government holds a minority or joint venture stake. Pakistan has a number of substantial positions under this category.

[2] For a detailed list of SOEs, see http://www.sbp.org.pk/departments/stats/Funds_Flow/Appendix%20I.pdf

[3] Some of these enterprises are corporatized entities which come under the auspices of the Companies Act, some are statutory entities and others have an unclear corporate status.

[4] Direct financial support to the large loss making SOE is currently around PKR 250 billion (US$ 3 billion) which constitutes approximately 1.5% of GDP. When one factors in hidden subsidies (depreciation, cost of capital, circular debt, contingent liabilities, etc.), the number is much larger.

[5] For instance, World Bank's Enterprise Survey Data in 2007 showed that firms estimate that power sector outages have reduced their sales volume by 10%, and only 4% of Pakistan's freight is carried by rail.

Audit report on the Karachi Port Trust (KPT) where it was observed that 380 acres of prime land worth PKR 25.84 billion had been leased for 99 years for PKR 540 million. As a result the Audit Office recommended sanctions. Table 2 shows the most recent profit or loss from 15 of the most significant SOEs. Accordingly, those with significant losses are Pakistan Electric Power Company (PEPCO), Pakistan Railways, Pakistan International Airlines (PIA), Pakistan Steel Mills and Karachi Electric Supply Corporation (KESCO). With the exception of PEPCO, which is projected to be dissolved in early 2012, addressing these losses remains centered on ad-hoc measures.

Table 2 Profits and Losses of 15 Large SOEs

	Profits and Losses (PKR Million)	Date	Source	Government Ownership (%)
Karachi Port Trust	4,000	2011	Estimate	100
Karachi Electrical Supply Company	(9,393)	2011	Annual Report	26
National Bank of Pakistan	17,700	2011	Annual Report	100
Oil & Gas Development Company	63,000	2011	Annual Report	74
Pakistan National Shipping	1,007	2011	Annual Report	80
Pakistan Railways	(25,000)	2011	Estimate	100
Pakistan Steel Mills	(10,000)	2011	Estimate	100
Pakistan Electric Power Company	(100,000)	2010	Estimate	100
Pakistan International Airlines	(20,785)	2010	Annual Report	86
Pakistan State Oil	14,779	2011	Annual Report	54
Pakistan Telecommunication Limited	8,405	2011	Annual Report	62
Sui Northern Gas Limited	1,125	2011	Annual Report	54
Sui Southern Gas Limited	4,724	2011	Annual Report	70
State Life Insurance	407	2010	Annual Report	100
Water & Power Development Authority	11,000	2010	Annual Report	100
Total	**(39,031)**			

3. In many cases the SOEs have been subject to reform previously whereas the power sector SOEs are undergoing reforms currently (see Box 1). In past, these reforms were unsustainable and had a limited impact over short term. The core question that the Government of Pakistan (GoP) faces is how to sustain and build on these reforms so that inter alia SOEs; (i) are governed properly, (ii) do not create fiscal problems or unmanageable contingencies, (iii) deliver the services consumers require in a cost effective manner, (iv) do not distort factor or product markets, and (v) contribute fully to the growth of Pakistan's economy.

4. As mentioned, this is not a new question, and there is a long history of different approaches. An Experts Advisory Cell (EAC) was established under the Ministry of Industries to monitor and support the industrial SOEs in 1980's. Later the emphasis moved to privatization (in 1990's) of the industrial and financial sectors with some important successes. Many large banks and industrial companies in the fertilizer and cement sectors

were privatized. The operational components of the main infrastructure sectors (power and transport particularly) were corporatized and in many cases privatization was attempted but failed under the weight of: (i) an unwilling bureaucracy, (ii) a reluctance to adjust tariffs and charges to levels that ensure financial sustainability, and (iii) a failure to address overstaffing adjustments required by buyers. Despite a few successes over the last two decades, Pakistan's weak foreign investment regime, unstable macro environment and deteriorating political and security situation could only attract limited interest from the international buyers. On the positive side there has been an overall consensus between the main political parties that these reforms were timely and crucial. However, this consensus could not translate into a strong will to address the above mentioned hurdles and to do away with the hiatus in privatization.

Box 1 **Current GOP Power Sector Reforms—Highlights from SOE Governance Reform 2011**

1. Dissolution of PEPCO by 30 June 2011 into generating companies and distribution companies (Implemented)
2. Establishment of new boards with 50% private sector representation (Implemented)
3. Empowerment of boards to appoint senior management
4. Appointment of new Chief Executive Officers (CEOs) on a fully competitive basis
5. Listing on the Stock Market
6. Significant investment in human resource upgradation at the senior management level
7. Hard budget constraints

5. One area that was never fully addressed in the past was the establishment of an overall SOE policy and framework for managing the SOEs. The assumption had always been that the SOEs would undergo privatization. It now seems that despite their significance for the national economy, a number of SOEs will not be subject to privatization in the near future. Also, in some cases, privatization may not be appropriate for some SOEs.

6. There are some sound justifications for the existence of SOEs. These include situations where the overall governance environment does not allow for effective regulation and contract enforcement, and where factors such as natural monopoly, capital market, social return externalities and equity considerations are in play.[6] The argument for privatizing SOEs is based on the principal-agent and free-rider problems. The need for reforms also arises when there are marginal incentives to effectively run the SOEs due to broader issues of patronage and weak governance.

7. Therefore there is now a clear need for such a policy framework. The GoP made some initial moves and the Prime Minister in January 2010 constituted a Cabinet Committee on Restructuring (CCOR) of Public Sector Enterprises (PSEs) to eliminate the financial bleeding of the country due to such loss making institutions. In addition to the CCOR, a task force comprising public and private sector representatives was set up to finalize the corporate governance regulations for SOEs that have a corporate structure. The task force has completed the work and the draft Public Sector Companies (Corporate Governance)

[6] Chang, Ha-Joon. 2007. "State-Owned Enterprise Reform". United Nations Department for Economic And Social Affairs (UNDESA). http://esa.un.org/techcoop/documents/PN_SOEReformNote.pdf

Regulations have been notified by the Securities and Exchange Commission of Pakistan (SECP) for public consultation and are also placed on SECP's website.[7]

Corporate Governance Impact on SOE Performance

8. The international experience shows that effective corporate governance of SOEs can have a positive impact on a country's economy especially when these enterprises are big in number. The benefits of improved governance include; improved SOE financial performance, better service delivery, and greater access to capital markets. Korea and Singapore are two notable success stories of strong corporate governance and well performing SOEs. In Pakistan's case, the SOEs that are listed on the Karachi Stock Exchange (KSE) and that follow KSE's corporate governance requirements are profitable.[8] Indeed this evidence suggests that there is nothing inherent in Pakistan's political economy that would prevent sound SOE corporate governance. A core challenge is how to mainstream these approaches to ensure a corporate mindset based on sound governance structure, is always in place.

9. The interesting question then is what is driving the weak performance of this short list of poor performers. Are there fundamental business problems that are so intractable that efforts to run the poor performing SOEs are doomed to failure? Are there special interests that prevail over business imperatives—consumers' unwillingness to pay tariffs? As can be expected there is no simple answer but the success of reforms in other seemingly intractable sectors, such as the financial sector during the 1990s, shows that this is doable. Pakistan has a well performing and well regulated financial sector which has moved from being largely public to largely private as a result of privatization efforts.

The Reform Program So Far

10. The Government placed SOE reform in the broader context of an overarching growth strategy, which includes a comprehensive civil service reform and a general upgrading of markets. It has taken modest initial steps in SOE reform. These include:

- The Cabinet Committee on Restructuring (CCOR) identified eight companies[9] for restructuring with the objective to improve overall corporate governance of Public Sector Enterprises (PSEs), curtail hemorrhaging, improve service delivery and reduce fiscal burden on exchequer
- Economic Reforms Unit (ERU) of the Ministry of Finance (MoF) is acting as CCOR secretariat for SOE reforms
- The SECP has drafted Corporate Governance Regulations for SOEs and these have been reviewed, amended and finalized by the Task Force
- General reforms such as implementation of rules for regulating public procurement of goods, services and works in the public sector by the Public Procurement Regulatory Authority (PPRA) have been introduced. The role of the Competition Commission of Pakistan (CCP) in providing a level playing field has been strengthened through a separate Act.

[7] See http://www.secp.gov.pk/notification/pdf/2012/S.R.O283(1)2012-DraftRegulationsforComments.pdf
[8] The only unprofitable listed SOE that we have identified is KESCO
[9] These include: Pakistan International Airlines, Pakistan Steel Mills, Pakistan Electric Power Company, Pakistan Railways, National Highway Authority, Pakistan Agricultural Storage and Services Corporation (PASSCO), Trading Corporation of Pakistan and Utility Stores Corporation.

- The Boards of 9 power sector distribution companies have been restructured. Similarly the Boards of National Transmission and Dispatch Company, power generation companies, Central Power Purchase Authority, Pakistan Steel Mills (PSM) and Pakistan Railways (PR) have also undergone restructuring. Turnaround plans for PR, PIA and PSM are under implementation.[10]
- CCOR has operationalized a restructuring framework for PR. An asset management company is being set up for optimum utilization of PR's assets. Repair of locomotives and freight operations have been prioritized. A new Board has been constituted which will start working after the amendment of the Railway Order. The process for recruitment of CEO and key management is ongoing.
- Restructuring plan of PIA has also been finalized and work is underway for establishing Strategic Business Units to outsource non-core functions of PIA. Similarly the Board of Directors (BoDs) of PSM has been reconstituted.
- Initial restructuring plans for TCP, PASSCO and Utility Stores Corporation (USC) have been framed.
- CCOR has approved the business plan of Pakistan Machine and Tools Factory (PMTF). Consequently, Economic Coordination Committee (ECC) has approved sovereign guarantee of PKR 1 billion for PMTF. The MoF has facilitated sovereign guarantee subject to implementation of reform plan by ERU.

11. More specifically, the GoP is now planning to address the SOEs that produce more significant fiscal losses, including electricity production and railways. In the power sector, the GoP has already made significant progress and plans to move its attention to railways over the next year (see Box 1 for progress in the power sector).

12. SOE reform is one of the comprehensive set of reforms that the Government is embarking on to set Pakistan on a forward growth path under the 2011 FEG. It requires proper organization and in some cases separation of GoP's ownership, financing, regulation, policy setting and service delivery roles.

13. In this regard, the SECP has established a set of draft SOE corporate governance regulations which substantially strengthen the independence, capacity and role of the BoD. These include measures such as the establishment of audit committees, distinguishing between the role of Chairman and CEO, and improving the process for the appointment of directors. These regulations have been reviewed and amended by the Task Force headed by the ERU and have been placed for public consultation. Once the consultative process is completed the regulations will be implemented.

An Assessment of Where Pakistan Stands: Substantial Room to Improve

14. The Organization for Economic Cooperation and Development (OECD) has developed a set of guidelines on corporate governance for state-owned enterprises.[11] This is a generally well accepted international benchmark and has been used to assess Pakistan's present status.

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[10] Source: Economic Reforms Unit (ERU), Ministry of Finance.
[11] See www.oecd.org/dataoecd/46/51/34803211.pdf

Table 3 **Review of Pakistan's Status based on OECD SOE Guidelines**

OECD Principle	Pakistan's SOE Status
Ensuring an effective legal and regulatory framework for SOEs by (i) establishing a level-playing field between SOEs and private companies and (ii) ensuring full compliance with OECD principles of corporate governance	Substantial room to improve – there is no policy, no explicit legal framework and no guidelines or regulations.
The State should act as an informed and active owner	While there are plans to strengthen GoP's role, there is substantial room to improve.
All shareholders should be treated equally	SOEs with minority holdings are run as "arms of the State". Hence improvements required.
Full recognition of responsibilities towards all stakeholders e.g. workers and consumers	Room to improve—apart from regulatory bodies there are no formal mechanisms within SOEs to address other stakeholder interests
Maintenance of high standards of transparency	Room to improve—disclosure requirements are fairly minimal
The boards of SOEs should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management	Room to improve – there is no guidance in this area

15. Generally the core objective of SOE reform is to transform these into profit making entities. This means developing: (i) effective systems of corporate governance including a willingness by the state to act as a non-political owner and (ii) an incentive system that replicates as best as it can—a "corporately governed" private sector firm operating in a fully competitive market place. This is the basis for the OECD Guidelines enumerated above.

16. Based on the OECD Guidelines and the present state of play in Pakistan, the following reforms on the governance side are required:

1. Establishing the "rules of the game"
2. Improving and professionalizing the role of the state as owner
3. Improving corporate governance practices at the SOE level

Establishing the Rules of the Game

17. The operating rules for SOEs in Pakistan need to be established in a consistent, unambiguous and enforceable manner. These rules are often derived through powers established under a SOE Act or equivalent piece of legislation. These rules typically include: (i) the requirement that SOEs be commercially oriented, (ii) SOEs are not allowed to expand or contract the scope of their activities without Governmental approval,[12] (iii) guidance on dividends, (iv) obligations to provide timely financial and management information, (v) clarity on which activities of Government should be turned into SOEs and those that shouldn't, and (vi) appointment of boards of directors. The rules may include hard budget constraints which incentivize the SOEs to run profitably. In parallel, the Government takes on the obligation to compensate in a timely manner the SOE when contractually agreed for services rendered to it. Nothing breaks down the SOE reform discipline quicker than non-

[12] While the Memorandum of Association provides some limitation on the scope of activity of any corporatized SOE, this issue is typically not monitored.

payment of amounts owed by other Government agencies.[13] A core question for the authorities is whether they need the equivalent of an SOE Act.

18. The appointment of directors is an area that requires specific attention. A recent example is Oil and Gas Development Corporation where an unqualified person was appointed as the CEO. After a substantial public outcry and an observation by the Supreme Court the CEO was removed. Specific measures and protections need to be developed to ensure only qualified directors without conflicts of interest are appointed.

19. The task of commercialization which is a key framework condition is a significant task and takes time and involves a substantial commitment of resources. The typical steps are: (i) the corporatization of the activity—the process of converting the enterprise into a company under the Companies Act–which has by and large happened, (ii) the identification and management of non commercial activities from the enterprise, (iii) financial and operational restructuring to clean up the balance sheet and establish an appropriate staffing level, (iv) establishing modern systems of professional management (information, human resources, etc.), (v) upgrading the human resources, and (vi) changing the culture. For this to happen, strong governance is required, and the evidence so far in Pakistan is very few SOEs have been able to implement a full commercialization. Indeed, as shown in Box 1 after decades of reform the power sector has still to make the most basic of reforms. It remains to be seen if they will be able to sustain the reforms this time.

20. It is likely that the commercialization process will lead to a rethinking of the efficiency as well as profitability of these SOEs then the question of retrenchment will come up. The government needs to think about it now to make sure that the right mechanisms are in place to manage departing staff, retrain them and or compensate them.

Improving and Professionalizing the Role of the State as Owner

21. A fundamental tenet of SOE reform is the need to separate the government's role as owner from its role as policy maker, coordinator, subsidy deliverer (typically handled by the line ministry) and regulator (typically handled by an independent regulator). In some environments the line ministry role is further reduced by moving the subsidy financing role elsewhere.

22. At present Pakistan has made little progress in separating the ownership of the SOEs as in most cases it still lies with the concerned line ministry. This situation requires reform through either (i) the establishment of an overall advisory/coordinating body, (ii) the transfer of ownership to a centralized non-corporate ownership entity, or (iii) transfer of ownership to a holding company.

23. In some cases holding companies have been created for this role, but internationally the results have been very mixed with success positively correlated with the general level of governance within the country. Bad governance on top of bad governance has not worked well. In Pakistan's case there are a few good examples and many bad examples of institutional governance. By and large the country can be proud of institutions like the State Bank of Pakistan (SBP). But all too often there are examples of institutions that are badly

[13] Often referred to as circular debt

managed as a result of private interests prevailing over the public interest. Therefore this is an area where one needs to be very careful.

24. In Pakistan there are two troubling experiences. The Board of Industrial Management that controlled the nationalized industries for many years proved after a promising start to be quite unsuccessful. As well as PEPCO, a holding company for the power sector, also proved unsuccessful and is scheduled to be dissolved. Whatever option is selected there needs to be a SOE monitoring function which typically will have the following functions: (i) monitoring the financial and managerial performance of SOEs, (ii) selecting the chairman and directors of SOEs, (iii) monitoring the performance of the directors, and (iv) negotiating performance and financial targets. While evaluating financial performance is important, it is crucial that the managerial performance (typically measured through Key Performance Indicators) is also monitored.

Introducing Modern Corporate Governance Practices

25. The ability to implement modern corporate governance practices will be closely influenced by the prevailing overall environment for corporate governance in Pakistan. In 2005 the World Bank conducted a corporate governance ROSC[14], which found that while the corporate governance environment was making progress there was generally a low awareness of the importance of the topic. This was compounded by a preponderance of family-owned private sector companies that tended to avoid modern corporate governance practices. This finding is not unusual in emerging markets and typically requires proactive interventions both on the enforcement side (regulatory body capacity, legislative protections and disclosure requirements) as well as building the capability of directors themselves in the form of support and training through a strong Institute of Directors or in the case of Pakistan the Pakistan Institute of Corporate Governance (PICG). Since 2005 the PICG has conducted formal director trainings and accredited 220 individuals including 19 women.

26. While there has been some progress, it appears that there is still need for further general reform. For SOEs, a significant finding from the ROSC was that there was no clear distinction between the ownership role referred to above and the role of the directors. This distinction is fundamental to effective corporate governance, particularly when there are minority shareholdings or multiple shareholding interests at stake. Thus good corporate governance begins with the appointment and empowering of an independent board of directors. It is not advisable to include current civil servants or ministers on the board, which is a common practice in Pakistan. Finding competent independent directors can also be quite challenging as the ROSC observed. Other key elements of SOE governance include: (i) a strong external and internal audit function with appropriate lines of communication, (ii) strong management information systems and allied internal control, (iii) accountable management (discussed further below), (iv) widely disseminated disclosure of financial and managerial performance, (v) establishing of board level committees like the Audit Committee, and (vi) ensuring key stakeholders–consumers, workers etc.–have a voice. The draft regulations prepared for the purpose are a good first step, but the real test lies in their

[14] Report on Observance of Standards and Codes (ROSC) which is based on OECD Principles of Good Governance. See http://www.worldbank.org/ifa/rosc_pakistan.htm

implementation. Further, the SOEs that are listed on the Stock Exchange are covered by the 2012 Code of Corporate Governance.[15]

27. Of particular importance in Pakistan is the role of the Chief Executive Officer. According to the Pakistan Institute of Corporate Governance the function of identifying and selecting a professional CEO of the enterprise independent of government interference, should be a "sine qua non". If there is a critical success factor for SOE reform–it is this–getting a competent CEO in charge.

28. Internal and external accountability is another important ingredient to the reform process. These accountability mechanisms are a function of formal relationships and disclosure. Accountability to the National Assembly through an annual report on SOEs which includes financial and operational reporting for each enterprise is the starting point. The Annual Report of the State Ownership Steering Department in the Prime Minister's Office, Finland, is a benchmark example of accountability to the National Assembly.[16] This can be augmented with substantial disclosure. A quick google of SOEs in Pakistan reveals a substantial awareness within Pakistan on the problems raised by these enterprises, and willingness to criticize and suggest reforms. Performance contracts can also be used to build accountability at the individual and enterprise level. The challenge is setting the right targets—as one of the major problems with these arrangements is setting the targets too soft. After early efforts in this area, some decades ago, there are no formal accountability mechanisms in Pakistan.

Complementary Market Reforms

29. These reforms aim to create a level playing field. As the analysis below shows considerable work remains in this regard. The key markets are: equity (the market for corporate control e.g. the stock market), financial markets (banks etc), labor markets and product markets (enterprise inputs and outputs). Pakistan has always operated with a predominantly market economy, so it is not faced with the challenges found in economies that transited from state to market control; however, there remains significant scope to improve the functioning of these markets. In addition to the task of general market reform, many of the sectors with SOE presence, including infrastructure, other service delivery sectors and financial sector, have very specific regulatory and financing challenges.

30. With respect to the specific market for corporate control, the ROSC notes that the relevant OECD standard: "Markets for corporate control should be allowed to function in an efficient and transparent manner" was only partially observed. Financial markets though being well regulated remain weak. Pakistan has one of the lowest private sector credit-to-GDP ratios in the region and in general banks struggle at properly assessing and managing risk outside well established customers with whom they have long-term banking relationships. There is a substantial way to go in reforming labor markets–it is still difficult for formal firms to lay off workers. In the product area there are substantial constraints on importing raw materials, human resources and capital equipment. Many of the SOEs enjoy

[15] The 2002 Code of Corporate Governance was revamped and brought in line with international practices. The 2012 Code was implemented in April 2012.
[16] See http://vnk.fi/julkaisut/listaus/julkaisu/fi.jsp?oid=330644

exclusive protections whether it is in service delivery, mineral exploitation or product protection.

31. In addition many of the SOEs are in specifically regulated sectors (infrastructure, finance, mining, etc)–with independent regulators. These regulators vary in quality. In some cases they are very good as in the case of the State Bank while others are quite weak as in the case of the power sector. In all cases these regulators would benefit from further strengthening. The focus of these reforms should be around the four main dimensions of regulatory effectiveness: (i) making sure the market structure of the concerned sector is conducive for competition, (ii) ensuring that they are accountable for their actions–that stakeholders have means of redress, (iii) establishing their financial autonomy so they are not at the mercy of budget processes, and (iv) they are relatively independent from political and bureaucratic pressure. A particular issue for regulators is their ability to set economic tariffs–in a number of cases they are constrained.

The Way Forward for Pakistan

32. The policy matrix (see Table 4) identifies the much needed policies for SOE reform and entry points indicated as short term possible measures. It is important to note the fundamental changes which are necessary to ensure that a sustainable reform will take some time. It also needs to be observed that parallel efforts to: (i) reform the civil service and (ii) improve the functioning of markets by relaxing and reforming red tape are critical to the long-term success and sustainability of these reforms.

33. This paper focuses on broad SOE reforms at the federal level. However with more power being devolved to the provinces, it is likely that these policy recommendations might also be relevant for the SOEs operating at a sub-national level. In particular it is important that the provinces adopt strong governance and monitoring arrangements for SOEs. These suggested reforms are supportive of specific measures focused on a particular SOE (like the parallel ongoing efforts for PR or PEPCO), which are not included in the paper.

34. In terms of next steps, immediate priority should be assigned to develop a comprehensive strategic framework. This can be complemented by: (i) the preparation and then promulgation of a policy in a consensus-driven manner as possible, (ii) the establishment of the ownership entity, and (iii) a review of the overall authorizing environment for the steps required.

35. Some key questions the policy needs to address at the outset include:

- What is the overall objective of the reform?
- What is the scope of the reform–all SOEs including those with minority shareholders, and enterprises that are not corporations under the Companies Act?
- Will the policy commit to embracing the kind of corporate governance reforms that empower boards?
- Who should be responsible for the reforms?
- What style of ownership and monitoring is required?
- Where should the ownership and monitoring function be located?
- Whether a law will be required to support these reforms?

- How much flexibility should there be–if something is already working well in a particular sector? Is there a need to change it?

Table 4 Policy Matrix

<table>
<tr><th rowspan="2">SOE Reform Objective</th><th rowspan="2">Reform Issue</th><th rowspan="2">Policy Response</th><th colspan="2">Timing and Targets</th></tr>
<tr><th>Short Term
(Next 12 months)</th><th>Medium Term
(Beyond 12 months)</th></tr>
<tr><td rowspan="2">Establish the rules of the game</td><td>No overall SOE Policy statement</td><td>Develop overall policy for SOEs</td><td>Develop an overall SOE policy statement</td><td></td></tr>
<tr><td>Lack of clear rules of SOE conduct that cover governance, scope of operations, requirements on operational and financial reporting, etc.</td><td>Promulgate the rules of the game

Requiring SOEs to submit a Statement of Corporate Intent (SCI)</td><td>Establish the rules of the game, together with sanctions for non compliance</td><td>Prepare SCIs for all SOEs</td></tr>
<tr><td>Ensure independence of SOE Boards</td><td>Avoid interference in SOE management</td><td>Increase competencies in SOE Boards</td><td>Provide training for SOE board members including induction orientation</td><td>Develop performance evaluation for SOE boards</td></tr>
<tr><td rowspan="3">Identify separate roles and exercise the ownership role</td><td>Lack of separation of Government responsibility as owner from policy and regulatory responsibilities</td><td>Determine SOE ownership modality</td><td>Establish a New Ownership Function</td><td></td></tr>
<tr><td>Weak SOE monitoring and evaluation capability</td><td>Strengthen and centralize existing monitoring and evaluation capability within New Ownership Function</td><td>Establish a centralized Monitoring and Evaluation capability[17] with responsibility for director appointments, financial and operational analysis</td><td>Establish a performance baseline for “top 10” SOEs

Establish baseline for all SOEs

Develop KPIs</td></tr>
<tr><td>Independent Regulators need strengthening</td><td>Strengthen Regulators</td><td></td><td>Carry out an assessment of all key regulators

Allow regulators to approve cost-based tariffs</td></tr>
</table>

[17] Monitoring and Evaluation should be closely coordinated with the line ministries.

SOE Reform Objective	Reform Issue	Policy Response	Timing and Targets	
			Short Term (Next 12 months)	Medium Term (Beyond 12 months)
Commercializing and ensuring an appropriate level of autonomy	SOEs are not fully commercial	Issue clear instructions on SOEs commercial objectives and guidance on how to manage non-commercial responsibilities Ensure State Acts as a Non- Political Owner		Require all SOEs to produce business plans Review and where appropriate remove exclusivity protections e.g. allow captive power plants
Building effective accountability mechanisms	SOEs are not accountable to stakeholders	Establish accountability mechanisms		Deliver an annual report to the National Assembly. Develop mechanisms to account for workers interests. Publish financial statements for all SOEs that follow the International Financial Reporting Standards (IFRS)