Briefing
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Reforming State-Owned Enterprises in the Extractive Industries: International Experiences and Implications for Myanmar

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As Myanmar seeks to open its oil, gas and mining industries to greater investment and use them as vehicles for long-term economic development, state-owned enterprise reform will be critical. Fortunately, the country can draw on several other countries' experiences as it considers its options. State-owned enterprises in many countries have been effective vehicles for the development of petroleum and mining industries, the generation of revenues, and the training of skilled national experts. In other countries, state-owned companies have hindered efforts to maximize revenues, discouraged private investment, exacerbated corruption and conflict, and/or become "states within states" that divert revenues from development priorities outside the normal procedures of public financial management.

The Natural Resource Governance Institute (NRGI) has conducted research on the experiences of state-owned enterprises throughout the world. These experiences, especially the story of the enterprises that have succeeded, offer several valuable lessons for Myanmar.

DEFINING COMMERCIAL AND NON-COMMERCIAL ROLES

Virtually every state-owned oil, gas and mining enterprise has a formal mandate to be a "commercial" entity, but this "commercial" role is sometimes ill-defined. This mandate is defined precisely and strategically in the cases of most high-performing state-owned enterprises. The broad contours of the role should be set by a company's shareholders and other executive branch officials responsible for the company's oversight. The details of the role can be developed by a company itself.

The precise scope of the commercial mandate can vary. Some state-owned extractive enterprises—such as Saudi Aramco (Saudi Arabia), Petronas (Malaysia) and Statoil (Norway)—engage in the range of activities associated with large international oil companies, including managing and financing complex exploration and production operations. Some of these "operating" state-owned enterprises in the oil and gas sector even run projects abroad, where they largely resemble private international oil companies. Other companies—such as GNPC (Ghana), Timor GAP (Timor Leste) and Sonangol (Angola)—have undertaken a much more limited set of commercial activities, with a frequent emphasis on selling the government share of petroleum or minerals, minority equity investments in oil and gas ventures, and investment in service activities that support the extractive process. Members of this latter group are likely more analogous to Myanmar's state-owned companies.

"Commercial" roles sometimes assigned to state-owned enterprises include:

- "Operatorship": leading technical/financial role in the execution of exploration and production projects
- Equity owner of shares in projects
- Sales of government portion of oil, gas or minerals
- Management of subsidiaries or joint ventures that are providing services to the oil and gas sector or other sectors
- Marketing of fuels and other refined products

Regardless of the particular scope of commercial ambition, clarity of mandate is essential. Global experience has shown that the most successful enterprises have defined their commercial objectives clearly and developed the structures and incentives needed to execute them.

It is also important to appropriately define and contain non-commercial roles, including "regulatory" and "quasi-fiscal" roles. State-owned enterprises are frequently called upon to perform regulatory duties, including the licensing of exploration and production rights, ensuring compliance by companies with law and contracts, and approving key decisions by partner companies regarding exploration and production.

Quasi-fiscal activities include those carried out by the state-owned enterprise that would typically be ascribed to other agencies of the government as part of the state's fiscal management, public expenditure or national development responsibilities. Examples include servicing national debt, building or maintaining infrastructure, promoting public health and education, providing consumer fuel subsidies, and purchasing arms.

"Non-commercial" roles sometimes assigned to state-owned enterprises include:

- Award of licenses or contracts
- Oversight of projects and enforcement of legal rules
- Large-scale infrastructure construction
- Building and operating schools and clinics
- Servicing national debt
- Managing fuel subsidies

Some analysts believe that mixing commercial and non-commercial responsibilities should be avoided altogether, but in countries that are new to the extractive business or that otherwise lack human or financial capacity, it may be necessary to combine mandates, at least initially. In Brazil and Ghana, for example, commercial and regulatory responsibilities were concentrated in the national oil companies during the early years of exploration and development, as a means to create credible entities that could shepherd the sector strategically.

Where roles are combined, however, the risk of conflict of interest rises, and global experience points to two imperatives. First, a clear definition of what is and is not permitted according to the non-commercial mandate is important, to limit abuse of power and ensure that all players in the industry and the country understand the rules of the game. Second, the government should avoid making the assignment of non-commercial responsibilities too large, as this can steer resources away from commercial development and impede performance. With companies such as Venezuela's PDVSA (oil and gas) or the Democratic Republic of Congo's Gécamines (copper), non-commercial responsibilities grew so large that the companies struggled to maintain focus on their core extractive activities.

DEVELOPING A WORKABLE APPROACH TO REVENUE COLLECTION AND RETENTION

A state-owned enterprise's ability to execute its commercial strategy is heavily influenced by the extent to which it can retain earnings from its activities, and the manner in which it transfers money *to* the state treasury and/or receives budgetary allocations *from* the treasury. In some countries—including Myanmar—state-owned enterprises are responsible for collecting huge shares of public revenue, in the form of taxes, royalties or bonuses paid by private companies, or by selling the state's share of oil, gas or minerals. In other countries the amount of revenues passing through state-owned companies is much more limited.

As commercial entities, these companies need reliable access to funds to allow them to pursue forward-looking strategies. At the same time, particularly in states where a major share of government revenue passes through the state-owned enterprise, leaving

the company with too much autonomy over revenues can have grave consequences for public financial management. In Angola, where national oil company Sonangol has had *de facto* control of huge revenue flows, the IMF uncovered an "unexplained residual" in state accounts initially measured at more than $31 billion between 2007 and 2010 (equivalent to one fourth of annual GDP) that had not been managed via ordinary rules of public financial management. A reconciliation of these discrepancies revealed that a large proportion of these expenditures were attributable to quasi-fiscal activities by Sonangol and the transfer of oil revenues to service external credit lines.

Finding a system that balances these risks is therefore critical. There is no universal model appropriate for all countries. But officials should give careful consideration to the revenue retention system that best suits their governments' goals and capacities. A weighing of where they stand vis-à-vis the two factors featured in the figure below can be informative.

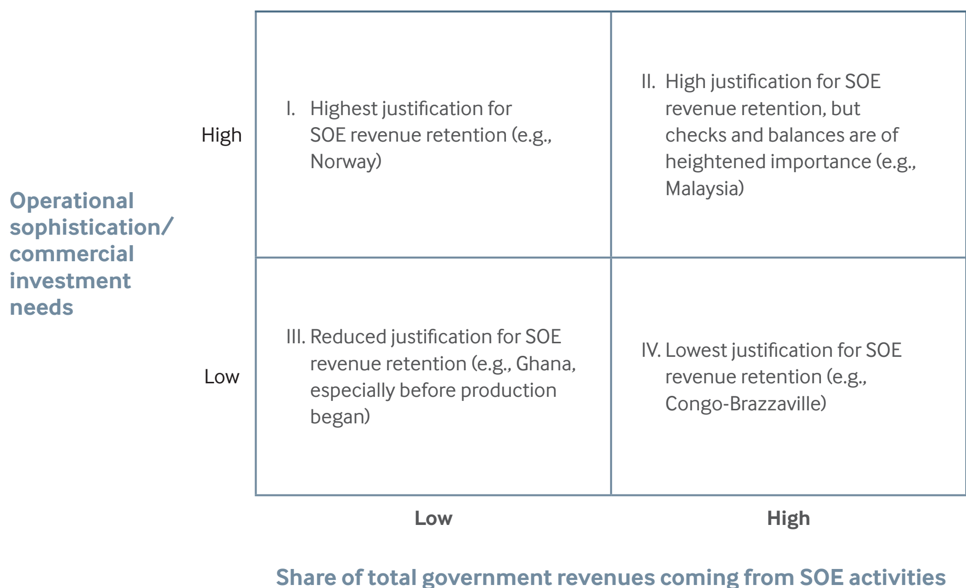

Figure 1. Determinants of SOE revenue retention

Quadrant I represents countries in which the state-owned enterprise is a sophisticated commercial entity with a need for large-scale investment to finance activities, and in which the company's revenues do not dominate the public budget. These countries present the strongest case for a model in which the company is able to retain its revenues and pay taxes, much like a private entity. Quadrant II is in the middle ground, where the company faces heavy operational costs and where a lack of predictable access to capital can be crippling, but also where the government should take special care to ensure the integrity of public revenues and the coherence of the budget. Governments of countries in quadrant III, where the risks of total disruption to the economy may not be large but where the company's needs for capital are not huge either, should consider a model where revenue retention is relatively limited. Finally, quadrant IV represents countries where the company is not a traditional commercial player—and thus its capital needs are relatively small and/or predictable—and where simultaneously a large share of public revenues pass through the company, subjecting the country to massive risks if the company budget becomes the *de facto* national budget. In these countries, there may be little to no justification for substantial revenue retention.

LIMITING POLITICAL INTERFERENCE IN TECHNICAL DECISIONS

All state-owned enterprises, even successful ones, are subject to some state interference. But our research has shown that the highest-performing enterprises entrust key business decisions to professional, independent management and boards, not politicians or their cronies. This allows for predictable planning, supports the exercise of sound business judgment, and reduces the risk of capture by narrow political interests. By contrast, enterprises facing the highest levels of political interference, such as the National Iranian Oil Company or the Societé Nationale des Hydrocarbures (Cameroon) have had less success in executing commercial strategies.

Among the steps that appear to be associated with a successful approach are:

- *Creating skilled, technocratic boards of directors, and empowering them to make decisions.* Effective technical leadership from boards of directors has proven to be one of the keys to strong technical performance and accountability. The boards of most high-performing state-owned oil, gas and mining companies have competent, politically autonomous members who are appointed through transparent and well-defined processes. Examples include Chile's Codelco (copper) and Norway's Statoil (oil and gas).

- *Investing in capacity among staff and leadership.* Strong efforts to develop the competence of personnel can safeguard against narrow, politicized decision-making. Executive appointments to Petronas (oil and gas) follow the Malaysian Code on Corporate Governance, which codifies principles of good governance and sets out mandatory training requirements for directors of private and state-owned Malaysian enterprises. Companies including Statoil and Sonangol invested heavily in developing a cadre of skilled professionals from the earliest days of their development, recognizing that one of the most important steps to building effective and accountable companies was world-class management. For example, Saudi Aramco prides itself on a rigorous training program to develop some of the region's top engineers and oil managers, to the point that being an "Aramcan" is among the most prestigious jobs in the country.

- *Creating a performance-based corporate culture.* Beyond hiring and training, it is important for the enterprise to develop and enforce meritocratic systems for internal promotion and compensation incentives, to ensure that performance, rather than a desire to benefit from patronage, is the principal motivator of staff behavior. Rules against conflicts of interest among high-level managers (and board members) represent an important step toward ensuring that the company is being managed according to long-term national and commercial goals, as opposed to narrow self-interest on the part of executives.

- *Defining clear structures and roles for state shareholders.* State-owned enterprises in which a strong, single state shareholder makes big-picture strategic decisions (but leaves day-to-day management to the company) have generally performed better than those where state shareholding is diffused among many government entities. Examples of the former model include Malaysia, where the prime minister's office is the sole shareholder in Petronas, and is responsible for collecting annual dividends and taxes from it. By contrast, splitting state shareholding across different agencies without clearly defining the roles of each shareholder has impeded the technical and economic performance of state-owned enterprises such as Mexico's Pemex (oil and gas).

PROMOTING STRONG TRANSPARENCY AND OVERSIGHT

Public disclosure of key data on company finances and activities in a consistent and timely fashion is critical, both because it gives citizens a sense of how their state-owned enterprises are using public resources, and because it strengthens the incentives for company leadership to perform. Relevant information for publication includes:

- *Revenues collected by the company* from its participation in exploration and production activities or any regulatory role, including revenue from oil or mineral sales, royalties, fees, taxes collected by the company, and dividends received from partnerships
- *A detailed accounting of the fiscal relationship between the company and the state*, including the rules governing fiscal transfers and disclosure of payments by the enterprise to the treasury or other state institutions, earnings retained by the company, and budgetary allocations from the state to the company
- *Assets held by the company in subsidiaries and joint ventures*, and the level of ownership of these entities
- Expenditures by the company on *quasi-fiscal activities*, as defined above
- *A description of major activities in exploration and production*, including past activities, progress against goals, and projections of forward-looking activities; and activities associated with state-owned enterprise participation in joint ventures or production sharing agreements
- *Corporate structure*, including composition of board and senior management (including dates of appointment), as well as structure, personnel and responsibilities of key divisions

Many of the state-owned oil, gas and mining enterprises worldwide that have delivered benefits effectively to their countries—including companies as diverse as Morocco's Office Chérifien des Phosphates and Colombia's Ecopetrol—have engaged in transparent reporting practices. The Global Standard of the Extractive Industries Transparency Initiative (EITI) provides a strong starting point for EITI-implementing countries to begin to publish more reliable data on their state-owned enterprises.

In addition to public reporting, securing independent, external audits is one of the most effective tools for strong performance and corporate governance among state-owned enterprises. Among the critical components of an international-standard auditing process are having the process managed by well-regarded private firms selected through open tenders, and publishing the results of the final audit reports.

State-owned enterprise reporting under the EITI Global Standard

EITI-implementing countries are required to publish:

- The level of beneficial ownership that the state-owned enterprise (including its subsidiaries) holds in companies operating within the country's oil, gas and mining sectors.
- The rules governing transfers of funds between the enterprise and the state, retained earnings, reinvestment and third-party financing.
- Material payments to the state-owned enterprise from private oil, gas and mining companies, and transfers between state-owned enterprises and other government agencies.
- Any quasi-fiscal expenditures made by the state-owned enterprise.

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