Broadening the Ownership of State-Owned Enterprises

A COMPARISON OF GOVERNANCE PRACTICES

OECD

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BETTER POLICIES FOR BETTER LIVES

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Foreword

This report provides a comparative mapping of relevant national experiences in broadening the ownership of state-owned enterprises (SOEs) through the practice of listing. Based on the national experiences of the People's Republic of China (hereafter "China"), India, New Zealand, Poland and Turkey, the report considers the motivation behind listing. It explores whether the nature of State participation and remaining State objectives in mixed-ownership companies has an impact on overall governance and performance especially in comparison with other non-state invested listed companies.

The analysis in this report is limited to majority or minority state-owned (or previously state-owned) enterprises which have undertaken equity share offerings (as opposed to debt offerings). National information was collected through a questionnaire exercise and supplemented with additional research, including input from external consultants. The countries were selected based on their recent experiences with listing.

The report is an outcome of the OECD Working Party on State Ownership and Privatisation Practices (Working Party) project on "Broadening the Ownership of SOEs." It was given final approval and declassified by the Working Party in March 2015. The report was prepared by Sara Sultan Balbuena, with input from Mary Crane-Charef and Yunhee Kim of the Corporate Affairs Division of the OECD Directorate for Financial and Enterprise Affairs. The development of this report benefited from consultations with the Business Industry Advisory Committee (BIAC), the Trade Union Advisory Committee, and OECD member and partner economies.

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Preface

The global landscape of publicly listed companies is characterised by a significant number of partly state-owned companies. In many of these companies, the State maintains effective control without being a majority owner. In developed economies, the State is invested in listed companies that represent six percent of total market capitalisation. In emerging economies, this share is estimated to be three to four times higher and likely to grow as countries with large state-owned sectors use partial stock market listing as a preferred method of disinvestment by the State.

This report sheds light on national circumstances for listing state-owned enterprises and why the State often continues to be an important shareholder after the listing. Based on experiences in the People's Republic of China, India, New Zealand, Poland and Turkey it illustrates that subjecting previously fully state-owned enterprises to the rules that are associated with being publicly traded plays an important role in improving their corporate governance practices - including with regard to financial and non-financial disclosure.

However, experiences also reveal important gaps in terms of compliance with securities regulations and listing rules. Listing on a stock exchange, in itself, does not necessarily shield the company from discretionary State policies or undue political influence. Such deviations from expected practices may generate significant losses for non-State shareholders and ultimately for the taxpayers.

With this work, the OECD has taken an important step in showing the merits of listing state-owned enterprises as a means to improve corporate governance. More notably, it illustrates the importance of maintaining a separation between the State's roles as shareholder, policy-maker and regulator. How this can be done in a consistent and coherent fashion is laid down in the *OECD Guidelines for Corporate Governance of State Owned Enterprises*, whose recent revision has been informed by the experiences that are presented in this report.

The OECD is ready to engage with governments as they embark on their reform processes. Our Working Party on State Ownership and Privatisation

Practices is the world's only multilateral body that continuously monitors SOE-related developments and policy making. An increasing number of Partner countries have become active participants in this forum and have used OECD experiences as a key input in their national reform processes. We welcome these developments and recommend this book as a source of inspiration for reform-minded policy makers and government officials.

Adrian Blundell-Wignall,

Director, OECD Directorate for Financial and Enterprise Affairs

Executive summary

This book provides a comparative mapping of relevant national experiences in broadening the ownership of state-owned enterprises (SOEs) through the practice of listing. It is organised around three chapters. The first chapter provides an overview of the ownership landscape of listed majority or partly state-owned enterprises around the world. It explores trends across OECD and major emerging markets. The second chapter explores the various national circumstances that influence a government decision to list. It walks through the listing process to understand how the nature of State participation may be a differentiating factor; it also draws some conclusions as to whether listing can serve to raise governance standards and improve company performance, drawing on diverse national experiences post-public offering. The final chapter provides detailed case studies of China (People's Republic), India, New Zealand, Poland and Turkey. The main findings are summarised below.

Ownership landscape of listed majority of partly-state-owned companies remains non-trivial across the globe. The ownership landscape around the world comprises a non-trivial share of listed state-owned enterprises (SOEs) in both emerging and industrialised economies. The State retains important shareholder rights in many cases. This landscape represents various trends including: (i) unfinished privatisations; (ii) planned "mixed-ownership" programmes; (iii) important minority shareholdings (just over 10 per cent) in companies with a "strategic" national interest (i.e. former national monopolies in the public utilities); and (iv) acquired minority shareholdings of large financial institutions as a result of capital infusions necessitated by the global financial and economic crisis.

National circumstances that influence a government decision to list vary according to historical, economic, political and fiscal factors. The main drivers behind a government decision to divest shares via the stock market can differ according to historical, economic, political and fiscal factors. The decision can be motivated by both commercial and sometime non-commercial reasons. The main dividing line is whether the state seeks to fully-privatise or if it plans to retain mixed-ownership. Government decisions can be influenced by the level of economic development, other

sought public policy goals (such as capital markets development), and the level of state-participation in the economy.

The pre-IPO phase is arguably the most important phase to ensure success of the share offering. The government may consider different types of governance arrangements before deeming an IPO is the most appropriate route to divest shares from a company it fully or partly owns. A number of factors influence a government's decision, including: (i) the history of the asset's ownership; ii) the financial and competitive position of the SOE; iii) the elected government's view of markets; iv) the regulatory environment; v) the interest of various stakeholders and interest groups; vi) the ability of the government to credibly commit to divestiture plans; vii) the sophistication of the capital markets, and other potential investors; and, viii) how willing the government may be to potentially open up its assets to foreign ownership. The pre-listing phase should ensure the right market conditions and regulatory environment are in place to secure the success of the IPO.

Governments pursue share offerings with a mix of public and fiscal policy considerations. Unlike private sector issuers, governments may pursue listing with different objectives, for example, providing opportunities for domestic investors, employees and citizens to own shares, or meeting specific fiscal objectives. When going to the stock market the government owner will decide how to price and market its company's shares, transfer control and allocate shares based on these objectives. Shares can either be offered under fixed priced, competitive tender, formal book building, or a combination thereof. The State may maintain residual ownership to signal a commitment that it is willing to share residual risk with investors. Government's often maintain effective control of the company through restrictions in the bylaws or charters of the firm, or by retaining golden shares (or a large proportion of high vote shares) – this is often the case for so-called "strategic" firms.

Mixed ownership can engender performance and governance improvements, yet specific issues should be considered where the State remains and important shareholder. Beyond improving corporate efficiency, driving company performance and providing access to capital and investment renewal, listing can raise SOE governance standards in line with practices recommended by the *OECD Guidelines on Corporate Governance of SOEs*. The presence of outside shareholders can have a disciplining effect include reinforcing board independence; increasing transparency and disclosure; and, controlling the level of State influence in company operations, while driving performance through a more increased focus on maximising shareholder value. However, the act of listing, alone, does not guarantee that SOEs will behave like a private firm. National

experiences demonstrate that abusive related party transactions and the protection of minority shareholder rights continue to be areas that need improvement, especially in markets where regulatory and enforcement regimes are not as strong. Moreover, the act of listing itself and the presence of private investors cannot guarantee that SOEs are completely averse to State interests and in some cases political interference. The case studies of China, India, New Zealand, Poland and Turkey demonstrate some of the challenges. As such, specific arrangements, as recommended by the Guidelines, can serve to mitigate any potential for political intervention, while and ensuring predictability and transparency for non-State investors.

Chapter 1

Introduction to broadening ownership of state-owned enterprises

The ownership landscape around the world comprises a non-trivial share of listed state-owned enterprises (SOEs) in both emerging and industrialised economies. The State retains important shareholder rights in many cases. This chapter looks at recent data to understand trends across OECD and major emerging markets, which may give insight to the motivations behind the public offerings of SOEs.

Since the 1980s, there has been an interest in the issue of broadening the ownership of state-owned enterprises (SOEs), not least because OECD governments were very active in public offerings of their state-owned enterprises as part of privatisation strategies which, in some jurisdictions, lasted through the mid-2000s. In former transition, emerging and developing markets, the trend towards share offerings of SOEs was a later phenomenon, but one that took shape and inspiration from the privatisation experience of industrialised economies.

Today, as a result of these share offerings, the ownership landscape around the world comprises a non-trivial share of listed (former) state-owned companies worldwide. Within the OECD area just over 3 per cent of the market value of SOEs relates to listed companies (accounting for total of US$ 632 billion). Listed SOEs also represent a significant share in terms of employment (almost 1 million jobs). The variation among countries, however, is high (1.1)[1] (OECD, 2014a). Among emerging economies, the share is estimated to be even higher. According to some calculations, SOEs' share of global market capitalisation is around 13 per cent (Economist, 2014).

In addition, government ownership is supplemented by a significant number of minority held stakes in listed companies.[2] Such companies with a significant government minority shareholding are commonly referred to as partly state-owned enterprises (PSOEs) (See 1.2).[3] Some European countries stand out in terms of their portfolio of listed PSOEs. The value and employment of listed minority government-held stakes is even larger than in majority-owned listed SOEs. The reasons for these minority shareholdings differ across countries and companies. In some cases they represent unfinished privatisations. In others cases, shares of just over 10 per cent (or such thresholds for squeeze-outs as established by national securities law) are maintained to secure effective control or to retain a material interest in the company. These are often found in companies with a "strategic" national interest, or where the government has been unwilling to divest completely from (former) natural monopolies (i.e. public utilities, finance institutions).[4]

Table 1.1. **Majority owned listed entities - 2012 (by central level of government)**

Country	2012 - Majority-owned listed entities				Total SOE Population
	N° of Listed SOEs	Share of total SOE employment (in %)	Market value of enterprises (USD bn)	Share of total SOE sector value (in %)	Total N° of SOEs
Austria	2	35	11.1	50.4	9
Belgium	1	18	9.1	89.0	8
Chile	3	1	1.1	4.9	34
Czech Republic	1	22	18.6	46.1	125
Denmark	1	3	0.1	1.2	17
Finland	3	26	19.8	44.7	42
France	3	10	45.1	40.5	57
Hungary	1	2	0.1	0.8	371
Italy	7	53	157	69.4	17
Japan	1	5	82.7	23.4	
Korea	8	33	41.4	20.6	57
Lithuania	2	2	0.2	2.8	137
New Zealand	1	25	0.8	5.1	18
Norway	3	29	108.6	44.6	45
Poland	6	23	27.8	45.2	326
Slovenia	5	22	1.5	11.8	39
Spain	1	21	1.3	24.0	53
Switzerland	1	19	21.7	54.7	4
Turkey	6	20	26.2	26.3	144
United Kingdom	1	41	57.5	86.9	17
United States	1	0.16	0.1	3.8	16
Total OECD [1]	58	*15*	*632*	*32.0*	1617
China	286	61	1625	37.5	
India	68	--	294	--	227

1. OECD totals were calculated including all OECD countries that were covered by OECD.

Source: OECD (2014a), *The Size and Sectoral Distribution of State-Owned Enterprises*, *http://dx.doi.org/10.1787/9789264215610-en,* Author calculations.

Table 1.2. **Minority owned listed entities – 2012 (by the central level of government)**

Country	2012 - Minority-owned listed entities (PSOEs)		
	N° of PSOEs	**N° of employees**	**Value of enterprises (USD bn.)**
Austria	2	45 104	14.8
Belgium	5	55 254	115.0
Denmark	2	16 970	3.1
Finland	11	139 911	70.9
France	11	954 245	167.3
Germany	3	713 890	84.4
Hungary	2	40 401	11.3
Ireland	1	3 566	0.2
Japan	1	224 239	73.6
Korea	2	3 312	0.002
Latvia	1	32	0.009
Lithuania	1	1 700	0.3
Norway	5	64 211	44.7
Poland	10	64 525	48.8
Slovenia	16	30 570	3.5
Spain	2	7 818	6.6
Sweden	3	73 156	65.5
Turkey	1	37 524	13.5
United Kingdom	1	7 091	53.4
United States	3	214 626	46.9
Total OECD [1]	*80*	*2 696 324*	*795*
China	409	3 673 141	1027
India	9	225 647	100

1. OECD totals were calculated including all OECD countries that were covered by OECD.

Source: OECD (2014a), *The Size and Sectoral Distribution of State-Owned Enterprises*, *http://dx.doi.org/10.1787/9789264215610-en,* Author calculations.

There has been more recent activity among emerging economies and a handful of OECD economies to float government-owned firms on local and foreign stock exchanges, as part of a renewed interest in promoting mixed ownership, if not full privatisation. Recent examples can be seen in the United Kingdom, Norway, and Spain (Box 1.1). Some OECD economies have also acquired minority shareholdings of large financial institutions as a result of capital infusions necessitated by the global financial and economic crisis.

Box 1.1. **Example of recent IPOs in the OECD area**

Norway

The Norwegian government has issued plans to undergo initial public offerings or divest additional shares in a number of state-owned companies. This is part of the government's first step in a broader initiative to increase the state's flexibility to reduce the state ownership and to support mergers or acquisitions or other strategic changes to its portfolio. The plans are aimed at selling the state's shares in companies where there is no specific justification for continued state ownership; whereas for other continued state ownership may be justified for strategic reasons (i.e. maintaining headquarter functions in Norway, the management of common natural resources, or sectorial policy objectives). The government proposal concerns 55 state-owned enterprises; with partial or full share offerings of at least 8 companies (Ambita,Baneservice,Cermaq, Entra, Flytoget, Mesta, SAS,Veterinærmedisinsk Oppdragssenter) and a reduction of state ownership to 34 percent in at least two companies (Telnor and Kongsberg Gruppen) foreseen in the near future.

Spain

Following the most recent non-binding recommendation by the Advisory Council on Privatisation, the government of Spain has gone forward with plans to privatise up to 49 per cent of shares in Aena – one of the world's largest state-owned airport operators. The Cabinet approved the recommendations which included plans for restructuring the company and the regulatory framework for airports. A multi-stakeholder Commission (bringing together the office of the President, shareholding Ministries and the company executive) has guided the privatisation process, including evaluating bids to gather a "stable core of shareholders" to purchase up to 21 per cent of the shares to be floated; and agreeing to an employee share programme. The listing is part of a medium-term broader government divestment plan.

United Kingdom

Following in-depth reviews of Royal Mail (in 2008 and subsequently in 2010), the UK authorities decided to proceed with an initial public offering of Royal Mail, with the aim of addressing challenges faced by the state-owned postal operator. The reviews highlighted that Royal Mail was in need of access to private capital; moreover, the Government determined that it should relieve Royal Mail of its historic pension deficit; and a new regulatory regime was needed that placed post within the broader communications market. In 2010-12, the government enacted legislation to make the share offering possible. In 2013, the company went public with the government retaining a 30% stake (valued at GBP 1.7 billion). Although the government took a cautious approach and prioritised certainty of execution over maximising the IPO, its restructuring and floatation ensured that the UK taxpayer bears less risk, while ensuring Royal Mail access to private capital.

Sources: CCP (2014), "Opinion on Privatisation of Aena," 23 October 2014.
Government of Norway (2014), "Adjustments in order to increase distribution of power and private ownership," Ministry of Trade, Industry and Fisheries Press Release, 6 June 2014.
OECD (2014b), "Royal Mail Initial Public Offering," Presentation by Shareholder Executive UK, Working Party on State Ownership and Privatisation Practices, 2 April 2014.

Given the continued presence of the State as a shareholder, the discourse today is not about the motives behind privatisation itself, even if that has historically been the main driver of share offerings of SOEs, but more about, what impact listing has had on the companies themselves and on the State as a shareholder. With the benefit of hindsight and more recent experiences with listing, both in OECD and emerging economies, this paper aims to answer some questions as to the motivation behind listing and why the State continues to remain an important shareholder. The paper attempts to illustrate, based on the national experiences of China, India, New Zealand, Poland and Turkey, whether the nature of State participation and remaining State objectives in these companies has an impact on the governance and performance especially in comparison with other listed companies without State participation and SOEs which remain under 100 per cent state ownership.

The remainder of this report will provide a comparative review of national practices in light of recommendations in the *Guidelines on the Corporate Governance of State-Owned Enterprises* (SOE Guidelines) (OECD, 2005); it will also attempt to draw out some examples of good practice (Chapter 2). It is followed by Chapters profiling the national experiences of China (People's Republic), India, New Zealand, Poland and Turkey (Chapter 3).[5]

Notes

1. There are 27 economies with available data. Employment and value is based on available data for 15 economies, and 48 listed SOEs.
2. Minority stakes are defined as at least 10% of the common stock, or equivalent voting rights.
3. In this paper majority-owned SOEs denote listed SOEs in which the State owns over 50 per cent of the shares. Companies which are minority-owned (under 50%) can be counted as majority-owned SOEs if the State can appoint more than half of board members or otherwise exercise effective control. PSOE denotes State ownership between 10 to 50 per cent of shares.
4. Other scenarios may also exist, but are not treated in the context of this document, these include: State takeovers of property, so-called "nationalisations", or takeovers of enemy property during periods of war.
5. National practices for China and India are drawn from a report drafted for the OECD by an external consultant, whereas those of New Zealand, Poland and Turkey are collected from government sources.

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Chapter 2

Main issues and comparative overview of national practices in broadening ownership of state-owned enterprises

The main drivers behind a government decision to float SOE shares differ according to the level of economic development and other sought public policy goals, such as capital markets development. The main dividing line is whether the state seeks to fully-privatise or if it plans to retain mixed ownership. Beyond improving corporate efficiency and driving company performance, listing can raise SOE governance standards in line with practices recommended by the *OECD Guidelines on Corporate Governance of SOEs*. An initial public offering can be complex to orchestrate involving the State in its multi-faceted role as shareholder, government owner and regulator. This chapter explores these and other related aspects drawing on a comparative overview of national experiences in China (People's Republic), India, New Zealand, Poland and Turkey.

2.1 Motivation to list

Not unlike privately-owned companies, prior to deciding whether to list, a government may consider a number options for new governance arrangements that can be motivated by both commercial and sometime non-commercial reasons. It is broadly accepted that listing can improve the efficiency of any company by subjecting it to the rigours of listing requirements and security regulations and enhancing its financial flexibility by opening new alleys for raising fresh capital (OECD, 2004).

The main dividing line among government owners relates to whether the intent behind an initial public offering (IPO) is an eventual full privatisation or a continued state majority, or significant minority ownership. Hybrid approaches are of course possible: some governments, at the time of IPO, defer possible secondary and tertiary offerings to a later decision. The division can be described thus (detailed in the following sections):

- *Continued government control of the listed entity is foreseen.* In this case the main motives behind listing can be purely fiscal, or it may reflect a strategy of relying on market mechanisms to lift the SOEs' corporate performance.
- *IPO is seen as first tranche of a full privatisation.* Large SOEs are usually privatised through listing rather than trade-sales. The pace of the privatisation process (i.e. of subsequent share offerings) may depend on a number of factors:
  - Going fast. If capital markets are liquid and have a high absorption capacity, and if the privatised company is perceived as well managed, then there is little incentive for governments to drag out the privatisation process. Some delays may, however, be necessary for practical reasons, such as settling legacy contractual and staff issues.
  - Going slow. Where the SOE to be privatised is large relative to domestic capital markets there is a clear case for going slow in order to obtain the best price. Also, a gradual process allows time to upgrade corporate governance and regulatory frameworks, thus further boosting the valuation of the company.

OECD (2009) showed that the largest privatisation proceeds from SOEs in the utilities sectors normally derive from the tertiary share offering.

For most countries, broadening the ownership of SOEs has apparently been motivated by the end-goal of full privatisation. This was the case with the surge of SOE market listings which took place over the course of the 1980s and 1990s across the OECD area, and progressively since in emerging and developing economies.[1] These listings were carried out in the context of pre-determined privatisation and economic reform programmes, or motivated by more ideological policies (See also OECD, 2009 and 2010). A distinguishing feature of India's and New Zealand's (most recent) listing policy has been to maintain majority ownership (i.e. over 51 per cent). Similarly, in China, the state has maintained a controlling or majority share in most of its listed SOEs. In Poland, this only applies to strategic companies (i.e. those in which the government has a stated policy to remain controlling owner), while the remainder of listed SOEs are owned at more than 25 per cent with no explicit government policy to retain shares over the long-term. In the case of Turkey, the State retains a considerable influence in the two partially privatized companies like Halkbank where it remains majority shareholder and Türk Telekom with 32 per cent.

The experiences of China, India, New Zealand, Poland and Turkey reveal how different historical factors may have influenced the decision to list (see 2.1).[2] Turkey began its privatisation initiative in 1984 to achieve a structural transformation and modernisation of its economy. The drive by the Turkish Government to list shares at this time was particularly important to promote the way for the future development of capital markets in Turkey as the merits of being listed was not fully understood and appreciated by the private companies at the time.

For India and Poland, the main driver for listing SOEs has been a long to medium-term strategy of privatisation (although in India the term "divestment" is used) given the historically large number of SOEs present in both economies (see data in Tables 1.1 and 1.2). In these jurisdictions policy-makers have found it politically palatable to privatise companies through floatation as a transparent means to transfer the ownership of these companies from full State-ownership to majority/minority ownership, while serving the dual purpose of developing the local stock market (mainly Poland) and encouraging citizen investment in it.

In New Zealand the motivation to list is slightly different. Most privatisations occurred in the 1990s and were completed shortly thereafter. The most recent listing policy reflects a political decision to encourage "mixed-ownership" of three large state-owned energy companies and to

broaden the ownership of the already listed national airline carrier. Many of these factors apply to the complex and evolving market environment in China, where listing has been seen as an effective means for diversifying their SOEs' equity structures, and securing financing, while improving corporate governance.

Regardless of the motivation, all cited national examples demonstrate that policy-makers see benefits that can be reaped from going to the market. These benefits are both for the companies themselves and as a means to serve broader public policy goals, such as improving corporate efficiency, driving performance, and – in the case of Poland (as a post-transition economy) as well as China and India (as emerging economies) – contributing to the development of capital markets. These and other issues are further discussed below.

2.1. **Motivation to list: A comparative table**

	China	India	New Zealand	Poland	Turkey
1. Performance improvements through market discipline	X	X	X	X	X
2. Capital market development /Strengthen local stock market	X	X	X	X	X
3. Maximise privatisation revenue/Free up capital		X	X	X	X
4. Attract financial resources for SOEs	X	X	X	X	X
5. Improve efficiency and transparency of SOEs	X	X	X	X	X
6. Freeing SOEs from public spending limits	X		X		
7. Raise governance standards	X	X			X
8. Encourage citizen investment in stock market		X	X	X	
9. Other		X	X		

Source: Author, based on submission received from government authorities.

Performance improvements by introducing market discipline. A number of studies show that the average long-run performance of companies which have mixed ownership and are listed yield better returns in terms of profitability, output and efficiency than companies remaining unlisted and 100 per cent state-owned (D'Souza *et al.*, 2007; Megginson and Netter, 2001; and Alanazi, *et al.*, 2011).[3] Most of the national experiences in this paper support this posit.

In India, the net worth and profits (both PAT and BPDIT) for listed companies over a twenty year period (from 1990 to 2012) show a steady increase for all listed SOEs. In Poland, from 2008 to 2011, during which 13 SOEs were privatised through the stock exchange, all companies achieved positive net financial results and increased operating income. Aside from the impact of the market on their performance, some of these improvements reflect the fact that the companies selected were already identified as suitable candidates for listing due to their ability to attract investment and generate profits. It may yet be too soon to measure the actual impact listing has on SOEs in China, though studies indicate listed SOEs tend to have higher rates of return, be more efficient, and demonstrate higher levels of corporate governance than non-listed SOEs.

Turkey began its privatisation initiative in 1984. Public offerings and private placements predominated in the privatisation programme: more than 20 SOEs were listed at the Istanbul Stock Exchange (ISE) between 1988 and 1991. IPOs have been observed to enhance the company performance at SOEs by means such as adopting financial reporting rules in line with private sector, establishing corporate governance practices, achieving compliance with public disclosure requirements and management approach to conduct operations under a profit oriented perspective. A total USD 19 billion has been raised from the listing of SOEs, which represents approximately one third of the total USD 60 billion of total privatisation revenues. An intentional by-product of the privatisation programme was a strong vitalization of Turkish stock markets which had previously been characterised by weak liquidity, sparse trading and generally small free floats.

For New Zealand's mixed ownership programme, it is also too early to tell whether performance improvements will be witnessed. In the case of previous privatisations, the government considers that corporatisation and subsequent privatisation has led to improved efficiency gains, which has been partly achieved through the pressures of capital markets and private investment (Wilson, 2010).

Generally, the benefits of listing can only be reaped in an environment where the stock market and legal system is sufficiently functional to establish effective corporate governance that protects the interests of all shareholders, especially minority shareholders (Wang *et al.*, 2004). In other words, the intensity of capital market pressure will also depend on the extent to which individual shareholder rights are protected and enforced; and the extent to which the disciplining effect of non-State shareholders may be felt more strongly. For example, some studies indicate that the post-listing benefits enjoyed by SOEs in China are linked to the development of China's

capital market. These benefits include greater awareness of the need for—and protections of—the rights of minority shareholders.

The performance benefits yielded by going to the market should also be weighed with the level of market competition and deregulation especially where (former) state-owned incumbents maintain natural monopolies (Gupta, 2005). Prior to embarking on the listing programme which involve three large state-owned energy companies in New Zealand, a number of public inquiries were made on the impact SOEs had on the marketplace, given their market share and presence. The government ensured that the energy market was adequately regulated to promote a high level of price competition between retailers regardless of their ownership prior to proceeding with the listing of its SOEs. In the Chinese context, which is transitioning towards a mixed ownership model, the consensus is to work on the market system and regulations, underpinned by a strong legal system, before undergoing a large scale sale of state-owned assets.

Attract financial resources for SOEs/free SOE from public spending limits. Mixed ownership of SOEs permits the government to share risk with private investors and attract financial resources for SOEs. This may provide an impetus to pursue business opportunities that may not have been palatable when the company remained 100 per cent under State ownership. The presence of private investors may allow for investments in longer-term and more risky projects, especially in certain capital intensive and sometimes uncertain investment projects in sectors such as in oil or mining.[4] The presence of a government shareholder may balance out the short-termism of private investors concerned with maximising shareholder value, while the market-orientation of private investors may balance out government pressures to reap short-term dividends associated with political or fiscal cycles (Pargendler *et al.*, 2013). This, for example, is one of the main motivations in China for listing SOEs. The Chinese government prioritises listing SOEs that, among other factors, have generally higher rates of capital expenditure and long-term investment needs.

In Turkey, with increasing depth and institutionalisation of Borsa Istanbul (BIST), along with the strong appetite of foreign institutional investors, both the amount of proceeds obtained from SOE public offerings and the amount of shares offered have substantially escalated in 2000s. Allocation of the shares to institutional investors globally and in the domestic market as well as the appetite of foreign investors to invest in Turkish capital markets has been significant factors for the success of IPOs realised in last decade.

New Zealand's mixed-ownership programme also demonstrates that listing provides an opportunity for the government to cease acting as the

main financier. One of the stated purposes of the listing programme is to free up capital for government investment in other priority areas (such as education or health care).

Capital market development/encourage citizen participation in the stock market. Countries with under-developed capital markets may list SOEs as means to develop capital markets. Poland, for example, used listing as a means for the State to gradually exit from these companies, while serving the dual purpose of developing a nascent capital market which was important for private sector development and broader economic policies. This also is true in China, as well as in India, reflecting the Indian government's "Peoplisation of SOEs" policy. In counties with well-developed stock markets, such as New Zealand, the motivation may be more oriented towards encouraging citizen participation in the stock market by increasing attractive investment opportunities.

Table 2.2**. Governance of listed SOEs vs. wholly-owned SOEs**

Governance features	Listed SOE	Wholly-owned SOE
Balancing commercial and non-commercial objectives	Focus on maximising shareholder value. Potential for conflict if minority shareholders pursuing profitability clash with the government following social or political goals.	Potential for double bottom line with profit maximisation jointly with other social objectives.
Selection and appointment of board and management	Board independence driving force, with key role in monitoring CEO. Act in the interest of all shareholders. Can balance the government (although there are still risks for the government as majority shareholder to co-opt the board). Professional directors and management selected according to competitive process.	Boards likely to include a mix of government appointed and independent directors. Potential for political interference and conformist as opposed to performance-oriented boards.
Transparency, accountability and disclosure	Subject to stock market listing requirements and securities laws. Accounting standards following internationally agreed methods. Subject to external audit. SOEs afforded no exceptions.	Potentially weaker incentives to monitor; incomplete information due to lack of separation of accounts.
Performance and risk	Stock prices and financial ratios are performance metrics. Shorter term horizon, with investment in riskier projects. Still government backing may serve as implicit/explicit guarantee.	Subject to softer budget constraints, but also public spending limits. Longer term horizon, and more risk averse.
Incentive-based performance	Pay-for-performance contracts, with stock options.	Low-powered incentives.

Source: Author and Pargendler, M., Musacchio, A. M. and Lazzarini, S. G. (2013), In Strange Company: The Puzzle of Private Investment in State-Controlled Firms, Harvard Business School Working Paper, No. 13–071, February 2013.

Improve efficiency and transparency of SOEs. Beyond performance improvements, listing can improve the efficiency and transparency of SOEs. This can be trigged by changes in the operational strategy of the company, management changes, and the involvement of private control of the enterprise. State involvement can lower transaction costs in areas where the enterprise continues to deliver on public policy objectives of a "social" nature through effective regulation. Moreover, the listing requirements of the stock market, including requiring audited financial statements is a feature which, if not in place prior to listing, may improve transparency around SOE operations.

For example, in China and India, listing has reportedly improved transparency around SOE operations as compared with non-listed companies and brought corporate governance measures in line with international standards. In China, this may be especially true for (usually large) SOEs that choose to issue shares on exchange markets outside mainland China, for example in Hong Kong, London, and in New York, which have rigorous reporting requirements.

Recently in the case of Turkey, four major pieces of legislation that impact transparency and corporate governance for companies in Turkey have been substantially amended - namely the TCC, the Turkish Code of Civil Procedures and Capital Markets Law. The new TCC generally aimed to raise the standards on transparency and corporate governance of Turkish companies, to reinforce minority shareholder rights, to provide additional restructuring tools, and to simplify the incorporation process.

Raise governance standards. Changes in the ownership structure of a company brought about by listing can engender improvements in management and governance. In the case of SOEs, the introduction of non-State shareholders introduces additional checks on company management. In addition, non-State shareholders may have better abilities and incentives to monitor and exercise effective control over the management (D'Souza *et al.*, 2007). In some cases, senior management may be replaced, especially if prior to listing senior managers were politically connected.[5] In the view of Chinese SOEs, for example, one of the biggest benefits to listing is increased autonomy from the State in the management of the enterprise's affairs. In Turkey, the so-called *Corporate Governance Communiqué* is designed to implement certain enhancements to Turkish corporate governance standards, including a requirement that at least one third of Board members be independent. Indeed, with the objective of approaching EU and global standards on capital markets and to strengthen investor protection and market liquidity, the new Turkish Capital Market Law has entered into force in 2012.

Listing may also serve as an incentive to monitor managerial performance through the design of incentive-based compensation packages, linked to the market value of the enterprise.

In order to better understand the nature of governance, performance or other changes that may arise out of listing, the following sections will look at the phase prior to listing, the "going to the stock market" phase, and the post-listing phase.

2.2 Prior to listing

An IPO process that involves the government differs from that of a private company, in that the government and its team is usually involved in many aspects of the IPO process in its multi-faceted role as shareholder, government owner and regulator. A number of factors influence a government's decision to list. This may be effected by the history of the asset's ownership; the financial and competitive position of the SOE; the elected government's view of markets; the regulatory environment; the interest of various stakeholders and interest groups; the ability of the government to credibly commit to divestiture plans; the sophistication of the capital markets, and other potential investors; and how willing the government may be to potentially open up its assets to foreign ownership.

More generally, for the IPO to be a success the government will have determined that the SOE is commercially viable; it is operating profitably and is likely to be a good investment option for potential investors. If these three criteria are not considered to be met the government may determine that other options for restructuring may be more suited to the particular SOE. Indeed, in all cited jurisdictions specific criteria have been established around which governments base their decision to list.

Above and beyond the above criteria, in New Zealand, each company is subject to a five-step test which factors in whether the sale would generate enough revenue to free up capital to fund new public assets; and whether industry-specifications are in place in advance of the sale to ensure adequate protections for consumers. In Poland, a team of experts in the Treasury evaluate each company which, beyond the above factors, takes into consideration whether listing would strengthen the domestic capital market and have an impact on the competitiveness of the Polish economy. In China, the National Development and Reform Commission (NDRC) must approve any request to restructure an SOE in preparation for potential listing before the SOE can be listed. In Turkey, following the approval of the Privatisation High Council (PHC) to initiate a public offering process, the Privatisation Administration (PA) undertakes the execution work in coordination and cooperation with the relevant SOE.

The pre-IPO stage is, arguably, one of the more important phases in the listing process. It represents the stage when the 'equity story' is being built and it can also have an impact on company operations. A carefully planned and executed floatation process is critical to the success to the initial public offering (IPO) and successive offerings. It is the government's role during an IPO to sell the SOE shares, and ensure that the process is implemented in line with the government's stated objectives. This phase includes a detailed review of the company by investment banking sector specialists, among others can result in new measures being introduced to bring about further operational efficiencies such as streamlining operations, or introducing a revision of company strategy. The main roles the government plays in planning the actual IPO is as follows: managing and driving the IPO process; preparing the investment strategy with the SOE; managing the offers; organising the offers; and, successfully listing the shares on the appropriate stock exchange(s) (refer to Figure 2.1).

For potential listing candidates, the government may determine that further restructuring is required in order to make the company more of an attractive investment opportunity. This can comprise of ownership changes such as establishing relations with strategic investors or developing employee-share ownership plans to help to redefine the firm's objectives. It can also comprise of restructuring by means of acquisitions, divestitures, and recapitalisations, such as in the case of India, as a means to ensure stronger post-listing efficiency gains. SOEs in China are subject to an in-depth eight-step restructuring plan before they are listed (outlined in Chapter 3, section 1).

Once the government determines that an IPO is the best option, part of the pre-listing phase will involve the government in its role as owner and regulator, to ensure the right conditions and environment are in place to secure the success of the IPO. This includes consulting with and gaining the support of various stakeholders to ensure that they are aware of the objectives and process. For example, employees are often made aware of employee share offer schemes in advance of the listing to ensure their buy-in. In Poland and New Zealand, where citizens were also among the targeted group of potential investors, media campaigns serve to create awareness of the potential investment opportunities. In Poland, a nationwide educational programme is offered to domestic investors to better inform them of the basics of investing on the stock market as a means to attract their business. All share offers are accompanied by detailed risk analyses including specific risk mitigation strategies for risks of a political, legal, financial, and/or social/economic nature. National experiences demonstrate that the timing of IPO transactions is critical to their success.

A number of governance changes may be in order to harmonise company practices with securities regulations and listing requirements. In China, for example, SOEs incorporated as legal persons under the SOE enterprise law (Law on Whole-People Ownership of Industrial Enterprises) may have business and management characteristics that are incompatible with those that regulators, markets and investors require of listed companies. In companies which have a number of State-appointed members of the board, or upper management with close relations with the State, listing may require some changes as is elaborated in the securities or capital markets laws. New management as a part of restructuring may help to prepare the company to be better prepared for listing, for example by changing the corporate strategy if necessary. Empirical evidence has found a positive relationship between the change in upper management and the market value of listed SOEs (D'Souza *et al*, 2007).

Changes of a legal and regulatory nature may also be necessitated, including having an adequate competition and regulatory framework in place where such an environment may already be in place, additional measures may be necessary to ensure harmonisation with the legal framework. In New Zealand, for example, companies that were handpicked for the "mixed-ownership programme" were still considered SOEs (i.e. in the government's vernacular, "Crown entities") according to the national SOE Act. The Act and all other relevant laws and regulations were amended to ensure full harmonisation with the new "mixed-ownership" status soon to be afforded to these companies. In some cases, company by-laws, articles of association or company charters must also be modified to prepare companies for listing (see also Section 2.3 below).

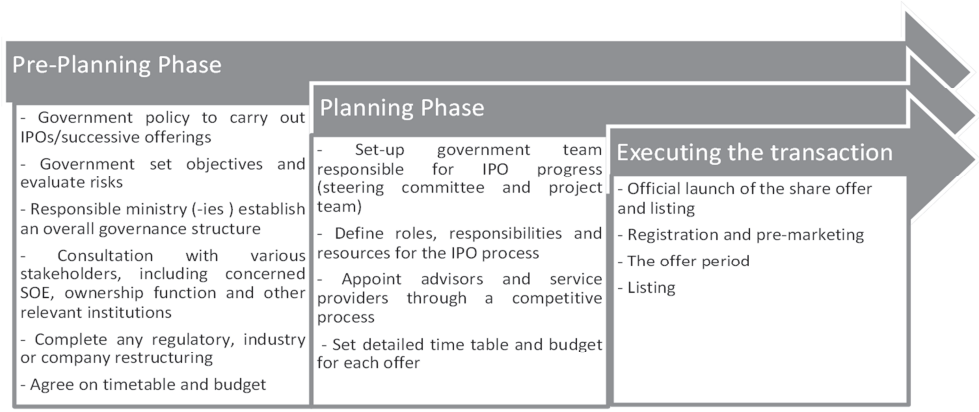
For each government and IPO the actors involved may be different. In India, New Zealand and Poland the main institution driving the IPO process is the Ministry of Finance/Treasury. A well-orchestrated IPO process is likely to involve a wider set of stakeholders, who are involved to different extents and capacities depending on the stage of the IPO process. These actors and stakeholders can include: Cabinet and relevant cabinet committees; inter-ministerial committees and an oversight committee; Ministry of Finance or Treasury; public enterprises; centralised/coordinating ownership function and/or relevant line ministry (i.e. the ownership ministry in a dual or decentralised system); sector regulator; the stock exchange(s); securities exchange regulator/capital markets board or equivalent; and, stakeholder bodies (i.e. labour organisations; consumer groups; broader public, etc.).

Governmental bodies in Turkey that are responsible from the undertaking of privatisation activities are Privatisation High Council (PHC) and the Privatisation Administration (PA). Following the approval of the

PHC to initiate a public offering process, the PA undertakes the execution work in coordination and cooperation with the relevant SOE. It is seen as essential for the success of an IPO that the SOE is commercially viable, operates profitably and has the fundamentals to prove to be a good investment opportunity for potential investors. Although PA is responsible for whole offering process, the SOE that is to be listed has a substantial role to play during the IPO taking into account that the cooperation of SOE and representation of its senior management, especially during investor road show sessions, is critical.

In China, the process of preparing an SOE for an IPO include the SOE's management, employees and stakeholders; the central ownership function (State-Owned Assets Supervision and Administration Commission - SASAC); the National Development and Reform Commission; and government officials from various levels of government. In India, an inter-ministerial process guides the decision to list, but in order for it to get to that point an "in-principle" agreement must be sought among the SOE, the oversight Ministry and the Ministry of Finance in charge of the divestment process. In all cited jurisdictions, cooperation between the various entities involved is considered to be important to ensure smooth governance of the process and success of the offering.

Figure 2.1. **Flowchart: Overview of the IPO Process**



Source: Authors.

Beyond technical considerations, the government must also weigh in whether the public and affected communities are adequately informed and supportive of the government's plans to list. This should involve as a first step, consultation with various stakeholders involved. It should also test the public "appetite" for listing, especially if historically there have been

negative preconceptions regarding the divestment of public assets. Governments must ensure that the public is adequately consulted on plans to list public enterprises, and that its intentions are clearly communicated in advance. Otherwise it can risk having mixed ownership plans postponed due to stakeholder opposition based on a lack of understanding of government plans (for example if employees or citizens see such a move as a precursor to privatisation).

2.3 Going to the stock market

When going to the stock market the government owner will be confronted with a series of decisions as to how to price and market its company's shares, how to transfer control and how to allocate shares. Unlike private sector issuers, governments may pursue listing with different objectives than private issuers. This may be influenced by both economic and political factors, and governments may approach listing by placing various weight on these two competing goals. The relative importance of each goal is determined by the country's unique motivation to list (i.e. historical, cultural, fiscal, etc.), which may have an impact on the pace, scope and structure of the listing process.

According to Jones *et al.* (1999), over 90 per cent of share-issue privatisations are oversubscribed. This is attributed to the fact that government's share allocations almost always guarantee significant portions of the offers to domestic and retail investors, as opposed to foreign and institutional investors. This is consistent with the experiences of China, India, New Zealand, Poland and Turkey, where one of the objectives has been to provide opportunities for domestic investors and citizens to own shares. By under-pricing stock, governments also indicate that they are willing to accept lower proceeds which result from privatisation. On the one hand, this can result in the IPO being criticised by opponents of privatisation, since in some cases under-priced stock can give the impression that SOEs are sold for "scrap value". On the other hand, it may provide political support for the process, and attract a larger share of domestic ownership, which may also benefit other goals such as developing local stock markets. Discounting shares for employees may also build further support for privatisation with labour unions or employees.

Another way in which listing may differ from private companies, is that the issuing government is presumed to have more complete information than other investors. This too can have an impact on firm value after the IPO. Studies indicate this may be the case regarding SOE IPOs in China; although it may be too early to measure post-listing profitability in more recent cases.

On the flip side, government officials may pursue higher prices as a strategy to maximise proceeds from privatisation to meet specific fiscal objectives. Countries with less developed capital markets are more likely to discount shares in IPOs to promote broader share ownership.[6] For example, in Poland, pricing primary or secondary offers is done typically in line with market practice; but IPOs tend to have some discount. If interest in the offering is low further discounts may be considered.

Governments usually do not sell an entire SOE or even controlling stake in the company in the initial offering. For example, in China, the State has retained 30 to 50 percent ownership in roughly half its listed SOEs and 50 percent or more ownership in 40 percent of the listed SOEs. The State may maintain residual ownership to signal a commitment that the government is willing to share the residual risk with investors. But also, in many cases the government may maintain effective control of the company through restrictions in the bylaws or charters of the firm, or by retaining golden shares/a large proportion of high vote shares (in a multiple class share structure) which are designed to ensure that companies are not fully controlled by foreign or other investors that could theoretically target a company for a takeover (Boubakri *et al.*, 2011).

In some cases this is motivated by national security or strategic reasons (See also section 2.3 below). For example, the articles of association of strategic companies in Poland (as designated by strategy and policy documents), carve out specific rights for the Treasury which would be necessary once ownership is diluted. These carve outs may include exemptions from restricted voting rights or additional voting rights. In New Zealand, the government has made it clear that it will retain 51 per cent ownership in the companies in which it has selected to take part in the mixed-ownership programme, while additional quotas were placed on the total per cent shares reserved for domestic investors in the Mighty River Power offering.

The choice of broadened or mixed ownership methods is guided by the size of the enterprises to be sold, market conditions and the objectives of the process. Shares can either be offered as, fixed priced, competitive tender, formal book building, or a combination of the first and second (see 2.3). In the case of share issue privatisations, most are fixed-price methods where government share price a few weeks in advance of the offering date. Governments typically use tender offers or book-building for the institutional or foreign tranches. A fixed price method is popular with risk averse issuers; whereas governments may be more willing to use book building or auctions to maximise issue proceeds in subsequent offerings (Jones *et al.*, 1999). Alternatively, as in the case of Poland, most offerings are not price fixed, but priced through book building.

Regardless of the country, it must be recognised that, aside from factors such as pricing, control and share allocation, the government may be capable of enticing investors thanks to the very nature of government ownership and the possible market-power the company may have as a result of its previous position as (former) monopoly. Some of the regulatory advantages that former SOEs may have as a result of their public ownership may also serve to attract investors, this can include explicit or implicit State guarantees, exemptions from bankruptcy laws, or lower cost of debt. Outside investors may favourably view SOE as an attractive investment with high performance potential thanks to such benefits. This is of course weighed with the potential pitfalls arising out of continued State-control or lack of adequate competition, which can also dissuade investors depending on the level of acceptable risk they may be willing to take (so long as a minimum of abusive behaviour is avoided and adequate transparency and disclosure allow for investors to make a relatively informed decisions).

Table 2.3. **Arrangements for broadening the ownership of SOEs**

Method	Form	Description
Trade Sales	Private placement	a) Sell a portion of SOE to a preferred private bidder; b) Block trades: Offering tranches of shares in already listed SOEs privately to groups of investors
	Trade sale auctions	Auctioning off a portion to highest bidder
Share Offerings	Initial public offering (IPO)	Offering a tranche of shares on the stock exchange(s)
	Secondary public offering	Offering additional tranches of SOE shares following IPO
	Convertible bonds	Disposing of additional tranches of listed SOEs through the issuing of convertible bonds
Management/Employee Buy-Out	Trade sale through private placement	Shares sold to legal entities controlled by staff and/or management
Partial Privatization by SOE	Capital Increases	Government or SOE issue additional stock to dilute the government's ownership share.

Source: Adapted from OECD (2009), Privatisation in the 21st Century: Recent Experiences of OECD Countries, Report on Good Practices, Corporate Governance, OECD, January 2009.

In some jurisdictions, SOEs may be subject to more stringent corporate governance and transparency requirements than private enterprises, especially where they are subject to public scrutiny. This may add a layer of protection and hence confidence to attract future investors. One kind of initial public offering process is typical to privatisation in Turkey. The legislation does not differentiate between the public offerings of a private sector or a public sector company. On the other hand the securities regulator, Capital Markets Board (CMB), has the authority to grant exemptions on certain requirements considering the nature of a public offering and its objectives. There have been cases that CMB has used this flexibility during offerings of SOEs.

In more nascent capital markets, SOEs may make up a significant share of market capitalisation/value, and therefore represent a larger proportion of investment opportunities (Pargendler *et al.*, 2013). In India, SOEs represent approximately 18 per cent of market capitalisation; in New Zealand SOEs represent approximately 2 per cent, while in Poland SOEs represent approximately 41 per cent (OECD, 2014a and Mishra, 2013). In China, listed SOEs account for less than a third of all listed companies (28 percent), but they account for nearly 67 percent of the total market value of all domestic listed companies. In general, some listed SOEs, especially those in the oil and gas sectors are among the largest firms operating worldwide and historically represent some of the largest offerings that have occurred over the last ten years.[7]

2.4 Post listing and specific issues to consider for listed SOEs

Share offerings for SOEs may have an impact on company performance, governance arrangements, and ultimately the quality of governance. The application of the *OECD Guidelines on the Corporate Governance of SOEs* (SOE Guidelines, OECD, 2005) and the *Principles on Corporate Governance* (Principles, OECD, 2004) (both revised in 2015) would go a long way in ensuring that listed companies with State participation are acting in accordance with good corporate governance practices (Box 2.1). However, due to the remaining State participation in the company, certain issues deserve specific attention which may differentiate SOEs from privately-owned companies. These types of differences could be reflected in the fact that (a) SOEs may have additional objectives above and beyond their commercial ones; and, (b) prior to being listed SOEs may have been subject to different governance arrangements from their listed peers (2.4). These issues and challenges are further discussed below.

Table 2.4. **Impact of listing on SOE governance and performance: A comparative table**

Q. Where changes occasioned after or due to listing?	China	India	New Zealand	Poland	Turkey
Commercial orientation	Y	Y		Y	
Access to capital and investment renewal	Y	Y	Y	Y	Y
Board independence	Y	Y			Y
Non-commercial objectives			Y		
Transparency and disclosure	Y	Y		Y	Y
Corporate Social Responsibility	Y		Y		Y
State influence		Y/N	Y		Y/N

Source: Author based on submissions received from government authorities.

Effective and better qualified management and independent boards are able to introduce operational efficiencies post listing. Following listing, part of the management and board may have undergone changes in composition as a result of the requirements as laid out in the securities or capital markets legislation. The mixed ownership as a result of listing may have an impact on board composition, including the addition of independent directors to boards which may have been primarily State-appointed prior to listing. The same goes for company management. Most SOEs which have been listed, will have a chief executive officer (CEO) that is approved by the annual general shareholders meeting, recruited based on professional merit, and is likely to be remunerated based on performance. Incentive-based compensation can serve to conserve the operational independence of CEOs and serve as a counter weight to government involvement in the day-to-day management of the company.

In New Zealand and Poland the act of listing alone does not lead to changes in board structure or composition. The only change that may be felt is that board members have a fiduciary duty to represent the interests of the company and all its shareholders, including minority shareholders. China and India report compositional changes to the board as a result of listing. In China, this requirement emanates out of listing regulations requiring that at least a third of the members of the board comprise of independent directors. In India, at least half of the board must be independent. In addition, Indian securities regulations require that the board must also constitute the relevant board committees, which in most cases were reportedly not in existence prior to the listing process. It is thought that the introduction of independent directors has improved corporate governance and created additional

oversight mechanisms in China and India, despite anecdotal evidence suggesting that there are a number of improvements that can be made (see "Board Independence" below).

Box 2.1. **OECD Guidelines on the Corporate Governance of SOEs**

Guidelines that explicitly apply to the activities of listed SOEs:

- **Guideline III. B.** SOEs should observe a high degree of transparency towards all shareholders.
- **Guideline III. D.** The participation of minority shareholders' in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.
- **Guideline IV. A.** Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.
- **Guidelines IV. B.** Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.
- **Guideline. V. D.** Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.
- **Guideline V. E.** SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public.

Source: OECD (2005), "OECD Guidelines on Corporate Governance of State-owned Enterprises", *www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/oecdguidelinesoncorporategovernanceofstate-ownedenterprises.htm*

Increased disclosure and reporting requirements following listing. Promoting higher standards of transparency and accountability (i.e. accounting procedures, financial statements, remuneration policy, etc.) is one of the outcomes of listing. Securities laws mandate the timely disclosure of information on the company, as well as publication of audited financial statements. Corporate laws impose certain limitations on related-party

transactions and other abusive dealings by managers and controlling shareholders. For example, SOEs may have to disclose information on the hiring of ex-employees and ex-executives by subsidiaries and non-subsidiary invested firms. Such laws may also require the disclosure of information on the employment of former employees and executives by other firms that have significant business transactions with an SOE. This is important to mitigate any abusive related party transactions, especially in jurisdictions where there is a strong link between the executives and managers of SOEs and previous employment in government institutions or ministries that exercise ownership over such enterprises.

However, the act of listing, alone, does not guarantee that SOEs will behave like a private firm. Different regimes are subject to varying degrees of enforcement, thus SOEs in some jurisdictions can be subject to more lenient restrictions. Furthermore, some SOEs due to regulatory carve-outs may benefit from a more favourable regulatory environment by virtue of their former State-ownership and the sector in which they operate.

In India, reporting and disclosure by SOEs is reported to improve following listing. Prior to listing, SOEs are only required to submit annual reports. Following listing, in addition to filing quarterly and audited annual reports, companies submit consolidated financial reporting of subsidiary accounts, and disclosures regarding related party transactions and other corporate governance requirements as dictated by the securities law. New Zealand and Poland do not report any significant changes from pre- to post-listing, although in the case of both countries reporting and transparency requirements are those specified in the securities law and listing requirements, as opposed to those established by the government as part of its accountability and transparency requirements. China views adhering to more stringent reporting and disclosure requirements as a means for attracting investors both home and abroad and it reports greater transparency and disclosure among listed SOEs. In Turkey, IPO's have been observed to enhance the company performance at SOE's by means such as adopting financial reporting rules in line with private sector, establishing corporate governance principles, achieving compliance with public disclosure requirements and management approach to conduct operations under a profit oriented perspective. As a result, IPOs has assisted the efforts to increase the institutionalisation and the financial discipline of the SOEs.

Presence of larger more active institutional investors brings about increased diligence and focus on performance. Large privatisation transactions through the stock market attract interest from institutional investors. Poland's listing of PZU in 2010, attracted global institutional investors and was ranked the largest IPO in Central and Eastern Europe, and the largest IPO in Europe since 2007. Cross listing SOEs can be means to

attract institutional investors, which in turn can impact increased diligence and focus on performance. In the case of New Zealand, cross-listing has been intended for the ease of attracting foreign capital from institutional investors in neighbouring Australia. Cross-listing SOEs on foreign exchanges may also improve increased diligence by committing to or being subject to higher standards of governance and transparency and enforcement than practiced in the home jurisdiction – especially where potential for conflicts of interest may arise from the State's dual role as regulator and shareholder.[8] (Pargendler *et al.*, 2013)

A number of medium- and large-size SOEs in China choose to list on exchanges outside of mainland China because of the rigorous corporate governance standards they require. Meeting these requirements is seen as providing a potential to improve SOE corporate governance, to attract investors, and to aid SOEs in expanding their business internationally. In Turkey, allocation of the shares to institutional investors globally and in the domestic market as well as the appetite of foreign investors to invest in capital markets has been significant factors for the success of IPO's realized in the last decade. Institutional investors having a long level of the share price to be determined has also been another significant factor. The IPOs executed by the Privatisation Administration and its pricing policy have been perceived very positively among retail investors in Turkey and this policy of PA creates an encouraging atmosphere for future IPOs.

Protection of minority shareholders. The presence of non-State minority shareholders is important, as it allows outside investors to participate in the shareholders' meetings and in some cases have a deciding vote in areas where the government as a controlling shareholder is conflicted. However, it might be appropriate for the State as an owner to reassure minority shareholders that their interests are taken into consideration (See Box 2.1, Guideline III). Particular concerns may arise where the State must balance the control of the SOE where (majority) public interests remain, while ensuring the protection of minority shareholders, as laid down in the relevant legislation and listing requirements. For SOEs to feel the full disciplining pressure of the stock market, the rights of shareholders (particularly voting rights) should be enforced by the legal system.[9]

Empirical research suggests that shareholder rights protection is positively related to performance improvements following listing. Interestingly, Boubakri, *et al.* (2011) find that in developing countries, where there is a lack of an established institutional framework for efficient corporate governance, concentrated ownership is more likely to ensure the success of privatisation than in countries with low investor protection. Still where the State remains the controlling shareholder its identity and intentions matter, as there is evidence to suggest that the government as a

controlling shareholder can alter the firm's objectives and management profile, and may be more tempted to pursue objectives that are inconsistent with profit maximisation.[10]

In India, protection of minority shareholders proves to be one of the more sticky issues concerning listing practices. Most key board decisions are made on behalf of the government, even in the presence of minority shareholders. In most companies, the State retains over 75 per cent of shares, corresponding to the majority required to make changes to company articles of association and other decisions that require qualified majorities without the consent of other shareholders. A number of questionable commercial transactions, involving cross-holdings and share buy backs among SOEs, have potentially undermined minority interest in benefit of the State as controlling shareholder. Few precautions are in place to balance minority shareholder protection and the continued use of SOEs for public policy purposes. Similarly, in China, awareness of the importance of protecting the rights of minority shareholders has increased since the 1990s.

In New Zealand and Poland, shareholder decisions are voted in accordance with the number of shares held. In New Zealand, individual minority shareholder participation is limited to 10 per cent of voting rights in each of the mixed-ownership companies. However, special resolutions with 75 per cent of the votes are necessary to make any changes to company charters; as such the government as majority shareholder is limited in its capacity to intervene. Moreover, under the Companies Act and Listing Rules, shareholders do not have formal rights of approval of transactions unless they involve assets worth at least 50 per cent of the company's value (unless they change the essential nature of the company). In Poland, certain exceptions apply to the exercise of voting rights, given that the State has special rights (as laid out in the articles of association) in some companies. Shareholders representing 10 per cent of the share capital may request extraordinary general meetings and may place matters of interest on the agenda.

In Turkey, the rights of minority shareholders and the fiduciary duties of directors and majority shareholders are considered to be relatively more limited than those countries such as the United States or the United Kingdom, however significant modifications have been introduced due to recent changes in the TCC, Turkish Code of Obligations and the Turkish Code of Civil Procedures since 2011-2012. A minority shareholder of a public company is defined as a single shareholder or a group of shareholders that holds 5 per cent or more of the public company's outstanding share capital.

Commercial orientation. Safeguarding the commercial orientation of companies by "insulating" them through another layer of corporate board responsibility is considered to be one of the checks put on companies following listing. Due to natural monopoly aspects of SOEs operating certain sectors, the effectiveness of capital markets in disciplining corporate control will depend on the efficiency of economic regulation.

In India, SOEs are expected to continue to carry out public service obligations in addition to commercial objectives, even after listing. These objectives are agreed upon through memorandum of understanding between the government and each individual SOE. It is not clear, to what extent the procedure would be different for listed companies and to what extent other shareholders and the board would have a say in agreeing to the objectives as defined by the government.

In New Zealand, all SOEs are expected to operate on a purely commercial basis whether listed or not. Any non-commercial provision of goods or services by listed SOEs is managed on an arms-length commercial basis, with the government paying the full costs. As such the government is prevented from influencing company objectives through its power as majority shareholder. Any other non-commercial objectives would be handled through the government's regulatory powers and would apply to all economic operators, regardless of ownership.

In Poland, a right balance between shareholder rights and the implementation of public policy goals is sought. Similarly, in China**,** one of the apparently major motivations for SOE listing is to more clearly delineate the State's administrative versus ownership functions. However, in these jurisdictions, it is not clear the mechanisms used to achieve these goals.

Board independence. Independent boards and their respective committees can serve to deter political interference in company decision-making and bolster oversight. Recent empirical studies suggest that politically-connected SOEs are common among listed companies in both developed and developing economies. Political connections are more prevalent in firms operating in strategic industries; firms located in major cities; firms listed in the context of a share-issue privatisation; and in jurisdictions with weak judicial independence (Bortolotti and Siniscalco, 2004). This is often manifested through the appointment of politicians or bureaucrats to key positions within the firm (either as in executive management or through board appointments).[11] Many countries have devised specific procedures for board nomination and appointment to ensure a competitive process, and have minimum requirements for the number of independent board members who sit on the board to balance composition with State-appointed representatives who may sit on the board (Box 2.2).

Box 2.2. **Board selection and composition in selected economies**

China: The proportion of independent directors shall be over one-third, as required in the governing provisions for listed companies.

India: Independent directors should form half of the board (in practice only 40 per cent of all board members are independent) with the remaining members made up of government directors and functional directors, some of which are CEOs in other SOE boards. Board members are appointed through a competitive process.

Poland: Number of state representatives on boards is indicated in company articles of association. The State appoints its representatives as members of supervisory boards, in companies in which the State is a majority holder and in which employees have the right to nominate two board representatives. Nominated according to qualifying exam; and minimum education and experience requirements.

New Zealand: All board members are independent, and selected according to a competitive process, although there are no formal requirements. Civil servants and members of parliament are disqualified.

Turkey: The Corporate Governance Communique is designed to implement certain enhancements to Turkish corporate governance standards, including a requirement that at least one third of Board members be independent.

Source: Author based submissions received from government authorities and OECD (2013), Boards of Directors of State-Owned Enterprises: An Overview of National Practices, Corporate Governance, OECD Publishing, Paris.

New Zealand has safeguarded board independence by appointing only independent directors (no State appointed directors sit on boards). In this way, board members are to act in the best interest of the company and its shareholders, without having any conflicting allegiances. Both India and Poland have State-appointed representatives sitting on (supervisory) boards representing the State as majority shareholder, in addition to independently appointed board members. In India, the securities law requires that at least half the board is made up of independent directors. The definition of independence is rather opaque; however, as persons serving as senior management of one SOE can serve as independent board member in another; and in practice, compliance with the provisions of the law is not guaranteed. In China, listed companies, including SOEs, must ensure that at least a third of their directors are independent.

In Poland, the State appoints its representatives as members of supervisory boards, in which employees have the right to nominate two representatives in companies in which the State is a majority holder. Civil servants are either appointed representatives (i.e. external experts) or

Treasury employees, and are appointed based on specific selection criteria to ensure politically neutral execution of tasks. Board members are further insulated from political interference, as no member is provided instructions or directors. In India, on the other hand, the State may issue directions or instructions for members of the board.

The Turkish Code of Civil Procedures generally aimed to raise the standards on transparency and corporate governance of Turkish companies. Approximately twenty articles of the new Turkish Commercial Code are directly related to the Corporate Governance Rules. These articles are based on four principles, namely transparency, accountability, fairness and liability.

State influence and means of control. The State can maintain control in a number of ways following listing. State influence can be exercised through some form of control (i.e. majority ownership) especially where there is a continued strategic public interest in the operations of the SOE (for example in public utilities or in financial institutions). Governments tend to retain influence in firms which have been privatised but remain subject to extensive government regulation (i.e. banking, telecommunications, utilities, etc.). Control can be exercised through the retention of a controlling stake as opposed to full exit; maintaining a stable core of investors; and/or through a golden share and veto rights that give ultimate control over (some) corporate decisions (as laid out in company by laws).

In OECD economies, post-privatisation control is often exerted through golden shares, whereas in emerging market economies, influence is often manifested through political connections (Boubakri, 2011). The possibility for the State to influence listed SOEs where it has an obligation to effectively exercise its ownership rights suggest that regardless of the level of State influence (whether as a minority or majority shareholder) it may resort to indirect means to maintain control on these firms. These indirect means can include having privileged access to information in respect to company operations, aside from more direct means by exercising influence through the board or senior management.

Authorities in India report that their Ministers have privileged access to information to listed SOEs and may exercise control by giving directives or instructions to members of the board. Whereas in New Zealand, any information above and beyond what can be requested by shareholders is obtained through an agreement with the companies and is limited to information necessary to prepare the Government's annual financial statements. The New Zealand government further sees that the State should have limited ability to intervene (only within the remit of its shareholder rights), relying on the independent boards of directors to take decisions

which are in the best interests of the company and all its shareholders. Any further direction that could be provided by the State is considered to be inconsistent with its mandate, and could potentially expose Ministers to liabilities.

In Poland, the Treasury exercises its rights like any other shareholder; however in some companies (as laid out in the companies' articles of association) the State has additional voting rights in comparison with its number of shares. In China, the government rarely directly holds shares in a listed company. It typically exercises its ownership rights via wholly state-owned holding companies. Where the state directly holds a controlling stake in an enterprise, they may have privileged access to information in that the board of directors will often consult with the majority shareholder before major decisions are taken.

In Turkey, the Corporate Governance Communiqué is designed to implement certain enhancements to Turkish corporate governance standards, including a requirement that at least one third of board members be independent. The Communiqué is currently in force for all listed companies, including state-owned companies and financial institutions.

Although, the residual control of the State can raise some concerns as to transparent governance, SOEs with a larger percentage of voting rights held by the State do not necessarily have weaker performance. This may be a result of a number of factors, including that many of such companies operate in strategic sectors and as former monopolies in energy, transportation, telecommunications and utilities, and may be shielded from competition. These companies may also enjoy favourable treatment in terms of subsidised loans, favourable regulatory treatment, and may benefit from their entrenched market presence (Bortolotti and Faccio, 2004). The *Navratna* and *Mini Ratna* status of some listed SOEs in India are a good example of special rights afforded as a result of their public sector status, in addition to their favourable market performance (See country profile for India).

Indeed, the act of listing itself and the presence of private investors, cannot guarantee that SOEs are completely averse to State interests and in some cases political interference. Governance arrangements that ensure representative boards, including minority shareholders; management that is professionally qualified; procedures and practices that ensure compliance and enforcement of listing requirements and the securities law, including transparent financial reporting; among other things, all contribute to mitigating any potential for political intervention. The following sections will provide more concrete examples of country practices to demonstrate various examples of such practices, with the aim of adding further to the policy debate on listed SOEs.

Notes

1. For this reason, sections of this paper may address privatisation synonymously with listing. The author recognises that listing can also be motivated by reasons other than privatisation. However, a large proportion of the literature and country experiences that the author draws from are based on data and country case studies of share issue privatisations.

2. Pargendler et al. (2013) caution that in some cases, listing SOEs may be a means through which the State can expand its grip over the economy by giving it additional leverage. The presence of private shareholders, allows the state to exercise control over a larger number of firms without making an additional financial investment, while continuing to exert control through minority-control structures. A similar observation is made for Brazil's former state-owned telecom operator. This may be more prevalent in jurisdictions with relatively low minority shareholder protections. See section 2.4 on "Protection of Minority Shareholders."

3. One study examining the Chinese experience of the early 2000s points to the counter argument that public listing as a means to reform SOEs has not worked wonders: company performance in the first post-listing year and onwards have yielded sharply lower levels of performance that in pre-listing and IPO years. (Wang et al., 2004)

4. Pargendler et al. (2013) draws from the stock offering by Brazil's Petrobras in 2010. The listing allowed for the company to fund the necessary deep water technology it needed to explore newly discovered offshore oil fields, which otherwise would not have been possible without the offering.

5. Other evidence suggest that regardless of whether firms are fully or partly state-owned, the government may still exert control on these firms through political connections (i.e. by appointing politicians or bureaucrats to key positions).

6. This may also be attributed to less confidence in the value of IPOs in less developed capital markets than in developed ones, though this may not apply to the Chinese market where some initial share offerings may have been over-priced. Also research by Pargendler et al. (2013) does not agree with the hypothesis that SOE share prices are "discounted" on the basis that private investors may be willing to accept risks of government involvement, and that the very nature of State participation can guarantee a steady supply of rents from its (sometimes) monopolistic exploitation of natural resources and public concessions. However, the analysis was limited to the oil sector.

7. The Economist reported that SOEs accounted for 9 out of the 15 largest IPOs between 2005 and 2012, and for two of the three largest offerings among them. (Economist, January 2012)

8. However, some sceptics attribute improved performance emanating out of cross-listing as a result of other factors, including correlation with the host market's stock market indices. Moreover, enforcement against violations by foreign firms can be weak.

9. Evidence shows that markets affording greater shareholder protection are consistently larger than those without adequate protections or enforcement of such rights. La Porta et al. (1998) note that although the protection of shareholder rights vary from one jurisdiction to another, jurisdictions with a common law tradition traditionally afford stronger legal protection that those with a civil law system.

10. Interestingly, Brazil's Corporation Law, grants appraisal rights to minority shareholders in the event that the government takes control of a private company. (See Pargendler et al., 2013)

11. Bortolotti and Siniscalco (2004) draw on the French privatisation experience. Privatisations were implemented via IPOs to avoid the possibility that a controlling owner would emerge. In parallel, the government appointed bureaucrats, linked to the government as CEOs of the firms. A network of cross shareholdings and cross-directorships were set up between privatised firms, banks and insurance companies to protect them from possible takeover threats.

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Chapter 3

Case studies of broadening ownership of state-owned enterprises

This chapter provides detailed case studies of China, India, New Zealand, Poland and Turkey, based on their recent experiences in broadening the ownership of state-owned enterprises. Each case study is organised around four sections focusing on: (i) the general context and landscape of listed companies, including national circumstances that influenced the government's decision to list; (ii) an overview of the "pre-IPO phase" and the factors considered to be important to ensure a successful share offering; (iii) an overview of the "going to the stock market" phase, and the various public and fiscal policy considerations that may have influenced of the timing and organisation of the share offering(s); and, finally (iv) an assessment of the outcome of share offerings, including on performance and governance.

3.1 China

General context

The number of SOEs listed in Chinese stock exchanges dwarfs all other economies in the world. All of the approximately 120 business groups overseen by the state ownership agency, the State-Owned Assets Supervision and Administration Commission, include at least one listed company, which effectively acts as the "public face" of the group. In addition, the sub-national levels of government own a multitude of listed companies. Zhang (2014) estimates that, as of 2012, 695 listed Chinese companies are either majority owned or otherwise subject to significant state influence, accounting for approximately 28 percent of all SOEs and almost 40 percent of all listed companies in China. The listing of SOEs continued during the financial crisis in 2008, increasing 15 percent between 2003 and 2012. However, this growth was outpaced by a strong showing of IPOs of private companies during this period, which more than doubled during the same period from 1 200 to 2 457. Nevertheless, listed SOEs make up a significant share of the Chinese business market: While listed SOEs today account for less than a third of all listed companies (28 percent), they account for nearly 67 percent of the total market value of all domestic listed companies.[1]

In China, the main purposes for a state-owned enterprise to go public can be classified into five categories: (1) to become a shareholding enterprise to improve corporate governance; (2) to promote the separation between administrative and business operations; (3) to introduce a standardized accounting system and incentives; (4) to raise funds to improve the SOE's financial status; and (5) to develop the primary stock market.

For the central and local governments, the most important reasons for listing SOEs are purposes (1), (3), (4) and (5). The availability of funds and the ability to sustain business operations in many enterprises, combined with the possible benefits of improved corporate governance, make the public listing of SOEs an important method for diversifying an enterprise's equity structure, especially given the heated debate over the erosion of state-owned assets. For the state-owned enterprises, (2) and (4) are the main reasons for wanting to be listed. Before listing, due to a lack of equity checks and

balances, enterprises experienced a strong administrative interference. This would be much more alleviated after going public. Besides, going public is also an important channel for an enterprise to raise long-term, low-cost funds for its development.

Some particularly large state-owned enterprises directly under the central government have chosen to go public overseas in an effort to improve their corporate governance structure, to establish a reputation and image, and to bring its governance in line with international standards. Public overseas listing calls for the restructuring of SOEs' businesses and assets, the adjustment of internal organisation and management structure, and the introduction of internationally standard corporate governance structure, accounting systems and incentives. Examples include:

- Petro China and China Unicom went public in Hong Kong, China and New York in 2000
- PICC went public in Hong Kong, China and New York in 2003
- Air China went public in Hong Kong, China and London in 2004
- Bank of Communications, China Construction Bank and Shenhua Group went public in Hong Kong, China in 2005
- ICBC went public in Hong Kong, China in 2006.

There are also some other middle-sized state-owned enterprises that choose to go public overseas, in an effort to raise foreign exchange funds and to introduce foreign capital (which is under foreign exchange control in China) in a short time and in a more efficient way. Listing overseas is also seen as a way to provide a channel for Chinese and foreign shares to exit, to improve the enterprise's corporate image, and to promote its business operations worldwide.

For the Government, developing a primary stock market has also been found in some empirical studies as a major motivator for listing SOEs. For example, a study found that the public listing of Chinese state-owned enterprises is not randomly implemented, but is carried out in a priority-based gradual manner. The government first chooses to place on the public listing list those enterprises with strong capability for profit-making, investment, and which demonstrate high operating efficiency. This is manifested in the following facts: (1) SOEs with strong profit capability are chosen to go public first; (2) Those with high operation efficiency are chosen to go public first; and (3) The capital expenditure and long-term investment of listed companies are both higher than non-listed companies.

Unfortunately, according to Zhang (2014) there are also some state-owned enterprises that choose to go public for the mere purpose of raising funds, failing to establish corporate governance system in its real meaning. The price signals from the stock market often do not reflect corporate fundamentals, which have led some listed companies to be indifferent to their business performance.

Leading up to the process of listing

Since most state-owned enterprises are registered as legal persons in accordance with the Chinese "Law on Whole-People Ownership Industrial Enterprises", they have several characteristics that are contradictory to the requirements for a listed enterprise. These characteristics include: (i) an unclear ownership systems; (ii) a governance structure that is inconsistent with modern requirements; (iii) administrative management imposed by the government on the enterprise; (iv) diversified businesses groups with weak controls at the apex; (v) bank loans as the sole financing channel; and (vi) long-term employment labour relations.

As a consequence, restructuring is needed to help state-owned enterprises meet the requirements for listing, as imposed by the market and investors. These requirements include introducing a clear ownership system (for instance, dividing the enterprise's assets into shares); a modern governance structure; the separation of administrative and business operations; reorganizing according to the dominant position of the enterprise's main businesses (separating between core businesses and non-core businesses); and introducing market-oriented labour relations.

In order to prepare an SOE for listing, the following steps are usually embarked upon to meet these market requirements (Zhang, 2014):

Establishing a restructuring work group. The to-be-restructured state-owned enterprise sets up a restructuring work group formed by the Party Committee, management personnel, and trade union and employee representatives. Specific restructuring work is to be carried out under the guidance of the restructuring work group and the superior authority (government ownership function) of the enterprise.

Filing a restructuring application. The enterprise submits an application to the National Development and Reform Commission (NDRC) for restructuring, and the NDRC will give reply as to whether it approves the restructuring and relevant advice on the way to restructure the SOE, according to the spirit of the relevant documents and the actual conditions of the enterprise.

Formulation and preliminary review of the restructuring scheme. First, the steps for restructuring should be identified and a restructuring scheme should be formulated to clarify the restructuring models and steps for implementation. Advice should also be sought from relevant authorities in taxation, industry and commerce, and finance. Second, the enterprise and its superior authority submit the restructuring scheme, an assets evaluation report, an audit report of the enterprise, a roster of employees, and the original copies of land-use and housing ownership certificates to the national assets management authority. The national assets management authority is then supposed to conduct preliminary review on the basic conditions for corporate restructuring, costs, and plan for restructuring, and then give reply to the enterprise on the restructuring scheme.

Submission of the restructuring scheme for review and approval. First, the enterprise submits the restructuring scheme as reviewed by the national assets management authority to the meeting of employee representatives (general meeting of shareholders) or the general meeting of employees for a vote, in order to form a formal scheme. Second, the enterprise submits the restructuring scheme passed at the meeting of employee representatives (general meeting of shareholders) and the resolutions of the meeting of employee representatives and the general meeting of shareholders to its superior authority, which then submits the scheme as a formal document to NDRC for review and approval.

Liquidation of assets, verification of capital and delimitation of ownership. According to the requirements for assets evaluation, the enterprise organizes a working group for asset liquidation and capital verification, which includes legal representatives, financial directors and personnel and employee representatives, who are responsible for conducting the liquidation on the properties of the enterprise and who entrust qualified intermediary organizations to audit and verify the enterprise's assets and financial status. The cancellation of non-performing assets (NPA) and the stripping of non-operating assets are subject to a special audit report based on comprehensive audit work. Unclear ownership shall be delimited, while the delimitation of land use rights shall be conducted by the national land resource management authority.

Evaluation of assets. According to the application of the enterprise and its superior authority, the assets owner hires a qualified intermediary organization to conduct a comprehensive independent evaluation on corporate assets (including land assets), in accordance with existing laws and regulations. The results of the evaluation will be released to the enterprise, and the evaluation report issued by the intermediary organization will be submitted to the national assets management authority, according to required procedures for verification or file-keeping.

Organisation and implementation of the restructuring, according to the approved scheme. First, the national assets management authority and the ownership transferee sign the ownership transfer contract, under the witness of an ownership trading agency. Second, the enterprise dismisses its employees' identity as employees of state-owned enterprises and reports to the labour and social security authority proposals for the adjustment of labour relations and the relocation of surplus personnel, and suggestions for the use of relocation fees, as agreed at the meeting of employee representatives. The provincial labour and social security authority are requested to review and approve these proposals. Finally, the enterprise performs the formalities relating to industrial and commercial, taxation, land, housing, creditor's right and debt certificates and price and payment, as per the restructuring scheme.

Handling relevant formalities regarding registration of new companies. Taking the establishment of a limited liability company as an example, the main registration procedure would be as follows: (1) Perfecting the restructuring scheme. (2) If state-owned equity is to be retained or transferred, the equity relocation scheme shall be submitted to the national assets management authority for review and approval. The relevant scheme for the allocation of land use rights shall be submitted to the national land resource management authority first for review and then for approval. (3) Signing the Organizer's Agreement. (4) Performing formalities for pre-review and registration of the company name. (5) The new shareholders subscribe shares and make payment, which is then verified. (6) Entrusting an accounting firm to verify the paid-in capital and to handle the new company's industrial and commercial registration and taxation registration.

Several organisations play key roles in the restructuring of state-owned enterprises, the first being the management personnel of these enterprises; the second being SASAC, NDRC, the labour and social security authority, the land resource administration authority, and other government authorities; and the third being the meeting of employee representatives or the general meeting of employees.

Going to the stock market

There are various conditions in state-owned enterprises. For example, the quality of assets of some SOEs are good, while some assets of other enterprises are inferior; some enterprises have outstanding major business, while the major business of some other enterprises are not outstanding; and the scale of some enterprises is large, while some enterprises are small in scale and are unqualified for listing. Therefore, there are several modes of system restructuring and listing. These modes are outlined below:

a) Overall restructuring and listing

One of the ways to restructure a state-owned enterprise is to carry out an overall system restructuring and transformation of the enterprises to bring them in line with the requirement for issuing new shares as listed companies. Such a mode is suitable for state-owned enterprises with a single and concentrated business and whose assets are difficult to divide effectively. The other way under this mode is for the group parent company of the state-owned enterprises to absorb the listed company and to list the whole company. A couple of examples are:

Bank of China was transformed as a whole to Bank of China Limited and then listed. The Bank of China announced on 26 August 2004 that it had been transformed to a stock-holding bank, i.e. Bank of China Limited, with the state holding the controlling number of shares via a state-owned and sole-funded commercial bank. Central Huijin Investment Ltd. holds 100 per cent of the stock rights of the Bank of China Limited on behalf of the state, under approval by the State Council, and exercises the rights and obligations of the Bank of China Limited as the contributor. The registered capital of Bank of China Limited is 186.39 billion RMB, which had been converted to 186.39 billion shares. The benefits of such a restructuring mode lie in that there is no associated transaction between the parent company and the subsidiaries. Due to the business nature of the bank, it is rather hard to carry out the disclosure of public information, while the system restructuring and listing of the enterprise as a whole can avoid such a problem.

TCL Group Co., Ltd. absorbs its subsidiary, TCL Telecommunication Equipment Co. Ltd., for listing as a whole. TCL Group held the controlling shares of the listed TCL Telecommunication Equipment before the entire Group was listed as a whole. TCL Group absorbed and merged with its telecommunications equipment subsidiary by issuing a certain number of new tradable shares of the overall TCL Group to the shareholders of the tradable shares of TCL Telecommunication Equipment company. In addition to the IPO of new tradable shares to the investors holding tradable shares in TCL Telecommunication Equipment, the overall group also issued new tradable shares through converting shares to the shareholders of the tradable shares of its telecommunications equipment subsidiary. Finally, the TCL Group was listed as a whole entity through an IPO.

b) Split restructuring and listing

Restructuring is carried out by splitting the assets of some businesses of a large state-owned enterprise for listing. Then, the transformed group becomes the primary shareholder of the listed company. This mode is quite common among current listed companies. Generally, large-scaled domestic

enterprise groups choose such a mode to restructure and list the subsidiaries under them. An example is:

Partial System Restructuring and Listing of Shanghai Baoshan Iron & Steel Group Company. The system restructuring program of Shanghai Baoshan Iron & Steel Group Company involved taking most of the manufacturing and operational assets, and part of the supporting assets for production of Baoshan Iron& Steel Group and transferring them to Baoshan Iron & Steel Co., Ltd. Some production and functional departments of Baoshan Iron & Steel Group were also transferred to the stock-holding company. Following the restructuring the stock-holding company boasted a complete set of production and technological processes, and scientific research, production, purchase and sales systems. Finally, Baoshan Iron& Steel Co., Ltd. became a limited stock-holding company, solely sponsored and established by Baoshan Iron & Steel Group, and was listed on the Shanghai Securities Exchange for trading.

c) Separation restructuring and listing

System restructuring through separation involves dividing a large state-owned enterprise into two separate companies, with one of the companies going through reorganization and listing under a stock-holding system. An example is:

Shanghai Petrochemical Co., Ltd. is separated from Shanghai Petrochemical Plant. According to the principle of changing the operational mechanism of the enterprise and establishing a new market-oriented enterprise system, the former Shanghai Petrochemical Plant was been reorganized. The reorganization resulted in the division and definition of relevant assets, liabilities and personnel. The manufacturing department, manufacturing supporting department, operational, trading, science and technology, and management department, as well as relevant assets and liabilities, were included in Shanghai Petrochemical Co., Ltd. after the reorganization. The enterprises and institutions, such as construction, design, machinery production and domestic service etc., which had not been transferred to the listed company from the Shanghai Petrochemical Plant, such as the departments and units exercising government functions and relevant assets and liabilities, were transferred to the newly-established China Petrochemical Shanghai Jinshan Industrial Company. China Petrochemical Company holds the shares of Shanghai Petrochemical Co., Ltd. on behalf of the state and exercises the rights and obligations as the state shareholder. China Petrochemical Shanghai Jinshan Industrial Company is a sole subsidiary of China Petrochemical. It is an independent legal person that carries out independent management and undertakes its own losses and profits. Thus, the former Shanghai Petrochemical Plant

ceased to exist as an independent legal person, and two companies with independent legal-person status were created: Shanghai Petrochemical Co., Ltd. and China Petrochemical Shanghai Jinshan Industrial Company. Shanghai Petrochemical Co., Ltd. is traded on the Shanghai Securities Exchange.

d) United restructuring and listing

The united system restructuring mode involves uniting several state-owned enterprises into a newly established stock-holding company that is then listed. Such a mode is suitable for some state-owned enterprises with smaller-scale and similar businesses and which want to be listed. An example is:

Several companies jointly contribute funds, sponsor and found Huayuan Kaima Mechanical Co., Ltd. Eleven separate enterprises and institutions[2] converted all their assets and liabilities to create new entities. Some of the assets and liabilities were united to create "Xingxing, Laidong, Weifang Tractor, Guangming, Jubao, and Machinery Import and Export," controlled by China Huayuan Group Co., Ltd.. The assets and liabilities of the major production and operation assets, including the horsepower tractor business of Shandong Tractor Factory, and part of the assets of China Agricultural Machinery Company, Shanghai Internal Combustion Engine Research Institute of Ministry of Mechanical Industry, and No. 4 Design and Research Institute of Ministry of Mechanical Industry, were converted into shares in 1998. These businesses together sponsored and founded Huayuan Kaima Mechanical Co., Ltd.. Huayuan Kaima Mechanical Co., Ltd. issues foreign capital shares (B share) to overseas exchanges and are listed and traded on the Shanghai Securities Exchange.

e) Overseas red-chip companies

Red-chip listing refers to companies registered abroad—usually in Cayman, Bermuda, or British Virgin Islands (BVI) etc., which are governed by local laws and accounting systems—and whose major assets and business are on mainland China. Such companies issue shares to investors and are listed on the stock exchanges of Hong Kong, China. All the shares can be circulated on the market after the end of the lock-up period. An example is:

Unicom is listed in "red-chip" mode. China Network Telecommunication Group (hereinafter referred to as Unicom) is an extraordinarily large state-owned telecommunication operational enterprise group under the central administration. The prospectus submitted by Unicom to U.S. Securities and Exchange Commission was formally publicized on October 18, 2004. As shown in the prospectus, Unicom

planned to list for trading on the stock markets of New York and Hong Kong, China on November 16 and 17, 2004, respectively. The major part of the listed company of China Unicom is founded through injecting funds based in Unicom HK. Unicom injected the businesses from six provinces in North China, two provinces in south China, an international subsidiary, and Asian Unicom into the listed company. The benefits of such a restructuring system lie in that, as the main body for listing in red-chip mode, the Hong Kong Company is registered in Hong Kong, China, therefore effectively solving the potential problems related to the foreign-capital shares of Unicom. As a result, international investors —such as its shareholder news groups and GS etc. — can be preserved, avoiding large payments to buy out foreign-capital shareholders and to purchase their shares. Had Unicom listed by means of issuing shares, the main body for listing would have been the company registered domestically, and it is hard to carry out the aforesaid operation.

Impact on governance and performance after listing

Some empirical research has shown that, in contrast to some state-owned enterprises that have not been listed, the profit-making level, operational efficiency and investing capacity measured by many indexes of listed state-owned enterprises have been significantly improved.[3] The reason for this positive impact on enterprise performance by public offering lies in the fact that China has gradually established a capital market and management system that comply with modern characteristics, and the constant improvement of such systems and mechanisms have guaranteed the successful listing of state-owned enterprises.

However, some other researches have shown[4] that the overall operational performance of state-owned enterprises (i.e., rate of return of total assets, rate of return of net assets and profit rate of sales) have attended to decline after listing, though the yielding level (actual sales volume) and operational efficiency (productivity rate) improved to a certain extent. This leads to the conclusion that merely listing cannot improve the profitability of state-owned enterprises. The aforementioned negative trends may be due to introducing tradable shares at a higher issuing price during the IPO. State-owned enterprises in these cases carry out a surplus management offering and listing, resulting in a profit level that rises by a large margin. The previous false rise of profit is compensated for through an artificial decrease of profit after listing. Meanwhile, offering and listing are realised through issuing new shares, and the total assets and net assets of the original state-owned enterprises have been increased, which may also lead to a decrease of the profit index.

There are, however, some areas where SOE corporate governance can be seen to have improved with listing. For example, this could be said of minority shareholder protections. Since the beginning of the development of the Chinese stock market in the 1990s, the protection of minority shareholders of various listed companies has undergone a process of greater awareness, the discovery of problems, and developing systematic protective measures. At present, the protection of minority shareholders of listed companies is far stronger than that in the early phase of the market. Where problems do arise, the infringements of the rights of minority shareholders in listed state-owned enterprises during the period following listing mainly arise from: related party transactions widely existing between the listed company and the enterprise of its parent group company. Such problems arise in the common single listing mode, i.e. part of the high-quality assets of the parent company are split off for restructuring and listing. However, the business chain of the split-off assets is incomplete, and materials or equipment are purchased from the member enterprises of the parent group company.

The big shareholder transfers the assets of the listed company by means of injecting super-highly priced assets, and then the controlling shareholder takes control of the funds of the listed company etc. The heavy influence of the actual controller, the lack of a corporate governance culture and respect for rules, and the potential for the controlling shareholder to focus only on reaping returns for its previous support are the main reasons for this problem.

A number of other changes to the governance and operations of SOEs as a consequence of listing are summarised in 3.1.

Table 3.1. **Changes in SOEs in consequence of stock-market listing**

Commercial orientation	- The financial structure has been improved through listing, and a low-cost financing channel has been obtained. - Due to the strict governing rules, the commercial orientation is more externally focused than before listing.
Independency of boards of directors	- Higher independency. Many state-owned enterprises had no board of directors pre-listing, or there were rather few external directors. In listed companies, the proportion of independent directors shall be over one third, as required in the governing provisions for listed companies.
Commercial and non-commercial objectives	- Though it is hard to assess some or several state-owned enterprises in the short run, the funds and system improvements brought about by listing have improved the commercial objectives and effect of the enterprise.
Transparency and disclosure	- Listed companies have higher transparency than non-listed companies.
Corporate social responsibility	- The social responsibility of the company has not become a compulsory disclosure provision. However, generally large listed state-owned companies are willing to improve corporate image through disclosure (via a social responsibility report).
State influences	- Usually the government seldom directly holds the stock rights of the listed company, and generally it exercises the ownership rights through its parent company. As for the listed companies with the state holding a controlling number of shares thereof, generally their big shareholder enjoys the priority to information, mainly due to the fact that the board of directors tend to consult with the big shareholder before discussion, and win the opinions of the big shareholders.

Source: Zhang, Z. (2014), "Governance and Performance of Listed State-Owned Enterprises", paper prepared for the annual meeting of the Asian Roundtable on Corporate Governance in Mumbai 2014.

3.2 India

General context

The government policy for "Peoplisation of SOEs," first coined in the 1960s, effectively recognised the potential for IPOs to mobilise resources for the government and as a source from which SOEs could raise financing. It was not until the 1990s when the government of India began divesting from SOEs through stock exchanges, a part of a "divestment" (i.e. privatisation) programme which continues today. The current disinvestment policy has among its stated goals, providing citizens with the right to own shares in SOEs; and to ensure that SOE wealth "rests in the hands of the people".

As a part of the government policy, the government's aim is to remain majority shareholder by retaining at least 51 per cent of the share and management control of SOEs explicitly reserved for the public sector or of a strategic nature. For all other SOEs, the government policy is to retain 26 per cent of shares, or gradually divest with the end goal of privatising non-strategic SOEs. For the latter type of companies, proceeds from such sales would be deployed from a dedicated national investment fund in the social sector (i.e. education, healthcare, employment); to refinance or restructure other SOEs (i.e. capital investments in selected profitable and revivable SOEs to enlarge their capital base to finance expansion or diversification); and to pay off government debt. However, it should be mentioned that despite these stipulations the government remains majority shareholder in almost all listed SOEs, and in many cases direct state ownership is greater than 76 per cent.

Out of a total of 227 SOEs, the government remains majority shareholder in 35 listed companies and minority shareholder in 15 listed companies (the scope of this section and data are limited to SOEs controlled and managed by the central government known as "Central Public Sector Enterprises"). The value of listed SOEs represents almost 18 per cent of the market value of SOEs in India, and 18 per cent of market capitalisation. All listed SOEs are registered in the Bombay Stock Exchange (BSE), and 45 of these companies are cross-listed on the National Stock Exchange of India (NSE), and other sub-national stock exchanges.[5]

The listing of SOEs has taken place over three main phases of divestment spanning the 1990s and 2000s. A more active policy of listing has been taken up by the government from 2009-2013. Going forward, the government has an ambitions listing programme for SOEs, with plans to list all profitable SOEs on stock exchanges. The Department of Disinvestment of the Ministry of Finance is mandated to handle all matters relating to the

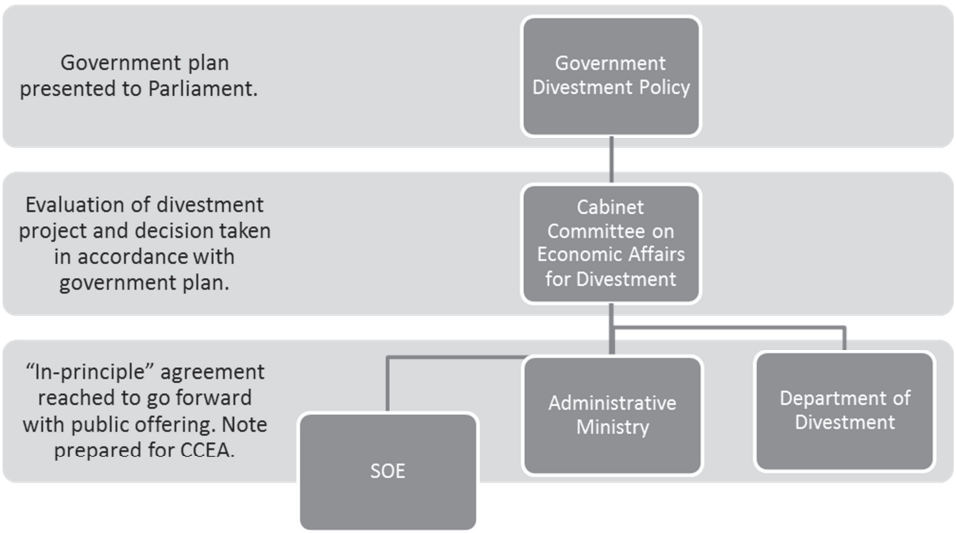
disinvestment of shareholding in Central Public Sector Enterprises (the technical term which is used in India to refer to a certain category of majority-owned SOEs).

Leading up to the process of listing

The Government announces its intentions of listing through planning documents and budgets presented to Parliament, which includes the government's disinvestment policy and yearly targets of disinvestment proceeds to be realised. A note is prepared for the Cabinet Committee on Economic Affairs (CCEA) for Disinvestment according to guidelines set by the Securities and Exchange Board of India (SEBI) and the Issue of Capital and Disclosure Requirements Regulations (ICDR). For a note to be submitted to Cabinet an 'in-principle' agreement regarding the public offering has to be arrived at between the administrative ministry, the Department of Divestments (DoD) and the concerned SOE. The proposal can either be mooted by the SOEs through its Administrative Ministry, or it is approved. In both the cases, the agreement of the administrative ministry, the DoD and the concerned SOE is important for the public offering to move forward successfully (See the Figure 3.1).

The CCEA note includes, among other things, a brief introduction of the SOE, its financial performance over the last 5 years, extent of proposed disinvestment along with its justification, aspects relating to issue of bonus and splitting shares, price incentives to retail investors, discount offered to employees, reservation of up to 5 per cent of the post issue capital of the SOE for allotment to employees of the issuer, the heads under which the costs are to be allocated between government and SOE in case it is a piggy-back transaction, appointment book builders, and information about the compliance with regard to the minimum number of independent directors. (Government of India, 2011)

Figure 3.1. **India: Process leading up to listing**



Source: Author based Mishra, R.K. (2013), Broadening the Ownership of SOEs through the Practice of Listing: the Case of India, OECD internal working document, Directorate for Financial and Enterprise Affairs.

Despite some of the observed improvements listing may bring in terms of performance and governance, the DoD may be challenged in obtaining agreement from SOEs and their administrative ministries to go to the market. This is due to the fact that listing requires additional responsibilities from the SOEs, including increased disclosure and supervision. Moreover, it requires SOEs to seek financing from the market and lending institutions according to market conditions, as opposed to relying on government transfers. For SOEs that meet the following criteria, the government's strategy is to push for divestment:

- Already listed profitable SOEs are list, at minimum, 10 per cent of their shares. If they are not compliant, they are considered for an 'Offer for Sale' through the issue of fresh shares;
- Unlisted SOEs with no accumulated losses and having earned net profit in three preceding consecutive years are to be listed;
- Follow-on public offers would be considered taking into consideration the need for capital investment of SOEs on a case by

case basis. The government could simultaneously or independently offer a portion of its equity shareholding;

- Depending on the type of company, the government would retain at least 51 per cent equity and the management control; 26 per cent for other types of companies; and gradually full privatisation in those which it deems to be non-strategic.
- The DoD in the Ministry of Finance is able to identify SOEs in consultation with respective administrative Ministries and submit proposal to government in cases requiring offer for sale of government equity.

A company, which goes to the market, has to ensure that it fulfils various statutory and regulatory requirements and directives issued by the government and the stock exchange(s). This may include Amendments to Memorandum of Association and Articles of Association; Amendments to agreements with other shareholders; compliance with minimum listing norms of stock exchanges; eligibility under ICDR regulations; capital restructuring; and other arrangements depending on whether the company has already issued shares and if it operates in the mining sector. It must be compliant with the 2013 Companies Act, Clause 49 of the Listing Agreement, and the Department of Public Enterprise Guidelines on Corporate Governance for Central Public Sector Enterprises.

Going to the stock market

Once the decision has been made by the Cabinet Committee to proceed with listing, the government appoints book builders and other intermediaries who manage the listing process. Book builders and other intermediaries are selected by an inter-ministerial group with the approval of the Ministry of Finance, following submissions of expressions of interest based on a competitive tender. The DoD manages the overall tender process, and in some cases the SOE does so (i.e. in cases of piggybacking). The book builders' overall responsibility is to carry out the public offering (whether initial or subsequent offerings).

A kick-off meeting is usually held by the SOE for the benefit of the book builders and other intermediaries (i.e. legal counsel). The book builders then decide upon a timeline, taking into consideration any specific procedures which may need to be followed depending on the type of SOE (i.e. if in hydrocarbon or mining activities), and any other changes which may be necessitated to conform with the relevant stock market criteria and securities law (i.e. independent directors, board committees, etc.). For investors residing outside of India, relevant approvals must be sought, and

potentially subject to the scrutiny of the Foreign Investment Promotion Board.

Upon completion of the above steps, this process is finalised through the preparation of a draft red herring prospectus,[6] which is eventually filed with the securities regulator (SEBI). Following approval of the prospectus, the SOE undergoes the formal listing process which includes organising road shows for marketing, pre-issue advertising and other publicity campaigns. This is followed by selection of bidders, revision of bids (or withdrawal of others), stipulations concerning minimum subscription, price discovery, signing of underwriter's agreement and filing of the final prospectus.

The allotment of shares is made based on specifics of the IPO process. As per *the Issue of Capital and Disclosure Requirements Regulations* (ICDR Regulations) IPO reservations can be made under three categories: retail individual investors (including employees up to 5 per cent); non-institutional investors; and qualified institutional bidders. Allotments are made on a proportional basis in book building issues; whereas for alternative book building issues, qualified institutional bidders are allotted shares on a priority basis. Individual investors and qualified institutional bidders are proportionally allowed more shares under the ICDR Regulations. "Core investors" (including promoters, qualified institutional bidders, insurance companies, mutual funds, investor institutions, retail investors and employees) are targeted, with institutional investors (already registered with the securities regulator) primarily targeted.

Strategic companies

For the purpose of divestment policies, the government through a Cabinet decision has identified the industries in which it should maintain majority ownership of at least 51 per cent, these include:

- Arms and ammunitions and the allied items of defence equipment, defence air-crafts and warships:
- Atomic energy (except in the areas related to the operation of nuclear power and applications of radiation and radio-isotopes to agriculture and non- strategic industries); and,
- Railway transport.

For all other types of non-strategic companies the level of State control is determined according to whether the company operates in an industrial sector that requires the presence of the public sector as a countervailing force to prevent concentration of power in private hands; and if the industrial sector in which the company operates requires a proposer

regulatory mechanism to protect the consumer interest before public sector enterprises are privatised. Additional hurdles may apply to companies operating in the mining and hydrocarbons sectors.

Impact on governance and performance after listing

Generally, listing has had a positive impact on the operational performance of SOEs, in terms of commercial orientation, encouraging more board independence, separating commercial from non-commercial activities, transparency and disclosure, corporate social responsibility and reducing State influence. An empirical study on the impact of privatisation in India determines that the sale of minority shareholdings of SOEs has resulted in improved SOEs finances and performance, as compared with fully-government owned SOEs (Gupta, 2005 and 2011).

Since 2010, the government has introduced mandatory Guidelines on Corporate Governance for all "Central Public Sector Enterprises", which includes those already listed on the stock exchange. This has served to improve SOE governance practices, by shifting government day-to-day management of SOEs towards a more shareholder rights-based approach. Still, this system has some ways to go before leading to greater empowerment of SOEs and further shielding them from political interference. Some examples of these improvements and challenges are described below.

Minority shareholder protection. Despite the presence of government-appointed persons to the board, SOEs do not report any issues with regard to the protection of minority shareholders. Boards are required to take decisions in the best interests of the company and its shareholders. However, the special status of listed SOEs limits the say of minority shareholders. As the State remains majority shareholder in almost all enterprises, key decisions including board selection and major transactions are essentially made on behalf of the government by directors. In many cases State ownership amounts to more than 76 per cent which is the majority required to make changes to company articles of association, and other decisions that require qualified majorities without the consent of other shareholders. Moreover, the government policy of cross-holdings and share buybacks among SOEs are detrimental to the interest of minority shareholders as it allows for the companies' capital to be used for the benefit of the controlling shareholder, as opposed to investment for growth and higher overall shareholder value (Som, 2013). Few precautions exist to ensure a balance between minority shareholder protection and the continued use of listed SOEs for public policy objectives. For example when Coal India was put under pressure to keep prices low from the Ministry of Coal, the interests of minority shareholders were not taken into account. Protests on the part of

the minority shareholder did not amount to a reversal of the decision, until legal action was taken (Refer to Box 3.1).

Box 3.1. **Case example: Coal India Ltd and alleged abuse of minority shareholder interest**

The proposed legal action of 'The Children's Investment Fund' (TCIF) against the government for alleged breach of international treaties over its investment in Coal India Ltd (CIL), is a case in point in the context of abuse of minority shareholders interest. As of December 31, 2011 the TCIF, the largest foreign shareholder in CIL, held a 1.1 per cent share in the company. The TCIF has asserted that the CIL did not stand up for the rights of its minority shareholders. In January 2012, CIL had raised prices of select grades of its output by changing the pricing system to gross calorific value form the earlier useful head value system. This was to conform to the auditor-general's accusation that the company was forgoing US$210 billion in potential revenues by selling coal assets too cheaply. However, the company reversed the price hikes under pressure from the Ministry of Coal after receiving complaints public sector units and users benefiting from the lower prices. The government wrote to CIL to reconsider the price increase. The Company obeyed and the price increase was promptly withdrawn. The decision, according to TCIF, does not make commercial sense for the company, and was a breach of the company's fiduciary duties towards shareholders. TCI was forced to file a case which resulted in a change in the CIL practices, towards the interest of CIL and its minority shareholders.

Source: Mishra, R.K. (2013), Broadening the Ownership of SOEs through the Practice of Listing: the Case of India, OECD internal working document, Directorate for Financial and Enterprise Affairs.

Som, L. (2013), Corporate Governance of Public Enterprises in India, ICRA Bulletin Money and Finance, June 2013.

Commercial orientation. Commercial orientation is further encouraged by listing. Although SOEs are considered to have an inherent role in public service delivery, one of the main criteria for listing is determined by the ability to earn profits. A special class of companies among those listed (mostly *Maharatna*, *Navratna*, and *Miniratna* companies)[7] are accorded autonomy in a range of decisions, including investments, capital expenditure, joint ventures, mergers and acquisitions, debt raising, etc.

Board independence. One of the key regulatory requirements for public issue of SOEs relates to board composition. The securities law stipulates that independent directors should form half of the board; however, in practice only 40 per cent of all board members are independent with the remaining

members made up of government directors and functional directors, some of which are CEOs in other SOEs.[8] Independent board members are appointed through a competitive process, but require approval by government committees. The presence of independent directors is an improvement to board composition prior to listing, where there was no requirement for the presence of independent board members. Boards are required to set up the appropriate committees (audit, remuneration, etc.); this has created additional oversight mechanisms to improve internal company governance. It is considered that the presence of independent board members has added to the quality of decision-making while also insulating the board from further political interference. Still, anecdotal evidence suggestions that there are a number of areas where boards still have no say, this includes in the appointment and removal of the CEO and board members; in some aspects of strategy formation and commercial decision-making (Som, 2013). For investment decisions, the government still intervenes in most decision-making, especially in transactions above a certain threshold.

Non-commercial objectives. One of the inherent roles of SOEs is their contribution to public services. As such, following listing companies do not report a change in their public service obligations. Where explicit subsidies are given for this purpose, they are reported in the annual report.

Transparency and disclosure. As per the listing requirements of the stock exchange and securities law, listing requires additional transparency and disclosure requirements from the SOE. This includes filing quarterly and external audited annual reports (which prior to listing only occurred on an annual basis); consolidated financial reporting of subsidiary accounts; disclosures with regard to related party transactions; and disclosure on compliance with corporate governance requirements, among other requirements. The quality of disclosure has improved considerably as compared to non-listed SOEs and in some cases, private enterprises.

Corporate social responsibility. Although some listed companies strive to integrate the interests of business with that of society, this is integrated in the vision statement for the company and are part of the Memorandum of Understanding it has with the government as a performance target. CSR obligations are not within the purview of the listing agreement.

State influence. The State has various means by which to exercise its control. This can be through direct and indirect means. Aside from its voting power at the AGM, the government may have additional powers as stated in the provisions of companies' articles of association. These articles may empower the government to issue directives or instructions for directors on issues with regard to the conduct of the business and affairs of the company, and to appoint the CEO and directors to the board. Some

companies which fall under the "*Navratna*" classification, although afforded autonomy on a number of decisions as per their articles of association, may ultimately be subject to the President of India who has the power to issue directives on any issue. Other companies have been afforded special rights according to their "*Miniratna*" classification – this is more of an indirect regulatory means of control by affording special and rights and privileges by virtue of their public sector status, the government can still intervene in investment decisions above a certain limit. Still both these classes of companies are afforded a level of autonomy that surpasses that of other listed SOEs, given their favourable commercial performance. Companies are still subject to pressures from their administrative ministries, and are not shielded from political influence. Control is further influenced by cross-holdings of one SOEs in another, which raises some issues as to related party transactions – although the government has plans to limit this to 10 per cent (Som, 2013).

Improved access to capital and investment renewal. Listed companies are better placed to raise funds from the market, and it offers an exit route for investors by way of option for sale of shares in the market. Still, public sector banks remain major lenders to SOEs, and may be able to borrow on more favourable terms than their private sector competitors thanks to an explicit guarantee by the government. Loans and equity finance is also provided through administrative ministries.

3.3 New Zealand

General context

The listing of SOEs is not a new phenomenon in New Zealand. It began in the 1980s as part of the then-government's privatisation policy. Well before the current divestment programme of the government, New Zealand had been successful in corporatising some SOEs and privatising others. Although the country's experience with privatisation has generated mixed results depending on the enterprise, globally the government considers that corporatisation and subsequent privatisation has led to commensurate gains in efficiency. This has been achieved through the pressures of capital markets and private investment; reduced government exposure to debt; and reduced reliance of government businesses to seek government aid in bad times. It has also promoted the development of capital markets; encouraged broader share ownership; and freed up capital for other types of government spending (Wilson, 2010).

The post-privatisation landscape has evolved to include a number of national and sub-national enterprises that have some level of continued State

participation or have resulted in full exit by the State. More recently, the government has launched a strategy to promote the "mixed ownership model" (MOM) where the government retains a controlling shareholding, but offers a minority stake to outside investors. The MOM Programme is a key initiative of the government that involves extending the MOM to a handful of state-owned energy companies and to reduce the Crown's majority shareholding in Air New Zealand. The share offer programme is a three to five year programme that began in 2012. These sections are based on New Zealand's most recent experience with listing (SOEs in New Zealand are referred to as "Crown companies").

The government of New Zealand remains a majority shareholder in four listed companies. These include Air New Zealand, the national airline carrier, for which the government owns under 75 per cent and was listed in 2002; the government share reduces each year as the Crown does not participate in the company's dividend reinvestment plan. An additional three energy companies were listed as part of the MOM programme which came to a completion in April 2014; the government intends to maintain at least 51 per cent ownership in these companies.[9] [10]

Although the decision to list is said to have been largely political, the main rationale behind the MOM Programme in New Zealand is to:

- Free up capital for the government to invest in higher priority areas, while reducing its need for extra borrowing;
- Improve the pool of investments available to New Zealand investors and deepen the capital markets;
- Allow companies access to capital and growth without depending entirely on the government; and,
- Place sharper market discipline and more transparency on company's performance through external oversight.

With an already mature regulatory and competition environment, the government sees the main rationale behind the most recent share offerings as better management of the Government's balance sheet. The listings will also have the added benefit of adding capital market disciplines and direct price signals on company performance, and can bring about further improvements in economic efficiency. The government also sees long-term benefits for fiscal planning, capital markets development and in other areas.

Leading up to the process of listing

Leading up to the MOM Programme, the responsible ministers took stock of prior experiences with privatisation in New Zealand and other

jurisdictions. For each company a five-step test was applied to determine whether the MOM was the appropriate model. The test aimed to assure that the companies were suitable candidates for the government to maintain a majority shareholding stake by owning at least 51 per cent of each company; that it would ensure national investors were at the front of the queue for shareholdings; that the companies provide good opportunities for investors; that it would generate enough revenue to free up capital that can be used to fund new public assets; and if there are adequate industry-specific regulations to ensure adequate protections for consumers. Once the government had determined that all the companies it identified met this test, it launched a multi-phased approach to listing. (Government of New Zealand, 2012a)

A number of legal changes to the 1986 SOE Act and other relevant Acts as grouped under the MOM Bill were necessary to harmonise them and ensure compatibility with the mixed ownership model. This includes, for example, the classification of the MOM companies prior to and following listing, under the Income Tax and the Public Finance Acts (below references to the MOM Bill refer to the amendments enacted or proposed under the MOM Bill). Additional changes were required to the company charter (i.e. constitution) prior to the listing process.

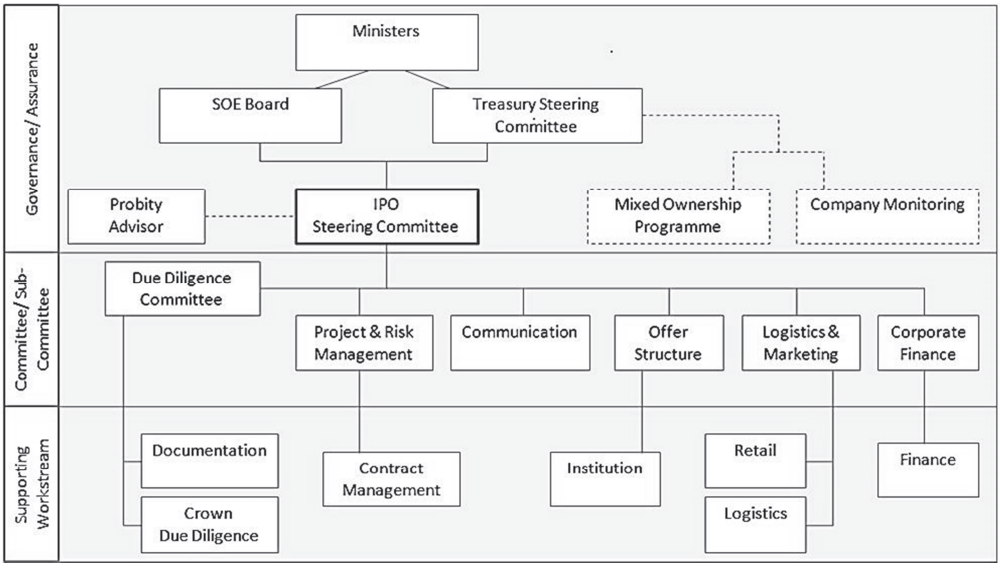
The IPO process is run jointly by the State and the relevant SOE. The State is represented by Ministers (Minister for State Owned Enterprises, Minister of Finance), under whose oversight the SOE board and a high-level Treasury Steering Committee assume operational responsibility (see Figure 3.2). Both the Ministers (as shareholders) and the directors of the company are liable under securities law for the offer – for which reason strong joint governance is considered to be an important factor in the IPO process. A commercial transaction team within the Treasury has the primary output responsibility to undertake the MOM programme. (Government of New Zealand, 2012f)

For example, during the execution phase for the Mighty River Power IPO, Ministers received regular reports (through meetings and written reports) on progress with the listing and various work streams. Relevant Ministers were briefed on issues related to due diligence, offer structure, and corporate finance.

Additionally, a number of public inquiries were made regarding the impact SOEs have had on the market, given their market share and presence. For example, given that energy companies have been the main focus of the Mixed Ownership Policy, this has raised questions as to the level of competition between public and private operators in New Zealand. Some stakeholders have posited that electricity prices of SOEs are lower than that

of private companies – however the Government is of the opinion that prices are not determined by ownership but through appropriate regulation of the electricity market, and the level of competition between retailers. Recent surveys suggest a high degree of price competition between the privately owned electricity companies and the SOEs. (Government of New Zealand, 2012b and 2012d)

Figure 3.2. **Governance of the Mixed Ownership Model Programme in New Zealand**



Source: Government of New Zealand (2012c), Governance of the Mixed Ownership Programme. Treasury.

Going to the stock market

Following a decision of the government to go ahead with the public offering of shares in Mighty River Power, a commercial IPO process was set in train, with "Joint Lead Managers" (JLM) appointed to carry through the sale. The JLMs (made up of internationally-recognised investment banks) provide project management, execution and advisory services for the IPO. JLMs are also responsible for appointing and managing the selling syndicate and assisting with the marketing of the offer to New Zealanders. The appointment process is based on a competitive tender for each IPO, taking into consideration the best combination of firms (usually more than one) to assist to achieve the government's objectives.

For Mighty River Power, at the time of the sales process there was a requirement minimum of 85 per cent New Zealand ownership, meaning that including the government's 51 per cent ownership stake, the number of shares that could be offered to offshore investors was limited.

Strategic companies

Some of the energy companies which are part of the government's MOM are considered to have control over "sensitive assets" (such as dams). For this reason, listing has brought about concerns over the possibility of the sale of sensitive assets to overseas investors if ownership is diluted. The government's policy to maintain control of at least 51 per cent of the companies is partially intended to safeguard these strategic assets. But this alone is not enough to ensure the government owner that the companies would not dispose of such strategic assets. Although the government has other means at its disposal to strengthen government control beyond that provided by the Companies Act and the Overseas Investment Act (which regulates foreign direct investment),[11] the government does not want to signal to the market that it has taken a step away from a standard commercial operating model. Regulatory controls available to the Crown give it reasonable control over the sale of sensitive energy generation assets.[12] (Government of New Zealand, 2012e)

Impact on governance and performance after listing

There are two ways for the Crown to influence MOM company transactions. First, it can do so as a shareholder, under the Companies Act 1993 (Companies Act) and the New Zealand Stock Exchange Listing Rules. Second, it can do so as a regulator, using its discretion under both sectoral legislation and the Overseas Investment Act 2005 (OIA – in the case of sale of sensitive assets). The Companies Act and the Listing Rules offer the Crown as shareholder limited control over transactions. Under both the Companies Act and the Listing Rules, shareholders do not have formal rights of approval of transactions unless they involve assets worth at least 50 per cent of the company's value. The listing rules also require shareholder approval if the transaction would change the essential nature of the listed company, which may apply to transactions worth less than 50 per cent of the company's value The New Zealand government sees that the limited ability for itself as shareholder to intervene as laid out in the relevant acts and rules is quite appropriate. Directors have a duty to act in what they believe to be the best interests of the company and it is appropriate that they are provided with the authority and ability to do this.

Minority shareholder protection. The legislation enacting the MOM Bill restricts individual non-Crown shareholders from holding more than 10 per cent of the voting rights in each of the companies and a 5 percent ownership cap for institutional investors. Although the policy of the Crown, as laid out in legislation, is to maintain at least a 51 per cent of the shares in each of the MOM companies, the Crown no longer has the complete control over the companies' charters (i.e. constitutions). Special resolutions with 75 per cent of votes are necessary to make any such changes. It is expected that boards take into account the interests of minority shareholders as well.

Commercial orientation. Although 100 per cent-owned Crown companies are expected to operate as "profitable and efficient as comparable businesses that are not owned by the Crown;" the SOE Act provides the government a say in determining a dividend policy and company objectives. For listed MOM companies, the provisions of the Company Act are the main guiding principles that inform the actions of the government as majority shareholder, therefore there are limitations on the types of directions that it can provide on any of the commercial objectives of the company. Moreover, company performance is determined by the result of share prices that are quoted on the stock exchange, not according to a government determined dividend policy.

Board independence. The relevant provisions of the Company Act apply to MOM companies for board nomination and director appointments. MOM companies will follow normal commercial used by most listed companies where the existing Board suggest nominees at a shareholders' meeting, which is then voted on by the shareholders. Boards are likely to consult with the government and other significant shareholders before putting forward nominees. Given the Crown's majority ownership, there is little chance that someone that is not acceptable to the Crown is appointed.

Non-commercial objectives. The 1986 SOE Act provides for that the Crown and SOEs enter into an agreement for the non-commercial provision of goods or services by a 100 per cent owned SOE, with the Crown paying all or part of the associated costs. For MOM companies, the government does not have similar provisions as it can contract with the companies on an arms-length commercial basis, with the Crown paying the full costs. Although making the MOM companies absorb some of the costs of non-commercial goods or services is theoretically possible, is not considered appropriate given the presence of minority shareholders. Any other non-commercial objectives can be pursued through the government's regulatory powers.

Transparency and disclosure. MOM companies are subject to the stock exchanges' continuous disclosure regime and are not required to disclose

any information beyond the regime (so as not to place it at a competitive disadvantage relative to its competitors). However, the State has some privileged access to financial information necessary to prepare the government's accounts.

Corporate social responsibility. Crown companies that fall under the 1986 SOE Act are expected to exhibit a "sense of social responsibility".[13] However, such obligations are not required of MOM companies– given that there is no precedent for such a provision in the company charters of other privately-owned listed companies or any requirements as laid out in the Companies Act framework. Although some listed companies have CSR programmes, their inclusion as obligations in their company charters/constitutions, which directors would have a duty to comply with, is not considered to be necessary and would not prevent MOM companies from development or continuing any existing CSR work.

State influence. The powers of the majority shareholder are limited to those that are reflected in the Companies Act. The Crown sees any further direction provided by the State on non-commercial matters inconsistent with its mandate. It also sees the potential risks of exposing Ministers to directors' liabilities by doing so. By intervening, the State could further undermine the role of the Board. State influence is thus formally restricted to: selling and buying shares (subject to the limitations as set out in the MOM Bill); voting on the appointment of directors, major transactions and other powers as conferred by the Companies Act or the company charters; voting on changes to the constitution (where there is a 75 per cent majority); deciding whether to take up any issue of new shares; and approving the appointment of the chairman of the Board (who is elected by the company's directors).

3.4 Poland

General context

Privatisation through the stock exchange has been one of the key elements in the broader context of the Polish economy's transition from command to free market economy. Share offerings of SOEs have been used as a means to develop Poland's capital markets, to strengthen the role of Warsaw as a regional financial centre, to maximise revenues from privatisation through the capital markets, and to attract financial resources for the companies themselves. In general, the State sees listing as the most appropriate route for the privatisation of large companies, to ensure transparency around their privatisation and market valuation, while creating

increased pressure for companies to introduce and apply better corporate governance standards.

The Polish State is currently shareholder in 502 companies, of which 18 are listed on the Warsaw Stock Exchange (WSE).[14] Its experience with listing is relatively recent, with two waves of listing between 2008 and 2009 and over the period 2008 and 2011. The State's stake in each listed company ranges from 28 to 84 per cent with shareholdings in the chemicals, energy, oil and gas, and mining sectors, in additional to a number of financial and real estate companies.[15]

The government's intention with the privatisation process has been to systematically increase the number of companies listed on the WSE. In the case of companies already listed on the WSE, it strives to ensure their continued presence on the floor and optimal level of liquidity of shares following completion of privatisation process. Among these companies, the State is required to maintain minimum stake in eight companies for "strategic" purposes and are considered of "strategic significance" to the national economy as determined by various government policy decisions which explicitly state the intention of the government to maintain a stake.[16]

Beyond the overarching goal of privatisation, Poland sees other benefits that can be reaped by going to the stock market. It can be used as a means to facilitate access to capital for companies in need of it, to improve the efficiency and transparency of companies, and to develop, expand, and find opportunities in other markets. Beyond commercial motivations to list, the Polish government is also keen on using share offerings as a means to promote the participation of its citizens in stock market transactions and encourage civic shareholdings. This also includes increasing stock exchange capitalisation and regulated market turnover of the WSE.[17]

Leading up to the process of listing

The Treasury must decide which course of action to take to privatise SOEs. The decision to list will hinge on optimising the opportunities for a company's further development, economic and other factors such as the company's financial situation, and market conditions. This is ensured through a company evaluation that is made by a team of Treasury experts. Beyond the company specific evaluation, the government must also factor in whether the transactions will help strengthen the domestic capital market, and will lead to an overall strengthening the competitiveness of the Polish economy.

Ultimately, the Treasury decides whether or not to go to the stock market. The Treasury is responsible for executing all listing transactions of SOEs, even if the SOE is under the supervision of a different Ministry. Once

the selection is made, advisors are appointed to a specific transaction. In the case of companies in good financial standing, which meet certain market criteria, and have the potential to create value for investors and the Warsaw capital market, privatisation through the stock exchange is the preferred route. The Treasury selects the most attractive SOEs to list after performing market analyses. Prior to listing on the stock exchange, an analysis of market conditions is carried out in order to determine the optimum transaction structure and timing for the company and the Treasury.

Going to the stock market

When preparing for an IPO, the company may need to undergo a number of changes, including to its Articles of Association. The Articles need to be in coherence with listing requirements, such as having audit and remuneration board committees. SOEs also adopt international accounting standards as required by the WSE. Other changes may be necessitated, such as introducing specific corporate rights for the State as the primary shareholder in strategic companies (see also below under "Strategic Companies"). In general, for most non-strategic SOEs, no restrictions are imposed when up for listing. However, in some companies certain actions such as the sale of a controlling stake, may give rise to certain additional procedures, such as public calls.

The Treasury selects and appoints advisors to execute the IPO process. This involves among, other things, preparing a detailed review of the company by investment banking sector specialists. New measures can be introduced to improve efficiency and streamline company operations. In some cases the company strategy must also be revisited. Company management is then prepared for road shows to stimulate investor interest in the company. The pre-IPO stage is considered to be one of the more important phases of the listing process as the 'equity story' is being built and it can have an impact on company operations.

IPO offerings are typically addressed to a wide group of institutional investors – domestic and international – as well as retail investors. The level of interest among domestic and international investor groups varies from transaction to transaction. The aim is to achieve a balance between international and domestic investors, with a preference given to stable, long-term investors. Historically, large privatisation transactions have attracted significant interest from global institutional investors (e.g. primary and secondary offerings of PGE, PKO BP, PZU); as well as successfully attracting record numbers of retail participation in IPOs (i.e. PZU the largest Polish insurer). Although dual listings have been considered for SOEs listed on the WSE, none have yet embarked on, as priority has been given to the WSE as a means of developing the domestic capital market.

As each IPO transaction is unique, allocations are specific to each transaction and take into account advice received from the underwriting syndicate. However their timing is considered critical to their success. Preference is given to transactions involving: stable investors (including pension funds); other investors who help support optimal book building through early declarations; placement of large orders; placement of orders at higher prices, or at any price (i.e. with no upper price limit); and/or to investors who were active participants and helped book building in previous transactions carried out by the Treasury. For small orders or low allocations, these offers may be excluded.

Strategic companies

For strategic SOEs (as defined by government strategy and policy documents), certain limitations are put into place under government policies and regulations to limit the possibility for the Treasury to dispose of its shares. The minimum stakes that the Treasury is to maintain in strategic companies is specified in government strategy or policy documents. The Treasury is accorded specific rights as specified in the company's article of association (i.e. exemptions from restricted voting rights). Sometimes these restrictions also apply to companies not labelled as "strategic" (such as Grupa Azoty, JSW and WSE), in which the State Treasury holds a number of the Company's shares authorising it to exercise at least a certain per cent of the vote plus one in all the votes in the Company.[18]

Given the importance of strategic companies to the Polish economy, the government strives to ensure that its objectives are in line with creating long-term shareholder value. It has introduced competitive compensation and incentive schemes to attract professional management to these companies, although it maintains a more active role as shareholder in company decision-making.

Impact on governance and performance after listing

The Polish government considers that listing has been a key factor in contributing to improvements in overall company performance and governance. This is due to a number of factors, including more effective and better qualified management teams which are able to introduce operational efficiencies after listing (e.g. cost reductions); increased disclosure and reporting requirements following listing; and the presence of larger more active institutional investors, which contributes to bringing about increased diligence and focus on company performance.

In companies where the State remains the majority shareholder, the State has the power and duty (through its seats on the supervisory board) to[19]:

- Appoint, dismiss and suspend board members;
- Recommend remuneration policy of the management board;
- Access company financial statements;
- Approve annual financial plans and long-term strategic goals;
- Monitor and control decisions which are material to the company;
- Approve investment/divestment decision above certain limits;
- Select company auditor and monitor the audit process; and,
- Assure continuous monitoring of performance and ability of the company to meet its financial and long-term strategic goals.

Minority shareholder protection. The Treasury considers equal shareholder rights to be of paramount importance, which is ensured according to the Commercial Companies Code and supported by codes of best practice. The Code specifically states that each share carries one vote. However certain exceptions apply, this includes: share with preferential voting rights, but not more than two votes per share; limitation in the exercise of voting rights by shareholders representing more than one-fifth of the total number of votes; and personal rights for individual shareholders, such as the right to appoint or remove members of the management and/or supervisory board. Shareholders representing at least one-tenth of the company's share capital may request an extraordinary general meeting to be convened in addition to placing matters of particular interest on the agenda of annual general meetings. Depending on the company, some rights may be granted to shareholders representing a smaller minority of the company's share capital. Representative of the Treasury on the Supervisory boards of companies in which the State is minority shareholder have a number of rights including: informing the appropriate supervisory units of any violation of the laws committed by company management or of any activities which may be harmful to the Treasury's interests; applying statutory provisions appropriately to secure the Treasury's best interests; and, initiating reporting and disclosure obligations by the company's board members.

Commercial orientation. Some companies continue to exercise public service obligations (organised and compensated in accordance with EU rules), the State strives to maintain a balance between its rights as

shareholder, and the implementation of public policy goals.[20] Prior to listing, company strategies are revisited to ensure compatibility with the Commercial Companies Code. Once listed, the presence of active shareholders can also have an influence on focusing company management towards enhancing company performance.

Improved access to capital and investment renewal. Access to capital for non-listed SOEs is more difficult due to procedural requirements, in addition to resource limitations that the State has to inject capital into its companies. Listed SOEs have improved access to capital and financing based on market conditions.

Board independence. The act of listing does not lead to changes in the board. The Commercial Code provides for a two-tier structure consisting of the supervisory and management boards. The former exercises day-to-day supervision and appoints the management board, while the latter is entrusted with managing company affairs[21]. Although the Ministry of Treasury continues to retain seats on the supervisory boards of companies in which it remains a shareholder, it strives to ensure board independence and does not follow a system of instructions for members it has appointed to the board. Overall 53 per cent of the supervisory board members of the 18 listed SOEs account for Ministry of Treasury employees or experts appointed by the State. In addition to supervisory board positions, the State may also have "representatives" of the Ministry of Treasury employed by the companies (approximately 67 representatives employed in total among listed companies).[22]

For some companies, the Treasury may exercise special rights on the selection and appointment of members to the supervisory and management boards. This is not linked to the per cent of State shares, but is articulated in the articles of association, and is different for each company. For example, in PKN Orlen the Treasury has the power to appoint/dismiss one member of the supervisory board; whereas in PGE, half the board plus one member can be appointed/dismissed by the Treasury; and in PKO BP, the Treasury determines the number of supervisory board members it wishes to select; moreover, it has the power to select the Chairperson and Deputy Chairperson. Where the Treasury has the power to appoint or dismiss board members, a competitive selection process is carried out in accordance with international good practices and based on guidance issued by the Treasury (see Box 3.2). Certain companies of key importance for the State may be subject to special procedures. For all other companies, the Commercial Companies Code specifies that shareholders acting in concert together holding 20 per cent of shares on application have the right to appoint one representative to the supervisory board.

Box 3.2. **Supervisory board criteria and selection process in Poland**

The Commercial Code provides for a two tier board structure, consisting of the supervisory board and management board. The supervisory board exercises day-today supervision, while the management board is entrusted with managing the affairs of the company. The supervisory board is appointed by the General Meeting.

The State Treasury as a shareholder has the right to appoint representatives to supervisory boards (either external experts or Treasury employees whose role depends on the State's shareholding) as determined by company articles of association. Only persons with appropriate qualifications and experience, including civil servants may be appointed as members of supervisory boards.

Selection criteria and principles of appointing supervisory board members aim to ensure professional, accurate and politically neutral execution of tasks. In order to be selected, all supervisory board members are required to pass an exam for candidates for supervisory board members; all government employees can sit on supervisory boards subject to passing the exam and having minimum 3 years' experience in the fields of economics, law, management or public administration. Ministers and deputy Ministers are not allowed to sit on supervisory boards, and supervisory board members cannot be part of company management. The selection to supervisory boards is conducted through a publicly announced process (this does not apply to civil servants). The management board is appointed by the supervisory board.

Source: Submission from Polish authorities and OECD (2013), Boards of Directors of State-Owned Enterprises: An Overview of National Practices, Corporate Governance, OECD Publishing.

Non-commercial objectives. The Treasury aims to strike the right balance between shareholder rights and the implementation of public policy goals.

Transparency and disclosure. The transparency and disclosure requirements are the same for all publicly listed companies as required by the securities law and the WSE. Listed companies have the obligation to disclose, for example, interim, quarterly and semi-annual reports, with audited annual reports; current reports on specific events; and certain material information on an immediate basis. Where the State is majority shareholder, listed companies must also prepare quarterly information reports to the Treasury.

State influence. The State exercises its influence through its rights as a shareholder in proportion to the number of voting shares that it holds (or through shareholder proxies). Poland formally owns shares through the Treasury which also fulfils corporate supervision of the State as shareholder. Line ministries may be involved in corporate supervision depending on their area of competence (such as in mining, rail, etc.). In some cases, it is afforded special rights as specified in the company's articles, and which are in compliance with Polish and European laws. In some non-strategic companies, the Treasury continues to exercise special rights as a result of its majority ownership but not as a result of any specific strategic interest. Despite some of these specific rights, the Treasury's aim is to create long-term value for shareholders of its listed companies by adhering to the OECD SOE Guidelines. State representatives who sit on supervisory boards are obliged to comply with the Commercial Companies Code and are expected to act in the best interests of the company and its shareholders.

3.5 Turkey

General context

Turkey began its privatisation programme in 1984 to enhance the structural transformation and modernisation of its economy. Public offerings and private placements were a significant component of the privatisation program, which resulted in almost 30 SOEs listed at the Borsa Istanbul (BISE) between 1988 and 2012 (3.2). Initially, the drive by the Government to list SOE shares was aimed at developing the capital markets in Turkey as the merits listing was not fully understood and appreciated by the private companies at the time. In the early period, IPOs consisted of selling minority stakes of SOEs in various industries (including cement, airport services, petrochemicals, iron-steel, petroleum refinery, retailing, automobile manufacturing and trading, telecommunications and airlines).

With increasing depth and institutionalisation of BIST, along with the strong appetite of foreign institutional investors, both the amount of proceeds obtained from SOE public offerings and the amount of shares offered have substantially escalated in 2000s. Over a period of thirty years, USD 11 billion has been raised from the listing of SOE's, which represents approximately one-sixth of the USD 60 billion of total privatisation revenues (3.2).[23]

Table 3.2. **IPOs Administered by the Turkish Privatisation Agency**

Listed companies	Transaction date	Stake offered (per cent)	Proceeds (US$)
Çukurova Electric Corp.	16.04.1990	5.45	38 829 409
Adana Cement Industry Corp.	18.02.1991	34.32	27 958 470
Afyon Cement Industry Corp.	21.03.1991	39.87	8 422 698
Arçelik Corp.	30.04.1990	5.83	19 890 196
Bolu Cement Industry Corp.	30.04.1990	10.38	8 268 150
Çelik Halat ve Tel Corp. (Steel Cable)	30.04.1990	13.25	7 750 179
DITAS Spare Part Manufacturing AND Technical Corp.	06.05.1991	2.51	219 411
Eregli Iron and Ore Factories Corp.	09.04.1990	2.93	53 105 711
GIMA Food and Supplies Corp.	03.06.1991	4.15	406 902
Kepez Elecktric Corp.	16.04.1990	8.14	9 390 359
Konya Cement Industry Corp.	24.10.1990	31.13	17 663 979
Mardin Cement Industry Corp.	22.11.1990	25.46	9 161 501
Migros Turk Corp.	25.02.1991	36.40	5 609 246
NETAS Northern Electric Telecommunications Corp.	03.03.1993	7.75	8 723 623
Niğde Cement Industry Corp.	13.05.1991	12.72	2 647 286
PETKİM Petrochemical Corp.- (1)	18.06.1990	7.83	145 795 530
PETKİM Petrochemical Corp. - (2)	13.04.2005	34.49	265 067 477
Petrol Ofisi A.Ş. - (1) (Petrolium Retailing)	27.05.1991	3.32	11 840 305
Petrol Ofisi A.Ş. - (2) (Petrolium Retailing)	15.03.2002	16.47	166 688 418
TELETAŞ Telecommunications Indusrty Trade Corp.	29.02.1988	20.94	12 015 463
TOFAŞ Oto Ticaret A.Ş.	13.06.1991	1.36	966 248
TOFAŞ Turk Automobile Trade Corp. - (1)	13.06.1991	0.85	6 119 572
TOFAŞ Turk Turk Automobile Trade Corp. - (2)	04.03.1994	16.80	319 129 239
Turkish Airlines - (1)	29.11.1990	1.54	4 837 562
Turkish Airlines - (2)	01.12.2004	22.98	190 542 949
Turkish Airlines - (3)	18.05.2006	26.06	186 841 944
Türk Telecom Corp.	09.05.2008	15.00	1 678 299 850
Halkbank - (1)	04.05.2007	24.94	1 831 279 269
Halkbank - (2)	16.11.2012	23.92	2 523 250 348
Is Bank	13.05.1998	12.25	611 391 767
Turkish Petrolium Refineries Corp. (TUPRAS) - (1)	27.05.1991	1.64	5 947 478
Turkish Petrolium Refineries Corp. (TÜPRAŞ) - (2)	07.04.2000	30.65	1 081 136 895
Aircraft Services Corp. (USAŞ)	20.10.1993	30.00	15 205 871
Ünye Cement Industry Corp.	01.11.1990	2.86	927 162
TOTAL			9 275 330 467
Private Placament Applications in Various Listed Companies			1 371 794 849
GRAND TOTAL			10 647 125 316

Source: Submission by Turkish government authorities.

Leading up to the process of listing

Governmental bodies that are responsible from the undertaking of privatisation activities in Turkey include the Privatisation High Council (PHC) and the Privatisation Administration (PA). The PHC is composed of four cabinet members chaired by the Prime Minister, which acts as the decision-making body. The PA is the body responsible for executing privatisation transactions. A public offering can be initiated following a proposal by the PA to the PHC. Following the approval of the PHC to initiate a public offering process, the PA undertakes the execution work in coordination with the competent line ministry and SOE.

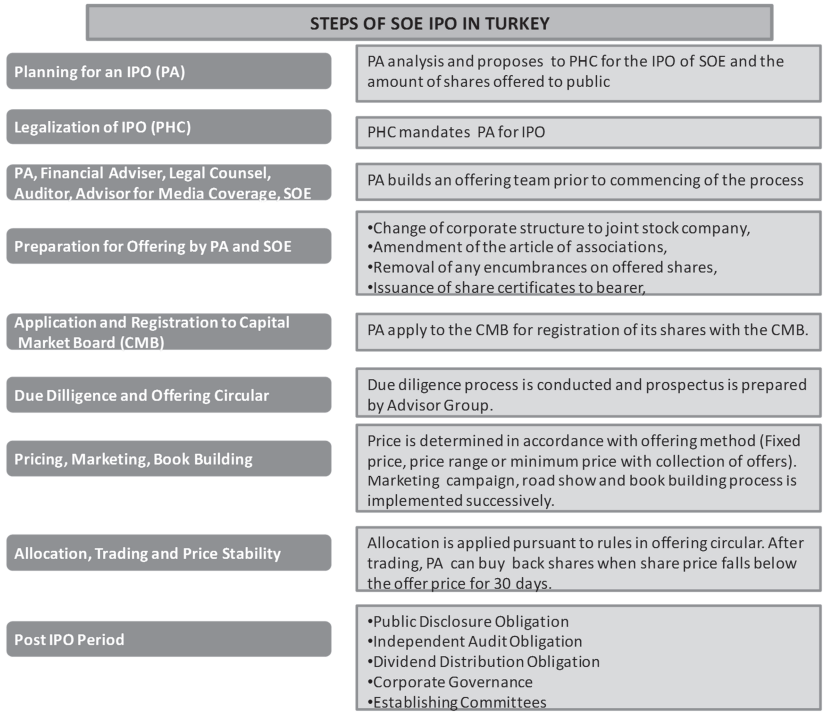
Political and economic factors in Turkey, as well as the outlook and developments in international markets are critical for determining the timing of an offering. These are presented to PHC by PA in order to assist PHC to take the final decision to launch an offering. For the success of an IPO it is vital that the SOE is commercially viable, operates profitably and has the fundamentals to prove to be a good investment opportunity for potential investors. Although PA is responsible for the offering process, the SOE that is to be listed has a substantial role to play during the IPO taking into account that the cooperation of SOE and representation of its senior management, especially during investor road show sessions, is critical.

Allocation of the shares to institutional investors globally and in the domestic market as well as the appetite of foreign investors to invest in Turkish capital markets has been significant factors for the success of IPO's realised in last decade. Institutional investors having a long level of the share price to be determined has also been another significant factor. The IPO's executed by the PA and its pricing policy have been perceived positively among retail investors in Turkey and this policy of PA has created an encouraging atmosphere for future IPOs.

Going to the stock market

A typical SOE initial public offering process in Turkey is described in Figure 3.3. Turkish legislation does not differentiate between the public offerings of a private or a public sector companies. The securities regulator - Capital Markets Board (CMB) - has the authority to grant exemptions on certain requirements considering the nature of a public offering and its objectives. There have been cases where CMB has used this flexibility during offerings of SOEs.

Figure 3.3. **SOE Public Offering Process**



Source: Government of Turkey (2014), Privatization of State-Owned Enterprises in Turkey, the Privatisation Administration of Turkey.

IPO's have been observed to enhance SOE performance by means such as adopting financial reporting rules in line with the private sector, establishing corporate governance principles, achieving compliance with public disclosure requirements and management approach to conduct operations with a profit-oriented perspective. As a result, IPOs have increased the institutionalisation and financial discipline of the SOEs.

Furthermore, public offerings help to establish a public market valuation for the remaining public stake in SOEs. Public listings have been used as a tool for the PA to establish valuation references, and to determine whether to privatize through a block sale or follow on public offerings. Türk Telekom's IPO in 2007 and Halkbank's SPO in 2012 (explained in detail in Annex 1) have been the most successful public offering applications of the PA. There the process of stock market listing is further illustrated by the example of Türk Telekom, which was introduced on the stock market after initially selling a controlling block to a strategic investor (Box 3.3).

Box 3.3. **Türk Telekom**

Since the IPO was planned in advance by the Turkish government, as the "second phase of privatisation", necessary stipulations were incorporated into the agreements undersigned by the Turkish government and the buying party at the time of block sale in 2005. In this context, the cooperation and involvement of the Oger Telecom to a listing to be undertaken by Turkish Treasury was guaranteed under the Shareholders' Agreement whereby the controlling shareholder was made liable to undertake certain actions (like taking necessary decisions about listing at the board level, voting for changes in the Articles of Association, complying with auditing requirements etc.) with regards to a listing. The agreement further regulates the distribution of the costs pertaining to a listing.

Shareholders' Agreement Article 11.1 (d) stipulates that "If the Treasury seeks to undertake a Listing the Investor agrees to co-operate fully with the Treasury and the Company and their respective financial and other advisers and to use its reasonable endeavors to assist the Company to achieve a listing in accordance with the rules and regulations of the relevant Listing Exchanges to which the application for listing is made and other applicable laws." Article 11.2 stipulates that ".....the Investor shall cooperate fully with the Treasury and the Company and their respective financial and other advisers and use its reasonable endeavors to ensure that all actions necessary to achieve the Listing are taken, including but not limited to taking the following steps:

- converting the Company into a suitable entity for listing;
- reorganising the share capital structure of the Company and determining the number of shares to be issued;
- changing the composition of the Board;
- amending the Company Articles as appropriate;
- instructing reporting accountants;
- prepare the Company for and cooperate and participate in any international roadshow and domestic marketing activities;
- meeting the financial reporting requirements of the relevant Listing Exchanges (for example as to trading history, extracts from audited accounts of prior years, cash flow and profit forecasts, working capital report and indebtedness statement);
- establishing or amending employee/executive share option schemes if necessary and obtaining relevant government clearance as appropriate;

Box 3.3. **Türk Telekom** (cont.)

- agreeing the form of the offer for sale agreement and in particular the form of the warranties to be given by the Directors and the Company and procuring that its appointees to the Board execute the offer for sale agreement where such agreement contains identical warranties given by each Director;
- setting the offer price of the shares to be sold and any issue price for the Listing Shares;
- carrying out verification of the prospectus and other documents pertinent to the Listing in respect of which verification is required;
- amending this Agreement and any other agreement between the Company and the Shareholders as appropriate;
- procuring that its nominees to the Board accept responsibility for any Information Memorandum, Listing Particulars or Prospectus to be issued by the Company (unless the Shareholder in question can demonstrate that the Director(s) in question, having regard to the relevant legislation regarding the general duty of disclosure, have reasonable grounds for refusing to accept such responsibility);
- procuring that its nominees to the Board provide any other confirmations or consents which are either reasonably necessary to secure the Listing of the Company;
- agreeing to any indemnities and/or warranties which are required to be given in connection with events and matters arising after the date hereof; and
- entering into an undertaking not to sell, to the extent such is permitted by this Agreement, any Shares not sold on Listing for such specified period as may be reasonably required in order to maintain an orderly market in the Shares following Listing.

Source: Government of Turkey (2014), Privatization of State-Owned Enterprises in Turkey, the Privatisation Administration of Turkey..

Impact on governance and performance after listing

Minority shareholder protection. In Turkey, the rights of minority shareholders and the fiduciary duties of directors and majority shareholders are considered to be relatively more limited than those countries such as the United States or the United Kingdom, however significant modifications have been introduced due to recent changes in the Turkish Commercial

Code (TCC), Turkish Code of Obligations and the Turkish Code of Civil Procedures since their enactment.

A minority shareholder of a public company is defined as a single shareholder or a group of shareholders that holds 5 per cent or more of the public company's outstanding share capital. Under Turkish law, minority shareholders have amongst other rights, the right to require the board of directors to:

- invite the shareholders to an extraordinary general assembly of shareholders;
- request that a matter be included on the agenda at both an ordinary and extraordinary general assembly of shareholders;
- request the appointment of special auditors; and
- require that the company take action against directors who have violated the Turkish Commercial Code or the company's articles of association or who have otherwise failed to perform their duties.

However, the board of directors may decline such request. In such a case, the minority shareholder may initiate a court action. Under the TCC and Turkish Code of Obligations, a shareholder can request the court to determine that a particular Board resolution is void.

Transparency and disclosure & board independence. Recently, four major pieces of legislation that impact transparency and corporate governance for companies in Turkey have been substantially amended in 2011 and 2012- namely the TCC, the Turkish Code of Civil Procedures and Capital Markets Law. The new TCC generally aimed to raise the standards on transparency and corporate governance of Turkish companies (such as by requiring external audit of accounts), to reinforce minority shareholder rights (such as by providing more detailed rights on derivative actions and exit options), to provide additional restructuring tools (such as mergers, spin-offs and conversions), and to simplify the incorporation process (such as by allowing single-shareholder companies and providing detailed rules on in-kind capital contributions). Approximately twenty articles of the new Turkish Commercial Code are directly related to the corporate governance rules. These articles are based on four principles, namely transparency, accountability, fairness and liability.

In addition, a Corporate Governance Communiqué came into force, which provides certain compulsory and non-mandatory principles applicable to all companies incorporated in Turkey and listed on BIST. The Communiqué is designed to enhance corporate governance standards, including a requirement that at least one third independent board members.

The Communiqué is currently in force for all listed companies, and following a one-year exception for banks, the rules have also become applicable to Halkbank.

When obtaining stock market listing, a Turkish SOE becomes subject to the Communiqué published by the CMB. The Communiqué are mostly mandatory for large companies. For example, companies are required to maintain annual and interim activity reports and make them available to shareholders through their corporate websites. In regular independent assessments of the governance of Turkish companies, Türk Telekom scores highly. The apparent qualities include a professional board of directors and a statutory separation of the roles of CEO and Chairman of the Board.

The 2012 Capital Market Law entered into force with amendments on regulations around right to exit for shareholders, squeeze-out rights and put option rules, share buy-backs, removal of privileges, approval process for public offerings similar to the EU practices and new definitions around capital market and brokerage activities and supervision measures and sanctions in case of certain criminal and administrative actions. Regarding corporate governance, the new law provides the CMB to take "ex officio" supervisory and audit measures on publicly traded companies, in case they do not comply with the corporate governance principles. Furthermore, the new law establishes a compensation centre for investors that will collect contributions from investment institutions for distribution to investors that suffer from such institutions' default of cash payments and delivery of securities, similar to the savings deposit insurance schemes established for banks.

State influence. The Turkish State retains a considerable influence in the two partially privatized companies reviewed in Annex 1. In Halkbank where it remains majority shareholder, it continues to appoint all members of the board of directors. In Türk Telekom, where it retains just under 32 per cent, it is protected, first, by a shareholder agreement conferring a veto subject to supermajority rules over decisions made at the Board and General assembly levels; secondly, by a non-transferrable right (the golden share) to approve decisions related to the company articles and transfer of registered shares.

Notes

1. Data in this paragraph are drawn exclusively from the Chinese questionnaire response and include listings from 2012. As such the figures may differ from those reported in Table 1.1. Moreover, calculation differences may be accounted for in the way holdings have been counted.

2. The eleven entities and institutions that were converted to found a new overall entity which was subsequently listed include: China Huayuan Group Co., Ltd.; Jiangsu Xingxing Mechanical Group Company; Shandong Laidong Internal Combustion Engine Co., Ltd.; Shandong Guangming Machine Factory; Shandong Shouguang Jubao Agricultural Vehicle Plant; Shandong Weifang Tractor Group Company; Shandong Tractor Factory; China Textile Scientific Technological Development Company; China Agricultural Machinery Company; Shanghai Internal Combustion Engine Research Institute of Ministry of Mechanical Industry; and No. 4 Design and Research Institute of Ministry of Mechanical Industry

3. For example, Wang *et al*. (2004).

4. Fan *et al*. (2007) and Chan *et al*. (2004).

5. Data in this paragraph are drawn exclusively from Mishra, 2013. As such the figures may differ from those reported on 2012 in Table 1.1. Large discrepancies may be accounted for by the fact that Table 1 includes government-owned entities that fall outside the definitional scope of Central Public Sector Enterprises, as referred to by Mishra, 2013.

6. A red herring prospectus, as a first or preliminary prospectus, is a document submitted by a company (issuer) as part of a public offering of securities. It is issued to potential investors, but does not have complete particulars on the price of the securities offered and amount of securities to be issued. It contains information on the purpose of the listing, and specific information concerning the offer, the company and additional disclosures. Upon the registration becoming effective, a final prospectus is prepared and distributed which includes the final public offering price and the number of shares issued. Only then, can the public offering of shares be completed.

7. *Navratna* was the title given originally to nine SOE national champions identified by the government of India in 1997 as "public sector companies that have comparative advantages", giving them greater autonomy to compete in the global market so as to "support [them] in their drive to become global giants". *Maharatna* and *Miniratna* companies are afforded similar privileges.

8. In some companies, the listing agreement requires that one-third of the board is to be comprised of independent directors. If the Chairman is an executive director or where the Chairman is related-party to a member of the board, one-half of the board should be independent. Further to this issue, is that the government has pursued an active policy of encouraging SOEs to aspire for board positions in other SOEs. With this arrangement the level of board independence can be put into question, in addition to preventing conflicts of interest and decision-making that make be in violation of the fiduciary duties of board members towards the company and its shareholders (including minority shareholders).

9. At the time of this report Meridian was planned to be offered on 29 October 2013.

10. Data in this paragraph are drawn exclusively from the New Zealand questionnaire response and include listings in 2013. As such the figures may differ from those reported on 2012 in Table 1.1.

11. The acquisition of a 25 per cent or more ownership or control interest in such assets by a foreign investor would trigger the OIA.

12. For example, restrictions can take the form of increased cost of debt paid by MOM companies, if debt holders become concerned at their ability to access company assets as security against their loans; or through more broad restrictions on the ability of the companies to dispose of their assets.

13. The Act states, among three defining qualities, SOEs have the characteristic of being an "organisation that exhibits a sense of social responsibility by having regard to the interest of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so."

14. Out of 502 companies, 252 are in the process of liquidation, while 250 companies remain active.

15. Data in this paragraph are drawn exclusively from the Polish questionnaire response and include listings in 2013. As such the figures may differ from those reported on 2012 in Table 1.1. Moreover, calculation differences may be accounted for in the way holdings have been counted.

16. For example, the Energy Policy 2030 policy document explicitly states the State's interest in PGE and Tauron.

17. As a means to promote this goal, educational projects have been launched to raise public awareness of ownership changes, business life and capital markets. A Civic Shareholding programme runs economic and capital

markets education sessions throughout the year to encourage individual investors to invest in Treasury shares.

18. The exemption related to these three companies which are not on the list of "strategic" companies was not explained by the Polish authorities.

19. The Polish authorities have not clarified whether information needed to make such decisions is obtained through the board or through the annual general meeting.

20. The Polish authorities do not specify how this is achieved (i.e. through by-laws, majority votes, regulation, or management contracts).

21. For some companies the company's articles may extend the supervisory board powers by providing that the management board must obtain the consent of the supervisory board prior to preforming certain acts listed in the company's articles.

22. The capacity of such employment, and the types of representatives were not provided by the questionnaire response.

23. Data in this paragraph are drawn exclusively from the Turkish questionnaire response and include listings from November 2012. As such the figures may differ from those reported on 2012 in Table 1.1. Moreover, calculation differences may be accounted for in the way holdings have been counted.

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Annex A

Listing of Halkbank and Türk Telekom

Halkbank SPO: Overview

Halkbank is a full-service commercial and retail banking group and provides a broad range of products and services to more than 8 million retail, small and medium-sized enterprise and commercial and corporate customers across Turkey and select international markets. Prior to the secondary public offering of Halkbank in November 2012, Halkbank was the sixth largest bank in Turkey in terms of total assets (TL101bn), the seventh largest in terms of loans (TL 60.5bn), the fifth largest in terms of deposits (TL78.2bn) and the sixth largest in terms of number of branches. Halkbank had almost 14 000 employees. (Banks Association of Turkey)

Reasons for the secondary offering. PA sold the Halkbank shares in line with Turkey's objective to minimize state involvement in the economy and to expand the existing capital market by promoting wider share ownership. The main drivers had been a long- to medium- term privatization programme, which included other state-owned industries as well as state-owned financial institutions.

Leading up to the process of listing

In 2000, the Turkish Parliament passed Statute 4603, pursuant to which state-owned banks were required to restructure their operations and prepare themselves for eventual privatisation. Under this law, it was agreed that Halkbank's organisational structure would be revised and its employees would be subject to private law provisions. According to the Decree number 2007/20, 21.73 per cent shares of Halkbank would be offered to public and the Decree stipulated the possible use of the over-allotment option. The first phase of the privatisation process of the Bank corresponding to 24.98 per cent of the shares was completed in May 2007 raising USD 1.9 billion.

Going to the stock market

For the secondary offering of Halkbank that would take place five years later, PA launched the process with the selection of financial advisors. Following a due diligence process and preparation of offering documentation, the deal was announced to the market, followed by a deal road-show and pricing of the shares in late 2012. The price range was determined as TL 13.80-15.90 per offer share and priced at TL15.10, generating TL4.5bn (USD 2.5 billon), including the 15 per cent green shoe allocation, which represented 23.9 per cent of total share capital. All the proceeds from the sale were retained by the primary shareholder, PA which transfers the privatisation revenues to the Treasury, with no proceeds retained by the company. In the post-offering the shareholding structure remains as 48.9 per cent traded at BIST and 51.1 per cent owned by the PA. The offering has been the largest Turkish equity offering to date.

Impact on governance and performance after listing

Transparency and disclosure & board independence. Applicable CMB Corporate Governance rules require that at least one third of the Halkbank Board members (3 members out of 9) be independent. Additionally, Halkbank has a number of Board Committees responsible for certain matters relating to the operation of the Bank. These committees include, among others, the Audit Committee, Corporate Governance Committee, Compensation Committee, Credit Committee, Assets and Liabilities Committee and Operational Risks Working Committee.

Corporate Social Responsibility. Halkbank uses loans from multinational development agencies to support financing of small- and medium-sized companies; in addition to providing consultancy and training services on social responsibility projects. Halkbank's has its own corporate social responsibility projects as well.

State Influence. PA continues to own a majority of the common shares of Halkbank after the secondary offering. Following the offering, the General Assembly is entitled to nominate all of the nine members of the Board. As a result, Treasury is able to control all matters requiring shareholder approval, including electing directors, approving significant transactions, making payments of dividends and restricting the pre-emption rights of shareholders.

Türk Telekom IPO: Overview

Türk Telekom is an integrated telecoms and technology services provider offering a range of fixed line, mobile, data and internet services as

well as convergence technologies. The company has 13.7 million access lines, 7.3 million broadband lines and 14.5 million mobile subscribers as of 2013. In 2005, 55 per cent of the company shares were privatized via block sale; they were sold to a private telecom company (Oger Telecom). The Treasury at the time retained a "golden share" in the company. The IPO was the second phase of the government plan for the privatisation of Türk Telekom in 2008. The process is described in A.1.

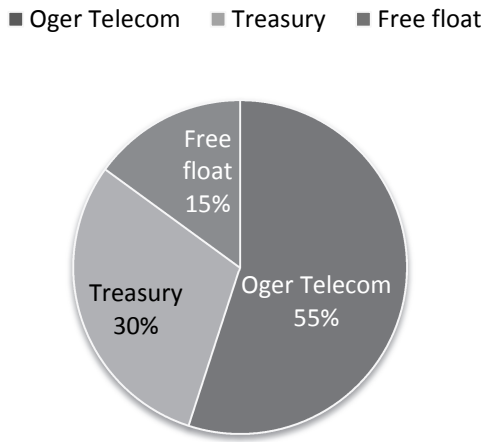
Rationale for listing. The rationale for the listing of Türk Telekom was to increase transparency, accountability, disclosure standards in Türk Telekom. It was considered that bringing in a private partner before its listing would result in increased efficiency, productivity, and service quality, which could impact the revenues that could be raised through the IPO. The listing had an impact on the value of the company which was valued at USD 13.2 billion, compared to USD 11.2 billion at the time of the block sale. The post-IPO shareholding is described in Figure A.1.

Table A.1. **IPO information**

Primary listing	**BIST**
Indicative offer size	15 per cent free float plus greenshoe
Greenshoe	Up to 15 per cent of the base deal size
Primary/secondary	100 per cent secondary sale by Treasury (Republic of Turkey, Prime Ministry, Under secretariat of Treasury)
Offer structure	Public offering in Turkey Global institutional offer regulation S outside the US rule 144A to QIBs in the US
Price stabilisation period	30 days post-IPO
Lock-up	180 days for the Treasury 180 days for the Company and majority shareholder (Oger Telecom)
Price range	YTL3.90 - 4.70 per round lot of 100 shares

Source: Government of Turkey (2014), Privatization of State-Owned Enterprises in Turkey, the Privatisation Administration of Turkey.

Figure A.1. **Post-IPO shareholder structure**



Source: Government of Turkey (2014), Privatization of State-Owned Enterprises in Turkey, the Privatisation Administration of Turkey.

Leading up to the process of listing

Necessary filings and procedures were undertaken on the part of Türk Telekom in order to comply with the CMB's requirements. In addition, special legislation governing the company's privatisation process, foresees the establishment of an independent Tender and Valuation Committees composed of representatives from the PA, the Treasury and the Ministry of Communications (with secretarial functions carried out by the PA). Every decision pertaining to the IPO process including the strategy setting, design of equity strategy, discounts, incentive schemes are assumed by the Tender Committee and pricing is assumed by the Valuation Committee. The strategy and pricing decisions are approved by the Council of Ministers at the final phase.

The special law also stipulates that 5 per cent of Türk Telekom shares are to be allocated to the company's and Postal Services Administration (PTT) employees and small scaled investors in case of an offering. Thus, the participation of the employees and small scaled investors was secured by law. The law also states that discounts and instalment payment mechanisms may be used during the course of the offerings to encourage the participation of the said parties.

In end-2007 the government issued a Council of Ministers Decree stipulating that 15 per cent of Türk Telekom shares would be offered to the public. The Tender Committee would determine the use of over allotment option, as well as the utilisation of various incentive mechanisms and instalment payment schemes. The Decree also regulated that 3 per cent (20 per cent of the offering) of Türk Telekom shares will be allocated to the Türk Telekom and PTT employees and small retail investors. Correspondingly, investors in the domestic offering were provided with certain incentives and were entitled to discounts of 4 per cent to 7 per cent; retail investors with significant purchasing power were entitled to a discount of 2 per cent to 5 per cent.

This Decree was partly to ensure that the government could secure the buy-in of company and PTT employees (they used to be a single company). The starting point of the IPO process, executed by the PA, was the procurement of advisory services for the offering.

According to capital markets regulations, financial advisors and capital markets licenced intermediary banks were mandated as well as lawyers, media and PR advisors. Joint Global Coordinators, International Bookrunner and Local Bookrunner assisted the PA in the IPO. There was further a requirement to incorporate the participation of the majority shareholder at the time of a block sale for the IPO.

Thus, in the case of Türk Telekom whereby the State was a minority shareholder, the second phase of privatisation was accomplished via IPO with the cooperation of the majority shareholder, under a structured shareholder's arrangement. This constitutes the only example of State being a minority selling shareholder in the IPO of a secondary public offering.

Going to the stock market

The Articles of Association of Türk Telekom were amended and necessary fillings were made to the Capital Markets Board (CMB) for the offering of Group D bearer shares with a total nominal value of TL 525 million which belonged to the Treasury and which corresponded to 15 per cent of Türk Telekom's paid-in capital. Due diligence took almost 1.5 months and the official start of the IPO was made.

During the public offering, "on the spot" publicity meetings and roadshows were conducted in six countries (Germany, USA, Sweden, UAE, UK, and Saudi Arabia). The pre book-building took place, followed by the actual book-building during which the floor and cap prices were set as TL3.90 and TL 4.70, respectively. The total size of the offering amounted to USD 1.9 billion (TL 2.4 billion).

The original plan was to allocate 35 per cent to domestic investors and 65 per cent to foreign non-resident institutional investors. On the basis of finalised bids that were received the allocation for domestic investors was revised to 40 per cent and 60 per cent, respectively. This would be the highest proportion of shares allocated to domestic investors in Turkish history.

Of the listed shares, 30 per cent were allocated to employees of PTT and the company, in addition to small investors. The remaining shares were split among major individual investors (3 per cent), institutional investors (2 per cent), and foreign non-resident investors (65 per cent). Of the total international sales of shares, 30 per cent went to the United Kingdom, 15 per cent to the United Arab Emirates, 11 per cent to the United States of America, 10 per cent to Sweden, 9 per cent to Lebanon, and 6 per cent to Singapore while the remaining 19 per cent bought by investors in other countries.

All of the bids submitted by PTT and Türk Telekom employees, and small investors were satisfied. In the case of institutional investors and individual major investors, the satisfaction rates were 95 per cent and 6 per cent, respectively. Although 15 per cent of the shares of Türk Telekom were offered to the public, 1.68 per cent of the shares were returned to the ownership of Treasury as part of a price stabilisation policy.

Impact on governance and performance after listing

Corporate social responsibility. In addition to social responsibility projects carried out nationally. Following its IPO, Türk Telekom received more than 80 national and international awards for the corporate social responsibility projects it has implemented.

Minority shareholder protection. Under the existing regulations, there is no upper limitation brought about to any shareholders right to vote. Voting rights of international allotters are also appropriately guaranteed.

Transparency and disclosure. Following listing, Türk Telekom received a positive assessment as a result of an independent review examining company practices vis-a-vis shareholder relations, public disclosure and transparency, stakeholder relations and board practices. The disclosure policy is carried out as per the provisions of the Regulations of Capital Markets Board (CMB), the Turkish Commercial Code, and the regulations of BIST. The company's disclosure policy is prepared and approved by the Board of Directors in coordination with the Capital Markets and Investor Relations Directorate. The company applies the following disclosures methods and means:

- Regulatory disclosures conveyed to BIST
- Financial statements, footnotes, independent audit report, declaration and activity report sent periodically to BIST
- Interim activity reports (published both in Turkish and English in the website)
- Annual activity reports (made to public both in Turkish and English in printed form and in the website)
- Corporate website
- Announcements and notices published via Turkish Trade Registry Gazette and daily papers
- Press releases published via press and mass media
- Meetings with investors and analysts conducted either face to face or via teleconference
- Communication methods and means such as phone, mobile phone, email, fax, etc.
- Statements made to data distribution organisations such as Reuters, Foreks and Bloomberg

Financial statements and footnotes are prepared in accordance with Turkish Accounting Standards and Financial Reporting Standards. The Company updates its annual and interim activity reports and corporate website, and makes them available to its shareholders.

Board independence. CMB Corporate Governance regulations require that at least one third of the Board Members (4 members out of 12) shall be independent. The company has 12 board members, 5 of which are appointed by the Treasury and 7 appointed by Oger Telecom. 4 of Treasury-appointed members are independent, and 1 member represents the Golden Share. Additionally, a number of committees operate relating to the operation of the company, these include, among others the Audit Committee, Corporate Governance Committee and the Early Identification and Management of

Risks Committee[1]. The Chief Executive Officer and Board chairperson roles are separated. The Corporate Governance Committee performs the functions of nomination and remuneration.

State influence. The Treasury continues to own 31.68 per cent of the common shares of Türk Telekom. In addition to the influence it can exert via the Board members it nominates, the Shareholders' Agreement stipulates that the Treasury can have veto powers as long as it owns 25 per cent of Türk Telekom, and can have supermajority decisions at the Board and General Assembly levels. On the other hand, the Treasury has a non-transferable right (golden share) to opine on and approve the following matters for the purpose of protecting the national interest in issues of national security and the economy:

- any proposed amendments to the Company Articles;
- the transfer of any registered Shares in the Company which would result in a change in the management control of the Company; and
- the registration of any transfer of registered shares in the Company's shareholders' ledger.

1. The Committee is designed to early identify any potential risks that might jeopardize the existence, development and continuation of the Company, to take and implement the necessary measures and preventive actions for the elimination of such detected potential risks as well as to perform and coordinate any studies related to risk management facilities and to manage and review the risks by applying a risk management system and to report the Board of the Directors thereon.

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A COMPARISON OF GOVERNANCE PRACTICES

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