Centre of Good Governance Working Papers

Centre for Good Governance CGG

Πρόταση για Πλαίσιο Διακυβέρνησης Κρατικών Οργανισμών και Κρατικών Επιχειρήσεων

Proposal for Governance Framework for State Organisations and State Enterprises

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The CGG Working Papers

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Abstract

As part of the efforts to improve the governance and performance of State Organisations and State Enterprises (SOSEs) in Cyprus, this article proposes a governance framework for SOSEs that should be implemented at the highest level of the executive branch of government. Drawing information and knowledge from the relevant literature, the article outlines specific recommendations, with the aim of achieving the sustainability, efficient operations, and profitability of these organisations within the open market they operate, while at the same time offering quality services and adopting a competitive pricing policy where this may apply.

I. Introduction

Considering the plummeting credibility of political actors in Cyprus (including politicians, political parties, the government and parliament) relative to other national institutions (Stockwatch Trust Index, September 2022)[2] and the public's perception that corruption is widespread (94% believe so and 92% believe that corruption exists in national public institutions) (European Commission, 2022a), one may conclude that corruption has also permeated through State Owned Enterprises and Organisations (SOSEs). Furthermore, it may be even argued that, in many cases, these organisations have become a tool for implementing clientelistic practices based on political expediency. In the absence of transparency and given a feeble governance framework that rests on short-sighted practices, certain longstanding weaknesses have developed which, if not addressed, are likely to render the organisations unsustainable and unable to function effectively within a competitive framework.

The purpose of this intervention is to propose a framework promoting the good governance of SOSEs that should be adopted by the state (i.e. the owner of these organisations). Through specific recommendations, the aim is to achieve the sustainability, efficient operation, and profitability of SOSEs that operate within an open market, while offering quality services and adopting a competitive pricing policy where applicable. Only through reforms such as the ones proposed here will SOSEs be able to maintain their current ownership status and not be a burden on the taxpayer.

Given that the state is the sole owner of these organisations they may be categorised as State Owned Enterprises (SOEs), a definition offered by the Organisation for Economic Cooperation and Development (OECD) and the World Bank. For SOEs, there is relevant academic literature (e.g. Nana Yaw Simpson 2014 and Daiser et al. 2017) and specific interventions by the OECD (OECD 2005, 2015, 2021) and the World Bank (World Bank 2014), which provide clear guidelines for their governance. These interventions are highlighted by the European Commission in its latest report (European Commission 2022b) as it urges Cyprus to consider them. Based on these suggested good practices and through empirical observations, the recommendations below have been formulated with a view to initiating a productive exchange of ideas with the relevant stakeholders that will assist in finalising a set of proposals.

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[2] The Stockwatch Trust Index measures trust in institutions and is available on the following website: https://trustindex.stockwatch.com.cy/

II. Establishment of a Central Independent Authority for the Governance of the SOSES with specific responsibilities

According to the OECD (OECD, 2021) and the World Bank (World Bank, 2014), the prevailing trend regarding the state's ownership responsibilities vis-à-vis SOEs is in favour of a more centralised approach. OECD (2021:16) explicitly notes: «A centralised ownership model is characterised by one central decision-making body undertaking the mission as shareholder in all companies and organisations controlled or held, directly or indirectly by the State». Alternatively, there can be a coordinating agency model where there is a co-ordinating department or specialised unit acting in an advisory capacity to shareholding ministries on technical and operational issues, in addition to being responsible for performance monitoring.

The present study proposes the former; that is, the ministries should transfer the responsibilities and ownership of state-owned entities to an Independent Authority ('Authority'). Through this:

1. The owner will be able to ensure consistency and continuity in the governance of the SOSEs (e.g. securing that corporate governance standards are consistently and uniformly applied by all organisations).
2. The responsibilities of the state will be separated. A ministry may have different roles in one industry (e.g. telecommunications), such as (a) being the owner of a company operating in the sector, (b) having a policy-making role, and (c) undertaking a regulatory/supervisory role. These different roles may be in conflict with one another and, by separating the ownership responsibilities of the State and transferring them to an independent authority, the possibility of cases of conflict of interest arising will be eliminated or at least minimised.
3. The concentration of relevant and specialised competences in one Authority will allow for an improved level of governance and more effective monitoring of the management of SOSEs.

III. Establishment of an Authority

Taking into account the tasks that the Authority will be assigned (see analysis under Point V), the number of SOSEs that the Authority will be responsible for monitoring, and the total workload that the Authority is expected to have, the Presidency should commission an independent Human Resources Management Consultancy to undertake a study to determine the number of members of the Authority Council and the personnel required to staff the authority (including an organisational chart to be posted on the Authority's website). This process should also look into the specific qualifications and experience that the members of the Authority Council and other staff members should have.

IV. Composition of the Authority

The members of the Authority's Council will be appointed with the assistance of an independent Human Resources Management Consultancy and through an open and transparent procedure.

In particular, the Presidency will outsource the process with a view to attracting the most suitable professionals. The call for applications will need to explicitly outline the responsibilities of the members as well as their remuneration packages, which should reflect their duties and responsibilities.

After reviewing all applications, the Consultancy will propose up to twice as many persons needed to fill the Authority's Council. The individuals to be selected must first receive the approval of House of Representatives and then the PoR will be able to select from among the successful candidates the individuals who will form the Council of the Authority.

The term of office of the members will be 7 years and there will be no right of reappointment. The appointments of the members of the Authority's Council will not be made all at once but an equal number of members will retire every 3.5 years. For the implementation of this provision, half of the members of the Authority who are to be initially appointed will have to retire in 3.5 years. This practice will ensure continuity in the work of the Authority as a change of all Council members at the same time will be avoided.

Because of the independence that the Authority will enjoy from the Executive branch of government, the PoR will not have the right to remove members of the Authority. The procedure for the dismissal of members will be the same as the procedure followed in the case of the Governor of the Central Bank. In the event that an alternative mechanism for removal of members is required, this can be discussed with the assistance of the Legal Service.

V. Duties of Authority:

This study proposes the following duties for the members of the Authority's Council:

i. Appointment of Boards of Directors of SOSEs:

Open and transparent selection process for individuals: Based on the criteria to be set and in compliance with the legal framework for the protection of personal data, there will be an open process inviting individuals to express their interest for specific board members positions. This process will be outsourced to an independent firm which will carry out an initial screening of the applicants and then suggest the most suitable candidates who in total do not exceed twice the number of the members to be appointed for every SOSE Board. The Authority will be responsible for confirming the validity of the process, the qualifications of the candidates (including interviews), and then will present a shortlist of candidates to the President and the Council of Ministers. Based on this proposal, the Executive branch of government will select those individuals who will comprise the Boards of SOSEs and inform the House of Representatives accordingly.

Importantly, any reference to criteria and procedures currently made in the applicable legislation is not considered sufficient and does not ensure transparency[3].

Guiding Principles: The entire process will have the public interest first and foremost and will not be influenced by political or other criteria. In particular, the Authority will be guided by the following principles:

- Integrity.
- Meritocracy.
- Transparency and Control.
- Impartiality.
- Objectivity.

Also, at the collective level, the Authority shall take into account the benefits stemming from professional diversity and act accordingly, targeting people with different professional and educational backgrounds, thus achieving collective suitability. Equally important, it will ensure adequate representation of men and women on each Board. It is of utmost importance that the Authority safeguards equal treatment and opportunities in all aspects and levels of its work.

Eligibility criteria: The Authority will be responsible for determining separately for each SOSE Board the qualification requirements for its Board members. These will include:

- Academic and professional qualifications.
- Professional experience.
- Participation and engagement in public affairs.
- Letters of recommendation.
- Integrity of character and honesty.
- Declaration of incompatibility and conflict of interest.

Remuneration of SOSEs' Board members: In order to attract successful professionals, the remuneration of Board Members should be determined depending on the organisation they serve, the tasks assigned to them, the time they will be required to devote for the performance of their duties, the qualifications required, and the equivalent remuneration packages offered by private organisations. The proposed remuneration will need to be justified and subject to government approval[4].

On taking up their duties, the Boards of Directors of the organisations shall be responsible for the management of the organisations, free from political intervention, and without any pressure to perform political party favours. The Boards will be held accountable for their work on the basis of specific transparent procedures (Point V(iii)).

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[3] The relevant law is: *Ο περί Ορισμένων Νομικών Προσώπων Δημόσιου Δικαίου (Διορισμός Διοικητικών Συμβουλίων) Νόμος του 1988 (149/1988)*

[4] It is common for salaries in state organisations not to equate those in the private sector but they should not be far below

ii. Monitoring/oversight of the performance of the SOSEs

The Authority is required to monitor and oversee the performance of the SOSEs. This will be done through four ways: the financial results, the budget, the strategic planning, and the Directors Report.

Financial Results:

Regarding the annual financial results, these should follow international standards and be presented to the Authority and Parliament. In addition to this, each organisation shall prepare and submit to the Authority a summary of the quarterly results. This will allow the Authority to identify potential deviations in a timely manner and ensure that the necessary corrective action is taken.

It is also important that, in addition to the financial results, the Authority will be responsible for establishing a set of quantitative and qualitative indicators (Key Performance Indicators - KPIs) for each organisation that will provide a credible assessment of the organisations' performance and will also allow for a comparative analysis with similar organisations in the private sector.

The World Bank (World Bank, 2014: 117) gives the characteristics that the indicators to be monitored should have:

- Should be linked to the company strategy and its objectives.
- Should be SMART—Specific, Measurable, Achievable, Results-oriented, and Time-based.
- Should be challenging but achievable, based on historical performance.
- Should facilitate benchmarking.
- Should be tracked by appropriate information systems.
- Should be linked to management performance.
- Should be audited.
- Should be simple at the start and enhanced over time.

It is necessary for each organisation to have a balanced approach between financial and non-financial indicators. Financial indicators could cover for example profitability, return on assets (ROA), return on equity (ROE), asset turnover, etc. At the same time (and depending on the size and nature of the organisation's activities), appropriate weight should be given to non-financial indicators with emphasis on the adoption of ESG criteria – Environmental, Social and Corporate Governance.

Budget:

Each organisation shall prepare and present its annual budget first to the Authority and then to the House of Representatives for approval.

Strategic Planning:

Complementary to the budget, the objectives for the following year, as well as goals based on a long-term horizon (five-year objectives), should be presented through a strategic plan. This document should include the following (Financial Reporting Council, 2018):

- A description of the strategy, objectives, vision, and business model.

- A review of the key trends and factors affecting the organisation.
- An assessment of the main risks and threats facing the organisation.
- An analysis of the organisation's growth and performance (including Key Performance Indicators).

Directors Report:

The Boards of the SOSEs shall prepare a Directors Report to be presented to the Authority on an annual basis. This report will include, inter alia, an analysis of whether the short-term objectives have been met (explaining any deviations), how the long-term objectives are being achieved, and the Organisation's compliance with the Code of Corporate Governance (point iv) and the Code of Conduct (point v) (explaining any cases of non-compliance). Based on this, the Authority will prepare a separate document outlining its own assessment of the Directors' Report and both texts will be sent to the House of Representatives.

iii. Accountability by the Authority

The Authority shall prepare and present an Annual Report to both the Council of Ministers and the House of Representatives, detailing the key activities of the Authority during the year and whether the objectives set have been achieved, explaining any failures in doing so.

In addition, a report will be provided on the progress of each SOSE separately, underlining any significant deviations from the planned course and the targets set.

In an effort to raise awareness and to have a more consistent and productive civil society participation in the governance of the SOSEs, the Authority will take relevant initiatives to promote direct accountability to the people. The Authority shall organise an annual press conference where it will present the year's activities and invite journalists to submit questions. Furthermore, there will be something similar to an Annual General Meeting, which already exists for the shareholders of companies. In this case, this meeting will be addressed to the wider society. Under this initiative, the Authority, on the basis of a transparent procedure to be communicated in a timely manner, will address questions submitted by organised groups such as Non-Governmental Organisations (NGOs), research centres, think-tanks, and other stakeholders, as well as citizens who wish to engage in the process.

iv. Implementation of Code of Corporate Governance of SOSEs

It is imperative for every organisation to operate within a framework of transparency, accountability, probity, honesty, fairness, efficiency, and sustainability, especially for SOSEs that are responsible for the delivery of essential public services and may rely on taxpayer support and/or operate in a monopolistic environment. This is advocated by the New Governance Team, which, operating under the auspices of the Institute of Directors (Cyprus Branch), has prepared a Corporate Governance Code to strengthen public administration, improve SOSEs' corporate governance, and thereby maximise the value that the public enjoys from public service providers[5].

The Code clearly sets the framework for the effective corporate governance of SOSEs based on specific practices and processes. The Council of Ministers has approved the Code (Decision No. 87.869, dated 25/7/2019) and invited all organisations to explain how they will implement it on the basis of the "comply or explain" principle. To date, there has been no progress in monitoring the implementation of this Code. The Authority will be assigned the responsibility to oversee the implementation of the Corporate Governance Code, thus assisting in an effective manner in the implementation of the decision of the Council of Ministers.

v. Implementation of the Code of Conduct and Ethics

In order to better address ethical risks, the Authority should ensure that a "Code of Conduct and Ethics" is in place and implemented in the SOSEs. This Code of Conduct and Ethics will:

- Comprise a comprehensive statement of values and principles, which should guide the day-to-day work of members of the organisation, indicate desirable and best practices, and provide the framework by which employees are able to resolve ethical dilemmas that may arise (covering cases of "conflict of interest" or "incompatibility").
- Cover the obligations and behaviour that an organisation must adopt towards the five key constituents: Employees, Owners, Suppliers, Customers and Society (with a focus on the natural environment).
- Be updated accordingly to respond effectively to problems that arise within the organisation.
- Indicate the procedures for raising questions and concerns.

A first version of the Code of Conduct for SOSEs will be prepared by the Authority. Then, each organisation will be free to propose any necessary adaptations applicable to that organisation that will be subject to the approval of the Authority.

Under the current legislation, the members of the Boards of SOSEs are required to comply with the Code of Conduct governing the functioning of the Boards, which, based on a decision of the Council of Ministers, should be prepared by the Minister of Finance and published in the Official Gazette.

While the legislation provides for a Code of Conduct, there is no such Code available, and no one has been assigned to oversee its implementation. The Authority will take over the responsibility for the implementation of this Code.

vi. Training of Board Members

The Authority should ensure that each organisation provides tailor-made induction programmes for new Board members and that Board members are given the opportunity (and required where

[5] The Code of Conduct is available on the website of the Audit Service. (Link)

appropriate) to have access to relevant training courses that will enable them to carry out their work more effectively.

vii. Legislative and Regulatory Framework

The Authority will contribute to the development of laws, regulations, and policies covering SOSEs.

viii. Promoting and Guiding SOSE reform

The Authority will have an active role and input into strategic decisions related to the reform and restructuring of SOSEs.

VI. Conclusions

The above recommendations aim at creating a good governance framework for SOSEs in order to eliminate inefficient malpractices and perceptions that work to the detriment of the organisations and seek to serve partisan agendas.

The proposed framework can be finalised on the basis of comments and observations from relevant stakeholders and then, depending on the political will, be implemented for the benefit of these organisations.

VII. References

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