How should state-owned enterprises be governed?

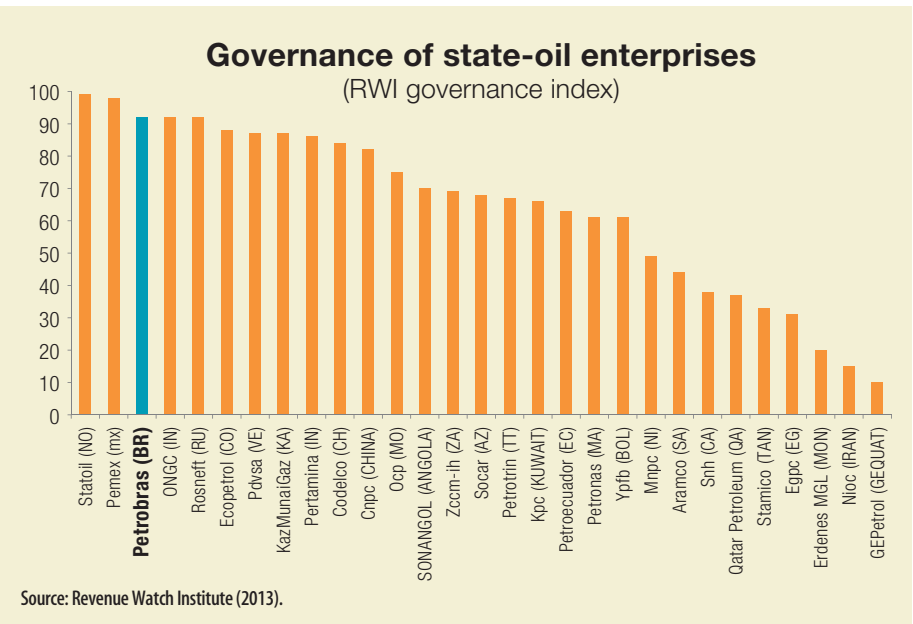
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THE CRISIS AT THE STATE OIL company, Petrobras, has sparked a passionate debate on the role of state-owned enterprises (SOEs) in the economy. Since March 2014, the country has been discussing what should be done with Brazil's largest company. So far the debate has been mainly motivated by ideology (public versus private ownership) and politics; there has been little attempt at diagnosis, much less solutions.

Did the Petrobras crisis result from a lack of management transparency? How have sectoral and macroeconomic policies (e.g., tariff-setting for the energy sector) affected company performance? Has Petrobras followed good corporate governance practices? How effective are Brazil's good governance policies for SOEs and what are good international practices? Ultimately, the design of effective policies for the SOEs will depend on the accuracy of the diagnosis.

Before the current crisis, Petrobras was thought to be in compliance with international standards for corporate governance. Since it entered the international capital markets in 2000, the company has followed the corporate governance rules of the New York Stock Exchange. According to the Revenue Watch Institute (RWI), in 2013 Brazil was among the countries where transparency and accountability in the oil and gas sector were good; that year Petrobras ranked among the top three state oil companies for transparency and accountability best practices. Few SOEs met such qualifications.

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Source: Revenue Watch Institute (2013).

And if RWI's assessments are analyzed in more depth, it can be concluded that internal controls were ineffective and that the measurement of governance took into account only formal aspects rather than what the company was doing in practice. For instance, with regard to the rules of the New York Stock Exchange, the differences between the governance of U.S. companies and that of Petrobras are significant: as a foreign company, Petrobras has to comply with only minimum standards of transparency.

Perhaps the most important difference is that the directors of Petrobras are not independent. This in practice is critical for professional management, especially of SOEs. In Brazil, Petrobras has never adhered fully to the standards of good corporate governance of the São Paulo Stock Exchange (Bovespa), complying only with the minimum standards for a stock exchange listing. In contrast, other Brazilian SOEs, such as electric utility Eletrobras, adhere to Bovespa's highest standards for good governance.

RWI's measurement of good governance is essentially formal, rather than objectively evaluating the company's operation controls in practice. For instance, in the RWI 2011 report, Petrobras was positioned well above half of the largest world oil companies, public and private, in terms of information on instruments against corruption. Yet Petrobras approved its first Corruption Prevention Program only in November 2013.

It would be desirable for Petrobras and other Brazilian SOEs tackle their governance problems more effectively, as SOEs elsewhere have done. For instance, Chile's Codelco, the National Copper Corporation that is the world's largest copper company, changed the composition of its Board of Directors so that a majority of members are appointed by the High Council of Public Management—a body of public administration responsible for the appointment of high-level government employees. At least 40% of the directors of Colombia's Electric Interconnection Corporation (ISA) must be independent; in practice, the majority of its directors are.

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Ultimately, governance of SOEs should respond to the real needs for transparency and good management in the context of their own operations. An effective system of governance must take into account the good management practices of both the private and the public sector. It would be desirable to consider how best to involve such government agencies as the Court of Auditors and the Comptroller General, in SOE audit systems to ensure their accountability.

Public policy intended to build up SOE governance and management should require the highest levels of financial and nonfinancial transparency, attract professional and independent directors and executives, grant the Court of Auditors power to control and evaluate SOEs, establish effective mechanisms for evaluating the performance of directors and executives, and give private shareholders guarantees that the company complies with high standards of corporate governance.