Chapter 4

State-owned enterprises in Kuwait: history and recent developments

by

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State-owned enterprises have been an important feature of the Kuwaiti economy since the establishment of the nation state. As highlighted in this chapter, their importance in the Kuwaiti economy has only increased over the years, and today they play an important role in the provision of basic services, employment and fiscal revenue. This analysis outlines the development of the state-owned sector in Kuwait, in order to situate the current structure of the sector and its governance practices in a historical context. Following the introduction of the privatisation legislation in Kuwait in 2010, the privatisation process, which until now has been slow, is expected to accelerate with the initial disposal of a stake in the Kuwaiti Airways Corporation.

Introduction

Kuwaiti society draws its roots from the mid-18th century, when the Al-Sabah family settled in what today is Kuwait. Although the population of neighbouring countries come from similar Arab tribes, the common history of those settled in Kuwait with the Al-Sabah family gave them elements of cohesion that have maintained the unity of Kuwaiti society to this day. Unlike most other countries of the Middle East and North Africa (MENA), Kuwait was never colonised. It was considered as a British Protectorate for about 60 years, although the involvement and impact of the British government on Kuwaiti society and politics was minimal.

The development of the hydrocarbons sector, beginning with the first oil shipment in 1946, marked the emergence of a modern economy in Kuwait. The fast development of the country's infrastructure, public services, institutions and welfare systems attracted professionals, entrepreneurs and private sector entities from abroad and contributed to the development of the Kuwaiti economy, within the framework and vision established by the ruler. At the same time, the influx of oil revenues increased public sector involvement in the economic sphere.

The priorities of the government at the time were oriented towards providing basic services such as water, electricity, health care and education to the population. For instance, the first water desalination plant was built in Shuwaikh area to replace the unsuitable and sporadic supply of water from Shatt Al-Arab, reducing the dependence of the population on the water wells (Ministry of Oil, 1983). The first public hospital was built in 1949, and several schools were built in subsequent years. In parallel, significant efforts were made to upgrade the country's infrastructure and to build homes for low-income Kuwaitis.

The ambitious industrial development agenda of the Kuwaiti government has to some extent resulted in the traditional activities of the private sector such as pearling, fishing and shipbuilding taking a secondary priority in the overall economic development of the country, and indeed with time some of these industries have disappeared. From 1946 until Kuwait's formal independence in 1961, the government's key priority was institution-building and the development of welfare-oriented programmes, with the state subsidising many enterprises that provided basic goods and services such as electricity, water, gasoline, education and health care. These subsidies were introduced in tandem with a generous housing scheme and social security system for Kuwaiti nationals.

During this period, private sector activity was focused primarily on trading, construction and banking. The largest Kuwaiti companies at the time were operating in the banking and hydrocarbons industries. For instance, the Kuwait Oil Company (KOC) was established as a joint venture between British Petroleum and the Gulf Oil Company as per the concession agreement signed with the ruler of Kuwait in 1934. The National Bank of Kuwait (NBK) was established in 1952 as the first private national bank in Kuwait and indeed in the Gulf region, following the refusal of the British Bank of the Middle East to grant credit to one prominent Kuwaiti merchant[1]. In 1957, the Kuwait Oil Tanker Company (KOTC) was established by a group of private investors who grasped the importance of maritime transport for the oil industry.

At this time, the Kuwaiti government started to involve the private sector in its ambitious infrastructure projects, mainly through public procurement. Foreign companies seeking to be involved in procurement for the Kuwaiti government were required to work through a local agent paid on commission. The laws of Kuwait at the time favoured involving Kuwaiti nationals in public sector activities as intermediaries. Nevertheless, this policy did not deter foreign private companies from the Kuwaiti market, where they were able to find business opportunities and execute profitable infrastructure contracts.

During the 15 years preceding Kuwait's independence, a welfare state emerged. All basic services were provided by the government at subsidised prices to make them affordable to every Kuwaiti, irrespective of income level. The state took a lead in almost all economic activities, while the role of the private sector was limited to trading and providing services that supported the objectives of the public sector. Oil revenues soared from $0.75 million in 1946 to about $500 million in 1961 (Khouja and Sadler, 1979). While there are no official figures on the magnitude of the economic activity at the time, it is estimated that the oil sector already represented more than 60% of Kuwait's GDP in the 1960s.

Historical background

The emergence of state-owned enterprises in Kuwait (1946-1961)

In considering the origins of the Kuwaiti state-owned enterprise (SOE) sector, it is important to keep in mind the social orientation of the government after it attained independence. The Constitution of Kuwait provides that the government is responsible for providing health care, education, water and electricity to the population. In its efforts to redistribute the oil wealth, the government introduced a welfare system that has historically been, and remains, an important fiscal burden.

During this period, the state moved to strengthen the welfare system by adopting a number of subsidised programmes and services. For example, a housing scheme for newlywed Kuwaitis that did not cover the real cost of housing was introduced. In addition, the Credit and Saving Bank was established to provide loans to Kuwaitis planning to build their own homes, initially at concession interest rates and later with no interest.

The cost of the welfare system established in the early state-building years was initially prohibitive and has grown over the years. Subsidies provided by the government are currently estimated to reach 15%-20% of GDP (Central Statistical Office, 2010). The real cost of goods, whether produced by public or private Kuwaiti companies, is underestimated because of these subsidies. The government remains concerned about the high cost of subsidies across sectors and services; however, it has become politically difficult to reduce or abolish them. Several attempts to increase tariffs on water and electricity have been made over the years, but the necessary parliamentary approvals were not obtained.[2]

The dominant role of the public sector in the local economy was to some extent welcomed by the private sector, which saw it as an opportunity to obtain contracts without taking the corresponding economic risks. The private sector's position was further strengthened by the legislative framework that protected it from outside competition. Indeed, until recently, the local commercial law prevented the establishment of majority foreign-controlled enterprises in Kuwait. In addition, foreign and local companies were not subject to the same fiscal treatment.

The post-independence era witnessed the establishment of several enterprises with majority government ownership. The key objectives behind the establishment of these SOEs related to the lack of the financial capacity of the local private sector to establish large-scale business ventures. These SOEs were provided with incentives and benefits such as heavily subsidised utilities, land concessions and customs exemptions that were politically acceptable because these companies were majority government-owned. SOEs were also shielded from competition and bankruptcy, and many benefited from a monopoly in the local market, which could have been viewed as favouritism had similar protections been offered to a private sector firm.

In the petroleum sector, enterprises were established with a majority ownership of the state. This was the case of the Kuwait National Petroleum Company (KNPC) established in 1960 and the Petrochemical Industries Company (PIC) established two years later with a minority shareholding from the private sector (limited to Kuwaiti nationals). Similarly, the National Industries Company was established in the 1960 as a wholly state-owned company to set up large construction projects that could not, at the time, have been undertaken by the private sector. Kuwait Flour Mills Company (KFMC) and Livestock Trading & Transport Company (LTTC) were also established in the 1960s to provide subsidised food products.

Growing state presence in the economy (1961-1980)

During the 1970s, two major events led to a further increase of government ownership in the commercial sphere. The first was the nationalisation of the oil sector, which resulted in the state taking full control over the crude oil production and hence the determination of the price of crude oil, refined and petrochemical products. Efforts to bring the petroleum sector under government control began with negotiations between the state of Kuwait, British Petroleum and Gulf Oil to acquire 60% ownership in the KOC established in 1934 under their joint ownership. A year later another round of negotiations was initiated, resulting in a complete transfer of ownership of KOC to the state.

This was followed by the state's acquisition of a 40% stake in Kuwait National Petroleum Company (KNPC), then a 5% stake in the Petrochemical Industries Company (PIC) and then, in 1979, the full nationalisation of the Kuwait Oil Tankers Company (KOTC). By the end of 1970s, the entire hydrocarbons sector was nationalised with the result that KNPC, PIC and KOTC were all de-listed from the Kuwait Stock Exchange and became 100% state-owned enterprises. Despite government efforts to diversify the local economy, oil revenue continued to provide more than 90% of the government revenue, especially after the oil shock of 1973 that resulted in a tremendous rise in oil prices.

The second event was the crash of the stock market in Kuwait in 1976-1977. In response, the government sought to shore up the market by buying shares in listed companies, which resulted in wide-scale state ownership in the banking, insurance, and real estate sectors. At the same time, the ongoing development of state institutions and companies established for specific projects continued to expand the state's role in the commercial sphere. These years saw the establishment of a number of authorities (e.g. the Supreme Petroleum

Council, the Public Port Authority) as well as additional SOEs (e.g. Kuwait Finance House). Again, significant benefits were bestowed on these newly established enterprises and they created highly paid managerial jobs for Kuwaiti nationals.

These trends continued unabated in the 1980s, and government ownership in commercial enterprises increased further, especially after the second stock market crash of 1982 - this time not of the official stock market, but of the parallel market, Souk Al-Manakh.[3] Similarly to the previous crash, the government injected substantial funds into the market, purchasing shares in most listed companies. However, the local economic context during this crash was different from the previous one in some important respects. On the one hand, the rescue required was more extensive. On the other, oil prices were low and the government was facing a real fiscal deficit. The government was forced to tap into its fiscal reserves to salvage the stock market.

By that time, it was clear that the public sector was very much dominating local economic activity. The contribution of the public sector to GDP was already in 1980s estimated to be above 65% (Ministry of Oil, 1983). One policy that further increased the size of the public sector over the years was a decision to provide lifetime government employment for all nationals entering the labour force, irrespective of their qualifications. In addition, key infrastructure development projects such as building power and water desalination plants, airports, sea ports and roads, were executed only by the public sector.

In 1980, a law was issued to establish Kuwait Petroleum Corporation (KPC) with paid-up capital of KWD 1 billion paid in kind and in cash (Legislation and Fatwa Department, 2005). KPC was structured as a statutory corporation not subject to commercial legislation. Effectively, it was established as a holding company consolidating the state's ownership in all oil-related companies and projects, including concession contracts. KPC's capital was increased to KWD 2.5 billion in 1982 (Kuwait Al-Youm), and today its capitalisation represents more than 30% of the total capitalisation of all companies listed on Kuwait Stock Exchange.

Reduction of the state's role during post-war reconstruction (1991-2000)

The intensive reconstruction programme introduced after Kuwait's liberation from the Iraqi invasion in 1991 forced the government not only to use most of its financial reserves, but also to borrow on the international financial market for the first time. Oil revenues were low and could not cover all government expenditures due to the low oil production caused by the destruction of oil wells during the war. At the same time, the state's financial obligations established post-independence, such as providing employment to Kuwaiti nationals, continued to weigh heavily on its budget.

In the early 1990s, the government had shares in 61 companies in a variety of sectors, with ownership ranging from as little as 1% to 100%. For a list of these companies, please see Table 4.1 below. All companies in this table were established pursuant to the Commercial Companies Law. Although the number of companies appears small, representing approximately 3% of the total number of commercial enterprises in Kuwait at the time (World Bank, 2001), they accounted for about 70% of the total capitalisation of the corporate sector (Kuwait Stock Exchange, 2010), without even including government authorities and statutory corporations.

Given the strain on the budget, the government took serious steps to divest some of the assets acquired during previous years and reduce its investment in the SOE sector, despite the losses suffered by SOEs during the war with Iraq and as a result of the subsequent economic slowdown. This period saw the introduction of various policies aimed at turning over the control and management of a significant number of SOEs to the private sector as well as at encouraging the private sector to employ Kuwaiti nationals.

The procedure that the government used to divest its holdings in these companies involved selling shares through a variety of methods, including auctions, initial public offerings (IPOs), direct sales to existing shareholders, or a combination of the above (Al Rifai, 2006). In some cases the government divested its ownership stake entirely, while in others the stake was reduced based on the relative importance of the sector and on future return expectations.

It bears mentioning that some government holdings were not divested either because the enterprises were loss-making or because the time frames set for divestment were unrealistic. In most cases, however, the rationale behind the continued presence of SOEs often related to the limited financial capacity of the private sector, to the need to deliver commercial activities that could not be performed profitably or to the state's wish to continue its presence in certain strategic sectors.

Table 4.1. Kuwait Investment Authority local holdings, 1993

Company Name	Government Ownership
National Industries Company	58.0%
Kuwait Cement	35.6%
Cold Storage Industries	28.8%
Gulf Cables	60.4%
Car Trading and Manufacturing Company	71.5%
Paper Trading and Manufacturing Company	30.0%
Kuwait Repair and Ship Building	56.4%
Steel Pipe Manufacturing Company	17.8%
Marine Works and Contracting Company	50.5%
Live Stock Transport and Trading Co.	54.5%
Poultry United Co.	56.4%
Agriculture Food Products Company	49.5%
United Agriculture Products Co.	16.6%
Agriculture Palm Company	87.4%
Flower Mill Company	100%
Boubyan Fishing Company	0.2%
United Fisheries Company	55.8%
Mobile Telecommunications Company	50.4%
Public Warehousing Company	53.0%
Kuwaiti Supply Company	97.5%
Kuwait Hotel Company	37.9%
Public Utilities Management Company	99.9%
Car Driving Teaching Company	98.1%
Kuwait International Exhibition Company	49.0%
Kuwait National Cinema Company	3.2%
Kuwait Touristic Enterprise	98.0%
Kuwaiti Commercial Markets Company	16.4%
National Bank of Kuwait	1.7%
Gulf Bank	17.5%
Burgan Bank	60.9%
Bank of Kuwait and Middle East	58.8%

Company Name	Government Ownership
Real Estate Bank	33.7%
Industrial Bank of Kuwait	31.4%
Commercial Bank of Kuwait	8.5%
Al-Ahli Bank of Kuwait	8.5%
Ahlia Insurance Company	20.3%
Kuwait Insurance Company	7.5%
Gulf Insurance Company	75.2%
Warba Insurance Company	55.8%
Commercial Facilities Company	56.3%
Kuwait Investment Projects Company	15.8%
Jawhara Investment Company	1.1%
Coast Development Company	2.7%
Kuwait Finance House	32.6%
Foreign Investment Company	99.6%
Kuwait Investment Company	70.0%
Financial Consulting Company	77.0%
Industrial Investment Company	33.0%
Financial Coupons Group	95.2%
Financial Coupons House	94.5%
Kuwait Consulting and Investment Company	30.0%
First Brokerage	23.2%
Financial Brokerage	14.6%
National Investment Company	14.6%
Real Estate Investment Consortium	98.9%
Real Estate Financing	57.8%
United Real Estate	40.0%
National Real Estate	13.7%
Kuwait Real Estate	13.7%
Kuwaiti Computer Company	4.8%
Kuwait Public Transport Company	100%

Source: World Bank, Energising the Private Sector in Kuwait, 1994.

Current composition and practices

Despite the privatisation activities conducted in the 1990s, the public sector dominates most economic activities, and its contribution to local GDP still exceeds 60%. The state's involvement in local economic activities is not declining, considering that the line ministries and various authorities continue to provide services through unincorporated entities. The state also has significant stakes in private companies, established in accordance with the Kuwaiti Commercial Companies Law, some of which are listed on the Kuwaiti Stock Exchange.

Consequently, the role of the state as an employer remains considerable. As of June 2010, the private sector employed only 72,000 from the national labour force of 348,000, while it employed more than one million of foreign workers (Central Statistical Office, 2010). Whereas KIA's local holdings have declined from 61 companies to 14 as of January 2011 (see Table 4.2), the state remains a shareholder in a number of large companies. It is important to bear in mind that Table 4.2 highlights only KIA's ownership stakes; other ministries exercise their ownership directly.

Table 4.2. Kuwait Investment Authority (KIA) local holdings, January 2011

Company Name	Government Ownership
National Technology Enterprises	100%
Kuwait Real Estate Investment Consortium	99.13%
Kuwait Investment Company	76.19%
Livestock Transport and Trading Company	51.55%
Kuwait International Investment Co.	30.10%
Kuwait Cement Company	29.36%
Mobile Telecommunications Company	24.61%
Kuwait Finance House	24.08%
Health Insurance Hospital Company	24.0%
Warba Bank	24.0%
National Mobile Telecommunications Co.	23.54%
Gulf Bank	16.08%
Kuwait China Investment Co.	15.0%
Kuwait Telecom Co.	6.0%

Source: Zawya.

As mentioned above, the oil sector in Kuwait was nationalised and de-listed in 1970s. Thus, for the past 30 years, the oil sector has been fully owned and operated by the public sector. During these years, it has experienced growth both in absolute terms and in relative importance in the local economy. In 2004 the sector was estimated to generate just over half of Kuwait's GDP - USD 60 billion. By 2008, it was contributing over 64% of the GDP, estimated at USD 140 billion. Likewise, in terms of government revenues, the oil sector's contribution was 88% in 2004; it increased to 94% in 2008.

Government control over SOE performance

Two main bodies were established to control the operation and performance of state-owned companies. The Central Tender Committee (CTC) controls the procurement processes in any SOE that makes purchases exceeding KWD 5000 (Legislation and Fatwa Department, 2005). Companies in the defence, security and hydrocarbons sectors are exempt from these procurement regulations, but they are generally subject to other procurement regulations and requirements.[4] The Audit Bureau - the state audit body of Kuwait - is responsible for auditing all government bodies, including companies in which state ownership exceeds 25% (Legislation and Fatwa Department, 2005). The Bureau reports directly to the Parliament[5], while the Central Tender Committee reports to the Council of Ministries.

The audit procedures and rights of the Audit Bureau are different for majority- and minority-owned companies: the state naturally has more powers in the case of the former. The Bureau conducts pre- and post-audits and has the right to request any relevant information from the management. Even for minority-owned companies with an ownership stake exceeding 25%, the Audit Bureau is allowed to conduct pre-audits of SOEs, as is the case of other GCC jurisdictions (e.g. Oman). Companies falling into this category must also seek approval from the Audit Bureau before they make any financial commitments if the latter go beyond the annual budget approved by the board of directors at the beginning of the fiscal year.

The Audit Bureau's mandate is to ensure that the appropriate funds are collected and channelled to the public treasury, to ensure that SOEs are adhering to their by-laws and internal regulations, and to examine the by-laws and other founding documentation to determine their appropriateness to the enterprise in question. In instances where the Bureau has comments or objections to any activity undertaken by majority-owned SOEs, it has the right to request that management take corrective action. In most cases, SOEs abide by the Audit Bureau's recommendations during the course of the year. If any comments are not dealt appropriately, the management is notified officially by the government entity with which ownership rights are vested and is requested to take action.

This procedure is necessary because the Audit Bureau has no legal powers to enforce its decisions, though it can inform management of its recommendations. The line ministries and authorities are, on the other hand, responsible for implementing comments of the Bureau. The Audit Bureau does not interact with the SOE's external auditor. However, the Ministry of Commerce and Industry (responsible for the administration of the Commercial Companies Law) reviews the work of the external auditor and attends general assembly meetings. It is also customary for the Audit Bureau to send a permanent representative, who can review any major expenditures and decisions taken by the management, to majority-owned SOEs.

SOEs and the budget process

Each year, the Minister of Finance presents a budget to the Council of Ministers. Once approved, it is sent to the Parliament for the final approval. Commercially oriented SOEs, established in accordance with the Commercial Companies Law No.15 of 1960, even if they are wholly owned by the state, are not included in the fiscal budget. The financial reports of these companies are usually approved by their board and are not presented to the Ministry of Finance for further reporting to the Parliament. The Kuwait Petroleum Corporation is especially important in the budget process since the government budget forecast is prepared on the assumption of an average price of oil per barrel put forth by the KPC.[6]

The government budget is split into three categories: (1) budgets of ministries and departments, (2) independent entities and (3) dependent entities. Independent budget entities (see Table 4.3) are institutions, authorities and statutory corporations that are wholly owned by the state, such as Kuwait Airways Corporation (KAC) or the Kuwait Port Authority (KPA). Entities considered as independent for the purposes of the budget are generally those that generate a profit and do not depend on the state for their operating expenses. The legal framework underlying the establishment of these entities stipulates that such agencies must have independent budgets and must operate on a commercial basis.

Dependent budget entities are government entities established for a specific, non-commercial purpose. The legal framework underlying the establishment of these agencies essentially provides that their budgets are dependent on another government entity and that the government is committed to subsidising or financing their operations. For example, KAC was originally formed as a publicly listed company with majority state ownership. Subsequently, the state acquired the company, de-listed it and changed its legal status in 1965. The 1965 law forming the company stated that KAC would continue to operate as a commercial entity, noting however that the state would cover losses if necessary. For the last four years, KAC has incurred KWD 30-35 million of losses that have been covered by the state.

Table 4.3. Independent and dependent budget SOEs

Independent Budget SOEs	Dependent Budget SOEs
Central Bank of Kuwait	National Assembly
Kuwait Fund for Arab Economic Development	Kuwait Municipality
Saving of Credit Bank	Kuwait University
Kuwait Airways Corporation	Public Authority for Housing
Public Authority for Industry	Public Authority for Civil Information
Kuwait News Agency	General Fire Department
Public Institution for Social Security	Kuwait Investment Authority
Kuwait Port Authority	Public Authority for Applied Education and Training
Kuwait Institute for Scientific Research	Public Authority for Minors Affairs
Zakat House	Public Authority for Agriculture and Fisheries
Public Authority for Environment	Public Authority for Assessment of Compensation for Damages Resulting from Iraqi Aggression
Kuwait Petroleum Corporation	Public Authority for Youth and Sports

Source: Central Statistical Office.

The ownership function

The government of Kuwait has established two funds, the General Reserve Fund (GRF)[7] and the Future Generations Fund (FGF)[8] in order to invest the surplus funds domestically and abroad (Legislation and Fatwa Department, 2005). In 1978, the scope of operation of both funds was defined by law, which limited the FGF's operations to developed countries and mature stock markets, while the GRF's investment activity was limited to the Middle East and some less developed markets. All government assets and investments were registered either under the GRF or the FGF, both managed by the Ministry of Finance.

The sources of these funds were defined by Law No.31 of 1978, which stipulated that 10% of the total annual state revenues were to be allocated to the FGF, while the remainder was to be managed by the GRF. In addition, the Law stipulated that annual expenditures of the government would be drawn from the GRF. This situation was altered in 1982 with the passage of legislation establishing the KIA and giving it the responsibility of managing the assets of Kuwaiti government under the supervision of the Ministry of Finance. As a result, KIA became fully responsible for managing GRF and FGF, as well as any other funds entrusted to it by the Minister of Finance. That said, KIA itself does not own any assets and its budgets are presented to the Parliament as part of the Ministry of Finance's reporting procedure.

KIA is entrusted with exercising the ownership function in a number of Kuwaiti SOEs. In some instances, this function is vested entirely with KIA; in others, a dual ownership function prevails. The centralised model is applicable to all SOEs established in accordance with the Commercial Companies Law. In those cases, KIA has the entire ownership and supervision responsibility, and the owner is considered to be the Ministry of Finance and/or KIA.

The dual model, on the other hand, applies to all SOEs not subject to the Commercial Companies Law. For example, the KPC and all of its subsidiaries are officially owned by the Ministry of Finance/ KIA, but the supervision of their operations is entrusted to the Ministry of Oil. Although the Ministry of Finance is represented on the board of directors, the Minister of Oil appoints all the other board members. Likewise, the Ministry of Finance owns the KPA, but the operational responsibilities are in the hands of the Minister of Communication.[9]

Corporate governance of Kuwaiti SOEs

This section of the paper will address specific elements of the corporate governance framework applicable to state-owned enterprises in Kuwait, whether the SOEs are subject to the Commercial Companies Law or special regimes created for statutory corporations or authorities.

The general assembly

Each SOE established in accordance with the Commercial Companies Law must hold a general assembly at least once a year to discuss and approve the financial statements, the management report, and the selection and remuneration of the external auditor. The composition and the quorum of the board are specified in the Commercial Companies Law, unless the company was created as a statutory corporation or an authority. The general assembly must elect the board every three years.

For the most part, entities that are considered as having an independent budget hold no general assembly meetings.[10] However, oil companies established in accordance with the Commercial Companies Law before the KPC was established have general assemblies. In these companies, the KPC, as a holding entity, represents the ordinary general assembly. The Supreme Petroleum Council, chaired by the prime minister and including the Ministers of Oil and Finance and other ministries and government agencies, represents the extraordinary assembly of these companies.

The chairperson of the board heads the general assembly meetings in the presence of an external auditor and a representative of the Ministry of Commerce. An invitation to the general assembly and its agenda is usually published in the local newspapers two weeks before the meeting. Although in principle, the general assembly is the highest governance organ, in practice it is often the weakest, since most decisions and discussions are usually taken outside its meetings. In majority-owned SOEs, general assembly meetings can often be considered a formality.

The weakness of the general assembly as a governance organ derives from the fact that the management of the enterprise usually has continuous contact with its major shareholders. In some cases, shareholders have signed a blank proxy, in others, shareholders do not even take an interest in attending general assembly meetings or voting by proxy. In practice, when management collects enough proxies to achieve a quorum, the remaining shareholders are often not directly notified of the meeting. Even the nominees for board posts are usually agreed upon between the major shareholders beforehand and the assembly is simply presented with the names for approval.

The minutes of general assembly meetings are prepared by the management and sent to the Ministry of Commerce for approval. The external auditor and the Audit Bureau are given copies of the approved minutes and subsequently, the Ministry of Commerce works with the management to implement the decisions of the general assembly. The effectiveness of this process is questionable. During the recent financial crisis, many commercial enterprises, both state-owned and private, suffered significant losses; however, very little criticism of management was expressed in general assemblies and no action was taken against the management of any SOE.

The board of directors

As in other jurisdictions, the board is generally considered as the second "line of command" after the general assembly. In the case of government authorities and the KPC, the board of directors is in fact the highest corporate organ. Typically, the board is comprised of an odd number of directors (minimum 5, maximum 11) and is led by an executive chair. Individual board nominations and board size are usually decided by major shareholders and endorsed by the general assembly. The directors can hold their membership for an indefinite number of terms, though the length of each term is limited to three years.

For statutory corporations, the by-laws define the size and structure of the board. There are no specific criteria for nominating board members, and it is not uncommon for them to be based on personal recommendations and political considerations. For instance, the founding documents of Kuwait Airways establish the size of the board at eight members and give the line minister the authority to appoint the entire board as well as the CEO. In case of KPA, another statutory corporation, the founding law states that the board shall be chaired by the Minister of Communication and shall be comprised of eight additional members from both public and private sectors, including the general manager. In practice, the remaining board members are nominated through a decree of the emir based on the recommendation of the line minister.

An emiri decree also specifies KPC's board size and composition. This decree appoints the Minister of Oil as the chair of the board, as well as 13 other board members from specific government entities. Another decree of the emir usually provides the exact names of the directors and appoints the vice-chair based on the recommendation of the Minister of Oil. The first KPC board was composed of the Minister of Oil, three directors representing the Ministry of Finance, the Ministry of Commerce and Industry and the Ministry of Planning, and six full-time outside directors. The same decree specified that the vice-chair of the board would act as the CEO.

Generally speaking, the appointment of directors in statutory corporations and companies in which the government has a majority stake is quite political. Even the appointments to fill management posts are sometimes politicised, especially in companies not perceived to be of strategic value. In companies of strategic economic value, such as KPC, management posts are usually filled based on professional credentials. Experience shows that some board members appointed on SOE boards have had conflicts of interest, despite the prohibition of such by the Commercial Companies Law. This is not a trivial point considering that Kuwait's commercial legislation places legal responsibility with the chair of the board, the vice chair and/or the members of the management team.

In enterprises in which the government owns a minority stake, the Ministry of Finance or KIA appoints its directors and co-ordinates with other major shareholder(s) when it comes to the appointment of the chair, vice chair and CEO. In newly established enterprises, the board is entirely appointed by the Ministry of Finance/ KIA, even if the government share is less than 50%, provided that the remaining shares are allocated equally to all Kuwaiti nationals and no major shareholder exists. For example, the Council of Ministers recently took a decision to establish a fifth Islamic Bank with paid-up capital of KWD 100 million. The articles of association stipulate that KIA will own 24% of the capital and that the remaining capital shall be allocated among Kuwaiti nationals. The first slate of board of directors was appointed entirely by KIA for a three-year term, after which directors will be elected under the Commercial Companies Law.

In all SOEs, whether established by specific legislation or in accordance with the Commercial Companies Law, the board is given full legal authority and responsibility over the operations. In statutory companies, the board of directors is granted even greater powers than in those enterprises subject to the Commercial Companies Law. The legal responsibility rests with authorised signatories like the chair of the board, the vice chair and the CEO. Legal proceedings against the enterprise are usually brought against the chair unless otherwise specified in the founding documents, which results in many SOEs' having insurance policies for its chair and board members.

The Commercial Companies Law gives broad powers to the board, including approval of the by-laws. In SOEs with majority government shareholding, the chair and/or the CEO may choose to co-ordinate with either KIA or the line minister before taking major decisions. The board is required to hold at least four meetings a year. It can form committees composed of directors and outside experts as it sees suitable to help monitor the operations. The CEO can sit on the board; in this case s/he is given the title of managing director. In fact, Kuwaiti SOEs have a history of combining the role of the chair with that of the CEO; however, this practice has been changing in recent years.

In terms of remuneration policies and practices, the board can usually approve a different salary scale for an SOE than that established by the Civil Services Commission (CSC), a regulatory body that establishes guidelines for civil servants' pay. If an SOE board approves remuneration higher than that established by the CSC, the amount is usually submitted to the Audit Bureau and the CSC for monitoring and control. Nonetheless, remuneration arrangements in the private sector are typically more competitive than those in the public sector, even in commercial SOEs. To compensate, members of SOE management are sometimes provided with generous health insurance as well as housing and schooling allowances.

Transparency and disclosure

The Commercial Companies Law outlines the disclosure requirements for enterprises, including for SOEs, subject to it. Additional requirements for SOEs are sometimes stipulated in company by-laws or in other founding documents. When additional reporting requirements (for example, on the frequency of reporting) apply, they are approved by the board of directors when it approves the by-laws. Where reporting requirements are outlined in company by-laws, they are not standardised. For instance, the legislation forming the KAC stipulates that the board of directors is responsible for overseeing the preparation of the annual report and must submit it to the Parliament after obtaining approval from the line minister and the Council of Ministers.

For listed SOEs, quarterly reporting is required by virtue of the listing requirements of the Kuwait Stock Exchange. SOEs are subject to the same listing procedures as are private sector companies, including providing the stock exchange with annual unaudited financial statements for the previous three years and one audited financial statement. The summary of the financial statements is usually posted on the stock exchange website; however, the details are generally not publicly disclosed.

Generally speaking, more emphasis is given to financial reporting, not only in SOEs but in all Kuwaiti enterprises. This is consistent with the situation of other MENA countries. Non-financial reporting is usually limited to information on the nomination and operation of the board of directors. Financial reports are generally circulated to the board of directors and are very seldom disclosed to other shareholders. KIA has the right to request additional reporting, financial or non-financial, beyond what the stock exchange or the securities regulator requires.

At the annual general assembly meetings, shareholders have the right to question management. Nevertheless, management has often refused to provide detailed financial reporting to the shareholders or to discuss the particular details of financial or operational performance. Most of the reporting is circulated only to the board of directors. The general public tends to be unaware of SOEs' financial or operational performance. On the other hand, the Audit Bureau has the right to request complete financial reporting.

SOE performance and prospects

Assessing SOE performance

Studies show that Kuwaiti SOEs are inefficient, both in terms of their use of human and financial resources. For instance, the KPC appears inefficient when benchmarked against similar private sector enterprises – in fact, government investments in KPC have not realised a financial return higher than investing in bonds (World Bank, 1994). Additional evidence of the inefficiency of Kuwaiti SOEs is that some of them are not able to compete successfully with private sector entrants. This was the case with both the Kuwait Airways Corporation and the Kuwait Public Transport Company, which were unable to compete when their respective sectors were liberalised and opened to competition. Both have been loss-making since then, in spite of the various direct and indirect subsidies made available to them. Similarly, some SOEs in the food sector appear profitable only because of the subsidies they receive.

Over the past decade, the government of Kuwait has been rethinking its role in some sectors of the economy, previously seen as strategic (e.g. airline transport). At the same time, while the Parliament recently passed antitrust legislation to prevent market monopolies by the private sector, some SOEs continue to enjoy monopoly or oligopoly positions. For instance, the KPA has total monopoly on seaport services. That said, although some SOEs benefit from an uneven playing field, they are subject to sectoral regulation. For example, their fee structure must be approved by the Council of Ministers. If the price of refined oil products in Kuwait is to be raised by KNPC, a decision from the Council of Ministries is required.

The reasons for Kuwaiti SOEs' low productivity and weak performance are numerous. First, management incentives and accountability structures are not in line with international good practices. Line ministries seldom hold SOEs accountable for their performance, and SOE managers have almost never been dismissed for inadequate performance. Even when SOEs incur losses, the state usually covers any deficits, in part to protect employment of nationals. Since SOEs are not required to report publicly on their performance, public scrutiny is not a consideration for the management. Last but not least, SOE management does not face market pressures to improve company performance considering that many SOE operate in non-competitive sectors.

Recent privatisation effort

During the past decade, the government of Kuwait has moved to divest some of its holdings in commercially oriented SOEs in order to energise the private sector and reduce the financial burden on the state. The first step was the sale of some stakes in SOEs owned by the Ministry of Finance/KIA and not part of the government budget. The privatisation methods varied from IPOs limited to Kuwaiti nationals to open auctions, closed bidding contests and combinations of the above. For instance, the Ministry of Finance/KIA stake in the Kuwaiti Mobile Telephone Company (now Zain) was diluted from 51% in the early 1990s to 24%. Mobile telephony is now entirely controlled by private operators. Some government stakes managed by the Ministry of Finance/KIA were divested completely (e.g. Kuwait Facilities Company, Gulf Cable Company).

In the oil sector, the government divested its interests in the refined product distribution segment. The Lube Oil plant part of the Kuwait National Petroleum Company, wholly owned by KPC, was sold to the private sector. Similarly, the Salt and Chlorine Plant of Petrochemical Industries Company (PIC), wholly owned by KPC, was also entirely privatised. Nevertheless, government ownership in the KPC or in its associated companies remained at 100%. In addition, none of the basic services such as electricity or water has been privatised so far.

The privatisation process in Kuwait can be described as rather slow despite progress in certain sectors, such as mobile telecommunications. State ownership in some sectors continues to be a heavy burden on the fiscal budget. For instance, both public and private companies provide health related services. The cost of publicly provided health care is estimated to be approximately USD 3 billion annually and is rising. Water and electricity are provided at heavily subsidised tariffs and are therefore also costly for the state.

During the past decade, the government has made a serious effort to pass the privatisation laws. In June 2010, Parliament passed the first Privatisation Law in the history of Kuwait, establishing the Higher Council for Privatisation. The law mandates the creation of a public shareholding company for each privatisation deal and requires the retention of two consulting companies, one with international experience, to evaluate each privatisation transaction.

The Law also requires that the share capital of each privatised company be allocated as follows: no less than 35% to be auctioned among interested investors, no more than 20% to be retained by the state, no more than 5% to be sold to the employees and no less than 40% to be sold to nationals through an IPO. The state will retain a golden share in each of the privatised companies.

This legislation also makes generous provisions with regard to treatment of SOE employees in transition. Specifically, the law provides that Kuwaiti nationals employed by an SOE prior to privatisation are to be transferred to the newly established company and must be given an employment contract of no fewer than five years, with the same salary and benefits as before the privatisation. Also, the state retains the responsibility for finding employment for Kuwaiti nationals who are unwilling to work for the privatised company.

Thus far, the largest recent experiment with privatisation is the case of the Kuwait Airways Corporation, described in further detail in Box 4.1.

Box 4.1. Privatisation of the Kuwait Airways Corporation

The Kuwait Airways Corporation (KAC) was previously owned by the Ministry of Finance/KIA and regulated by the Ministry of Communication. Until five years ago, KAC had a monopoly on airline services in Kuwait and was granted benefits in the form of facilities, fuel discounts, etc. KAC has been loss-making ever since other airline companies were permitted to enter the market. In February 2008, the Parliament passed a law to privatise KAC.

The Council of Ministers was charged with nominating a government agency to establish a shareholding company within two years from the date of this law. KIA was designated as the appropriate entity. KAC's assets and liabilities will be transferred to a newly established company, the capital of which will be determined based on the results of an evaluation. KIA has retained two international companies, selected through a transparent competitive bidding process, to evaluate the assets. The evaluation results were reviewed by KIA, provided to the Audit Bureau for comments and then presented to the Council of Ministers.

In February 2010, the Council of Ministers passed a decision adopting the evaluation results and entrusted KIA to establish a Kuwaiti Public Shareholding Company under the name of Kuwait Airways Company with paid-up capital of KWD 220 million (approximately USD 787 million) in accordance with the Commercial Companies Law.

The shares of the new company will be allocated as follows: a bloc of 35% to be auctioned to strategic investors, 20% of capital to be allocated to KIA, 5% to be allocated equally among the current employees of KAC (who will be not allowed to trade shares for three years), and 40% to be offered to Kuwaiti nationals through an IPO. Local airline companies are not allowed to participate in this auction. Government income from the divestment proceeds will be divided equally between the General Reserve Fund (GRF) and the Future Generation Reserve Fund (FGF).

An application was submitted to the Ministry of Commerce to incorporate the new company in accordance with the Commercial Companies Law, with the capital specified in the Council of Ministers' decision and per the allocation of share capital as described above. Technical experts are currently working with KAC management and the Civil Service Commission to deal with issues concerning Kuwaiti nationals employed by the company. In the near future, it is expected that strategic investors will be solicited regarding acquiring 35% of the new company's capital.

The success of the KAC's privatisation is crucial to the overall privatisation process in Kuwait. If completed, it will be the second full privatisation in the country. At this point, it is early to judge the success of this experience. KIA has already succeeded in divesting many of its smaller holdings in listed companies, and the oil sector has seen limited privatisation as well. It is hoped that the KAC transaction will pave the way for future privatisation deals in Kuwait and to an eventual reduction of the state's role in commercial activities. This might be a challenge considering that the state is continuing to establish SOEs in certain sectors.

Notes

1. National Bank of Kuwait website (nbk.com).
2. In 1995, the Kuwaiti Parliament prevented the government from changing the tariff on these services without special legislation.
3. The Souk Al Manakh market was established in 1979 as an unofficial over-the-counter stock market, specialised in the trade of highly speculative unregulated Kuwaiti incorporated foreign companies, principally from Bahrain and the United Arab Emirates. The regulated official stock market became less popular considering that after the 1976-1977 crash it became subject to heavier regulation.
4. For example, refer to Resolution 7 of 2009 of the board of directors of the Kuwait National Petroleum Company "on material purchase, entrusting services, contracting, consultancy services and sale of surplus material items."
5. At the end of each financial year, the Audit Bureau conducts complete financial and operational audit and submits its report, covering all SOEs under its audit jurisdiction, to the Speaker of the Parliament.
6. Historically, this price has been on the low side, resulting in a very conservative budget presented by the government in order to avoid potential questioning from the Parliament at the end of the year.
7. The GRF was established as a main treasury for the government. It receives all revenues (including oil revenues), and all budgetary expenditures are paid out of it.
8. At the outset, the Future Generation Fund was created by transferring 50% of the GRF capital. No assets can be withdrawn from the FGF unless sanctioned by law.
9. The operational responsibility can be shifted from one ministry to another by a decision from the Council of Ministers, but the ownership is centralised in the Ministry of Finance. For example, Kuwait Airways Corporation was under the

operational responsibility of the Ministry of Finance, but recently this was shifted to the Minister of Communication.

10. An exception to this is Kuwait Airways Corporation, for which the law specifies the Minister of Finance in the general assembly.

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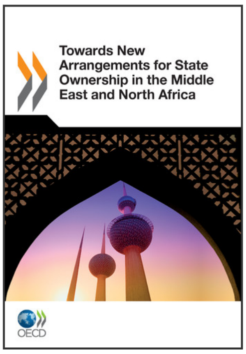

From:
Towards New Arrangements for State Ownership in the Middle East and North Africa

Access the complete publication at:
https://doi.org/10.1787/9789264169111-en

Please cite this chapter as:

Sartawi, Mithqal (2012), "State-owned enterprises in Kuwait: history and recent developments", in OECD, *Towards New Arrangements for State Ownership in the Middle East and North Africa*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264169111-6-en

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