9 State-owned enterprises (Dimension 6)

State-owned enterprises (SOEs) are an integral part of the Western Balkans' economic architecture. They often operate in vital sectors of the economy and deliver crucial public services, making their efficient operations decisive for broader economic and societal outcomes. Depending on whether they are profitable or loss-making, SOEs can also have significant, and sometimes unexpected, impacts on fiscal budgets. For these reasons, ensuring that SOEs operate efficiently, transparently and on a level playing field with private companies is important. This chapter assesses these aspects through four key sub-dimensions. The first, efficiency and performance through improved governance, summarises available data on the region's SOE landscape, notably sectoral distribution, employment contributions and performance. It then examines state ownership and corporate governance arrangements and how they affect SOEs' efficiency. The second sub-dimension, transparency and accountability practices, discusses SOEs' accountability to the state, the general public and minority shareholders. The third sub-dimension, ensuring a level playing field, explores how the legal treatment and financing conditions for SOEs influence the level playing field with private companies, and how they affect economic efficiency. The final sub-dimension, reforming and privatising SOEs, reviews regional trends concerning SOE reform and privatisation. Each sub-dimension section makes specific recommendations for going forward.

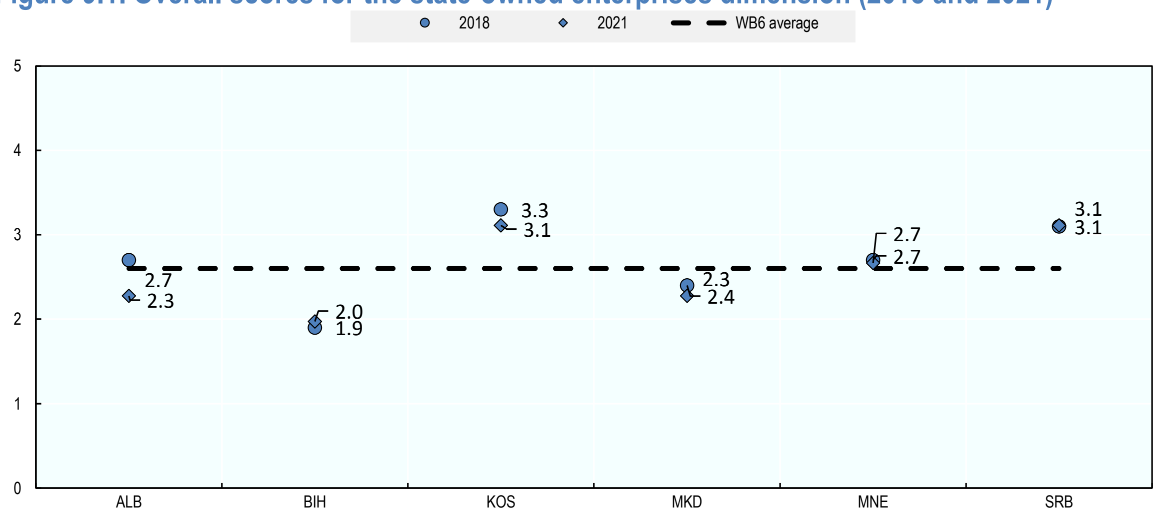
Key findings

- **The efficiency of SOEs is key for economic development, societal well-being and healthy public finances**. The Western Balkans has over 500 SOEs, which are highly concentrated in sectors that both the general public and companies depend on for their everyday operations, including electricity and gas, water supply and sewage, transportation and telecommunications. Although performance monitoring of central SOEs is limited, external assessments point to their frequent underperformance, which often strains public budgets and contributes to the sub-optimal allocation of economic resources.
- **Most of the region's public authorities have not developed ownership policies** outlining why the state owns companies and what it expects them to achieve, which contributes to SOEs' often unclear or ad hoc performance objectives and limited accountability among state actors for SOE performance.
- **SOE ownership arrangements are predominantly decentralised** across the region, with several line ministries or other public bodies exercising ownership rights over distinct portfolios of SOEs. This can lead to the problematic mixing of roles on the part of state actors (e.g. ownership and regulatory roles), increase the risk for political influence over corporate decision making, and make it difficult to obtain a holistic overview of SOE performance.
- **Small steps have been taken to improve SOE board appointment processes in some of the region's economies.** For example basic qualifications criteria have been introduced in some economies, as well as requirements for independent directors on boards. SOE board positions are nonetheless frequently perceived to be awarded based on political connections rather than purely professional qualifications. Political influence on SOE boards can trickle down to management appointments and increase the risk that corporate decisions are influenced by political factors rather than value creation.
- **SOEs are mostly subject to sound basic requirements for financial reporting, but compliance is not consistent.** In several cases financial audits have uncovered issues with the credibility of SOEs' corporate disclosures. Non-financial reporting, particularly concerning the nature and costs of SOEs' public service obligations (or other non-commercial objectives), is underdeveloped in the region. There is significant scope to strengthen disclosure by the state as shareholder, notably through aggregate reports that analyse the performance of all SOEs.
- **Non-state minority shareholders are an important element of the region's SOE landscape.** This is particularly the case in Bosnia and Herzegovina, Montenegro and Serbia, where a significant number of SOEs have private minority shareholders. Across the region there is scope to improve minority shareholders' legislated rights (applicable to all companies, including SOEs). There is also a need to engage in more targeted efforts to communicate with the minority shareholders of SOEs, be accountable to them and ensure they play an adequate role in corporate decision-making so that SOEs create value for all shareholders.
- **Across the region, the legal and regulatory treatment of most SOEs is broadly aligned with the treatment of private companies**. However, the existence of a separate legal form of "public enterprise" for some SOEs in several economies (Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia) may distort the playing field with private companies. Many SOEs do not earn economically significant rates of return, which can mean that resources are allocated inefficiently (although it can also sometimes reflect public policy obligations financed by commercial revenue). This should be addressed through reforms within individual enterprises.

Comparison with the 2018 assessment

There have been very limited changes to the scores of the six Western Balkan (WB6) economies for the state-owned enterprise policy dimension since the 2018 assessment, reflecting limited efforts by the economies' authorities to reform state ownership practices (Figure 9.1). For the most part, score changes since 2018 reflect the fact that the current iteration of the assessment has involved more in-depth information gathering at the economy level, allowing for the fine-tuning of individual economy scores.

Figure 9.1. Overall scores for the state-owned enterprises dimension (2018 and 2021)



Note: Scores for 2021 are not directly comparable to the 2018 scores due to the addition/removal of relevant qualitative indicators. Therefore, changes in the scores may reflect the change in methodology more than actual changes to policy. The reader should focus on the narrative parts of the report to compare performance over time. See the Methodology and assessment process chapter for information on the assessment methodology.

Implementation of the Competitiveness Outlook 2018 recommendations

Progress in implementing the policy recommendations made in the Competitiveness Outlook (CO) 2018 has been limited overall (Table 9.1), although preliminary steps have been taken to professionalise the state shareholding function in three economies (Albania, Bosnia and Herzegovina and Serbia) through proposals to establish dedicated state ownership units. However, the region's authorities have not taken any significant efforts to clarify SOEs' financial and non-financial objectives, or to strengthen accountability to the public and to SOE minority shareholders.

Table 9.1. Implementation of the Competitiveness Outlook 2018 policy recommendations: State-owned enterprises dimension

	Competitiveness Outlook 2021	
2018 policy recommendations	**Main developments during the assessment period**	**Regional progress status**
Professionalise the state ownership function as a priority in all WB6 economies	• There have been no substantial reforms to date, but preliminary proposals have been made to establish central state ownership monitoring or co-ordinating entities in three economies (Albania,[1] Bosnia and Herzegovina and Serbia).	Limited
Foster clarity in financial and non-financial objectives for individual SOEs	• There is no evidence that any authority has taken steps to clarify SOEs' financial and non-financial objectives for a significant proportion of SOEs. • Reforms of individual SOEs have been undertaken in some economies, often clarifying the sources of underperformance and establishing clearer performance objectives.	None
Ensure governments engage in aggregate reporting on their SOEs	• No additional authorities have undertaken SOE aggregate reporting since 2018. • Kosovo remains the only economy where aggregate reports are published, with plans to publish the latest edition in 2021. Serbian authorities have undertaken various forms of public reporting on their SOEs.	None
Strengthen the protection of non-state investors further	• Amendments to the company law in Montenegro increased requirements for independent members of company boards of directors. While not directly related to minority shareholder rights, this development could help ensure that SOE boards of directors are better equipped to make decisions in the interest of all shareholders, including minority investors. • There is no evidence that any targeted efforts have been undertaken in the region's economies to go beyond the basic requirements of the general company law to strengthen accountability to SOEs' minority shareholders.	Limited

[1]Note: In Albania, a proposal to establish a central state ownership agency was made by the Ministry of Finance but not agreed upon by the government.

Introduction

Ensuring that state-owned enterprises operate efficiently, transparently and on a level playing field with private companies is key for the economic development and competitiveness of the Western Balkans. SOEs are an integral part of the region's economic architecture, often operating in systemically important sectors, such as electricity and gas, telecommunications, and public transportation, on which other businesses and the general public depend for their everyday operations. Because SOEs frequently operate the public utilities and infrastructure that most other companies rely on for their operations, their efficiency directly impacts the competitiveness of these companies, including notably the producers of tradeables. SOEs can also positively or negatively influence public finances. For example, SOE performance, and whether they provide dividends to the state, affects the capacity of public authorities to finance necessary investments, such as infrastructure and government services. If SOEs are loss-making they can place a significant strain on public finances, which can become a long-term problem if the structural sources of corporate losses are not addressed. If state ownership confers any unwarranted competitive advantages on SOEs compared to private competitors, such as direct financial support or regulatory leniency, then this can distort the level playing field with private companies and ultimately crowd out more productive firms. SOEs can also face unwarranted competitive disadvantages, such as public service obligations that are insufficiently subsidised by the state, jeopardise their commercial viability and even threaten the provision of public services.

This chapter focuses on establishing the appropriate ownership, corporate governance, legal and accountability arrangements to address some of the most prevalent reasons for poor SOE performance and limited accountability. SOE operations have implications for several other policy areas assessed by the Competitiveness Outlook. Most notably these include:

- **Chapter 4: Investment policy and promotion**. SOEs sometimes operate in sectors of the economy that are deemed strategic or important for national security, and which therefore the authorities wish to maintain under national (non-foreign) and/or state ownership and control, such as energy or telecommunications infrastructure. The maintenance of state ownership and/or control in these sectors is often enshrined in domestic law and can limit the sectors to which inward investment can flow, or the degree of control that can be granted to foreign investors in certain undertakings. More broadly, sound SOE governance and regulation can have far-reaching impacts on an economy's overall investment attractiveness. Foreign investors need to be confident that the state as an owner of structurally important enterprises – and as a regulator of both state-owned and private corporations – will act professionally, predictably and in the interest of a healthy competitive environment.
- **Chapter 8: Competition policy**. Ensuring that SOEs compete on a level playing field with private companies is crucial to establishing a robust competition environment. Even if SOEs are not explicitly exempt from the application of competition rules, the fact that they are owned by the state can result in leniency on the part of competition authorities or courts. SOEs also often operate the network infrastructure (e.g. in the electricity and telecommunications sectors) that private companies depend upon for their operations. In cases where a market has recently been liberalised, state-owned network operators may tend to offer privileged access or conditions to SOEs rather than their private competitors.
- **Chapter 19: Anti-corruption policy**. SOEs can face particularly heightened risks of corruption given their closeness to the public administration – public officials often serve as board members – as well their frequent presence in sectors generally associated with higher corruption risk, such as mining and gas. Ensuring that SOEs are well governed, including through boards of directors that are free of excessive political influence, is crucial to reducing corruption risk. Strong transparency is also important for identifying and addressing illicit or unethical practices. Issues related to corruption risks specifically in the state-owned enterprise sector are not examined in great detail in this publication. Related guidance can be found in the OECD's Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises (OECD, 2019[1]).

Assessment framework

Structure

This chapter assesses policies to strengthen state-owned enterprise governance in the WB6 by examining practices in four broad sub-dimensions:

1. **Sub-dimension 6.1: Efficiency and governance through improved governance** examines the extent to which state ownership decisions are guided by clear policies and efficient institutional arrangements. It also assesses the extent to which SOE boards of directors are equipped with sufficiently independent and qualified professionals to allow them to effectively oversee corporate management and make decisions in the interests of the enterprises they serve.
2. **Sub-dimension 6.2: Transparency and accountability practices** examines the extent to which SOEs are accountable to the state, to their minority shareholders and to the general public. It analyses SOE corporate disclosure and audit requirements and practices, examines minority shareholder rights and access to information, and reviews the transparency of the state as a shareholder.

3. **Sub-dimension 6.3: Ensuring a level playing field** focuses on the extent to which SOEs' legal and regulatory framework, as well as their financing conditions, impact the competitive landscape with private companies.
4. **Sub-dimension 6.4: Reforming and privatising SOEs** summarises recent SOE governance reforms and privatisation efforts.

Figure 9.2 shows how the sub-dimensions and their indicators make up the SOE dimension assessment framework. The indicators draw on the standards set forth in the OECD Guidelines on Corporate Governance of State-Owned Enterprises, which provides a blueprint for SOEs (OECD, 2015[2]).

The assessment was carried out by collecting qualitative data with the help of questionnaires filled out by governments, as well as face-to-face interviews with relevant non-government stakeholders. Alongside these qualitative inputs, quantitative data on certain indicators – provided by the economies' statistical offices, relevant ministries and agencies, and other databases – formed an integral part of this assessment. In particular, data were collected on the number of SOEs, their sectors of operation and their employment contributions to contextualise the qualitative assessment and shed light on the economic importance of SOEs. For more information on the methodology see the Assessment methodology and process chapter.

Figure 9.2. State-owned enterprise dimension assessment framework

State-owned enterprises dimension

Outcome indicators
1. Number of central government SOEs per economy
2. SOE share of total national employment per economy
3. Sectoral distribution of SOEs

Sub-dimension 6.1 Efficiency and performance through improved governance	**Sub-dimension 6.2** Transparency and accountability practices	**Sub-dimension 6.3** Ensuring a level playing field	**Sub-dimension 6.4** Reforming and privatising SOEs
Qualitative indicators 1. Clarification of ownership policy and rationales 2. Professionalising state ownership 3. Robust board nomination framework 4. Promoting independent and professional boards	**Qualitative indicators** 5. Financial and non-financial reporting 6. Auditing practices 7. Protection of minority shareholders	**Qualitative indicators** 8. Legal and regulatory treatment 9. Access to finance	**Qualitative indicators** **Descriptive Indicators (not scored)** 10. Recent state ownership reforms 11. Privatisation practices
OECD Instruments OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[2]): • Chapter I: Rationales for state ownership • Chapter II: The state's role as an owner • Chapter VII: The responsibilities of the boards of state-owned enterprises	**OECD Instruments** OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[2]): • Chapter IV: Equitable treatment of shareholders and other investors • Chapter VI: Disclosure and transparency	**OECD Instruments** OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015[2]): • Chapter III: State-owned enterprises in the marketplaces	

Quantitative indicators	Quantitative indicators	Quantitative indicators	Quantitative indicators
1. Number of SOEs (majority- and wholly-owned enterprises) and state minority-owned companies 2. Sectoral distribution of SOEs and state minority-owned companies 3. Number of employees of SOEs and % of total domestic employment	4. Number of SOEs with non-state shareholders	5. Proportion of SOEs that are fully corporatised (incorporated under general companies law)	6. Number of SOEs privatised 7. Number of employees of minority-owned entities, and % of total domestic employment

Key methodological changes to the assessment framework

Since the 2018 edition of the Competitiveness Outlook, a fourth sub-dimension has been added to gather information on recent SOE reforms and privatisation efforts. The indicators under this fourth dimension are not scored. No other methodological changes to the assessment framework have taken place.

State-owned enterprise performance and context in the WB6

The purpose of improving the ownership, governance, and legal and disclosure arrangements of SOEs is to ensure that they create value for and are accountable to the general public, who are considered their ultimate owners. As well as commercial profitability, SOEs can create value for society through efficient public service delivery or other non-commercial objectives. The state as owner must clearly define how SOEs are expected to create value and allow for robust performance assessments. Value creation also implies that SOE operations should not hinder other firms from creating value, i.e. they should compete on a level playing field.

Sound state ownership and governance arrangements contribute to value creation by clarifying SOE objectives and establishing clear accountability mechanisms to achieve those objectives. A professional state owner should define clear performance objectives for SOEs, strong SOE boards should be sufficiently independent from both political influence and corporate management to ensure that corporate decisions are taken in the interest of the enterprise, and professional management should oversee the day-to-day operations that lead to performance objectives being achieved. Robust corporate disclosure underpins the accountability of boards and management to the state shareholder and the general public, and can be considered an end in itself as it reinforces the state's accountability to citizens. However, when SOEs are not governed effectively they can become vehicles for political patronage by state actors or be used by management for their own personal gain, leading to inefficiencies and low performance. Poor corporate disclosure can then make it difficult to identify and address the sources of efficiency shortcomings.

An overarching concern in the Western Balkans is the fact that most of the region's authorities do not maintain sufficient centralised data on their SOE portfolios to allow for a complete picture of their size, value, or performance. The absence of robust data on SOEs' financial and non-financial performance reflects the overall weak public accountability systems that most public authorities have established for their state portfolios. Albania, Kosovo, and North Macedonia maintain partial online lists of state-owned enterprises, but Kosovo is the only economy in the region where the authorities gather and recurrently publish financial performance data on the central government's main portfolio of SOEs. The Serbian authorities have also undertaken various forms of public reporting on their SOEs. In Albania and North Macedonia, the lists of SOEs provide basic information such as the name of each enterprise and its sector of operation, but no employment or financial performance figures.

Despite the absence of robust performance monitoring frameworks, external assessments (e.g. by international financial institutions) have shed some light on SOE performance in the region. The results of these assessments will be discussed below, followed by an overview of the available data on the characteristics of SOEs in the region, including their sectoral distribution and employment contributions.

External assessments point to the frequent underperformance of SOEs

External assessments at both the regional and economy levels point to the frequent underperformance of many SOEs in the region. For example, an extensive analysis of firm financial statements published by the International Monetary Fund (IMF) (IMF, 2019[3]) found that surveyed SOEs in the region are consistently less efficient than their private sector peers, producing lower revenues per employee, paying higher wages and posting significantly lower profitability levels.[1] Another study by the European Bank for Reconstruction and Development assessed firm profitability between 2014 and 2016 and found that surveyed SOEs operating in Bosnia and Herzegovina and Serbia posted average losses amounting to approximately 0.5% of gross domestic product (GDP). SOEs in North Macedonia and Montenegro posted profits of below 0.5% of GDP, and Albania and Kosovo were not included in the analysis (EBRD, 2020[4]). The presence of insolvent and/or inactive SOEs is also not uncommon in some of the region's economies.[2]

When SOEs underperform they contribute to the inefficient allocation of resources in the broader economy. Given that SOEs often receive public support, for example in the form of direct subsidies or foregone dividends, their inefficiencies can also lead to additional strains on already depressed public budgets. Even in the absence of formal state guarantees for their debt or other forms of explicit public support, the state is often expected to step in to shore up failing SOEs. While such state support may be economically warranted in some circumstances – for example in the context of the economic downturn associated with the COVID-19 pandemic – in "normal" times it can contribute to inefficiencies by reducing SOEs' incentives to undertake necessary structural improvements, while contributing to an unlevel playing field where SOEs compete in the marketplace.

SOE underperformance can stem from costly public service obligations subsidised from commercial revenue, but there is limited evidence that this is consistently the case in the WB6 economies' SOEs. There is a significant lack of clarity in the region regarding the non-commercial objectives of SOEs, their actual cost and whether they are delivering on their objectives. It is considered good practice, as set out in the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines), to ensure that SOEs' public policy objectives are clearly articulated and transparently financed from the public budget (OECD, 2015[2]). There is therefore a strong need in the region to clarify the commercial and non-commercial objectives of SOEs and to strengthen accountability among responsible public actors and SOEs to achieve these objectives.

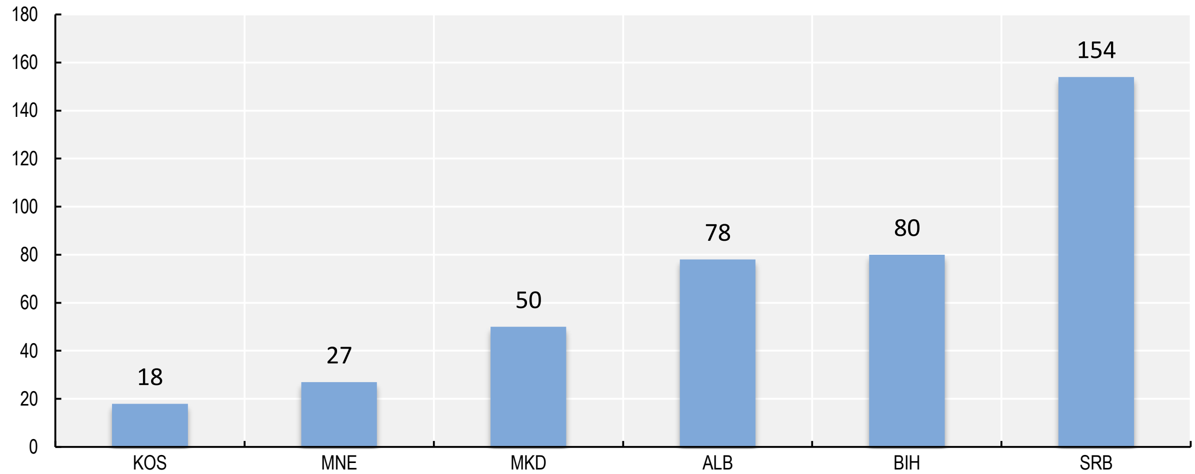
The efficient operation of SOEs is vital for economic competitiveness in the WB region

Preliminary data on SOEs gathered in the context of this assessment reveal that SOEs are important economic actors in the WB region, representing a notable proportion of employment and often operating in systemically important sectors. This makes their efficient operations essential for broader economic competitiveness.

While the data gathered for this assessment shed some light on SOEs' economic footprint in the region, the overview that follows can only be considered a preliminary and imperfect mapping of the region's SOE landscape. This is because there were notable differences in the scope of data provided by the public authorities. For example, some authorities provided information on SOEs held only by the central level of government, whereas others included municipality owned companies and did not always distinguish between the two. Limitations in the comparability of data provided by the region's authorities only serves to underscore the need to strengthen economy-level data on SOE portfolios and their performance.

The number of enterprises owned by each central-level government ranges from 18 in Kosovo to just over 150 in Serbia (Figure 9.3).[3] The state's presence in the marketplace is, unsurprisingly, more pronounced when enterprises owned by other levels of government are included: in Bosnia and Herzegovina an estimated additional 334 enterprises are owned by cantons and municipalities, while in North Macedonia an estimated 265 enterprises are owned by municipalities.[4] Figures on municipal SOEs were not provided for the other four economies in the context of this assessment.

Figure 9.3. Number of central government SOEs in WB6 economies

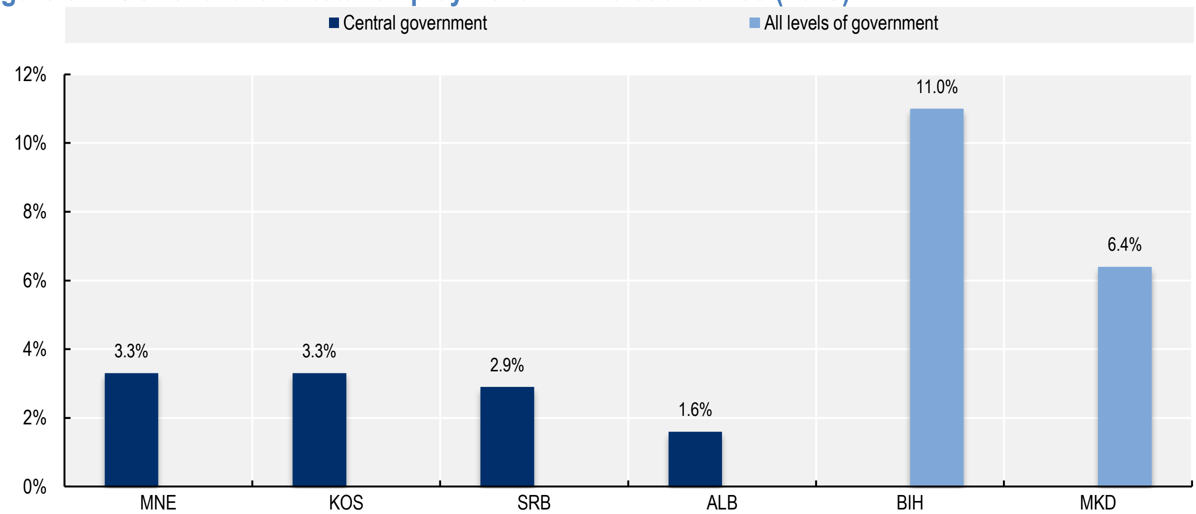


Note: For Bosnia and Herzegovina, the estimated number of SOEs reflects the portfolios of both the Federation of Bosnia and Herzegovina (FBiH) (53 SOEs) and Republika Srpska (RS) (24 SOEs). It is based on figures reported in (OECD, 2018[5]) as well as data provided by the Republika Srpska Share Fund in the context of the current assessment. The figure is an estimate because the data provided by the FBiH for the current assessment aggregated SOEs at all levels of government, without distinguishing between the different levels.

Source: Author's calculations based on data provided by the economy or entity authorities; (OECD, 2018[5]), *Competitiveness in Southeast Europe: A Policy Outlook 2018*, https://doi.org/10.1787/9789264298576-en.

Measuring SOEs' share of economic activity is difficult in the absence of comprehensive performance data, for example on SOEs' value added; however, SOEs' share of employment offers a useful measure of their role in the economy. SOEs account for a notable proportion of total employment in all Western Balkan economies, ranging from 1.6% in Albania (limited to central government SOEs) to 11% in Bosnia and Herzegovina (including SOEs at all levels of government) (Figure 9.4).[5] Importantly, in economies where SOE data are limited to central government entities, the employment figures mask the economic importance of public utilities, which are often owned by local governments. SOEs in OECD economies represent between 2% and 3% of total non-agricultural employment, on average (OECD, 2017[6]). However, the comparison with OECD economies is not perfect as the figures are based on different measures of employment (non-agricultural employment in the OECD and total employment in the WB6).[6] Nonetheless, the available data point to the overarching conclusion that SOEs are an important element in all economies of the region and probably account for a higher share of employment than SOEs in OECD economies.

Figure 9.4. SOEs' share of total employment in WB6 economies (2019)

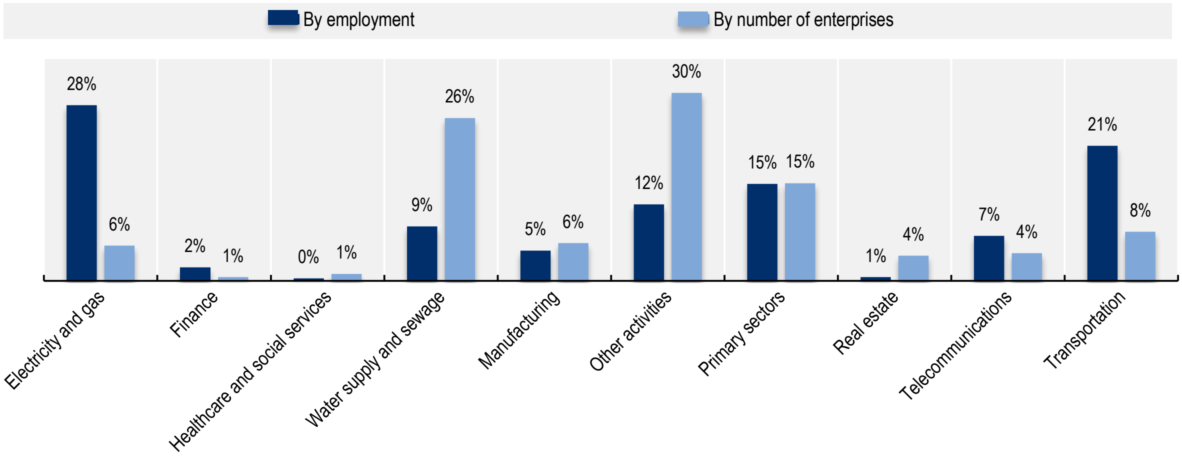


Note: Data from end-2019 or latest available.

Source: Calculations based on data provided by the economy-level or entity authorities, and employment figures from economies' statistical offices.

SOEs' presence in systemically important sectors further demonstrates their economic and societal importance. SOEs in the Western Balkans are particularly concentrated in transportation (21% of all SOEs by employment), electricity and gas (28%), and water supply and sewage (9%). SOEs are also somewhat concentrated in the primary sectors (e.g. agriculture, forestry and mining) (15%) and, to a lesser extent, in telecommunications (7%). State-owned manufacturing enterprises are also common in SOE portfolios, accounting for 5% of all SOE employees (Figure 9.5). The sectoral distribution of SOEs in the region is broadly similar to their distribution in the 40 economies (mostly OECD but also other large emerging market economies) reviewed in the OECD's recurrent data collection exercise on SOE sectors.[7] Some differences include the near absence of state-owned financial firms in the Western Balkans (2% of SOE employment in the WB vs. 8% in the OECD's sample area) and the higher concentration of SOEs operating in the primary sector (15% of SOE employment in the WB vs. 6% in the OECD's sample economies) (OECD, 2017[6]).

Figure 9.5. Sectoral distribution of SOEs across the Western Balkans



Note: SOEs' sectoral distribution is based on central government SOEs for Albania, Kosovo, Montenegro and Serbia, and includes sub-national SOEs for Bosnia and Herzegovina and North Macedonia. For Bosnia and Herzegovina, the classification of SOEs according to sector (based on the below-referenced IMF report) has been updated to align with the classification used in this regional overview.
Source: Calculations based on data provided by the authorities in the context of this assessment, except for Bosnia and Herzegovina, for which calculations are based on (IMF, 2019[7]), *State-Owned Enterprises in Bosnia and Herzegovina: Assessing Performance and Oversight*, https://www.imf.org/en/Publications/WP/Issues/2019/09/20/State-Owned-Enterprises-in-Bosnia-and-Herzegovina-Assessing-Performance-and-Oversight-48621.

Efficiency and performance through improved governance (Sub-dimension 6.1)

To ensure that SOEs perform well, the state needs to develop clear performance objectives and establish appropriate ownership and governance arrangements to make shareholding entities and SOE boards of directors accountable for achieving those objectives. Good practice calls for the state ownership function to be exercised independently of other functions, including notably market regulation, to avoid unclear or conflicting objectives on the part of economic actors. This can be done through the establishment of a separate ownership agency or, when this is not possible, through a co-ordinating unit that harmonises ownership practices across the public administration. Such units can also help to professionalise and increase the efficiency of the state ownership function by centralising relevant expertise in one body and improving the monitoring of the whole SOE portfolio. To ensure that state ownership is an informed policy decision, the state should develop an ownership policy that outlines why it owns companies and what it expects those companies to achieve. The roles and responsibilities of all state actors involved in implementing the ownership policy should be clearly outlined. The state should ensure that SOE boards of directors are sufficiently qualified and independent to make decisions in the interest of achieving SOEs' clearly defined objectives. More specifically, SOE boards should be independent of any conflicts of interest – for example political or financial connections – that could jeopardise their incentives to act in the best interests of the enterprises they serve.

The Western Balkan economies achieve below-average scores in the efficiency and performance through improved governance sub-dimension (Table 9.2). This reflects the absence of ownership policies in most of the region's economies, together with predominantly decentralised ownership arrangements (albeit with some exceptions where elements of more centralised ownership decisions are in place). Although some steps have been taken to improve the professionalism and independence of SOEs' boards of directors, SOE boards in the region are widely perceived to be subject to political influence, which can undermine corporate efficiency.

Table 9.2. Scores for Sub-dimension 6.1: Efficiency and performance through improved governance

Sub-dimension	Qualitative indicator	ALB	BIH	KOS	MKD	MNE	SRB	WB6 average
Efficiency and performance through improved governance	1. Clarification of ownership policy and rationales	1.5	1.0	3.0	1.5	2.0	3.0	2.0
	2. Professionalising state ownership	2.0	1.3	3.5	1.5	2.0	3.0	2.2
	3. Robust board nomination framework	2.0	1.5	3.5	2.0	2.5	2.5	2.3
	4. Promoting independent and professional boards	1.0	2.5	2.5	2.0	2.5	2.5	2.2
Sub-dimension average score		1.6	1.6	3.1	1.8	2.3	2.8	2.2

Ownership policies and rationales are still unclear

There have been limited policy developments to clarify ownership policies and rationales for SOEs in the region. Most WB6 public authorities have not developed a dedicated state ownership policy outlining why the state owns enterprises and what they are expected to achieve. This absence of ownership policies contributes to the often unclear objectives of SOEs and ultimately serves to weaken accountability among public shareholding entities, boards and management regarding the performance and efficiency of SOEs. However, there are small signs of progress in this domain: the Federation of Bosnia and Herzegovina (FBiH) has announced near-term plans to develop an ownership policy, and the Serbian authorities recently developed a state-ownership strategy document concerning future SOE reforms, which notably envisages the greater centralisation of state ownership responsibilities under the Ministry of Economy, as well as the development of an ownership policy.

The rationales for state ownership are also generally not clearly or consistently communicated by public authorities, which have not, for the most part, detailed why state ownership of enterprises should be chosen over private ownership. Clearly outlining the rationales that underpin state ownership is important to ensure that government ownership of commercial enterprises is an informed policy decision and not just a result of historical factors. In cases where the stated rationale(s) for government ownership are no longer present, this can support the decision to privatise or liquidate the concerned enterprises.

According to information provided in the context of this assessment, all WB6 economies identify supporting domestic economic and strategic interests as a rationale for state ownership. Montenegro and North Macedonia also identify supplying public goods and services that the market is not able to supply as a rationale, and Albania, Kosovo, and Serbia identify supporting social objectives. Albania is the only economy to consider the maintenance of enterprises in domestic (non-foreign) ownership as a rationale for state ownership. No public authorities identified the operation of natural monopolies as a rationale for state ownership (Table 9.3).

Table 9.3. Rationales for economy ownership, as reported by WB6 authorities

	Supporting domestic economic and strategic interests	Ensuring continued domestic ownership of enterprises	Supply public goods or services that the market cannot provide	Performing business operations in a natural monopoly situation	Supporting social objectives
Albania	√	√	√		√
Bosnia and Herzegovina	√				
Kosovo	√				√
Montenegro	√		√		
North Macedonia	√		√		
Serbia	√		√		√

Note: Responses for Bosnia and Herzegovina reflect both FBiH and RS responses.
Source: Questionnaire responses from economy-level and entity authorities in the context of this assessment.

Although these reported rationales shed some light on the possible justifications for state ownership in the region, it is often not evident how many individual SOEs, particularly those with predominantly commercial activities (e.g. those operating in competitive sectors such as manufacturing), fulfil these rationales. For example, how does maintaining a manufacturing company in state rather than private ownership support economic and strategic interests? This reflects the fact that some of the reported rationales remain very broad in scope, and that the authorities often do not subsequently define the rationales for state ownership at the level of individual enterprises. The rationales for state ownership may in some cases be gleaned from sectoral or enterprise-specific legislation, for example where public service expectations are very clearly defined, but this is generally not consistent across entire economy portfolios. Many public authority portfolios in the region include companies that remain in state ownership owing to stalled or failed privatisations, or that are insolvent, inactive and/or in the process of being liquidated. This points to a disconnect between the reported rationales for maintaining enterprises in state ownership and actual state ownership practices.

Efforts to professionalise state ownership are similarly limited in the region

Most of the region's economies have predominantly decentralised state ownership arrangements, meaning that several line ministries or other state agencies exercise shareholding rights over a distinct portfolio of SOEs. This can be problematic as it risks, among other things, conflicting or unclear objectives among state entities that are simultaneously responsible for ownership, market regulation and/or sectoral policy. A recent trend in economies around the world that are implementing good-practice reforms of state ownership arrangements is to centralise state ownership in a single agency or unit that is either tasked with undertaking the state's shareholding duties or performing a co-ordination and monitoring role among state shareholding entities (OECD, 2020[8]) (see Lithuanian example in Box 9.1).

In the Western Balkans, some elements of domestic practice diverge from the fully decentralised model of ownership, and a degree of professionalisation and co-ordination of ownership decisions has been introduced across the public administration. This is notably the case in Albania, Kosovo, and Montenegro, where a significant proportion of the state's portfolio is subject to some degree of central or co-ordinated ownership, for example through board nomination procedures that involve more than just the responsible line ministry and that are guided by whole-of-government policy documents.[8] In Bosnia and Herzegovina, both the FBiH and RS have announced plans to establish a central state ownership monitoring entity to be housed within each entity's prime minister's office. Similarly, Serbia's new state ownership policy foresees the establishment of a state ownership and co-ordinating body. The region's authorities could build on these preliminary steps to further strengthen central ownership institutions and professionalise the state shareholding function.

Box 9.1. Creating a state ownership co-ordination entity in Lithuania

Similar to most Western Balkans economies, Lithuania has predominantly decentralised state ownership arrangements, with line ministries exercising shareholding functions in distinct portfolios of SOEs. In the context of these decentralised arrangements, Lithuania has taken several steps to harmonise and professionalise ownership practices across the public administration. These steps notably include the development of a whole-of-government ownership policy and the establishment of a central co-ordination and monitoring unit, the Governance Co-ordination Centre (GCC), to monitor implementation across the SOE portfolio. The GCC is housed in the Monitoring and Forecast Agency, a public institution under the purview of the Ministry of Economy.

Roles undertaken by the GCC to support more professional and accountable ownership practices include:

- Supporting SOE performance improvements by developing three-year rate-of-return targets for SOEs, which are agreed upon by the government.
- Maintaining centralised data on SOEs, including through the collection of SOEs' quarterly and yearly financial reports.
- Participating in an inter-ministerial selection commission, which also involves private recruitment agencies, to choose qualified independent members (those without significant business or personal ties to SOE management) for SOE boards of directors.
- Producing aggregate reports addressed to the public on the activities and performance of the SOE portfolio.

Source: (OECD, 2018[9]), *Corporate Governance in Lithuania*, https://doi.org/10.1787/9789264302617-en; (OECD, 2020[10]), *Note by the OECD Secretariat on Lithuania's implementation of corporate governance accession review recommendations*, http://www.oecd.org/corporate/Lithuania-Corporate-Governance-Progress-Note.pdf.

Despite progress on board nomination frameworks, the process is seen as lacking transparency

Preliminary steps have been taken by some WB6 governments to introduce a more robust SOE board nomination framework and ensure transparent and merit-based procedures for recruiting board members. The authorities of Albania, Kosovo and Serbia have established formal procedures for SOE board nominations that are laid out in dedicated legislative or policy documents. In Bosnia and Herzegovina, related requirements have been formalised but apply to all government appointments rather than being specific to the SOE sector. Overall, even where formal nomination procedures exist, the criteria and process for selecting individual SOE board members are widely perceived to lack transparency. Box 9.2 summarises efforts taken by the authorities of Latvia to strengthen SOE board nomination practices.

Box 9.2. Establishing professional and independent SOE boards in Latvia

At the time of Latvia's accession to the OECD, several commercially oriented SOEs were not operating under boards of directors and were overseen directly by shareholding ministries. As part of its OECD accession process, Latvia made a pledge to establish professional boards of directors in all large commercially oriented SOEs that did not yet have boards in place. As a result, Latvia established a new SOE board nomination framework to be implemented by shareholding ministries. It undertook the following steps to establish more professional boards in SOEs:

- Adopted requirements that all shareholding ministries establish dedicated SOE board nomination committees to undertake board selection processes and make appointment recommendations to shareholding ministries. All committees were required to include a representative of the state's ownership co-ordination body, the Cross-Sectoral Co-ordination Centre (CSCC), as well as independent experts not employed by shareholding ministries.
- The CSCC developed guidelines on how SOE board candidates should be selected and subsequently assessed.
- Strengthened board member qualifications criteria, for example regarding educational level and professional experience, as well as industry expertise and/or experience managing limited liability companies.
- Introduced requirements that at least half of SOE board members are independent. Clear criteria for establishing independence include the absence of working relationships with the shareholding ministry, not having previously been a board member of the SOE or its subsidiaries, and not having been a representative of the SOE's external audit firm for the previous three years.
- Used an executive search firm to support board recruitment for Latvia's largest SOE, the state-owned electricity company, Latvenergo.

Through the establishment of this new SOE board nomination framework, Latvia was able to successfully establish boards in 12 SOEs that previously had no boards in place. These boards included independent directors, in line with the new requirements.

Source: (OECD, 2017[11]), *Note by the OECD Secretariat on Latvia's implementation of corporate governance accession review recommendations*, https://www.oecd.org/daf/ca/OECD-Note-Latvia-Corporate-Governance-Accession.pdf.

There has been limited progress in promoting independent and professional boards

Establishing independent and professional boards in SOEs is crucial to ensure sufficient outside oversight of corporate management and to shield SOEs from political interference. In practice, SOE boards in the region are often perceived to be operating as extensions of their ownership ministries and subject to political interference. Even in economies where SOE boards must comprise a minimum proportion of "independent" directors – which is the case to some extent in Kosovo, North Macedonia and Serbia, and will soon be the case in Montenegro following recent amendments to the company law – SOE board positions are frequently perceived to be accorded based on political or personal connections rather than purely based on merit. The resulting risk for the politicisation of SOE boards often extends to the senior management members appointed and can mean that corporate decisions, such as those related to procurement or staffing, are politically motivated rather than in the interest of corporate performance. In some cases, the state, rather than SOE boards of directors, is responsible for appointing senior management, further exacerbating the risk of political influence over corporate decisions.

The way forward for efficiency and performance through improved governance

To improve state ownership arrangements and the functioning of SOE boards of directors, WB6 authorities should consider the following steps:

- **Strengthen the institutional and policy arrangements for state ownership**. All Western Balkans economies would benefit from improvements to the institutional arrangements for state ownership and, where applicable, the development of ownership policies that outline why the government owns companies and what it expects them to achieve. Albania and Bosnia and Herzegovina should move forward with implementing proposals to create dedicated state ownership entities or co-ordination units. State ownership units should gather and maintain centralised data on the state-owned enterprise portfolio, including the number of SOEs, their sectors of operation, their employment figures and their financial statement data. Lithuania's experience in establishing a central state ownership monitoring and co-ordination entity (while maintaining predominantly decentralised ownership arrangements) is highlighted in Box 9.1 and may be useful for WB6 economies.
- **Strengthen the professionalism and independence of SOE boards of directors through transparent and merit-based nomination procedures.** Although the authorities of some WB6 economies have established formal procedures for SOE board nominations, there remains the perception across the region that SOE board appointments are often made based on political or personal connections, rather than purely professional experience and merit. The authorities in all WB6 economies should take steps to strengthen SOE board composition requirements and nominating procedures to ensure that SOE boards have sufficient expertise, as well as independence from shareholding ministries and SOE management, to effectively oversee SOE decision making in the interest of achieving well-defined corporate objectives. The authorities could consider using private recruitment agencies to support the process. The experience of Latvia in implementing new SOE board nomination procedures for its large commercial SOEs is outlined in Box 9.2.

Transparency and accountability practices (Sub-dimension 6.2)

Ensuring that SOEs are accountable to the state shareholder, to other shareholders as relevant, and to the general public (the ultimate "owners" of SOEs) is key for their efficiency and performance. Once the state has established performance objectives for SOEs, the enterprises themselves should produce reliable and high-quality financial and non-financial reports that allow the state to assess how well they have achieved their objectives. SOEs' financial statements should be audited by external audit firms to ensure that these disclosures can be relied upon to present an accurate overview of SOEs' financial situation and help the state and boards identify any structural shortcomings that are holding back SOE performance. SOEs' non-financial reporting should place a particular emphasis on activities undertaken in the public interest. In addition to ensuring that the minority shareholders of SOEs have sound basic rights – such as equitable treatment and access to information – the state should also take steps to regularly communicate with minority shareholders and ensure that SOE corporate decision making considers the needs of all shareholders. The state as shareholder should also be accountable to the general public by being transparent about the enterprises that it owns and reporting to the public on the performance of the state's portfolio.

The Western Balkans region performs relatively well when compared internationally in terms of the financial reporting standards of SOEs, although there is scope for them to strengthen their compliance with applicable requirements (Table 6.4). There is limited information available on non-financial reporting, indicating that efforts should be improved in this domain. Concerning accountability towards minority shareholders and the protection of their rights, there is scope in some WB6 economies to improve basic legislated minority shareholder rights (applicable to all company shareholders), as well as to undertake more targeted efforts to communicate with minority shareholders and involve them in SOE corporate decision making.

Table 9.4. Scores for Sub-dimension 6.2: Transparency and accountability practices

Sub-dimension	Qualitative indicator	ALB	BIH	KOS	MKD	MNE	SRB	WB6 average
Transparency and accountability practices	1. Financial and non-financial reporting	2.5	2.0	3.5	2.5	3.0	3.5	2.8
	2. Auditing practices	3.0	2.5	3.0	2.5	3.0	4.0	3.0
	3. Protection of minority shareholders	3.0	3.0	3.0	3.5	3.0	3.0	3.1
Sub-dimension average score		2.8	2.5	3.2	2.8	3.0	3.5	3.0

Financial reporting standards are sound, but non-financial reporting could be strengthened

There are legislative provisions in all Wb6 economies that establish basic financial reporting requirements for at least a significant proportion of SOEs, usually involving the mandatory submission of financial statements to a central registry. Financial reporting requirements are often equivalent to those applicable to privately owned companies, and do not always involve reporting in line with internationally recognised standards. In Kosovo, North Macedonia and Serbia, SOEs' financial statements must also be publicly disclosed, either directly by the enterprises or by a government body such as a business registry. While there appear to be sound basic requirements for financial reporting in the region, there is significant scope to strengthen non-financial reporting requirements and practices, particularly concerning activities undertaken in the public interest.

SOEs in the Western Balkans demonstrate weak compliance with applicable reporting requirements, with recent monitoring studies in some individual economies pointing to SOEs' failure to submit required reports and/or delays in submitting them to the authorities.[9] Although this compliance issue may not be a pressing concern in all six economies, no governments in the region (with the exception of Kosovo) appear to undertake the systematic monitoring of SOE compliance with reporting requirements, which is necessary to identify and address any related shortcomings.

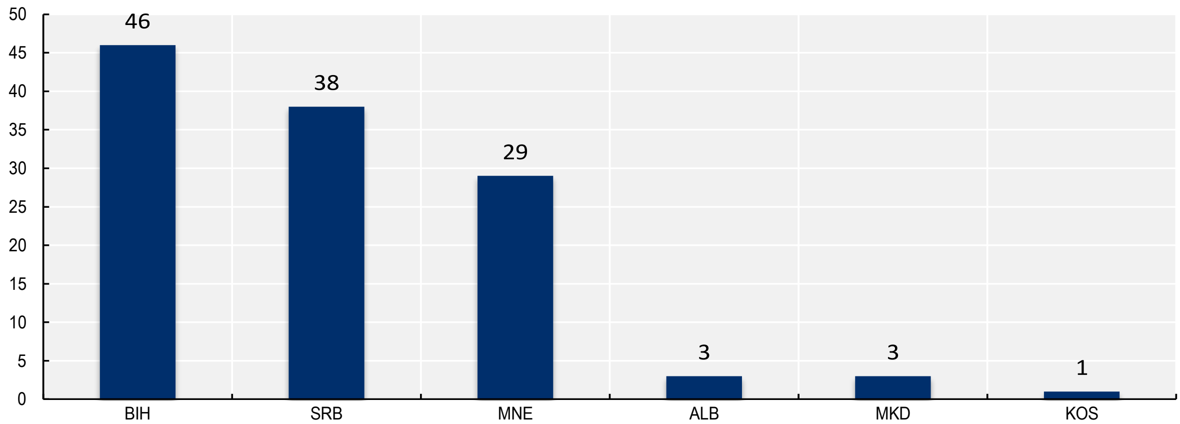
Financial auditing practices are mostly supported by sound basic legislation

In most WB6 economies, the financial auditing practices of SOEs are supported by sound basic legislation that, for example, requires external audits of financial statements for at least the largest SOEs. In practice, however, some recent external audits of large SOEs in the region have identified significant shortcomings in the soundness of their financial statements, pointing to the need to improve the quality and credibility of SOEs' corporate disclosures.[10] In some cases the state audit office, instead of private firms, conducts SOEs' financial statement audits. This is not considered good practice and could be indicative of broader issues related to the underdevelopment of the audit profession in the region.

Protection of SOEs' minority shareholders could be improved

The protection of SOE minority shareholders is particularly pertinent for economies where a large proportion of SOEs include non-state investors in their shareholding structure, notably Bosnia and Herzegovina, Montenegro and Serbia (Figure 9.6). Bosnia and Herzegovina has the largest absolute number of SOEs with private shareholders (46), although this figure is inflated by the inclusion of municipality-owned enterprises. Albania, Kosovo, and North Macedonia have a very small number of SOEs with private shareholders (fewer than three companies each), which means that protecting minority shareholders, although important for the broader business climate, is less of an immediate priority for state ownership policy reform. In Kosovo, only one SOE, the Trepča Mine, has non-public shareholders. This mine was expropriated in 2016 and is 20% owned by its employees. For North Macedonia, the three enterprises reflected in Figure 9.6 do not currently have any private shareholders but are nominally listed on the economy's stock exchange.

Figure 9.6. Estimated number of SOEs with private shareholders in WB6 economies (2019)

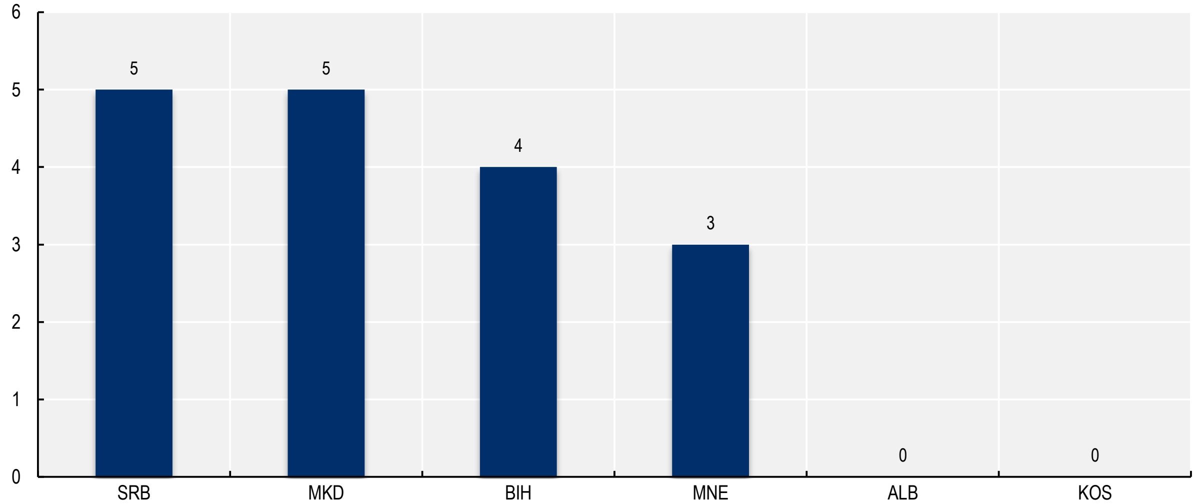


Note: Although three SOEs in North Macedonia are nominally listed on the stock exchange, they currently do not have any private shareholders. For Bosnia and Herzegovina there are an estimated 34 SOEs in FBiH and 12 in RS. Data from end-2019 or latest available.
Source: Information provided by the authorities in the context of this assessment.

Ensuring that minority shareholders are treated equitably is important to ensure that SOEs create value for all shareholders and for attracting private capital to the state-owned enterprise sector. Basic minority shareholder rights, for example the right to access information and to participate in corporate decision making, such as board elections, should be enshrined in law and consistently respected. There should also be a strong degree of transparency from the state towards minority shareholders, particularly in cases where the state encourages corporate decisions that may impact SOE profitability and dividend pay-outs. This is especially relevant when the state expects SOEs to pursue objectives other than profit maximisation. Minority shareholders should be adequately informed of such expectations, both at the time of their investment and on an ongoing basis.

External assessments conducted by the World Bank in the context of its Doing Business reviews point to the presence of sound basic rights in some WB6 economies regarding basic minority shareholder protections, with Serbia the highest performer in the region, followed by North Macedonia and Bosnia and Herzegovina (Figure 9.7) (World Bank, 2020[12]). Among the three economies with the highest number of SOEs with private shareholders, Montenegro receives the lowest score regarding the extent of minority shareholder rights (three out of six). Albania and Kosovo are excluded from the index's scoring as they do not have active stock markets. The ranking presented in Figure 9.7 is based on the economies' scores for the World Bank's Doing Business review's index on the extent of shareholder rights, which examines the extent to which six shareholder rights are enshrined in law for stock-exchange listed companies.[11] These six rights include the right for shareholders to elect and dismiss the company's external audit, and the right for those with at least 10% of equity capital to call for a general shareholders' meeting.[12]

Figure 9.7. Extent of shareholder rights for stock-exchange listed companies in the WB6 (2019)

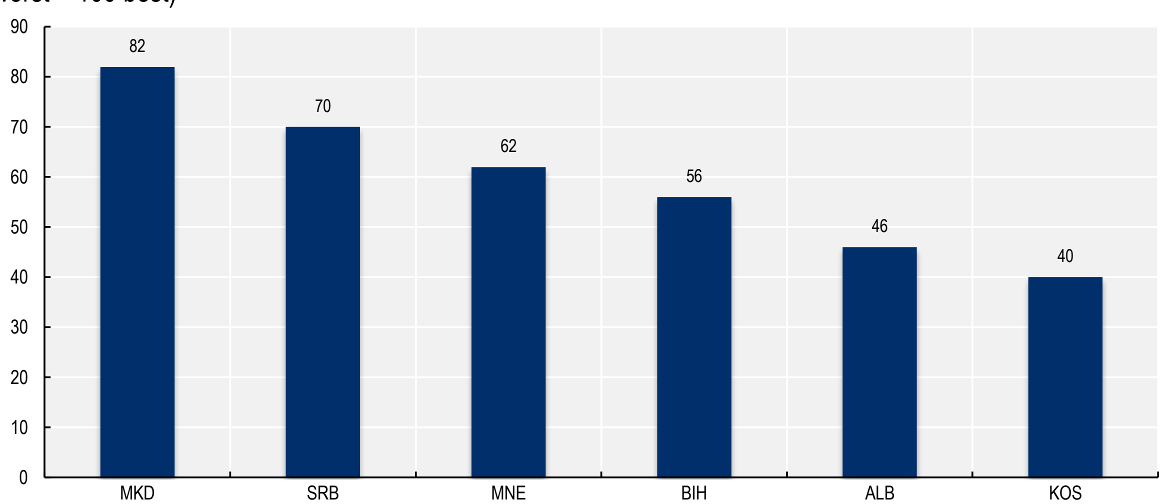


Note: Albania and Kosovo receive scores of 0 on this index owing to the absence of active stock exchanges.
Source: (World Bank, 2020[12]), *Doing Business 2020: Comparing Business Regulation in 190 Economies*, https://openknowledge.worldbank.org/handle/10986/32436.

The Doing Business review's broader index on the extent of shareholder governance, which includes the shareholder rights dimension but also assesses legal safeguards against undue board control as well as corporate transparency towards shareholders, also identifies room for improvement in the six economies, with a similar ranking to the above (Figure 9.8).

Figure 9.8. Minority investor protections for stock-exchange listed companies in the WB6

(0 worst – 100 best)



Note: Scores for Albania and Kosovo are negatively impacted by the score of 0 accorded for the index on extent of shareholder rights (which is one of the components comprising the index on minority investor protections).
Source: (World Bank, 2020[12]), *Doing Business 2020: Comparing Business Regulation in 190 Economies*, https://openknowledge.worldbank.org/handle/10986/32436.

Although SOEs in the region are not excluded from the applicability of laws intended to accord minority shareholders equal treatment, there are several risks associated with state ownership that call for targeted measures to ensure that minority shareholders are adequately informed and involved in corporate decision making. Based on information gathered for this assessment, there is limited evidence that any of the region's authorities undertake targeted efforts to mitigate these risks and strengthen transparency regarding SOE minority shareholders consistently or as a matter of state shareholding policy.

The risks associated with state ownership include the fact that the state as the dominant shareholder may exclude minority shareholders from key corporate decision making and/or make decisions not in their interest, for example decisions motivated by public policy concerns rather than based on commercial justifications. The presence of politically affiliated individuals on the boards of many SOEs in the region may exacerbate this problem. The state as a shareholder may also have privileged access to corporate information compared to private shareholders, for example through communication channels with the board of directors that omit minority shareholders. Weak rule of law in the region, coupled with the risk that state judicial systems may have a tendency to side with state shareholders, may also make it more difficult for minority shareholders to obtain adequate redress in cases where their legal rights have been violated.

The OECD SOE Guidelines outline several specific efforts that governments should take to ensure that SOE minority shareholders are treated equitably and have equal access to corporate information. These include ensuring that crucial corporate information is shared simultaneously with the state and minority shareholders, facilitating their participation in shareholder meetings, and developing an active policy of communication and consultation with all shareholders (OECD, 2015[2]). Regarding corporate transparency, particular emphasis is placed on ensuring that minority shareholders are aware of any public policy objectives that SOEs are expected to achieve. Given that public policy objectives (especially if ad hoc) are often in conflict with commercial objectives, it is important that minority shareholders are fully informed about their scope and impact on corporate profits. For example, SOEs should be sufficiently clear about public policy objectives (which would normally also be established via clear regulations) in their non-financial disclosures. These avenues for minority shareholder involvement could offer some inspiration for the WB6 authorities as they seek to improve the relationship between the state and minority shareholders.

Accountability to the general public could be significantly strengthened

There have been limited developments in the WB6 economies regarding how the state reports to the public on its activities as a shareholder, and on the performance of the SOE portfolio. Although SOEs are generally required to submit their financial statements to a central registry, very few public authorities use the information collected to undertake or publish an analysis of SOEs' financial performance at the portfolio level. The authorities of only one economy, Kosovo, recurrently publish an aggregate report on the activities and performance of SOEs. Aggregate reports can offer a useful mechanism for increased accountability and help encourage improvements in SOE performance, transparency, and governance practices (Box 9.3).

Box 9.3. International experience in good-practice aggregate reporting

To strengthen the state shareholder's accountability to the public, many economies around the world produce publicly available aggregate reports that synthesise information about the operations and performance of the state's SOE portfolio. These reports complement SOE-specific disclosures by presenting a more holistic overview of the state's portfolio performance and a summary of the trends in ownership or governance practices, or significant changes in the state's portfolio. The OECD is currently developing a good practice guide on aggregate reporting which will contain useful guidance for policy makers looking to develop such public reports. The following elements are included in aggregate reports worldwide:

- **SOEs' financial performance and value**. This information is often presented both at the sectoral level and at the enterprise-specific level, allowing for a general overview of, for example, SOE revenue, net income and dividends distributed to the state, as well as financial metrics such as leverage ratios and rates of return on debt and equity.
- **SOE employment figures**. This can include information on, and explanations for, any substantial changes in SOE employment levels.
- **Implementation of the state's ownership policy**. This can include information on any recent changes to the state's ownership policy and the institutional roles and responsibilities for its implementation. Many countries also report on SOEs' compliance with applicable governance and disclosure standards.
- **Board composition and/or remuneration in SOEs**. Information on SOEs' board composition can include reporting on the number of board members considered "independent directors" (those without material business or personal connections to enterprise management that could constitute a conflict of interest) and/or information on gender diversity on the boards. Some countries also provide information on individual board member remuneration.
- **Costs and financing of SOEs' public policy activities**. This can include SOE-specific information on how much SOEs' public policy activities cost and how they are paid for (through the state budget or from commercial revenue). Some countries disclose the amount of state subsidies that individual SOEs have received over the preceding year.

Source: (OECD, 2018[13]), *Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices*, http://www.oecd.org/corporate/Ownership-and-Governance-of-State-Owned-Enterprises-A-Compendium-of-National-Practices.pdf.

The way forward for transparency and accountability practices

To improve SOEs' accountability to the state, minority shareholders (as relevant) and the general public, the following steps are recommended:

- **Review all SOEs' compliance with existing disclosure requirements**. This assessment has revealed that in most of the region's economies, at least the largest SOEs are subject to strong requirements for financial reporting to a central entity. However, there are gaps in compliance in some cases, for example a significant proportion of SOEs are not reporting on time or at all. WB6 authorities are encouraged to undertake more in-depth monitoring of SOE compliance with applicable financial reporting standards to identify and address gaps in compliance. Where monitoring uncovers significant issues with the quality and credibility of SOEs' corporate disclosures (for example as a result of external audits), steps should be taken to address these issues.
- **Strengthen SOEs' non-financial reporting requirements and practices**. Special efforts should be made to ensure that SOEs report to the state shareholder(s) and to the public, in particular on

activities undertaken in the public interest. This implies complementary efforts to better define SOEs' public interest activities and to develop clearer non-financial performance objectives to assess SOEs' success in this regard.

- **Strengthen accountability to SOEs' minority shareholders**. In addition to improving basic minority shareholder rights for all companies, the state should take steps to review and improve communications with SOEs' private minority shareholders. SOEs should be accountable to, and create value for, all shareholders.
- **Produce publicly available aggregate reports on the state ownership portfolio**. In most of the region's economies there is already a mechanism in place to collect SOEs' financial statements, usually involving their submission to a central registry. The authorities could build on this process by collating and analysing SOEs' financial performance data to produce an overview of the performance of the SOE portfolio as a whole. To encourage improvements, aggregate reports could also include information on the number of SOEs that do not comply with financial (and non-financial) reporting requirements. They could also present qualitative information on SOEs' corporate governance practices, their public service activities and other information of relevance to the general public. Box 9.3 presents some elements of international experience in producing aggregate reports and highlights the type of information that such reports can include.

Ensuring a level playing field (Sub-dimension 6.3)

To ensure a level playing field, SOEs' legal and regulatory treatment and their financial conditions should be similar to those of private enterprises. This means that SOEs should not be exempt from the application of general laws and regulations applicable to private companies, including notably competition rules and other market regulations. Concerning their financing conditions, SOEs should not benefit from any direct or indirect state support – including implicit or explicit guarantees on commercial debt – that may confer a competitive advantage over private enterprises. At the same time, SOEs should not face competitive disadvantages owing to, for example, under-compensated non-commercial objectives (e.g., providing local employment) that can jeopardise their commercial viability or otherwise lead to structural inefficiencies.

The WB6 region achieves average performance on SOEs' legal and regulatory treatment (Table 9.5), reflecting the fact that most SOEs are incorporated subject to general company law and do not benefit from many of the explicit exemptions to the laws and regulations applicable to private companies. The region underperforms on SOEs' financing conditions, reflecting the fact that many SOEs do not achieve economically significant rates of return, which amounts to below-market costs of equity capital (provided by the state).

Table 9.5. Scores for Sub-Dimension 6.3: Ensuring a level playing field

Sub-dimension	Qualitative indicator	ALB	BIH	KOS	MKD	MNE	SRB	WB6 average
Ensuring a level playing field	1. Legal and regulatory treatment	3.5	2.0	4.0	3.0	3.5	3.5	3.3
	2. Access to finance	2.0	2.0	2.0	2.0	2.5	3.0	2.3
Sub-dimension average score		2.8	2.0	3.0	2.5	3.0	3.3	2.8

Most SOEs in WB6 economies are incorporated under company law

Concerning SOEs' legal and regulatory treatment, a significant proportion of SOEs in WB6 economies – in many cases a majority – are incorporated as joint-stock or limited liability companies, and thus subject to the general company law that is also applicable to privately owned corporations. This establishes a sound foundation for ensuring that SOEs face similar legal and regulatory treatment to private companies, which is important for maintaining a level playing field between state and privately owned companies.

Nevertheless, in four of the six economies (all except for Albania and Kosovo, according to authorities involved in this assessment) at least some SOEs are incorporated under the distinct legal form of "public enterprise" and subject primarily to SOE-specific legislation. Maintaining SOEs under such a separate legal form introduces material operational differences between SOEs and private companies that can distort the level playing field (for example by exempting SOEs from the possibility of bankruptcy) and is not considered good practice. In general, maintaining SOEs under a separate legal regime often results in different transparency and accountability requirements, particularly compared to stock-exchange listed corporations, which are usually the "gold standard" for corporate reporting and governance practices. For example, the boards of directors of SOEs with special legal status are often not subject to corporate liability, which can greatly weaken their incentive to act purely in the interest of corporate performance. In some cases, SOEs with a separate legal status are effectively operated as arms of the public administration, increasing the risk of political interference in corporate decision making. SOEs with special legal status may also face different accounting requirements, which can, among other things, make it difficult to benchmark their performance against industry peers. The maintenance of some SOEs under a separate legal form is undertaken in Bosnia and Herzegovina, North Macedonia and Serbia, all of which have developed separate laws on public enterprises. Montenegro also maintains some SOEs under the separate legal form of public enterprise, all of which reportedly undertake public service activities, but the authorities report that most of these enterprises are owned by municipalities. In every WB6 economy there are some nuances related to this overarching trend; for example, in North Macedonia, the Law on Public Enterprises stipulates that all SOEs undertaking public interest activities must be incorporated as limited liability or joint-stock companies, but in practice several SOEs are still incorporated under the separate legal form of public enterprise. Only in Albania and Kosovo are all SOEs reportedly incorporated as joint-stock or limited liability companies operating primarily under general company law.

Concerning SOEs' regulatory treatment, the authorities of most countries report very few explicit regulatory exemptions granted to SOEs, and generally maintain that SOEs face the same treatment as private companies in terms of taxation, competition rules, and environmental and zoning regulations. However, this assessment has found that in practice SOEs face some apparent regulatory leniency from public authorities, resulting in, for example, tax payment arrears or barriers to free competition in sectors where the state previously held a monopoly position.[13] External assessments confirm the existence of operational advantages granted to SOEs in some cases; for example, in a recent IMF study the authorities of Albania, Bosnia and Herzegovina and North Macedonia reported that they grant some legal preferences to SOEs (IMF, 2019[3]).

Most SOEs access at least some financing on the commercial marketplace

Many SOEs in the WB region benefit from explicit state guarantees on debt, which constitutes an operational advantage that may distort the level playing field with private companies. This being said, explicit state guarantees that distort competition are prohibited in economies subject to EU state aid rules. Even in cases where no explicit guarantees are provided, it is likely that many commercial banks perceive an implicit state guarantee – i.e. that the state will step in if an SOE is unable to service its debt – and may price their financing accordingly. Such financing conditions are by no means unique to the Western Balkan economies, with the authorities of many OECD economies considering that SOEs are likely to benefit from advantageous commercial lending conditions owing to implicit state guarantees. Few economies have established mechanisms to offset such operational privileges to maintain "competitive neutrality" (the absence of differences in the competitive landscape that stem from state ownership, regulation or activity in the market) between state-owned and private firms (OECD, 2014[14]). Other problematic financing arrangements include state recapitalisations that are not undertaken on market terms, leading to competitive distortions.

Many SOEs in the WB6 economies do not earn economically significant rates of return. It is not uncommon for SOEs to be outright loss-making, which places a significant burden on public budgets and often channels economic resources to less efficient economic actors. Although some of the corporate inefficiencies of SOEs may stem from under-compensated public service obligations, there is no evidence that this is consistently the case, particularly given that most of the region's authorities have not clearly defined or disclosed the costs of SOEs' public service obligations or other activities undertaken "in the public interest". The OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOE Guidelines) recommend that any public policy objectives that SOEs are expected to achieve should be clearly articulated and their costs transparently accounted for and funded directly from the public budget (OECD, 2015[2]).

The way forward for ensuring a level playing field

To further level the playing field with private enterprises, WB6 authorities are encouraged to consider the following measures:

- **Fully corporatise SOEs that engage in commercial activities**. While the majority of SOEs in the region are incorporated as limited liability or joint-stock companies, in most of the region's economies there remains a subset of SOEs incorporated according to separate enterprise-specific (or SOE-specific) legislation. SOEs engaged in commercial activities should, wherever possible, be incorporated according to the general company law and not face regulatory exemptions that could distort the level playing field with private companies. In cases where the authorities deem it more efficient to maintain certain SOEs under a separate legal form, the rationales for doing so should be clearly and transparently defined.
- **Improve SOEs' efficiency so that they achieve economically significant rates of return on their commercial activities**. A fundamental issue in many of the region's economies is that many SOEs do not earn economically significant rates of return, in some cases posting persistent losses. Efforts should be made to ensure that SOEs achieve minimum profitability levels on their commercial activities. This may require the clarification of SOEs' commercial and non-commercial activities, as well as structural changes within individual enterprises to improve efficiency.

Reforming and privatising state-owned enterprises (Sub-dimension 6.4)

The frequent underperformance of the Western Balkans' SOEs, together with underdeveloped policy and institutional frameworks for state ownership in most WB6 economies, point to the need for substantial state ownership reforms. The presence of many SOEs for which the rationales for state ownership are not clear, or which have become insolvent, indicate the need to optimise state ownership portfolios through enterprise liquidation, restructuring and/or privatisation. This section summarises recent domestic SOE reform initiatives and sheds light on the privatisation landscape in the region. This sub-dimension is purely descriptive and is not scored.

SOE reforms have been limited in the region

No WB6 government has reported any significant state ownership reforms since the 2018 Competitiveness Outlook. Recent state ownership reforms have mostly been limited to restructuring individual SOEs that were suffering persistent losses and/or were insolvent, for example through organisational changes and/or corporate mergers. In Albania and Bosnia and Herzegovina, proposals to strengthen institutional arrangements for state ownership have been discussed by the authorities, but formal steps have not been taken to follow through on preliminary discussions. The largest legislative reform effort affecting SOEs could be considered to have taken place in Montenegro through recent amendments to the general company law, which notably introduces independence requirements for certain company boards of directors that will apply to fully corporatised SOEs. However, no WB6 government has recently undertaken any significant policy, institutional or legislative reforms specific to state ownership.

Small-scale privatisation efforts are continuing in some WB6 economies

Small-scale privatisation efforts often involve the sale of remaining state equity in companies that had been partially privatised in earlier years. Most of the recent privatisations in the region have not involved large or systemically important SOEs. The authorities of Kosovo, and North Macedonia have had preliminary discussions about potential future privatisations of the state-owned telecommunications (Kosovo[14]) and railway (North Macedonia) enterprises, but no further progress has been made. The region's economies can be divided into two main groups in terms of privatisation programmes: in Albania, Bosnia and Herzegovina, Montenegro, and Serbia, privatisations have taken place with some regularity over the past decade, and in Kosovo and North Macedonia, privatisation programmes have been considerably less active.[15] This assessment has also uncovered individual cases of recent "failed" privatisations, for example where the authorities have been unable to identify interested or suitable investors. This underscores that many elements must be in place for a privatisation to be successful, including the political will and agreement to privatise, the presence of interested investors with sufficient capital for the purchase, and sufficiently strong corporate performance to attract purchase offers that justify relinquishing ownership.

Almost all public authorities in the region maintain state minority shareholdings (ownership shares of between 10% and 50%) in a notable number of companies. These minority shareholdings often reflect privatisation processes already initiated (through partial sales) that have either stalled or been cancelled. Based on available data, Albania, Bosnia and Herzegovina, Montenegro, and Serbia all hold state minority shareholdings in a large number of companies, ranging from 17 to 38 (see Table 9.6). In some cases, the maintenance of state minority shareholdings seems to reflect general policy inertia regarding their eventual privatisation, rather than the result of an informed decision on the part of the public authorities to maintain strategic shares in such companies. However, state minority shareholdings can also reflect temporary capital injections made to shore up private companies, or efforts to maintain some degree of strategic influence (without full control) over certain companies or within certain sectors of the economy.

Table 9.6. Companies with state minority shareholdings in WB6 economies (2019)

State minority shareholdings of 10-50%

	ALB	BIH		KOS	MKD	MNE	SRB
		FBiH	RS				
Estimated number of companies with state minority shareholdings	28	4	13	n.a	n.a	21	38

Source: Data provided by economy-level or entity authorities for this assessment.

The way forward for reforming and privatising SOEs

- **Make state ownership reform a policy priority**. In most of the region's economies, state ownership reforms have been particularly limited in recent years, even though SOEs are often loss-making and represent substantial fiscal liabilities for the authorities. The authorities of all WB6 economies should make state ownership reforms, in line with this assessment's recommendations, a policy priority.
- **Review the rationales for maintaining state ownership in commercially oriented enterprises**. The rationales for state ownership should be clearly defined and regularly reviewed. This is particularly relevant for state majority shareholdings but can also be applied to state minority shareholdings. Limited information is available on why several governments in the region maintain minority state shareholdings in a large number of companies, which also reflects the broader issue

of limited state ownership policy development in the region. Going forward, governments in the region should review the benefits that existing shareholdings bring to the state and, where those benefits are not evident, reconsider their maintenance in state ownership. Such a review could complement the development of economy-level ownership policies that outline the rationales for state ownership, as recommended earlier in this assessment. Policy makers considering privatisation may find the OECD's recent guidance on privatisation practices useful (OECD, 2019[15]).

Conclusion

Strengthening state ownership and governance arrangements in WB6 economies could significantly improve the efficiency of the region's SOEs and help ensure that they create value alongside private companies. Improving the efficiency of state portfolios – including through operational changes that increase productivity and winding down insolvent or inactive SOEs – can also have significant fiscal impact by reducing the need for excessive state support of SOEs and by ultimately increasing the level of dividends that SOEs are able to return to the state budget. Strengthening the transparency of SOEs' operations can help make those responsible for their oversight, notably state shareholding entities and SOE boards of directors, more accountable to SOEs' ultimate shareholders, the general public.

Because SOEs operate at the nexus of the public and private sectors, improving their operations often requires reforms in multiple policy areas that cannot be tackled all at once. These include public governance reforms that impact institutional arrangements for state ownership and company law reforms that relate to how boards of directors oversee management decisions. The OECD SOE Guidelines provide an aspirational standard across seven policy areas that can guide the region's authorities in implementing the state ownership reforms they consider the most pressing and relevant to their context (OECD, 2015[2]).

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Notes

[1] Albania and Kosovo were excluded from the IMF analysis of SOE performance owing to insufficient data availability. The IMF analysis used firm financial statements from 2014-16 where available and considered all firms with at least 25% state ownership to be SOEs, whereas OECD definitions use majority share ownership (or other means of exercising an equivalent degree of control) as the threshold to consider an enterprise an SOE. The number of SOEs included in the analysis for each economy is as follows: 8 in Bosnia and Herzegovina, 9 in Montenegro, 59 in North Macedonia and 370 in Serbia.

[2] For example, in Albania eight insolvent SOEs were recently merged with other SOEs, reportedly to avoid costly and lengthy insolvency procedures.

[3] Figures for Kosovo exclude the estimated 500+ companies in the portfolio of the Kosovo Privatisation Agency.

[4] In Bosnia and Herzegovina, responsibilities for state ownership policy are exercised separately by the Federation of Bosnia and Herzegovina and Republika Srpska. In the FBiH, state ownership rights are shared between the Federation, the ten cantons and municipalities.

[5] For Bosnia and Herzegovina, SOEs' estimated share of domestic employment is based on IMF (2019[3]). For Montenegro, North Macedonia, Kosovo and Serbia, SOEs' share of domestic employment is based on SOE employment data provided by the public authorities in the context of this assessment and total domestic employment figures reported by economies' statistical offices.

[6] This comparison with OECD economies' SOE sectors is only an approximation owing to differences in methodology. For example, OECD figures on SOE employment relate to their share of total non-agriculture employment, whereas figures for the Western Balkans relate to total employment. Using total non-agricultural employment would inflate SOEs' employment share in the Western Balkan economies.

[7] The OECD's recurrent data collection exercise on national SOE sectors has been undertaken three times since 2011, the latest edition being published in 2017 (OECD, 2017[6]). It is based on self-reporting by authorities and carried out by the OECD Working Party on State Ownership and Privatisation Practices. The dataset includes information on the number of SOEs held by the central level of government, their sectors of operation and their employment contributions.

[8] In Albania, for example, SOE board nominations are jointly decided by the Ministry of Finance and responsible line ministries, which mitigates the degree of decentralised decision making involving SOEs. Kosovo has centralised ownership rights over its main portfolio of 17 SOEs under the Ministry of Economy

and Finance, while many of Montenegro's SOEs are overseen by several state funds that do not exercise regulatory functions.

[9] For example, in Montenegro, according to monitoring by the Securities Commission, only an estimated 50% of state-owned joint-stock companies respect applicable disclosure requirements (OECD, 2018[5]). Similarly, a recent IMF assessment of SOEs in Bosnia and Herzegovina found that a significant proportion of SOEs do not make their financial statements available in a timely manner (IMF, 2019[7]).

[10] For example, recent state audits of Kosovo Telecom found that their financial statements did not present a fair view of their financial situation.

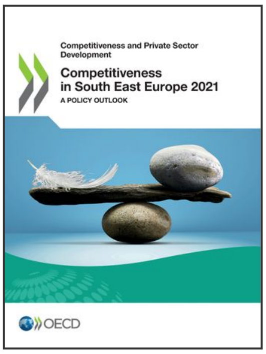
[11] The six shareholder rights examined in the Doing Business index are: 1) shareholder approval requirements for the sale of 51% of company assets; 2) the right of shareholders holding 10% of shares to call a meeting of shareholders; 3) the requirement to obtain shareholder approval for new share issuance; 4) whether existing shareholders have pre-emptive rights to purchase newly issued shares; 5) the right of shareholders to select and dismiss the external auditor; and 6) whether shareholders that hold a separate class of shares must approve any changes to the rights attached to such shares.

[12] Although the World Bank's extent of shareholder rights index explicitly excludes state-owned companies from its assessment, the findings are still considered relevant in the case of SOEs, as usually SOEs are not, at least explicitly, excluded from the provisions of domestic company law or listing rules applicable to corporations owned by non-state investors. For the broader "extent of shareholder governance" index, which comprises scores for "extent of shareholder rights", the World Bank does not assign a score for economies where the stock exchange does not have at least 10 listings that are not state-owned.

[13] An example is the case of Kosovo Telecom, which was involved in a dispute with the private mobile services operator Z-Mobile. Z-Mobile alleged that the state-owned Kosovo Telecom was not respecting its contractual responsibilities to provide access to network infrastructure. The dispute went to international arbitration, which concluded in favour of the private operator. More information on the Kosovo Telecom dispute is available here: https://www.reuters.com/article/kosovo-telecom-court/state-owned-kosovo-telecom-may-face-bankruptcy-after-court-ruling-says-ceo-idUSL5N1EG23Y.

[14] The public authority previously announced its intention to privatise Kosovo Telecom in 2019, but the privatisation has not taken place and the authorities report that the enterprise's performance will need to improve prior to privatisation to increase the company's attractiveness to potential investors.

[15] The Privatisation Agency of Kosovo holds administrative rights in an estimated 500+ formerly "socially-owned enterprises" for which the mandate to eventually privatise remains in place, but the authority does not currently have any announced plans to privatise any the state's "main" portfolio of 18 SOEs. The Macedonian authorities reported that they do not currently have an active privatisation programme in place and that the Macedonian Privatisation Agency was disbanded in 2005, with responsibilities for its remaining portfolio of enterprises divided among other public institutions and ministries.



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