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STRATEGY, INDEPENDENCE, AND GOVERNANCE OF STATE-OWNED ENTERPRISES IN ASIA

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Abstract

New public management emphasizes the organizational and behavioral aspects of state-owned enterprises (SOEs). The main assumption is that, if governments constitute SOEs as "market" enterprises and allow their management to follow the logic of the "market," SOEs will become productive, innovative, and customer-oriented. This paper claims that, although new public management is a necessary condition, it is not sufficient for guiding (or reforming) SOEs. Strategic guidance from the owner (i.e. the state) as well as independence from the government have to complement it. The strategic guidance that the owner gives to an SOE has to address several areas of guidance. Ideally, it parallels the ownership strategies that are typical of more mature family enterprises. On the other hand, once the ownership strategy is in place, SOEs have to maintain their independence from the government, that is, its owners, to avoid co-option from political goals or short-term deviations from the strategy.

Keywords: SOE, governance, strategy, new public management, market imbalance, strategic management, competition

JEL Classification: H00, H11, M10

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1. INTRODUCTION

State-owned enterprises (SOEs)—refer to section 1 below for a definition—are important, especially in an Asian context. According to Fortune Magazine's (2018) 500 list, three out of the world's top-10 largest companies by revenues were Chinese SOEs: State Grid (rank 2), Sinopec (rank 3), and China National Petroleum (rank 4). Depending on the degree of direct and indirect government support, the next five ranks contain at least a group of near-state enterprises—near-state meaning companies in which the state either is a minor shareholder or has an institutionalized stake: Royal Dutch Shell, Toyota Motor, Volkswagen, BP, and Exxon Mobil. This only leaves two of the world's ten largest companies neither belonging to nor being backed by the state, Walmart (rank 1) and Berkshire Hathaway (rank 10).

Adopting an even more restrictive understanding, SOEs—companies of which the state is the majority shareholder—account for around 25% of the Fortune 500 entries by number of companies. Around 15% of them are in the People's Republic of China (PRC), 5% are in other Asian countries, and 5% are in the rest of the world. Following the same criterion, in the list for the year 2005, SOEs constituted only about 6% of the total.

SOEs not only seem to be important as an economic phenomenon; they also seem to be especially relevant to economies in Asia. Some SOEs are not only economically important but also play other, non-economic roles, like attracting, fomenting, and diffusing knowledge and education or securing the political interest of the state. In recent years, successful SOEs have served as symbols of the (re-)emergence of many Asian economies.

On the other hand, there are concerns about SOEs' governance structures. The Organisation for Economic Co-operation and Development (OECD) published its *Guidelines on Corporate Governance of State-Owned Enterprises* as early as 2005, most recently updating them in 2015 (OECD 2015). In a 2016 report, the same organization cautioned governments to strengthen their governance standards in SOEs (OECD 2016a). In 2017, the OECD again reminded governments that SOEs could lead to remarkable distortions and to unfair competition (OECD 2017). In 2018, the OECD compared different practices on the governance of SOEs around the globe. It insisted on the need to strengthen monitoring and reporting mechanisms (OECD 2018a). In another report, it identified the independence of boards as success factors in the performance of SOEs (OECD 2018b), and, in yet another, it highlighted risk management as elemental (OECD 2016b).

However, not only international organizations but also state agencies are paying attention to the governance structure of SOEs. An example of national evaluation—in the "East" and the "West"—is the PRC's State-owned Assets Supervision and Administration Commission (SASAC), which is advancing an agenda on the reform of SOEs to strengthen their governance, focusing especially on the independence of the institutions and their board members as well as on the economic desiderata that the SOEs must fulfill (SASAC 2018). India is considering restructuring and privatization (Khanna 2012; Mishra 2014).

On a regional level, the Asian Development Bank (ADB) has published many reports on SOE reform, the most recent being its thematic evaluation *State-Owned Enterprise Engagement and Reform* (ADB 2018), in which it states that "SOE reform is challenging, but critical" (xxii). This reform, according to the evaluation, should focus on government

oversight and the political independence of SOEs, because they tend to improve the governance and performance of those entities (xxv).

This paper is interested in the governance of SOEs. With insights gained from institutional economics, it answers the following question: How can countries reform SOEs to strengthen their governance? Here, this paper claims that, although the guidelines and lessons learned that the above-mentioned authors have identified are necessary for SOE reform, they are not sufficient. This paper asserts that, in a setting based on new public management (NPM), the ownership strategy and independence are building blocks for the good governance, and for the reform, of SOEs.

As important as this answer is, it comes with a limitation of scope. Why does the state set up a company under its control or of which it is the main shareholder? The answer is either to secure strategic sectors or operations or to produce goods in a productive, innovative, and customer-oriented way. While the first part of the last sentence follows a political paradigm, the second follows an institutional paradigm, in this case NPM. In answering the question about how to govern SOEs, this paper limits its scope to the latter, deliberately leaving questions about politics and political economy aside. In reality, however, the two paradigms come together. The last section of the main body of this text briefly addresses this limitation of scope. Other papers deal in more detail with the interaction of politics and institutions regarding SOEs.

The remainder of this text proceeds as follows. After defining state-owned enterprises and new public management, the paper develops a framework for ownership strategy and independence. An examination of how the three factors—new public management, strategy, and independence—enhance the governance of SOEs leads to its conclusion (reviewing its limitations) and to policy recommendations.

2. SETTING THE STAGE: SOES AND NPM

This section defines SOEs and NPM, thus setting the stage for analyzing them as economic institutions. Economic institutions are well-established arrangements that are part of the culture or society in which economic interaction takes place. Institutions are the "rules of the game" when describing economic interactions, that is, social exchanges and the relevant "games." Institutions that become formal administrations are called organizations. In this sense, the state and SOEs are institutions-cum-organizations, while NPM, as a theory with normative implications, is an institution.

2.1 State-Owned Enterprises

Government corporations, government business enterprises, government-linked companies, parastatals, public enterprises, public sector units, and enterprises are some of the names for state-owned enterprises (SOEs). The name and the definition of SOEs vary depending on factors such as: the level of government that owns the enterprise (central/federal, state/regional, or local); the way in which the enterprise was founded; the position in the public administration hierarchy; the purpose of the SOE; the status of the SOE (held by the state, held by a state-led or sponsored cooperative, or in the process of privatization); full, majority, or minority ownership of the government; listing (or not) on a stock exchange; government shareholdings through vehicles such as government pension funds, asset management funds, restructuring corporations, and development lenders; or state-enabled (for example enterprises that the state has granted exclusive rights). ADB's report summarized "there is no common definition of SOE" (ADB 2018, xii).

This paper defines SOEs as enterprises of which the state has significant control through full, majority, or significant minority ownership. This control can be direct or indirect, and the company can operate at the central, federal, regional, or local level. This text also uses the terms "state" and "government" synonymously to describe all levels and manners of the formal organization of the political body. State refers, thus, to all branches of government, agencies, bodies, or official functions.

These varying names and forms of SOEs do not only occur at the conceptual level. On the practical level, this differentiation provides governments with flexibility. They can set up SOEs according to their needs and the specifications of the markets in which they operate or adapt them to other constraints. On the other hand, these multiple forms may complicate the ownership policy, making SOEs less transparent and eventually insulating them from the legal framework applicable to other companies, including competition laws, bankruptcy provisions, or securities laws. These unintended negative consequences have led to different calls for reforming SOEs, as the introduction described. Before delving into the reform as such, it is advantageous to survey briefly the economic mechanism that makes SOEs attractive for governments and at the same time problematic.

There are several rationales for setting up and running an SOE, constituting two groups. The rationales that belong to the first group are: providing public goods (e.g., national defense and public parks) and merit goods (e.g., public health and education), both of which benefit all the individuals within a society and for which collective payment through tax may be preferable to users paying individually; increasing access to public services, whereby the state could enforce SOEs to sell certain goods and services at reduced prices to targeted groups as a means of making certain services more affordable for the public good through cross-subsidization; launching new and emerging industries by channeling capital into SOEs that are, or can become, large enough to achieve economies of scale in sectors in which the start-up costs are otherwise significant; or generating public funds. The rationales in the second group are: improving labor relations, particularly in "strategic" sectors; limiting private and foreign control in the domestic economy; encouraging economic development and industrialization; sustaining sectors of special interest for the economy, particularly to preserve employment; or controlling the decline of sunset industries, with the state receiving ownership stakes as part of the enterprise restructuring.

The rationales belonging to the first group are typical outcomes of NPM. The ones belonging to the second group are political. Since this paper focuses on the first group, a greater understanding of NPM becomes necessary.

2.2 New Public Management

Most OECD countries have introduced new public management (NPM) policies since the 1980s. Policy makers and scholars have argued that NPM techniques will increase the efficiency in the state sector by introducing criteria from private sector management into traditional methods of public administration (Christensen and Lægreid 2016). NPM is an approach in public administration that employs the knowledge and experiences acquired in business management and other disciplines to improve the efficiency, effectiveness, and general performance of public services in the administration of the state and its bureaucratic apparatus.

NPM encompasses a variety of concepts. These range from the general idea of "modernization of the public sector" to the narrower meaning of rationalization of the public administration. Although universal on a principle level, it is necessary to operationalize the different tenets of NPM. Its instantiation, therefore, ranges from

complete openness to market forces and privatization, as is the case in Taipei,China, to the radical replanning of the public sector, as in New Zealand, the Republic of Korea, or Viet Nam. It can also indicate a spectrum from cases of rapid advance toward managerial running to cases of coexistence with residual links with more traditional forms of bureaucratic government in accordance with predefined rules, as for example in Japan, the PRC, or Malaysia (OECD 2018a).

This differentiation notwithstanding, it is possible to synthesize the basic features of NPM into three fundamental elements (Christensen and Lægreid 2016):

1. Redefinition of the boundaries between state and market through privatization and externalization.
2. Reformulation of the macro-structure of the public sector by delegating state functions (at the lower organizational level) within it.
3. Redefinition of the operational rules characterizing the way in which the public sector carries out its functions and achieves its goals. This point consists of seven sub-components:
    a. Toning down of the ties conditioning the public sector as compared with the private sector – this phenomenon includes the transformation of state economic bodies into limited companies;
    b. Restructuring of activities/businesses in the public administration so that they operate “on a commercial basis,” that is, in a state of equilibrium between costs and revenue (corporatization);
    c. Creation of a market with competition or simulated competition for public and merit goods;
    d. Devolution of functions and competences from the center toward the outermost units or the lowest organizational levels within every entity in the public sector;
    e. Redefinition of the administrative machinery replacing the bureaucratic model with the managerial one, shifting from formally structured and law-oriented organization to management and efficient breakdown of public resources according to the new economic role of the state’s functions;
    f. Deregulation of the functioning of economic and social systems; and
    g. Redefinition of citizens’ roles and rights.

NPM is not without controversy. Indeed, the body of criticism is growing. For example, Hood and Dixon (2015) claimed that NPM brings little more than higher costs and more complaints. In a cautious evaluation, Dan and Pollitt (2015) asserted that NPM can work under clear conditions. In their words: “An adequate degree of administrative capacity, sustained reform over time and a ‘fitting context’ are the main factors that can tip the scale for the success of these management instruments.” Pollitt and Bouckaert (2017) examined the institutional arrangements under which NPM can work. Hyndman and Lapsley (2016) claimed that NPM’s “story continues,” especially in the management of state-owned enterprises.

2.3 Applying NPM to SOEs

Independent from its conceptual and empirical merits or shortcomings, NPM as an institution, or as a set of normative principles, relates to SOEs and their management. Institutional economics analyzes the role of normative principles in shaping economic behavior. As public choice, it also explains how institutions themselves behave as rational agents maximizing their own goals. The connection of agents in institutions and institutions as agents is a vast area of work, which Buchanan (2003) especially described. Regarding SOEs, Buchanan (1968) had already suggested how they might act if confronted with a dual mandate, that of providing public or merit goods and that of being entrepreneurial and making profits.

NPM is a normative basis for the rules of the game; the state, however, decides which game to play. In other words, while NPM is an approach to *how* the state produces and distributes goods or organizes its processes as if they were productive and distributive processes, NPM cannot stipulate *which* goods, in what amount, or who receives them nor which processes and structure the state should have. The answer to the "which" question is a result of political deliberation. NPM addresses the "how" aspect. This seems straightforward, but it has an important consequence from the point of view of institutional, public choice economics.

The state sets political goals – which goods to provide – and NPM leads to an additional goal – efficiency in the achievement of these goals. Note that efficiency is not a constraint under which the enterprises provide these goods; it is a goal in itself. NPM wants state agents to maximize their efficiency, instituting a continuous process for increasing it and measuring the output of processes in terms of input. NPM measures and manages the efficiency of the state structure and of the individuals working in that organization. In most cases, increasing the efficiency of the individuals working in the structure increases the efficiency of the organization. A system following NPM also rewards the individuals' enhanced performance.

NPM, therefore, operates on and influences two levels, the level of the organization and the level of the individuals working in the organization. Policies and instruments should thus address both of these levels to be effective.

How do NPM and SOEs interact conceptually? In markets and the theory of the firm, make-or-buy decisions are a standard way of increasing efficiency. Make-or-buy decisions concern whether to produce a good in house or to buy it from external sources. Typically, make-or-buy decisions weigh the costs of in-house production against the costs of external source commission and integration of the product. In applying NPM, governments take make-or-buy decisions regarding the provision of public and merit goods. Either they provide the goods themselves or they externalize the provision to state-owned but run-as-private enterprises. They suppose that the provision of the predetermined good via the organization of a run-as-private enterprise will bring down the political and coordination costs of production as well as opening new perspectives on the provision of the good. The set-up of an independent company with the sole task of providing the predetermined good thus promises to increase efficiency while delivering on the goal that the state has set, the provision of goods. NPM, paralleling the make-or-buy decision and creating the SOE, fulfills both goals, the one related to the political desiderata and the one related to efficiency.

The set-up of SOEs is not only a tool for combining these two goals. The very form of the SOE as such produces a further desideratum. SOEs, as companies, should be financially self-sustaining and produce profits. Even if they are not (yet), their set-up, per se, presupposes that they are or should become financially self-sustaining. This triangle of different goals poses a problem. If the state is to provide public or merit goods via SOEs, and if SOEs are to make a profit, then the SOEs would price their profits into those goods. This, in turn, would mean that the goods in question are not public or merit but in reality marketable and, consequently, non-state agents could provide them at an even lower price. The incidence of gain would at least stipulate the lowering of the pricing practices of the SOEs, which in turn would contradict the goal of operating at a profit.

This is more than conceptual tension; it is a challenge for the management of SOEs. Often, the response is two-pronged. In their core activities, SOEs provide the goods that the state stipulates at the cost level. In addition to providing the assigned public or merit goods, SOEs seek new business opportunities, for example entering new markets, offering non-public/merit goods, or expanding their field of activities. In their core activities, SOEs maximize efficiency, and, in the additional opportunities, they maximize profits. To ease the conceptual and managerial tension of their goals, SOEs become hybrid organizations. They are at the same time a state agent and a market agent (Bruton et al. 2015).

While this approach eases the tensions of SOEs under NPM, from the point of view of institutional or public choice economics, it creates problematic incentives. These perverse incentives have recently become an object of research (for example Cuervo-Cazurra, Inkpen, and Musacchio 2014; Bruton et al. 2015; Liang, Ren, and Sun 2015; Schneider 2016; Daiser, Ysa, and Schmitt 2017; Guo, Huy, and Xiao 2017; Li, Xia, and Zajac 2018). It is possible to cluster them into two groups.

The first cluster consists of perverse incentives affecting the SOE as an organization:

- Whether they are too big to fail or not, SOEs enjoy a state guarantee; in some cases, it is an explicit and in others an implicit guarantee. Regardless, it is extremely unlikely that the state as the owner of the SOE would allow its liquidation. This state guarantee is comparable to insurance; the owner, however, externalizes its premium. This leads SOEs to expand their activities in riskier markets or to invest in less secure investments, relying on the guarantee in the case of failure. At least, most SOEs do not fully internalize the value of the state guarantee in their internal accounting.
- As entities enjoying a state guarantee, with a sovereign equity holder and often with exclusivity if not a monopoly over their core activities, SOEs also aim to become financially self-sustainable. This makes them more appealing to non-state investors. Because of this implied stability, SOEs can raise money from debt at below-average market rates. This gives them an advantage over their private competition, which ironically leads to market competition challenging SOEs less, incentivizing them to be less efficient.
- SOEs often cross-subsidize their activities. Under NPM, SOEs have the incentive to cross-subsidize from their core activities—from which they cannot make profits but can enjoy exclusivity and monopoly and therefore have little incentive to be efficient—to their pursuit of additional business opportunities. If they have no means for cross-subsidizing or if the law forbids them to do so, this still occurs, albeit indirectly, for example through adjusting their overhead costs or cost of capital. This, again, leads to the distortion of the competitive markets in which not only SOEs but also private companies operate.

An example of these incentives materializing in Asian economies is the situation in which Chinese SOEs have easier access to capital and the capital that they access is cheaper. This is the result not only of pushing banks to lend money to other SOEs but also of the fact that, in the banks' risk management systems, they usually rank SOEs as less risky than other investments and therefore lend means at a lower price. In Japan, the postal system uses its monopoly to cross-subsidize its banking branch (ADB 2018).

The second cluster consists of those perverse incentives affecting the people who work in an SOE—this is the cluster that arises from NPM influencing not only the organizational level but also the personal level:

- People working in SOEs have an incentive to show entrepreneurialism—or at least management performance—since the SOEs employ them not only to provide goods but also to run a company according to management benchmarks. Showing entrepreneurialism in an organization that makes it possible to underestimate costs or to externalize risks rationally entails acting on the incentives shown above. This means that there are not only incentives for the organization but also an incentive within the organization for management agents to act on those incentives. This, in turn, accelerates the imbalances discussed above.
- SOEs are near-state entities. The state is not only the owner but also the lawmaker and regulator. People change their roles easily, since many former state employees work in SOEs and vice versa. Agents within SOEs and agents within the state have incentives to use the double role of the owner to maintain a legal and regulatory environment that is favorable for SOEs. Furthermore, they are motivated, if an SOE becomes troubled, to change the legal or regulatory framework to maintain the troubled asset. This, again, accelerates the market imbalances, especially in relation to private entrepreneurs, but also expunges the agents' personal responsibility for their decisions, which again, negatively affects efficiency.
- People working in SOEs have incentives to act as entrepreneurs, but they are equally motivated to act as state agents. This could lead to the arbitrage of responsibility: when business progresses well, these agents understand themselves as entrepreneurs; when business proceeds badly, they see themselves as state agents. Rewarding managers for their entrepreneurialism but not holding them responsible for mistakes again provides disincentives for efficiency.

Two examples make these incentives plausible. In Viet Nam, there is often a "revolving door" between institutions of the state and SOEs; this means that individuals often change their place of employment between these two. In India and the Republic of Korea, the state administration has often changed the regulatory rules to accommodate the needs of SOEs (ADB 2018).

In sum, applying NPM to SOEs is not as straightforward as it seems. Compiled from the perspective of institutional, public choice economics, this brief list shows that applying NPM to SOEs sets perverse incentives for the organization and the individuals working for it. The many calls for reforming SOEs in the "East" and the "West" confirm this finding. The literature that the introductory section to this paper referred to indicates not only that supranational and regional organizations are concerned about the many wrong incentives on which SOEs act contemporarily but also that even national agencies and those holding SOEs are committed to a reform.

This reform, however, needs neither the entire abandonment of the SOE model nor the replacement of NPM. Indeed, NPM itself can advance resources for the reform. It is the goal of the next section to explain how strengthening the institutional basis that NPM sets out can make SOE reform possible.

3. DEVELOPING A FRAMEWORK: STRATEGY AND INDEPENDENCE

The above-mentioned perverse incentives and imbalances occur because the "rules of the game" for SOE allow them. While committing to NPM, an ownership strategy and independence can complement these institutions on which the government runs SOEs.

3.1 Strategy

Strategic management involves the formulation and implementation of the major goals and initiatives that an organization's top management adopts on behalf of owners, based on consideration of the resources and an assessment of the internal and external environments in which the organization operates (Nag, Hambrick, and Chen 2007; Hill, Jones, and Schilling 2014). Porter (2006) identified three principles underlying strategy: creating a "unique and valuable market position"; making trade-offs by choosing "what not to do"; and creating "fit" by aligning company activities with one another to support the chosen strategy. Management theory and practice often make a distinction between strategic management and operational management, with operational management concerned primarily with improving efficiency and controlling costs within the boundaries that the organization's strategy sets.

Most studies consider strategic management from the perspective of the enterprise—most SOEs do have a strategy—it can also be an instrument for its owner (or owners), in which case they call it the ownership strategy. In this strategy, the owner answers two questions: what does the owner want to achieve with the enterprise and what does the owner want the enterprise to achieve. Formulating an ownership strategy is the task of the owner; for the enterprise that it addresses, the ownership strategy is an institution, part of the "rule of the game," or a normative basis.

This instrument is applicable to SOEs. When the state develops an ownership strategy for each SOE that it owns, it can mitigate the problems mentioned above while strengthening governance and even positively influencing performance. In the past, many state owners either did not devise a comprehensive ownership strategy for their SOEs or limited the strategy to setting strategic goals, for example profit expectations, annual growth, or annual efficiency increases. Formulating strategic goals does not suffice as an ownership strategy; indeed, they even intensify the perverse incentives discussed earlier.

The ownership strategy is much more far reaching, and, as Porter (2006) stated, it is a balance between what to achieve and what not to achieve, stating clear outcomes for both. For any specific SOE, the ownership strategy should consist of the following elements (based on Schedler 2008; Schedler and Finger 2008; Sonderegger 2014, 2015; World Bank 2014):

- A legal and regulatory basis, including a statement about how enterprises can adapt this basis, which drivers lead to their adaptation, and which body is responsible for adapting them; it is necessary specifically to exclude the concerned SOE itself from all activities relating to the adaptation of the legal and regulatory base for its running, except for providing information though planned and organized channels in a planned and organized rhythm.
- Grounded on the legal and regulatory basis, a clear statement about which public or merit good(s) the government tasks the concerned SOE with providing.
- An analysis of the market environment, especially addressing the question of whether non-state, non-SEO agents can provide the same good; the analysis of the market environment contains a scenario analysis about the development of markets and goods.
- The positioning of the SOE regarding the provision of the good that the government has tasked it with providing as well as the market analysis; here, a clear statement about how the owner adapts its ownership strategy according to the development of the market scenarios, especially if the good becomes marketable, is necessary—for example, the owner could state that, in the case of a good becoming a marketable good, it will privatize the SOE that provides it.
- The goals that the state owner wants to achieve with the SOE as well those that the SOE has to achieve for the state owner; these goals should be at least clear and ideally measurable.
- The areas of activity of the SOE, consisting of guidance in at least two areas, one on the core activities of the SOE and another on those business opportunities that the SOE can pursue additionally; this guidance is a closed list—SOEs should not operate outside the activities stated here.
- The boundaries of activities of the SOE concerned; this section enumerates the activities in which the SOE concerned cannot engage as well as the reasons for the boundaries—this is a deliberate repletion (in negative) of the point made previously: the concerned SOE can only engage in positively listed activities.
- The weighted average cost of capital (WACC) that the SOE has to use in its internal and managerial accounting; in this step, the objective of treating the cost of capital as exogenous is to diminish the incentive for externalizing risk—by setting the WACC, the owner is forcing the SOE to internalize the state guarantee as well as its more secured capital structure. Even if the SOE finds financial means at a lower cost than the WACC, the obligation is still to calculate with the WACC that the ownership strategy sets.
- Human resource-related matters, especially the obligations of managers and employees as well as their personal responsibility, including automatic career penalties for creating or accepting conflicts with the ownership strategy or for engaging with the state outside the channels and rhythms that this strategy establishes.
- Risk management, especially communicating the state owner's tolerance of risk; this section also includes the SOE's obligation to set up a risk management system disclosing and communicating information related to risks and the measures that it takes to mitigate them.
- Matters related to the acquisition of and cooperation with other SOEs and private enterprises; here, again, the concept is of a closed positive list of situations in

which acquisition and cooperation are possible—situations that this list does not foresee do not constitute opportunities for acquisition or cooperation.

- The establishment of two circles of reporting and controlling, one within the SEO—between its strategic and its operative management—and one between the SOE's strategic management and the owner.
- Provisions for conflict resolution, especially for conflicts arising between the ownership strategy and the SOE's strategy.
- Channels and rhythm for the SOE to provide information and engage in dialogue with the owner.
- Channels and rhythm for the review of the ownership strategy.

3.2 Independence

While the ownership strategy ties an SOE to its owner, independence aims to strengthen its organizational structure as non-state. The goal is to reduce or eliminate the political influence on the SOE and the influence of the SOE on politics and policies. Vernon (1984) was among the first to research the meaning of independence in the setting of SOEs. Under the title "Linking Managers with Ministers," he showed that dependence is a two-way street. On the one hand, there is dependence of managers from the state, but, on the other hand, state agents seek SOEs as dependent organizations.

Further research has narrowed this scope. Much of the subsequent work focused on the members of the SOEs' executive and non-executive boards. The OECD (2018a, 30–31), after a global comparison, put forward four key takeaways with policy implications. These takeaways are broadly the same as those that the World Bank (2014) identified in its toolkit for SOE corporate governance. They are:

- Defining the responsibilities of boards of directors through centralization and professionalization of the ownership function: An unclear distinction between the respective roles of the board and the ownership function can hinder the board from achieving the key functions of establishing a corporate strategy and overseeing the management. Good practice calls for a clear definition and founding in legislation of the role of the board, in line with general company law. Insofar as all SOEs have boards of directors, it is necessary to assign SOE boards a clear mandate and ultimate responsibility for the company's performance.
- Professionalizing board nomination frameworks: The nomination process should be rule-based and a state function should supervise it on a whole-of-government basis. This could involve seeking expertise from external recruitment consultants, establishing databases of pools of directors, and involving the incumbent board. When SOEs have minority non-state investors, formal legal arrangements should also ensure their adequate board representation through legal provisions or corporate bylaws that safeguard minority representation and the state's active engagement with shareholder agreements.
- Improving disclosure related to board nomination and election processes: Formal eligibility rules should ensure the recruitment of suitable and competent board members. These could include processes to advise or vet ministerial candidates

for board appointment or actual or de facto nomination committees proposing candidates for the ultimate decision of ministers.

- Strengthening the role of SOEs in improving board efficiency and performance, setting goals, and measuring and reporting outputs.

While all these points are valid, from a perspective rooted in institutional, public choice economics, it is advisable to return to Vernon's (1984) original research idea, looking at the two-way relationship of dependence. In addition, two different levels interact here. The first is the organizational independence of SOEs and the state. The second level concerns the people working for SOEs. As discussed in the previous section, NPM affects the economic behavior of organizations and of the individuals therein. While the ownership strategy includes provisions for the independence of the organization, these (and other) guidelines address the independence of the people working for an SOE. These guidelines and the literature that the introduction to this paper quoted, however, focus on the board of the company. While the board is important, so are other people who work for the SOE. Additionally, state employees can be pivotal for maintaining independence.

Here, because of this broader view of the interrelation of SOEs and the state, the addressees of independence are, as the discussion of NPM asserts, the organizational as well as the individual level. On the organizational level, the following policies can help in maintaining not only the independence of the SOE from the state but also the independence of the state from the SOE:

- With the exception of those channels and rhythms that the ownership strategy defines, the SOE should not maintain any contact—formal or informal—with the state and vice versa.
- If contact occurs, it is necessary to document and report it in the two circles of controlling mentioned in the ownership strategy.
- When in contact, for example through the channels and rhythms that the ownership strategy stipulates, the SOE and the state must follow a pre-established agenda; furthermore, an independent agent should audit the conformity of the contact with the legal and regulatory base as well as with the ownership strategy.
- The SOE must abstain from public affairs and lobbying activities in general.
- The SOE must abstain from marketing activities, at least in their core areas of operation.

At the level of the individuals working for or in an SOE as well as for or in the state, the following policies should apply:

- A change in employment from the state to an SOE and vice versa at any level can only occur after a cooling down period of at least two years.
- Current or former government officials, including elected officials, cannot work for an SOE or be elected or appointed to an organ of an SOE.
- Current or former members of organs of an SOE, especially executive and non-executive directors, cannot stand for election or be appointed to any function within the state.
- Members of organs of an SOE, and the management in general, should be personally accountable for their decisions.

- The government should also implement other policies maintaining or increasing professionalism, integrity, and efficiency in the SOE, as the World Bank and the OECD proposed. It should broaden their scope from non-executive boards to all levels of executives and managers.

3.3 NPM + Strategy + Independence = A Framework for Governance

On an institutional level, NPM enables the pursuit of three goals: the provision of public or merit goods, the increase of efficiency in providing these goods, and the provision of these goods through an enterprise operating with profits. NPM, however, does not suffice. These three goals can lead to conceptual and managerial contradictions, setting perverse incentives for SOEs and the people working in them, leading to moral hazards, competitive failures, and other imbalances.

This study claims that, while NPM can—or should—serve as an institutional basis, two other instruments should complement this basis to assure the balancing of these three goals. These instruments are an ownership strategy and independence on an organizational as well as a personal level. Different agents have already suggested these instruments. This paper, however, operationalizes them by broadening their scope: the elements of the ownership strategy flanked by the elements of independence applied to NPM create a framework that minimizes perverse incentives and maximizes the incentives for SOEs to pursue the three goals while balancing them.

4. LIMITATIONS AND CHALLENGES

Having developed the framework, it is useful to review the limitations of this model as well as the challenges that it might face in its implementation. While the framework for governance that section 2 developed addresses and broadens all the desiderata that the relevant literature has mentioned, the scope of this paper still constrains it. As the introduction and section 1 remarked, this paper concerned the institutional aspect of SOE reform. Next to this there is also a political aspect, which this paper did not address. It is important, however, to stress that only if the political aspect wishes and works for reform can the institutional aspect yield positive effects. Simply said, the framework presented above only works if politics backs and implements it.

It is worthwhile noting that the main impediments to SOE reform that research has tackled to date arise not from the institutional set-up but from the political aspect. For example, Leutert (2016), studying the PRC, identified four impediments to SOE reform there. One was related to NPM, consolidating hybrid organizations, and three were related to political will, aligning mismatched management, untangling managerial and party roles, and overcoming political promises. Setting up the framework mentioned in this paper helps in reforming SOEs but not without the political will to match, untangle, and overcome politics itself.

Similar concerns apply to India, where network roles—party, family, religion, and brotherhoods—are more important (Bruton et al. 2015). In the Republic of Korea, the Lao People's Democratic Republic, and Viet Nam, SOEs have the additional task: helping to overcome past and present conflicts. While conflict-solving is an important aspect, it adds to the difficulties of governing SOEs. Conflict-solving is an explicitly political and not an entrepreneurial task. Assigning this task to SOEs leads to their further involvement with and in politics (Turner, O'Donnell, and Kwon 2017).

While there is plenty of literature on reforming SOEs in Asia, there is considerably less output on Africa and South America and almost none regarding North America and Europe (with the notable exception of Vernon and Aharoni (2014), which is, however, an update of an older study that they published in 1981. This might be an indication either that SOEs are more important in an Asian context or that they are in particular need of reform there. On the other hand, it might also point out a blind spot in the research about SOE reform. While the framework developed here addresses the need for SOE reform in Asia and therefore relies on Asia-specific research, its formulation makes it applicable to other regions as well.

While there is almost no argument against SOE reform, there is a wide variety of possible reforms. Defining which reform path to pursue might be as difficult on the conceptual level as implementing the reform on the practical one. However, the main limitation of the framework presented here is the question left open: what if the government itself does not want a reform of SOEs?

5. CONCLUSION AND POLICY RECOMMENDATION

The following 10 theses about SOEs, their governance, and their reform conclude this paper (based on Schedler and Finger 2008):

1. Governments create SOEs to provide public and merit goods in organizational autonomy.
2. The function of corporate governance in SOEs is to increase their effectiveness and efficiency, thus creating value, while maintaining their adherence to the law and regulations.
3. Increased effectiveness, greater efficiency, innovation, and customer orientation are the factors that give SOEs legitimacy, especially in comparison with administrative units of the state. These legitimize their set-up as enterprises.
4. The obligation to provide public or merit goods is a factor that gives SOEs legitimacy. This legitimizes their set-up as state-owned entities.
5. The state is in a conflict of interest: its interest as owner and its interest as provisioner of public and merit goods are never in full harmony.
6. NPM might exacerbate this conflict of interest by making SOEs balance three goals: the provision of the public or merit good, increased efficiency, and operating with a profit.
7. The state can minimize this conflict of interests by devising an ownership strategy for each SOE. The ownership strategy becomes part of the normative cadre for the SOE.
8. Controlling and reporting are necessary to maintain and operationalize the ownership strategy.
9. The state can minimize this conflict of interest by developing a policy on independence with two elements, the organizational independence of the SOE and the personal independence of the people working in an SOE.
10. Independence also calls for the state to be independent from SOEs at the organizational as well as at the personal level.

The policy recommendation that this paper makes is the following: while NPM serves as an institutional basis, two other instruments should complement this basis to assure good

governance and the eradication of perverse incentives. These instruments are an ownership strategy that the state—as the owner—gives to SOEs and independence on an organizational as well as on a personal level—which the state should set as policies.

The ownership strategy of an SOE should contain the following elements:

- A legal and regulatory basis including a statement about how enterprises can adapt this basis, which drivers lead to adaptation, and which body is responsible for adapting it.
- Basing on the legal and regulatory basis, a clear statement about which public or merit good(s) the government tasks the concerned SOE with providing.
- An analysis of the market environment, especially addressing the question of whether non-state, non-SEO agents can provide the same good.
- The positioning of the SOE regarding the provisions of the good that it must provide as well as the market analysis.
- The goals that the state owner wants to achieve with the SOE as well those that the SOE has to achieve for the state owner.
- The areas of activities of the SOE—the SOE should not operate outside the activities stated here.
- The boundaries of the SOE's activities.
- The weighted average cost of capital (WACC) for the SOE concerned.
- Human resource-related matters.
- Risk management, especially communicating the state owner's tolerance of risk.
- Matters related to acquisitions of and cooperation with other SOEs and private enterprises.
- The establishment of two circles of reporting and controlling, one within the SEO—between its strategic and its operative management—and one between the SOE's strategic management and the owner.
- Provisions for conflict resolution, especially for conflicts arising between the ownership strategy and the SOE's strategy.
- Channels and rhythm for the SOE to provide information and engage in dialogue with the owner.
- Channels and rhythm for the review of the ownership strategy.

Independence, the second addition to NPM, consists of the following elements on the organizational level:

- The SOE and the state should not maintain any contact—formal or informal—except for the channels that the ownership strategy stipulates.
- If contact occurs, it is necessary to document and report it in the two circles of controlling mentioned in the ownership strategy.
- When in contact, there is a pre-established agenda and auditing.
- SOEs must abstain from involvement in public affairs.

- SOEs must abstain from engaging in marketing activities.

At the individual level, independence consists of the following:

- A change in employment from the state to an SOE and vice versa at any level can only occur after a cooling down period of at least two years.
- Current or former government officials, including elected officials, cannot work for an SOE or be elected or appointed to an organ of an SOE.
- Current or former members of organs of an SOE, especially executive and non-executive directors, cannot stand for election or be appointed to any function within the state.
- Members of organs of an SOE, and the management in general, should be personally accountable for their decisions.
- Guidelines on professionalism, integrity, and efficiency in SOEs should be applicable to all levels of executives and managers.

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