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# Privatization Alternatives From the Baltics: Part 1

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The persistence of state ownership among major Russian blue chip companies, ranging from energy to finance to infrastructure, is among the globally more prominent ones. Following the breakup of the Soviet Union, the Russian state sought to manage its large state holdings inherited from the socialist ownership structures through several cycles of privatization and nationalization — the success of these efforts often contested. However, another former Soviet republic in Russia's immediate neighbourhood might offer a viable alternative to Kremlin's current thinking on state owned enterprise (SOE) management.

More than two years ago the Economist wrote about the"brave attempt" of the Lithuanian government to reform SOEs. Pointing out the determination of the reform initiators, The Economist shared some doubt whether they will succeed in turning "the greediest and most unproductive sacred cows of the ex-communist world" into transparent, productive and competitive business entities. Concerns were raised that such reform would lack political support and may be cancelled as the ruling coalition would face pressure from the opposition parties.

Reform which aimed to transform management of SOE's and to extract value without privatizing them look ambitious and, as the Economist noted, largely unrealistic. It went against usual recommendation that is given to countries in crisis, namely "privatize everything".

Luckily, reforms were not suspended but rather took an alternative direction. Although the initial ambition to set up a holding company and centralize the ownership functions of all SOEs was rejected, the Lithuanian government chose a step-by-step approach to implement its programme and has fairly succeeded in making the desired changes in the SOE sector.

First, high transparency standards were set for all SOEs. The government adopted transparency guidelines that obliged SOEs to follow the same disclosure requirements as publicly listed companies. Since then, SOEs publish financial reports publicly every quarter, while the Ministry of Economy compiles and publishes four interim and one annual review of aggregate SOE portfolio throughout the year. All financial data of SOEs is also available online so the companies have been put under higher public scrutiny than ever before. Media attention was also drawn to the SOE reports so that the companies could feel the growing interest in and the accountability for their results. The government kept its commitment to publish annual reports in English, providing more insight for international investors.

Within two years' time the government also developed the Ownership Guidelines that, following the best practices in OECD countries, lay down the key principles of representation of the state as a shareholder or owner of the companies, formation of SOE boards and clear shareholder objectives for companies. The Ownership Guidelines, adopted in June 2012, stipulate that the state distinguishes between the two main groups of SOEs — those companies whose primary objective is to increase the value of business and thus they have to generate returns as required by the market, and those entities which operate primarily to serve for the social and political objectives but also have to seek profitability (i.e. efficiency). Such distinction helps both the government and SOEs to realize what is expected of them and to develop their strategic plans and make decisions accordingly.

Moreover, under the Ownership Guidelines the government established the function of Governance Coordination Centre (GCC). GCC supervises the implementation of Ownership Guidelines, analyses financial and non-financial ratios of SOEs, performs quality reviews of SOEs strategic plans and monitors the implementation of corporate governance policies in SOEs. GCC reports directly to the government and other institutions that represent state ownership rights in SOEs. Although GCC maintains only a consultative role, it serves as an important tool for the government to keep the track of SOE performance.

The commitment to the reform programme and the adoption of the two aforementioned legal acts had more impact than expected in such short period of time. First, the compilation and analysis of financial results carried out by the Ministry of Economy raised awareness about the actual capabilities of SOEs to contribute dividends to the budget. SOEs assigned 150 EUR million in dividends and profit contributions to be paid to the budget this year, 3 times more than initially planned and 12 times more than 2 years ago.

The importance of turning around SOEs into profitable, dividend-paying entities is an important step in establishing alternatives to privatization in times of economic downturn. While most Russian SOEs have dividend paying track records, largely due to being charged with management of Russia's vast natural endowment, governance remains an issue to be addressed in most companies. When the Russian government sold almost 20 percent of Rosneft to British oil company BP late last year, thus granting BP two board seats, the move was indicative of rising concerns over financial needs as well as a necessity to improve governance in the Russian state oil champion. However, much remains to be done if the Russian state decides to hold on to its major enterprise holdings.

*This article is the first in a two-part series on state-owned enterprise management written with Rimantas Žylius, Lithuanian Minister of Economy (2011-2012) who previously served as Vice Minister and Advisor to the Prime Minister of Lithuania. He currently works as a public policy and management consultant.*

*The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.*

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