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Author(s):	Kankaanpää, Jari; Oulasvirta, Lasse; Wacker, Jani
Title:	Steering and Monitoring Model of State-Owned Enterprises
Year:	2014
Journal Title:	International Journal of Public Administration
Vol and number:	37 : 7
Pages:	409-423
ISSN:	0190-0692
Discipline:	Business and management; Political science
School /Other Unit:	School of Management
Item Type:	Journal Article
Language:	en
DOI:	http://dx.doi.org/10.1080/01900692.2013.858355
URN:	URN:NBN:fi:uta-201405281513

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Steering and Monitoring Model of State-Owned Enterprises

Introduction

Privatisation of state-owned enterprises (SOEs) gained considerable momentum in developing and developed countries in the 1980s and 1990s (The World Bank, 2006, p. 3). Despite wide-ranging privatisation programmes, SOEs are still and will be an important part of many economies, especially in developing economies (La Porta, Lopez-de-Silanes, & Shleifer, 1999; Ezzamel, Wilmott, & Worthington, 2008; Vagliasindi, 2008; Ennsner-Jedenastik, 2013). According to the United Nations, SOEs in high-income countries constitute an 8% share of GDP and a 13% share of investments (Ernst & Young, 2010). In the least developed countries, the shares are even higher: 14% and 28%, respectively. In China, for example, the central government controls 17,000 SOEs, and local governments control over 150,000 SOEs. Furthermore, Indian Railways employs 1.6 million people and is one of the world's largest commercial employers.

State-ownership has been criticised due to undue political interference by governments or to passive state ownership (The Organisation for Economic Co-operation and Development (OECD) 2005, 28). In many places, state-ownership has led to inefficiency and wasted resources compared to private ownership in competitive environments (Ramamurti, 1991; Vagliasindi, 2008). It is often stated that state-owned enterprises operate behind a curtain, revealing little information beyond their general mandate. SOEs' objectives are unclear or conflicting, and the lack of transparency can also be traced to political motivations to avoid public comparisons with the private sector (Ramamurti, 1991; OECD, 2005). In some cases, governments may attempt to reduce their budgets and reported deficits by pushing spending and debts to their SOEs (Papenfuss & Schaefer, 2009, p. 717-718; Blondy et al., 2013, p. 270).

On the other hand, through public ownership, the state can sustain sectors of long-term strategic or national security interests that are presently uneconomical for private investments. Natural monopolies are perhaps appropriate to keep in public ownership (OECD, 2005; Vihn Le & Buck, 2011). Moreover, governments often find that SOEs are a useful strategy to pursue social goals, such as

greater equality and social stability (Ramamurti, 1987; Bozec & Breton, 2003; Austvik, 2012). However, state ownership may also be motivated by purely financial objectives (Goldeng, Grünfeld, & Benito, 2008; Krivogorsky & Grudnitski, 2010). There is also variation in the ownership shares from full, 100% ownership to less-than-10% minority ownership (Liu & Sun, 2005; Lopez-de-Foronda, Lopez-Iturriaga, & Santamaria-Mariscal, 2007; Okhmatovskiy, 2010). When considering these utterly different categories of enterprises, it is crucial to understand what objectives the state-owner may set for such enterprises (Luke, 2010).

The purpose of this article is not to discuss corporatisation of government activities or privatisation of SOEs but to the heterogeneous field of SOEs. This modelling is performed especially for ownership steering and parliamentary surveillance perspectives.

The research objective is divided into two questions:

1. What objectives do SOEs have and how can we classify different SOEs based on these objectives?
2. How can we form a steering and monitoring model that takes into consideration the different objectives and different types of SOEs? This model is then tested with the case country data.

The theoretical concepts have been derived from the agency theory. The practical concepts of SOE surveillance and steering are inserted into the theoretical model in a way that allows the formulation and implementation of state ownership policies. By using the Finnish state's share portfolio as an example, we create a framework (or model) that emphasises different ownership policies and steering objectives within the heterogeneous SOE context. This framework is crucial to understanding the objectives set for different types of ownership and determining the most critical information, especially from the point-of-view of parliamentary supervision. The framework is suitable for organising and systematising the necessary performance and accountability information of SOEs in developed and developing countries, which have a wide variety of SOEs.

The results help form an outline of the issues that are salient in the pursuit of good SOE governance and ownership steering. The Finnish data is suitable for this study because, as a Nordic welfare country, the state of Finland owns a wide variety of different enterprises. Corporate governance of SOEs in Nordic countries functions well when considered from an international perspective (Frederic, 2011, p. 12-13)

Some of the Finnish state's enterprise ownership is based purely on financial interests, some is based solely on strategic interests and some on strategic and financial interests (Parliament of Finland, 2009). Moreover, some of these SOEs have corporation charters that make them not-for-profit companies. In addition, the Finnish state shareholdings range from 100% sole ownership to less-than-10% ownership (see Appendix 1). It should be noted that governments in the UK and other western countries have largely divested themselves of such ownership in companies operating on a purely for-profit basis (Jupe, 2012). Hence, national ownership policies, e.g. in the UK, focus on a much more homogenous group of companies than those in Finland and other Nordic countries.

The findings are interesting, especially in the context of transition economies and developing countries. In these countries, the dimensions of owner steering may, in many respects, be in their infancy, and the variety of their SOEs is significant (Koppel, 2007). Consistency in the basis, extent and listing status of SOEs as tools for steering and reporting creates good preconditions for ownership policy decision-making and ultimately improves the outcomes of government ownership policy and steering. Transparency and published motives for ownership policies are important to keep a broad range of stakeholders aligned on the objectives and achievements of ownership policy.

After the introductory section, this article proceeds as follows. In section 2, we present a theoretical framework, and we review the institutional settings in section 3. In section 4, we address the basis for ownership steering and the classification of state-owned enterprises for surveillance, which are then applied to the ownership steering and reporting model in section 5. In section 6, we draw conclusions.

Theoretical Framework

The Three-Stage Agency Model

The theoretical framework of this study is based on agency theory, which describes the relationship between two or more parties in which one party, designated as the principal, engages another party, designated as the agent, to perform some tasks on behalf of the principal (Coase, 1937; Jensen & Meckling, 1976; Eisenhardt, 1989). Agency theory is concerned with analysing and resolving problems that may occur in the agency-principal relationship. The theory assumes that once principals delegate authority to agents, they often have problems controlling them because the agents' goals often differ from theirs, and agents often have better information about their capacity and activities

than principals. Agency theory focuses on the measures principals utilise to mitigate this problem by selecting certain types of agents and certain forms of monitoring their actions as well as by using economic incentives (Kiser, 1999).

In the present study, the agency theory setup is three-staged; this frame of reference is presented in Figure 1. The first stage in the agency relationship is between the management and owners of individual SOEs; the second is between a political decision-making body and the central administration responsible for implementing owner steering; and the third is between the political decision-maker and the electorate (Huber, 2000; Muller, 2000). This multiple-stage reporting relationship is typical for owner steering, particularly in Nordic countries but also in some other OECD countries such as Australia, New Zealand, and the Netherlands (OECD, 2005a). According to the OECD Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2005a), the ideal model is a governance structure composed of three distinct layers, each with a distinct role: 1) a state-ownership function that is responsible for defining the ownership policy and high-level objectives for SOEs; 2) a board that is charged by the state with overseeing the development and progress of the chosen strategy to achieve the state's objectives; and 3) an executive-management SOE that proposes a strategy and that is then accountable to the board for implementing the strategic plan.

The most important focus of the study is on the second principal-agent relationship, shown in the central panel of Figure 1 between the political decision-making body and the central administration responsible for implementing ownership steering. In this principal-agent relationship, state administration (the possible ownership steering unit and the relevant ministries) is now in the role of agent and the principal is the political decision-making body, which in the case of Finland is the Parliament and its Audit Committee. The third principal-agent relationship portrays how the political decision-maker is responsible to its own principal, the electorate. This relation is ultimately expressed in the parliamentary elections.

Direct and Indirect Ownership Steering

In Figure 1, the left-hand panel presents the first tier of the principal-agent relationship manifested between the management and owners of individual companies. More specifically, the left-hand panel shows that state ownership steering can be either direct or indirect. In direct steering, the individual SOEs (agents) are obligated to report not only to the officials of the state's central government (principal I) representing the state-owner but also to other owners (principal II). Fundamentally, this agent relationship reflects the problems caused by the differentiation of the roles of corporate management,

the agent and the owner (the principal) (Berle & Means, 1932; Jensen & Meckling, 1976; Shleifer & Vishny, 1997).

INSERT FIGURE 1 HERE

On the other hand, the ownership steering is indirect if the state does not directly own the shares but rather indirectly owns them through a holding company, which then owns shares in other companies (Liu & Sun, 2005).¹ One reason for establishing a holding company is that it is a fast decision-maker; therefore, it can exploit the stock markets better than a government when a suitable opportunity opens for selling (or buying) shares. The individual SOEs are responsible for reporting to the holding company, but the holding company itself is required to report its operations to the state government. Thus, the state holding company is at the first stage of the agent relationship in both the agent's and the principal's roles. This also complicates the principal-agency relations and, ultimately, owner steering.

Principal-agency Problems

Conflicting objectives, political interference and a lack of public transparency are considered the main problems for SOEs. A crucial problem for the entire principal-agency chain is a situation in which the principal, i.e. the state, has no consistent and *transparent ownership policy* with identifiable objectives. The goals of public enterprises may be difficult to specify due to the problems of multiple objectives (commercial versus non-commercial) as well as plural principals and agents (Jones, 1991, p. 181). *Many levels of principal-agent relationships* and accountability chains easily result in tensions and conflicts. The state government is not one entity but rather consists of different administrative levels, ministries and units that may have different perceptions of what the goals should be or what the goals mean for practical implementation. The problem of *common agency* occurs when each relevant part of the government has somewhat different objectives and each tries to influence the SOEs accordingly. Managing multiple, and potentially conflicting, objectives is one of the central challenges in the governance of SOEs (The World Bank, 2006, p. 3-4).

Agency problems emerge when politicians and bureaucrats as agents tend to harness their private or narrow group interests and do not carry out their work in accordance with the interests of society as the ultimate principal. For instance, politicians may force companies to perform unprofitable activities in their electoral district in order for the politician to be re-elected in the next election (Kamal,

¹ In Finland, for example, the state completely owns a holding company Solidium, which then owns further shares of listed companies.

2010, p. 214). On the other hand, SOEs' management may challenge the legacy of their nonfinancial obligations set by politicians—for example, by supporting unrelated industries through indirect subsidies such as products, services or financing offered at below-market rates (Budiman et al., 2009).

The government should not overly interfere in SOEs' decision-making. The OECD and the World Bank have stated that, as a best practice, SOE boards should be shielded from political ad-hoc interventions once their objectives have been defined. The perception that the operation and control of SOEs can be influenced by changing political climates can make them less attractive to other investors than the state owner (Frederick, 2011; Latin American Development Bank, 2012).

One solution to alleviate public principal-agency problems is total privatisation, which detaches the government from the ownership role but, on the other hand, preserves the role of the government as a regulator of markets and corporations acting on the markets. Another solution is to remain an owner but, at the same time, develop an incentive system as the agency theory suggests. A good incentive system can steer and motivate managers to manage their enterprises efficiently and act in the interest of society as a whole. Jones (1991) uses the concept of a signalling system that has three components. The first is a performance evaluation system, in which national goals are translated into enterprise objectives and quantified in a performance criterion. The second is a performance information system that monitors actual achievements. The third is an incentive system, in which the welfare of managers and workers are linked to national welfare by pecuniary or non-pecuniary bonus systems based on the achievement of target values. Governments can also make contracts with SOE boards and managements about the performance expected from the SOE in question (Jones, 1991, p. 180; Vagliasindi, 2008, p. 18-19; The World Bank, 2006, p. 16-17). However, in this paper we concentrate more on the government as an owner of enterprises and on the accountability relationship, especially to the political body, and less on the incentive and performance management systems of SOEs.

The reporting lines in our model (Figure 1) show the accountability relations from the agents to the principals at the same time. Accountability for the performance of SOEs involves a complex chain of agents without clearly identifiable, i.e. remote, principals. This chain of agents can include management, enterprise management boards and in two-tier enterprise board structures also supervisory boards above management boards, ownership steering entities, ministries and governments. According to the OECD, it is a challenge to structure this web of accountabilities in order to ensure efficient decisions and good corporate governance (OECD, 2005a, p. 10). Modelling of accountability relations can be used to identify and mitigate principal-agent conflicts (Luke, 2010, p. 138).

As shown in Figure 1, on one hand the administration responsible for owner steering serves as a principal under which individual enterprises operate. On the other hand, the state government is obliged to report to its own principal about whether owner steering and owner policies have been implemented according to the approved political objectives. Thus, it is important that high-quality monitoring information is systematically reported not only to relevant state administrations but also to Parliament.

INSERT FIGURE 2 HERE

Figure 2 shows four different dimensions (type of main owner interest, listed or non-listed enterprises, organising of steering function and extent of state ownership of shares) for the appropriate design of groups of SOEs, including their accountability and steering systems. Cells in the figure are not divided according to the fourth dimension regarding the organisation of steering in order to keep the figure readable.

The emphasis on ownership interest in SOEs affects the performance goals that are set for SOEs. In a consistent model of ownership policy, this should be the first thing the state does; after this, the state can determine which ownership structure will facilitate the achievement of defined goals. There are three important options in regard to SOE ownership structure: concentrated ownership, in which a state owns 100% of the shares; shared ownership with the state as the majority owner; and shared ownership with the state as the minority owner. The shares can be made publicly available by listing shares in local and international capital markets, which makes widely dispersed ownership possible. Furthermore, the enterprise may be non-listed and owned completely by the state or by a combination of public and private investors.

There are three main types of organisations of steering functions. The first is the decentralised (sector) model, in which SOEs are under the responsibility of several relevant sector ministries. In the dual model, the responsibility is shared between the sector ministry and the Finance Ministry or the Treasury. In the centralised model, the ownership function is concentrated in one main ministry or one special ownership agency under the government (OECD, 2005b, p. 41-49; Vagliasindi, 2008, p. 9-13; The World Bank, 2006, p. 11-13).

The disadvantages of the decentralised model are that it may mix the ownership function with the regulatory role in a sector ministry easier than the other models might, and it may lead to more interferences in SOE operating decisions compared to the other two models (OECD, 2005b, p. 45; Vagliasindi, 2008, p. 13-14). A centralised model or a dual model may better separate the functions of ownership and regulation as OECD recommends (2005a). The dual model is in use in many developing countries. In this model, there may be dual responsibility for certain tasks, for example if the ministry of finance and the sector ministry in question both nominate representatives for the board of directors. The main disadvantage of the dual model is the multi-principal agency problem, especially in developing countries that have weak governance arrangements (Vagliasindi, 2008, p. 16).

Cells A₁, A₃–A₆, B₃–B₆ and C₅–C₆ show how ownership policy steering has been arranged in the case country explained in the next section. The government of Finland has established a holding company that is completely owned by the government. The holding company owns shares in listed commercial companies, with the government owning less than 50% of the shares. Listed companies that are strategic are owned directly by the Ownership Steering Department (OSD).

OSD is responsible for steering the holding company as well as the commercial companies with strategic interests. These may be listed (such as Neste Oil and Fortum, which are leading oil and energy companies in Finland) or non-listed. Enterprises with social and public policy objectives are non-listed and are owned directly, and they are under the steering responsibility of sector ministries. In section 5, we elaborate on the classification of SOEs in Finland according to three dimensions: type of main owner interest, listed or non-listed enterprises and extent of state ownership of shares.

According to Vagliasindi (2008, p. 11), the main advantage of a holding company solution is that it can be used to facilitate nationwide programs for the privatisation and restructuring of state-owned industry. The disadvantage is that a holding company doesn't change the possible poor corporate governance in the country. It requires its own specific programs for developing corporate governance for SOEs.

The case of Finland shows that a holding company can also be used to buy shares of industrially important companies. The Finnish government added its ownership of an existing telecommunication company and of a new mining company at the end of the 2000s and in the beginning of the 2010s.

In Finland, SOEs with social and public policy objectives (known as *special state assignment enterprises*) are mainly organised under the steering responsibility of the appropriate sector ministry; for instance, the Finnish Broadcasting Network company is under the rule of the Ministry of Traffic and Media. These enterprises are typically non-listed.

Cells C₁, C₃ and C₅ show problematic or nonviable solutions for SOEs with important social and public policy objectives. These objectives are difficult or impossible to accomplish if the enterprises are listed companies and the state is not the only owner. If the enterprise is non-listed and the state does not control the enterprise (C₅), problems may emerge in fulfilling the special social objectives. Cell B₁, which shows enterprises with strategic commercial value for government, is even more problematic because in this cell, the state is only a minority owner and the ownership is indirect through a holding company

The three main multi-agency chain alternatives that mediate the ownership policy lines to implementation in a parliamentary democracy and report to the principal of the ownership policy can be drawn as follows.

- a) **Centralised organisation:** State government > ownership agency/coordinating ministry (holding company) > SOE > board (in a two-tier system, a supervisory board and a management board) > chief executive officer (CEO)
- b) **Dual system:** State government > ownership agency/coordinating ministry > (holding company) and sector ministries > SOE > board (or supervisory board and management board) > CEO
- c) **Decentralised organisation:** State government > sector ministries > SOE > board (or supervisory board and management board) > CEO

In Parliament, there may be a special audit committee or economy committee that prepares SOE matters for plenary sessions. This special committee may have the right to audit SOE matters and arrange public or secret hearings of agents responsible in the multi-agency chain. Furthermore, the parliament may obtain independent evaluation information from the supreme audit institution in the country regarding the implementation of the ownership policy. In the next section, we shed more light on the ownership policy in the case country Finland as we implement our classification model for Finnish SOEs.

Institutional Case Environment

The Finnish history of state industrial policy extends back to the first decades after independence in 1917 (Hyytinen, Kuosa, & Takalo, 2003). During the years before and after the Second World War, there was a lack of capital to support important heavy industries, such as the energy, metal, wood, and paper industries. Because of this, the state took the initiative and established state-owned companies in these fields. This historical background explains the wide array of Finnish state ownership in the heavy industries (Moen & Lilja, 2005; Ornston, 2012).

Beginning in the late 1980s, the New Public Management (NPM) movement, which aimed to reform hierarchically operating public administrations in a more flexible managerial direction and to apply market models, had an influence in Finland (Hood, 1996; Temmes, 1998; Green-Peders, 2002). The NPM trend in the Finnish public sector caused the transfer of business-like operations from the state budget into off-budget entities and further into state-owned corporations. However, the systematic state ownership policy as a separate policy field in the platform of the Finnish government did not begin until the 2000s (Vuoria, 2004). The first separate and explicit ownership policy and corporate governance government resolution were formulated in 2003. Today, the state ownership policy and corporate governance are delineated in each government program and in each government resolution pertaining to state ownership policy. The latest government resolution on state ownership policy was adopted in 2011.

The current Finnish SOE policy is based on the international principles for state ownership recommended by the OECD (2005a). Among the main principles of the recommendations are 1) that the finances of the enterprise and the finances of the state be kept separately, and 2) that the state should maintain clear separation of responsibilities among the bodies of the companies and operate only as the owner. Thus, the state-owner executes its owner rights in owners' general meetings and has an evaluative and monitoring role with regards to SOE operations, and it does not intervene in operational business decision-making. The ownership steering function is mainly centralised in Finland as OECD recommends, although there are some traits of a dual system because sector ministries have certain substantial steering functions for special state assignment enterprises.

The basic law that the ownership steering must follow is the State Shareholdings and Ownership Steering Act (1368/2007). According to that act, state ownership steering refers to the exercising of the state's right to vote in general meetings as well as to other measures by which the state as a

shareholder contributes to companies' administration and operating principles. Thus, the concept of 'state ownership steering' refers to various actions by which the governmental authorities as an owner may influence the companies. Duties relating to state ownership steering are handled in the sector ministries and the coordinating Ownership Steering Department located within the Prime Minister's Office. Finnish SOE policy has been based on the corporatisation of SOEs in accordance with OECD recommendations (2005a). Corporatisation means that companies must follow general company law. Therefore, the government of Finland cannot directly nominate or dismiss board members or CEOs because these actions belong to the owners in the general meeting or to the board of the company. Special assignment companies must follow a separate law that has been enacted especially for the company, such as for the Finnish broadcast company. These separate laws or articles of incorporation define what the special assignment is and, therefore, the trade-off factors with commercial goals for those companies.

The owner steering function of the state of Finland is in accordance with the executive power and division of tasks in the legislation on the Finnish Companies Act (624/2006), which is most closely related to the corresponding laws in other Nordic countries such as Sweden, Denmark and Norway (Liljebloom & Löflund, 2006; Kankaanpää, 2009). Moreover, in relation to the publicly listed SOEs, the regulatory body of Finnish corporate governance also includes the Securities Market Act, the Rules of the NASDAQ Helsinki Stock Exchange and the Finnish Financial Supervision Authority governed by the Bank of Finland (Securities Market Association 2010).

Classification Basis for State-Owned Enterprises

In the SOE literature, the basic demarcation line has been drawn between enterprises with commercial goals and those that also have non-commercial goals. For instance, in Indonesia, there are two types of SOEs: general companies that have social purposes and limited liability companies that are business-oriented SOEs (Kamal, 2010). In Finland, SOEs have been classified in three categories: commercial enterprises, commercial enterprises with strategic value and special state assignment enterprises with societal goals. In some Latin American countries, SOEs have been classified in four categories: SOEs created for the purpose of achieving public policy objectives; SOEs responsible for providing public utilities and services (e.g. water, electricity, gas, etc.); SOEs that exclusively provide goods or services required by the state (e.g. military suppliers); and SOEs responsible for producing

revenue for the state that compete with the private sector under equal conditions (Latin American Development Bank, 2012, p. 20-21).

In this paper, we use a basic classification in which SOEs are divided according to the type of owner's interest: non-commercial enterprises (special state assignment enterprises), commercial enterprises with pure commercial shareholder interest and commercial enterprises with strategic value for the government. A division into two classes is too crude, and the above-mentioned division into four classes unnecessarily mixes the type of owner's interest with the type of produced goods.

Division According to Basis of Ownership

Through public ownership, the state can sustain sectors of long-term strategic or national security interests that are presently uneconomical for private investment (Luke, 2010). In addition, governments often find SOEs to be a useful strategy for pursuing social goals, such as greater equality and social stability (Ramamurti, 1987; Bozec & Breton, 2003; Austvik, 2012). In Finland, the owner interests of the state of Finland fall into three groups: economic, strategic and special state assignment (Finnish Council of State, 2007, 2011).

The tasks of *special state assignment enterprises* are generally provided for in the legislations of various countries, and they determine the state ownership policy and how state steering is carried out (Luke, 2010). In special state assignments, the objectives of state ownership are primarily societal, albeit with the general aim that the operations should be cost-effective (Finnish Council of State, 2007, 2011). The sector ministries in charge are responsible for steering special state assignment enterprises.

In Finland the corporate charter is a crucial tool in state ownership steering of special state assignment companies. In the corporate charter, the state defines the societal goals as well as the social and environmental responsibilities that the company must advance; it must comply with these goals even if they are in conflict with business or economic goals. However, the business strategy of a special state assignment company must not jeopardise the societal goals laid down by management and administrative bodies (OECD, 2005a).

Enterprises with economic and strategic interests (*commercial companies*) operate under market conditions. Market conditions are the operating principles, funding structure and target proceeds in enterprises owned by the state that can be compared with other enterprises operating in the same fields;

the aim is to achieve an optimal economic profit (Vuoria, 2004). The responsibility for ownership steering companies operating under market conditions lies primarily with the Prime Minister's Office and the OSD.

However, in Finland, the fact that SOEs with economic and strategic interests are a very heterogeneous group is problematic (Parliament of Finland, 1/2009, 5/2010, 11/2010). Some SOEs operating under market conditions are also linked to the state's strategic interests, such as objectives connected to maintaining and ensuring infrastructure or to basic services, but some of them are involved in purely market-based business. Moreover, some SOEs with economic and strategic interests are publicly listed, but some are not. Thus, it appears that the category 'enterprises with economic and strategic interests' is too general, especially for parliamentary monitoring purposes.

Division According to the Extent of Ownership

State ownership shares vary from full 100% ownership to less-than-10% minority ownership (Liu & Sun, 2005; Okhmatovskiy, 2010). State majority-owned companies are those in which the state holds more than 50% but less than 100% of the votes. If the state owns 100% of the share capital, this is a 'company with sole state ownership'. Then the sole owner, the state, is free to set objectives (other than economic ones) without endangering the positions of other owners or infringing on their rights. In Finland, a 'state associated company' refers to an enterprise in which the state holds at least 10%, but not more than 50%, of all the voting shares. It is important to note that the advent of a single minority shareholder changes the nature of the company, especially in the operations of publicly listed SOEs because then enterprises are obligated to ensure equal treatment of all shareholders in all their actions (Liu & Sun, 2005).

Division According to Stock Exchange Listing

Decisive steps regarding market direction and market conditions (excluding the owner's non-market modes of operation or demands) are taken when the enterprise is listed on the Stock Exchange (OECD, 2005a; Goldeng, Grünfeld, & Benito, 2008). Special assignments of social services are excluded in publicly listed companies in the Stock Exchange, unless these assignments are accepted by the investors and owners in the markets.

At the beginning of May 2013, the Finnish state was a majority owner in three strategically important listed companies (see Appendix 1 and Category IV B). In addition, the state has a considerable minority shareholding in 11 associated companies (Appendix 1, Category V C). The ownership steering

of listed companies is accomplished through the Prime Minister's Office in such a way that companies with a majority of shares owned by the state are in direct relation to the state steering unit of the Prime Minister's Office. On the other hand, for companies in which a minority of shares are state-owned, steering is indirect because steering is centralised to the holding company Solidium. Solidium itself is a 100% state-owned special state assignment company that falls within the steering responsibility of the Prime Minister's Office VNK (compare to Figure 1).

Social Service Assignment and Shareholder Value Interest

As noted in the previous section, the state can sustain sectors of long-term strategic interests such as national security through public ownership, but the state may also be motivated by purely financial objectives. Based on the division according to the basis of ownership, we divided ownership steering purposes regarding SOEs into the social service assignment principle and the shareholder value creation principle.

The social service assignment principle refers to how effectively the company promotes its social goals and fulfils its special service assignment set by Parliament and the ministries or the Prime Minister's Office. The shareholder value creation principle refers to how profitable and competitive the company is in relation to its competitors in the same industry, i.e. how effectively it creates shareholder value. Some companies in the state portfolio are more oriented toward social service assignment, while others are oriented toward pure shareholder value creation.

Classification of Finnish SOEs for Steering and Reporting

The two-class SOE classification system according to basis of ownership ('special state assignment' and 'enterprises with economic and strategic interests') by the Finnish Council of State is too general for parliamentary monitoring purposes. A system is needed that further clarifies the nature of state ownership (Parliament of Finland, 1/2009). While some SOEs with economic and strategic interests are also linked to the state's strategic interests, others are involved in purely market-based business. In addition, some SOEs with economic and strategic interests are publicly listed, but some are not.

Based on different ownerships and Stock Exchange listing statuses, we grouped Finnish SOEs into five new categories as follows:

- I. Special state assignment companies;
- II. Unlisted companies operating under market conditions in which the state also has a strategic interest;
- III. Unlisted companies operating under market conditions in which the state has a pure shareholder interest;
- IV. Stock-Exchange-listed companies with the state as the majority shareholder in which the state has a strategic interest; and
- V. Stock-Exchange-listed companies in which the state is an associate shareholder.

We also divided the companies in each of the five categories (I–V) into three sub-categories (A, B and C) according to the extent of state ownership. The three sub-categories are as follows:

- A. Companies with sole state ownership (100% of the votes);
- B. State-majority-owned companies (more than 50%, but less than 100%, of the votes); and
- C. State-associated companies (more than 10%, but less than 50%, of the votes).

In Figure 3, the state’s ownership of companies is grouped into five categories (I–V) according to how much the state as an owner is focused on the social service assignment principle (the white area in Figure 2) or purely shareholder value interests (the grey area in Figure 3). The greater the share of the white column (and the smaller the grey one), the more state ownership steering of SOEs is focused on the social service assignment. Similarly, the greater the share of the grey column (and the smaller the white one), the more SOEs are focused on creating shareholder value. This system also provides a basis for structuring an information and communication system in which the goals are defined and performance is discussed and modified between the principals and agents.

The five categories (I–V) and three sub-groups (A, B and C) of individual SOEs in the Finnish state portfolio are listed in Appendix 1.

INSERT FIGURE 3 HERE

On the left of Figure 3, category I A includes the 100% state-owned special state assignment companies. The state-ownership steering in these companies is strongly oriented toward social service assignment (thus the white area is long), although the general goal of profitable operations applies as well (as shown by the short grey area). On the other hand, category V C on the right of Figure 2 displays listed companies in which the state is a minority shareholder and has pure shareholder value interests without social service assignment. Thus, category V C is completely grey.

It is important to note that the advent of a single minority shareholder (sub-groups B and C) changes the nature of the company. Then, the decision-making of the company and the ownership steering must be arranged with due respect for equal treatment of shareholders. This restriction has been rendered in the figure with a spotted area, and it appears in all SOE categories in which there are other owners in addition to the state (i.e. categories I B&C, II B&C, III B&C and IV B). In the Stock-Exchange-listed state-associated companies in category V, the state-owner has a pure shareholder value interest. Therefore, the state ownership interests do not diverge in any form from the objectives of achieving profits according to the Finnish Companies Act (624/2006).

Figures 2 and 3 are analytical tools used to design and evaluate solutions for arranging the state ownership policy. The government of Finland has some SOEs (Appendix 1) in sub-groups I C and II C, which is problematic if the social and strategic goals that the government has set for those enterprises are endangered because of the decision-making power of the majority of owners. In category IV B, the Finnish government has decided to keep the majority of shares because of the strategic interests. For this reason, we have no sub-group C in this class. If the government of Finland wished to sell its shares of these listed strategic companies below the line of having the majority of votes, they would require Parliament's permission.

The novelty of our model is not only the more subtle classification tool created but also that the agency theory (Jensen & Meckling, 1979; Eisenhardt 1989) used in conjunction with our model creates a template for testing hypotheses with further research. For instance, in line with Vagliasindi (2008), we anticipate that the longer the principal-agency chain (i.e. the more levels in the chain), the more the chain will contain dual and parallel roles for principals and agents. In addition, the more the principal is politically disharmonious, the higher the probability of biased, contradictory, delayed and/or misinterpreted steering signalling from principals to the ultimate agents (SOEs). If the principal, i.e. the ruling cabinet in the country, cannot politically agree on the ownership policy content and

is unable to consistently classify SOEs according to their ownership interests and goals, the probability of inconsistent steering signalling will be very high. This is related to the problem of *common agency* (see the theoretical framework, p. 5-6.)

One tentative example is the case of the icebreaking company Arctic Shipping Ltd., which is fully owned by the Finnish government and is under the steering competence of ODS. It is a commercial company with a strategic value (category II in Figure 3) because of the importance of keeping shipping routes open in the Baltic Sea during the winter. During the summer, the multipurpose icebreakers are hired in the offshore oil and gas fields, most recently for the Shell Company's oil-drilling activities in Arctic waters. This business is exercised by the subsidiary Arctia Offshore Ltd., which is fully owned by the parent company Arctia Shipping Ltd. The steering chain is very long and contains dual and partially parallel principals and agents. After the 2011 parliamentary elections, an internally disconnected, multiparty Cabinet came into power, led by Prime Minister Katainen. Therefore, it is likely that conflicts will occur in the chain.

In 2013, these conflicts became apparent. Arctia and the minister for state ownership steering, the Green League's Heidi Hautala, were at the centre of a scandal that emerged when the minister indirectly intervened to protect Greenpeace activists who boarded Arctia vessels in protest of the Shell deal. The OSD's interference with the Arctia Offshore Ltd.'s decision-making, along with the minister's contribution, was considered by the media and the most powerful Cabinet party (the moderate-right party Kokoomus) to be inappropriate. Hautala resigned from her post on October 11, 2013. During the conflict, different interpretations were expressed on whether it was appropriate for the fully state-owned icebreaking company with a strategic interest in Baltic Sea to form a leasing business via its subsidiary company with Shell Oil in Arctic waters. Some criticised this as against government environmental policy because of the heavy risks involved in drilling oil in Arctic waters, while others argued that the Finnish special expertise regarding icebreaking and offshore services should be utilised commercially.

Arctic Shipping, which has a monopoly in the Finnish market, charges higher fees than comparable Swedish companies. This raised suspicions in the Transport Ministry that earnings from ordinary operations were supporting riskier offshore ventures during the summer months. The risk comes from any spills that might occur. If Arctia has to pay to clean up oil spills, its own assets are on the line; however, a report by the Research Institute for the Finnish Economy (ETLA) in 2012 stated that the government, as a 100% owner, could also be liable. In 2010, Arctia was warned by the Transport and

Communications Ministry about its risk management policies. The ministry was particularly dissatisfied with risk management in Arctia's offshore agreements (Yle News, 2013.)

To maintain the steering mechanism's viability, the commercial activity of the offshore business could have been separated from the government steering chain by privatising the commercial company and its risks. In addition, if the strategic icebreaking service as a monopoly is not functioning satisfactorily from the principal's point-of-view, it could be transferred nearer to the principal and its representative, the Finnish Transport Agency. It could ultimately be changed from an SOE to a public utility under the jurisdiction of the Finnish Transport Agency.

Reporting Priorities for Parliamentary Monitoring Purposes

Transparency requires simultaneously reporting information to all shareholders in order to ensure equitable treatment (OECD, 2005a, pp. 34, 38-39). According to the OECD recommendations, the coordinating or ownership entity should ensure that adequate external reporting systems are in place for all SOEs (OECD, 2005a, p. 30). Coordinating or centralised ownership entities should develop aggregate reporting that covers all SOEs and make the reports a key disclosure tool directed to the general public, the Parliament and the media (OECD, 2005a, p. 41)

Non-commercial objectives are particularly troublesome because they are typically difficult to quantify in money terms. It is not easy to measure the achievements of non-commercial objectives and incorporate them into the performance evaluation and reporting system. If it is not possible to quantify performance, non-commercial outcomes should be evaluated in qualitative terms and entered into the system of performance indicators. When the costs are quantifiable, the enterprise in question can be compensated by an amount that covers the incremental costs of meeting non-commercial objectives (Jones, 1991, pp. 186, 195-205). According to the OECD, when the SOE is also used for public policy objectives, such as general services obligations, it should also report on how these are being achieved (OECD, 2005a, p. 44).

In this article, we limit detailed technical discussion of the best practices for financial reporting by governments and SOEs. Financial reporting for listed and large non-listed SOEs should comply with international standards (The World Bank, 2006, p. 20-21). Accounting methods should be based on accrual-based accounting, which allows for a full balance sheet showing the full scope of assets and liabilities of the government as well of the SOEs. Traditionally, central governments' financial reports have been tied to the budget entities of the government, which might have hidden spending and debts

transferred to SOEs and other off-budget entities. Modern accounting principles require companies to consolidate accounts for all the entities they control. This principle, when adapted to the public sector, means that governments should also provide consolidated financial statements that include government-controlled SOEs. At the moment, few governments consolidate SOEs in their financial statements (Blondy et al., 2013, p. 267-2719). SOEs should also report non-financial information, including related party transactions (especially with other SOEs), changes in board membership and high-level executives and changes in ownership structure. Performance indicators related to SOE objectives could also be reported to the public as well as information regarding commercial and non-commercial policy objectives, estimates of the latter's cost and financial assistance from the state (The World Bank, 2006, p. 20-21). SOEs should also have a heightened sensitivity to corporate social responsibility reporting (Frederic, 2011, p. 22).

The SOE classification in Figure 3 systematises the information needed for parliamentary monitoring. The more the SOEs are situated toward the left in Figure 2, the more the state as an owner has interests other than pure shareholder value and the more Parliament requires surveillance information on how well the company fulfils its social service assignment. The focus for special state assignment companies (the companies in category I) is on the steering perspective set by the ministry in charge. The general goal is that operations are profitable, but the monitoring information stresses quantifying and assessing the companies' social service assignments.

The focus in category II-V SOEs is primarily on economic principles, and strategic interests should be reconciled with these. The aim is that the companies' profitability and financial structures should be at least as good as those of domestic and international competitors. Regarding profitability, good parameters are, among others, the earnings before interest and taxes (EBIT) describing the structure of the result, the return on equity (ROE), and the return on assets (ROA). For the analysis of financial structure, the appropriate measures include debt-to-equity and gearing (see e.g. Revsine et al., 2005; Stolowy & Lebas, 2006). In the Stock-Exchange-listed SOEs in categories IV and V, the analysis can be supplemented with figures based on market information. Among others, the main information to be reported is the development of market value and its relation to the general development of the shares, the yield of the portfolio in relation to the average market yield and the amount of dividends received by the state (Shareholder Executive, 2009).

If the solution is not to have only one aggregate performance report for the parliament containing performance information from all SOEs, an alternative solution is to have one report on commercial

SOEs prepared by the coordinating ownership agency and separate reports prepared by sector ministries responsible for special state assignment enterprises with social and public policy goals for the parliament. The important factor here is that the principal, i.e. the parliament, can receive complete information on how the ownership policy steering and implementation has been performed. Reporting should cover all categories of SOEs if performance reporting and monitoring is to be consistent and comprehensive for parliamentary surveillance purposes.

Summary and Conclusions

This study aimed to create a basis for a general model that is able to systematically categorise state ownership policy and steering. The theoretical concepts were derived from the agency theory, and the practical concept of steering was then inserted into the theoretical model in a way that serves state ownership policy and steering of SOEs (Figure 1). In Figure 2, we showed four different dimensions (type of main owner interest, listed or non-listed enterprises, concentration of steering function and extent of state ownership of shares) connected to methods for appropriately organising groups of SOEs, their accountability and steering system. We outlined three main multi-agency chains that, in a parliamentary democracy, mediate the ownership policy lines to implementation by the accountable agents.

In Figure 3, we constructed a model that appropriately categorises the state ownership policy of state-owned companies for accountability and steering purposes. Based on the heterogeneous field of the Finnish state's share portfolio, we used the model to classify SOEs in the case country Finland. First, we classified SOEs according to the basis of ownership, extent of ownership and Stock Exchange listing status. Second, we divided the objectives for SOE ownership steering into two main principles: the social service assignment principle and the shareholder value creation principle. Third, on the basis of ownership, extent of ownership, and listing status, we grouped the SOEs into different categories according to the extent to which the state as an owner is focused on the social service assignment principle or purely on shareholder value interests. This SOE classification systematises the information needed for parliamentary monitoring. Consistency in ownership goals, steering and reporting creates good preconditions for consistent reporting for ownership policy decision-making and

ultimately improves the outcomes of ownership policy and steering. Reporting should cover all categories of SOEs if performance reporting and monitoring is to be consistent and comprehensive for parliamentary surveillance purposes.

We need a consistent model for designing and monitoring the implementation of ownership policy not only for parliamentary surveillance purposes but also because the government is accountable for the general public, voters and taxpayers. Each government should publish, either online or via other accessible media, its ownership policy lines and how it categorises its SOEs into the different classes outlined in this paper.

The theoretical contribution of the paper is that it elaborates on the most commonly used simple division of SOEs to commercial and non-commercial enterprises. The novelty of this study comes from our creation of a model that is based on the agency theoretical basis and includes different ownership policy dimensions and principal-agent steering chain characteristics. This paper also has several practical contributions. The three-dimensional division of SOEs, together with the dimension of how to organise the steering function, creates a consistent and systematic basis for a monitoring and reporting system. The model or framework in this paper may show problematic solutions in ownership policy and steering and lead to reconsideration of the appropriateness of the present system in the country. The detailed classification suggested in the paper may reveal that the extent of state ownership in some categories of SOEs is not justified or that, in some cases, the state should own more shares or possibly all shares of the SOEs in question. Furthermore, we show that the state should withdraw from ownership in some cases.

The research findings obtained within the context of the state of Finland and its Parliament are also applicable globally as they form an outline of salient issues in the pursuit of good governance, administration and parliamentary monitoring in ownership steering. The findings are interesting, especially in the context of developing countries in Asia, South-America and Africa as well as for transition economies in some Eastern European countries. In these countries, the dimensions of owner steering may be in need of development and the variety of their SOEs is significant.

One limitation of the study is that we theorised a framework (model) that was tested with only one case country, even though it was a good fit for the testing purposes. Another limitation is related to the outline of this paper. We used the model mainly for classification purposes, even though the model and its bases (agency theory) create possibilities for testing assumptions connected to the principal-

agency chain characteristics (causes) and ownership policy and steering outcomes (effects). The principal-agency characteristics may contain variables such as the length and levels of steering chains; the occurrence of parallel and dual principal and agent roles; and the variety of SOEs and steering purposes. The effects (outcomes) may consist of conflicts of interest in steering, noncompliance with rules of steering and conduct of SOEs, inefficiency in SOEs' performance, agency costs and asymmetric information serving SOEs' self-interests. These and other formulated assumptions and hypotheses can be tested with future research projects.

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Appendix 1. Finnish State Shareholding on May 2, 2013²

Category I: Unlisted special assignment companies

A State as a sole proprietor	State Shareholding	Ownership Steering
Alko Oy	100.0%	STM
Arsenal Ltd	100.0%	VM
CSC Scientific Computing Ltd	100.0%	OKM
Finavia Corporation	100.0%	LVM
Finnish Industry Investment Ltd	100.0%	TEM
Finnpilot Pilotage Ltd	100.0%	LVM
Finnvera Oyj	100.0%	TEM
Governia Oy	100.0%	VNK
Hansel Ltd	100.0%	VM
Haus Kehittämiskeskus Oy	100.0%	VM
Solidium Oy	100.0%	VNK
Suomen Erillisverkot Oy	100.0%	VNK
Veikkaus. Oy	100.0%	OKM
Yleisradio Oy	100.0%	LVM
B State majority-owned companies		
Finnfund Ltd	90.4%	UM
Tietokarhu	80.0%	VM
Yrityspankki Skop Oyj	95.2%	VM
C State associated companies		
Aalto University Properties Ltd	33.3%	VM
Finnish Aviation Academy Ltd	49.5%	OKM
Helsingin yliopistokiinteistöt Oy	33.3%	VM
Horse Institute Ltd	25.0%	OKM
Suomen yliopistokiinteistöt Oy	33.3%	VM

Category II: Unlisted companies in which the state also has a strategic interest

A State as a sole proprietor	State Shareholding	Ownership Steering
Actia Shipping Ltd	100.0%	VNK
Itella Corporation	100.0%	VNK
Leijona Catering Oy	100.0%	VNK
Meritaito Oy	100.0%	VNK
Motiva Oy	100.0%	VNK
Suomen Lauttaliikenne Oy	100.0%	VNK
Mint of Finland Ltd	100.0%	VNK
Suomen Viljava Oy	100.0%	VNK
VR-Group Ltd	100.0%	VNK
B State majority-owned companies		
Boreal Plant Breeding Ltd	60.8%	VNK
Fingrid Oyj	53.1%	VNK
Patria Plc	73.2%	VNK
Vapo Oy	50.1%	VNK

² Ownership Steering Department, 2013

C State associated companies

Ekokem Oy	34.1%	VNK
Gasum Corporation	24.0%	VNK
Municipality Finance	16.0%	YM

Category III: Unlisted companies in which the state has a pure shareholder interest

A State as a sole proprietor	State Shareholding	Ownership Steering
Altia Plc	100.0%	VNK
Destia Ltd	100.0%	VNK
Edita Plc	100.0%	VNK
B State majority-owned companies		
Raskone Ltd	85.0%	VNK
Kemijoki Oy	50.1%	VNK
C State associated companies		
Art and Design City Helsinki Oy Ab	35.2%	VNK
Finnish Seed Potato Centre Ltd	22.0%	VNK

Category IV B: Listed companies with the state as a majority shareholder

	State Shareholding	Ownership Steering
Finnair Plc	55.8%	VNK
Fortum Corporation	50.8%	VNK
Neste Oil Corporation	50.1%	VNK

Category V C: Listed companies with the state as an associate shareholder

	State Shareholding	Ownership Steering
Elisa Corporation	10.1%	VNK Solidium
Kemira Oyj	16.7%	VNK Solidium
Metso Corporation	11.1%	VNK Solidium
Outokumpu Oyj	21.8%	VNK Solidium
Outoteck Oyj	10.0%	VNK Solidium
Rautaruukki Corporation	39.7%	VNK Solidium
Sampo Plc	14.2%	VNK Solidium
Stora Enso Oyj	12.3%	VNK Solidium
Talvivaara Mining Company Plc	16.7%	VNK Solidium
TeliaSonera AB	11.7%	VNK Solidium
Tieto Corporation	10.3%	VNK Solidium

Abbreviations:

LVM = Ministry of Transport and Communications

OKM = Ministry of Education and Culture

STM = Ministry of Social Affairs and Health

TEM = Ministry of Employment and the Economy

UM = Ministry for Foreign Affairs

VM = Ministry of Finance

VNK = Ownership Steering Department in the Prime Minister's Office

YM = Ministry of the Environment

Figures

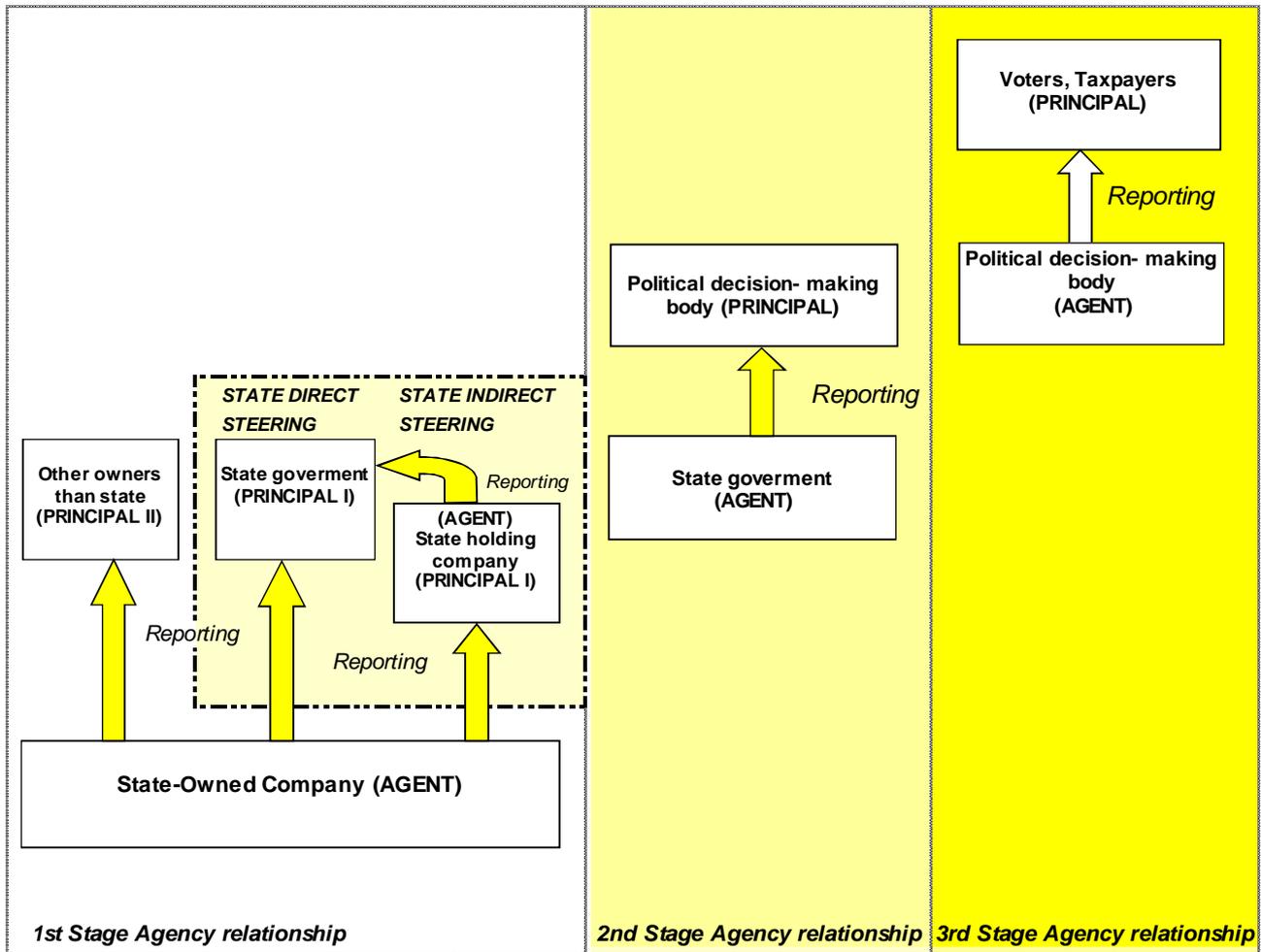
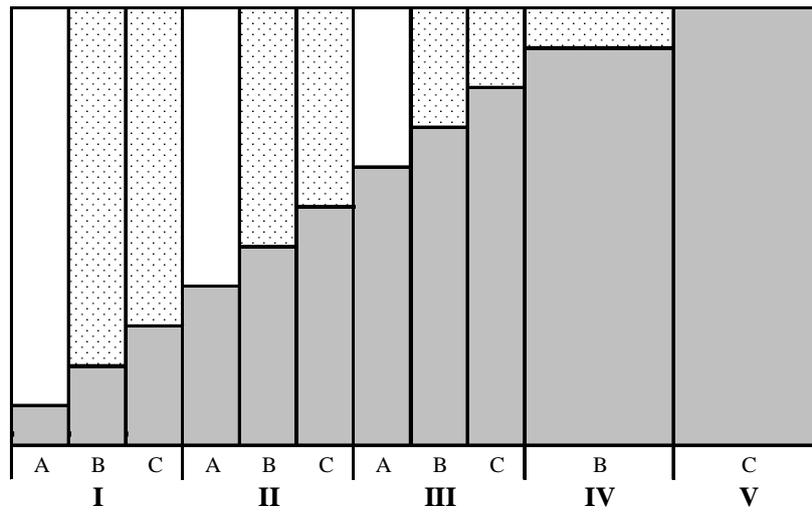


Figure 1. Three-Stage Agency Model and Reporting Responsibilities

	Emphasis of ownership interest in SOE			
Organisation of principal-agent relationships	Economic shareholder value	Strategic commercial value	Social and public policy objectives	Dispersed concentrated ownership (state as a majority or sole owner of shares)
Indirect ownership through a state-owned holding company (listed companies or non-listed)	A ₁	B ₁	C ₁	Dispersed ownership
	A ₂	B ₂	C ₂	Concentrated ownership
direct ownership, listed companies	A ₃	B ₃	C ₃	Dispersed ownership
	A ₄	B ₄	C ₄	Concentrated ownership
direct ownership, non-listed enterprises	A ₅	B ₅	C ₅	Dispersed ownership
	A ₆	B ₆	C ₆	Concentrated ownership
	Organization of steering: 1) a government ownership steering agency/coordinating ministry, 2) decentralized to sector ministries, or a 3) dual model			

Figure 2. Configuration of Organising Steering and Reporting of Ownership Policy

Social service assignment
(White area)



Shareholder value creating
(Grey area)

Figure 3. The SOE Classification for Steering and Parliamentary Monitoring Purposes