State Owners: Inefficient or Value–Adding?

In the wake of the global financial crisis government stakeholders have shown they are more than capable of running profitable businesses. The key to success is strong governance.

Traditionally state-owned enterprises have been perceived as large, quasi-monopoly entities often inefficiently run for political or social purposes. This thinking, never totally correct in the first place, has changed further since the global financial crisis when the governments of many industrialised, market-orientated economies took equity stakes in private companies as part of rescue packages. By bringing a new perspective and much needed financial support, government owners have helped turn many of these failing companies around, getting them back on track before, in many instances, making a successful exit.

These short-term interventions are evidence the state as an owner cannot only avoid significant destruction of value, but can help firms cope with external uncertainties and bring value-creation objectives to both listed and un-listed organisations.

State owners, no matter how large or small their stake, can add value to businesses in a number of ways.

Unlike many private stakeholders, state-owners have long-term purposes and horizons. They also have plenty of capital to put behind projects and are able to help stabilise a firm's cost of debt financing. Value can also be gained from the state-owner's holistic view of consequences when it comes to development projects in which their companies invest.

Consider EDF, the French electricity company. It took long-term vision to embark on a large nuclear generation programme, spanning decades, and giving France quasi-energy independence. Similarly, it took long-term vision for Telenor, the Norwegian telecom group, to address the unmet telecom needs of South-East Asia as early as the 1990s. As a result of that vision, Telenor today is one of the largest telcos in the world in terms of subscribers. Both these companies are amongst the better valued companies in their respective sectors.

However, any or all of these benefits can easily be offset if the processes by which the states govern the enterprise are flawed. For example, if appointments to management or the board are politically motivated or driven by nepotism. Similarly, if boards fail to exercise quality oversight of management, or if the objectives they try to pursue are conflicting each other or are wanting.

Good governance is perhaps even more important for state-owned enterprises than for private companies, because of the multiple objectives that states will want to pursue, and the multiple roles they serve, as owner, clients, and often regulators. To create this environment states must put in place mechanisms to enable their ownership to be directed in a proper way.

This often starts with the state ensuring that its ownership in any given state-owned enterprise is under the responsibility of a single ministry, or one entity within a ministry. A decade ago, the French state put in place the Agence des participations de l'Etat (APE), a dedicated group within the Ministry of Economy. This has had a marked (positive) impact on the governance of state-owned groups in France.

In most cases when governments own a stake in a company, they will be represented on the board of directors, giving them the opportunity to play a constructive role ensuring that all the key elements of good governance are properly implemented from nomination to assessment, oversight, strategy and risk-taking.

Listing a state-owned enterprise on a stock exchange helps further good governance, but does not guarantee it. More important are independent directors (assuming they exist!) who play their role efficiently and constructively, and a strong desire within the government to make good governance happen.

With good governance, the advantages mentioned above can really come into play, and state ownership can create great value, not just for firms coming out of crisis but also for listed and non-listed state-owned operations in any market.

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