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Bhutan

State Owned Enterprises and Corporate Governance (SOE-CG) Report

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ACRONYMS & ABBREVIATIONS

BEA: Bhutan Electricity authority

BICMA: Bhutan Information Communications and Media Authority

BPC: Bhutan Power Corporation

CA, 2000 or the Act: Companies Act, 2000

Cumulative voting: Cumulative voting allows minority shareholders to cast all their votes for one candidate. Suppose that a publicly traded company has two shareholders, one holding 80 percent of the votes and another with 20 percent. Five directors need to be elected. Without a cumulative voting rule, each shareholder must vote separately for each director. The majority shareholder will get all five seats, as s/he will always outvote the minority shareholder by 80:20. Cumulative voting would allow the minority shareholder to cast all his/her votes (five times 20 percent) for one board member, thereby allowing his/her chosen candidate to win that seat.

DADM: Department of Aid & Debt Management

DE: Departmental Enterprises

FI: Financial institution.

FIA: The 1992 Financial Institution Act of Bhutan

GG+: Good Governance Plus Document

GDP: Gross Domestic Product

GNP: Gross national Product

GMS: General meeting of shareholders

GNH: Gross National Happiness

ICAI: Institution of Chartered Accountants of India

The Guidelines: The Guidelines for Boards of Government Corporations and for Government-appointed Board Directors

IFRS: International Financial Reporting Standards

ISA: International Standards on Auditing

MoF: Ministry of Finance

MTI: Ministry of Trade and Industry

Nu: Ngultrum, the currency of Bhutan. The Ngultrum is fixed at parity with the Indian Rupee.

OECD Guidelines: The OECD Guidelines on the Corporate Governance of State-Owned Enterprises

OECD Principles: The OECD Principles of Corporate Governance.

Pre-emptive rights: Pre-emptive rights give existing shareholders a chance to purchase shares of a new issue before it is offered to others. These rights protect shareholders from dilution of value and control when new shares are issued.

Proportional representation: Proportional representation gives shareholders with a certain fixed percentage of shares the right to appoint a board member.

RAA: Royal Audit Authority

Registrar: Registrar of Companies

RGoB: Royal Government of Bhutan.

RMA: Royal Monetary Authority, the Central Bank of Bhutan

RSEB: Royal Stock Exchange of Bhutan

RPT: Related party transactions. The OECD Principles of Corporate Governance hold that it is important for the market to know whether a company is being operated with due regard to the interests of all its investors. It is therefore vital for the company to fully disclose material related party transactions to the market, including whether they have occurred at arms-length and on normal market terms. Related parties can include entities that control or are under common control with the company, and significant shareholders, such as relatives and key managers.

SOE: State owned enterprise.

USD: United States dollar.

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Foreword

The *Bhutan: State-owned Enterprises Corporate Governance (SOE-CG) Report* is being undertaken at the request of the Ministry of Finance, Royal Government of Bhutan (RGoB). The World Bank Group's support was sought to assess the performance, efficiency, and remuneration policies of its State Owned enterprises (SOEs). It was agreed that the SOE-CG study would be undertaken in the context of a broad review of the country's legal and regulatory framework for *corporate governance, and that* a review of remuneration policy of senior executives, board members and employees of SOEs would form part of the SOE-CG study.

Corporate governance refers to structures and processes that direct and control companies. It deals with relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders. Good corporate governance is reflected in more accountable boards and management, increased financial transparency, improved internal controls, resulting in companies that operate on a more commercial basis with improved profitability and sustainable employment. By enhancing company performance, better corporate governance increases access to outside capital and contributes to sustainable economic development.

For many countries corporate governance has not been seen as a high priority reform issue because of the relatively few local companies either held by many shareholders or listed on a stock exchange. There is, nonetheless, considerable interest in the corporate governance of SOEs where state ownership and government control present inherent governance challenges, often contributing to their poor performance. The focus of SOE reform has been primarily on privatization, which remains the most direct solution to the problems of state ownership. It has become clear that, for both political and economic reasons, the state will remain a major owner of productive assets in a number of economies.

Extensive experience with privatization has also highlighted the importance of corporate governance before, during and after the state divests its assets. SOE corporate governance reform incorporates lessons on how to improve corporate governance in the private sector, and the international consensus that has developed regarding corporate governance reform. It builds on reforms to SOE administration and management in the 1970s and 1980s, and later efforts to prepare SOEs for privatization. Overall, corporate governance provides a coherent and tested framework for addressing key weaknesses of SOEs.

The *OECD Guidelines on the Corporate Governance of State Owned-Enterprises* outlines this framework, and what SOEs and governments need to do to ensure good corporate governance. This report follows the OECD Guidelines and defines an SOE as any enterprises with state ownership, a distinct legal form (separate from the public administration) and having commercial sales and revenues. This definition includes banks and financial institutions, as well as industrial companies and utilities. It also includes privatized companies with minority state ownership.

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The report reflects technical discussions with the Ministry of Finance, Ministry of Trade and Industry, Royal Monetary Authority, Royal Audit Authority, Anti-Corruption Commission, Royal Securities Exchange of Bhutan, Department of Aid and Debt Management, Department of Energy, Energy Regulatory Agency, Bhutan Chamber of Commerce and Industry, and other key stakeholders.

Executive Summary

Bhutan: State-owned Enterprises Corporate Governance (SOE-CG) reviews SOE corporate governance in Bhutan, outlines SOE compensation and personnel management policies, and recommends policy options to improve state enterprise performance and facilitate greater autonomy in SOE pay and personal management. Following the *OECD Guidelines on the Corporate Governance of State Owned Enterprises* the report defines an SOE as any enterprise with state ownership, a distinct legal form (separate from the public administration) and having commercial sales and revenues. This definition includes both wholly owned enterprises and those with minority state ownership.

SOEs are a central feature of the Bhutanese economy and evolved as an effort by the Royal Government of Bhutan (RGOB) to provide infrastructure and public services and to diversify the economy away from agriculture and hydropower. Private sector development, recent and small, continues to face constraints such as relative lack of scale and high fixed operating costs.

Of 175 registered companies, 84 were active, including 22 wholly or partially-owned by the RGoB. Taken together, these are the largest companies as measured by assets, turnover, or employment. About a quarter of all SOEs are loss-making. All loss-making SOEs are 100 percent government-owned and several fulfill non-commercial social objectives within their mandate, such as providing service to rural areas and subsidized tariffs.

CORPORATE GOVERNANCE FRAMEWORK: All SOEs have been corporatized and are governed by the 2000 Companies Act (CA) and other relevant guidelines governing companies. Guidelines for Boards of Government Owned Corporations and for Government Appointed Board Directors, issued in 2004, include standard provisions for corporate governance and oversight. State ownership is organized under a variation of the dual model with the Ministry of Finance (MoF) and a designated administrative ministry sharing ownership rights in each SOE. SOEs are required to have external auditors and are subject to audit by the Royal Audit Authority (the public sector auditor). Some oversight is also provided by parliament, the cabinet of ministers, and sector specific regulators.

SOE governance in Bhutan follows many aspects of good practice, and numerous OECD Guidelines recommendations have been established, including separation of ownership and regulatory functions, autonomy from government interference in day to day decision making, clear mandates and responsibilities for boards of directors, and adequate protection of minority shareholders of partially state-owned SOEs under the CA.

In several areas, however, SOE governance diverges from international best practices and requires remediation to strengthen the existing organization of corporate ownership. These include: the inability of boards of directors to remove their CEOs; heavy participation by ministers and civil servants on boards with little private sector or commercial expertise; and the lack of training for board members. Critically, responsibility for the state's ownership rights is diffused with limited accountability and sometimes unclear authority.

Several SOEs have broad and often opaque social mandates, combining commercial activities with crossed-subsidized social functions that are not always transparent or explicit. This weakens financial performance and limits the ability of SOEs to enact performance-based compensation policies. It also obscures the costs and benefits of government policy decisions for both the government and civil society.

SOEs face numerous and time-consuming accounting and auditing requirements At the same time, key weaknesses persist, and there is no effective aggregate reporting to the public that would present a transparent view of the state owned sector.

PAY AND PERSONNEL POLICIES: Government rules and practices heavily influence pay and personnel management policies of SOEs. Managing directors are often civil servants, and human resource management practices tend to emulate those of the government. Majority and wholly-owned SOEs must adhere to government guidelines, resulting in expensive and cumbersome procedures.

Wage expenditures for most loss-making SOEs often exceed the OECD average of 30 percent of expenditures and vary substantially as a proportion of total expenditures across all SOEs despite the utilization of three uniform and identical pay scales. Pay scales in SOEs with minority government ownership vary substantially and provide an interesting comparison to those set by the government.

Constrained personnel management policies include: the involvement of the Ministry of Labor and Human Resources in labor recruitment of majority or wholly-government owned companies; ineffective performance evaluation procedures; limited training opportunity; and remuneration policies that fail to link effectively the pay of personnel and directors to performance, productivity or efficiency.

A compressed base pay structure, particularly for majority and wholly government-owned SOEs, reduces the appeal of within-company promotions and increases the difficulty of attracting and retaining scarce management and specialized skilled employees. More accurate wage comparisons must consider full compensation packages; some of the most valuable benefits associated with public sector jobs, such as greater job security and more generous old-age pensions, are difficult to quantify.

POLICY RECOMMENDATIONS FOR STRENGTHENING CORPORATE GOVERNANCE

Strengthen the ownership function by creating a specialized division in the Ministry of Finance to represent the government as a shareholder and work with the administrative ministries to improve SOE corporate governance. The new ownership entity should be held clearly accountable to the general public and have the resources needed to protect their interest.

Regularly monitor and assess SOE performance at the aggregate level. Aggregate reporting, standard practice in many OECD countries, should be encouraged as an important instrument to introduce greater government accountability to the public.

Establish well structured and transparent board nomination processes in wholly or majority-owned SOEs. The ultimate selection criteria for board members should be competencies and skill relevant for the SOE.

Encourage active ownership and the systematic exercising of state ownership rights, including voting the state's shares. To facilitate this, the functions of shareholder and board member should be de-linked and different individuals should assume these roles.

Strengthen board responsibilities, qualifications, and independence. This can be facilitated by: allowing boards to select CEOs; broadening their composition to include individuals from the private sector with relevant industry expertise; reducing conflicts of interest by establishing audit committees and prohibiting ministers from serving as board members; evaluating and rewarding board performance; and increasing board remuneration and training.

Make transparent and explicit subsidies to various categories of consumers through SOEs, and measure the efficiency of their delivery to consumers. Where SOEs are required to achieve non-commercial objectives, the latter must be clearly and explicitly identified and agreement reached between shareholders and the corporation's agents on the nature and timing of these measures.

Focus and streamline RAA audits. Serious consideration should be given to streamlining audits to focus on SOEs use of implicit and explicit subsidies.

POLICY RECOMMENDATIONS FOR STRENGTHENING PAY & PERSONNEL POLICIES

Provide SOEs greater autonomy in determining pay and personnel policies. Given their diverse circumstances, SOEs need increased autonomy to develop specific pay and personnel policies that best fit their individual requirements and markets in order to attract and retain qualified people. Older practices inherited from an earlier era, when all SOE employees were part of the civil service, should be replaced by more market-oriented practices. SOEs that perform a social mandate and are loss-making will require additional reforms before implementing market-based remuneration policies.

Improve human resource policies. Human resource management in SOEs should be based on the merit principle of appointing the best person for any given job. This should be conducted through transparent, publicly understood, and merit-based recruitment and promotion policies that can be challenged if breached.

Develop a competitive and sustainable remuneration system. Remuneration should be competitive and market driven while remaining consistent with the economic realities of the SOE.

Remuneration for managing directors should provide incentives to enhance the corporation's value and to perform their responsibilities. New policies should reflect the need to further decompress the pay structure and to link management remuneration directly to corporate performance and profitability.

Performance evaluation policies should emphasize merit and employee development. Such policies would include: performance management systems to link clearly defined organizational objectives to individual work objectives; performance appraisal; and linking performance appraisal systems with clear incentives.

Strengthening training is critical for improving the functioning and performance of SOEs. Effective and targeted training can help address skills scarcities (such as technical and managerial skills) and build required capacity, for example to effectively implement and apply a more comprehensive performance system.

Areas for future research. To facilitate the design of a new remuneration policy for SOEs, availability of data on total compensation (wages, allowances and other benefits) and employment within companies is essential, as is the need for conducting market competitiveness analysis.

CHAPTER 1: **INTRODUCTION**

The SOE-CG study is structured as follows: ***Chapter 1*** presents a brief overview of Bhutan's economy, discusses the motivation behind establishing SOEs, and reviews the current SOE portfolio. ***Chapter 2*** surveys the SOE governance framework in Bhutan, including legal and institutional frameworks for ownership and control of SOEs, and highlights key SOE corporate governance issues. ***Chapter 3*** outlines compensation and personnel management policies of SOEs and highlights important issues. ***Chapter 4*** presents policy recommendations for improving state enterprise efficiency and principles for de-linking SOE employee compensation from the civil service pay scale. These draw on a detailed review of SOE governance in Bhutan relative to OECD Guidelines on SOE Governance (Annex 1), and an analysis of pay and personnel policies (Chapter 3).

I. Overview of Bhutan's Economy

Bhutan is a small economy with a GDP of Nu 32,814 million (US$ 735.6 million).[1] Landlocked between regional giants China and India, its population is estimated at 672,425.[2] Over the past 25 years, the country has made rapid progress, driven by the exploitation of vast hydropower potential and donor support.[3] Real GDP growth averaged more than 6 percent a year over this period, and sustained growth has increased Gross National Income (GNI) per capita in 2004 to about US$720. The economy is modernizing rapidly, albeit agriculture continues to account for about 26 percent of GDP, with industry and services representing 43 percent of GDP and 31 percent of GDP respectively. ***Much of the impressive transformation that has taken place since the opening up of the economy in the 1960s is attributed to the initiatives spearheaded by the government.*** As Table 1 indicates, public sector enterprises are a central feature of the Bhutanese economy, with expenditures amounting to 16.6 percent of GDP in 2004.[4]

Rationale for Establishing SOEs in Bhutan

The following factors have motivated the RGoB to establish SOEs:

- *Lack of scale and high fixed operating costs constrain private sector participation in Bhutan.* The small and dispersed population, combined with the country's formidable climate and topography, make vital infrastructure costly to build and maintain, and economies of scale difficult to achieve in service delivery. This often means that in the absence of such government intervention, many critical goods or social services may simply be unavailable. For example, informal discussions held with international airlines that could take advantage of landing rights in Bhutan through reciprocal arrangements found that they are not interested in doing so.[5] Similarly, Citibank, a major US bank, was invited to operate in Bhutan in 2001, and after just a few years discontinued operations. In the absence of the state-owned banks, financial intermediation would be much more limited and even today key features of modern commerce, like credit card use is very low in Bhutan. Hence, it is unclear to what extent the SOEs crowd out the private sector, and the need

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1These are estimated figures for 2004-05, as reported in the Statistical Year Book, 2004, National Statistical Bureau, Selected Economic Indicators, June 2005, Royal Monetary Authority, Royal Government of Bhutan.

2 This is according to the Bhutan Census 2005. Previously, the RGoB reported a population estimate of 734,000 in the Statistical Yearbook of Bhutan 2003, and other figures are noted elsewhere (including the World Bank's World Development Indicators). Greater consensus is expected once more demographic data analysis has been undertaken on the census. 79 percent of the population lives in rural areas.

3 Power generation provides approximately 35 percent of government revenue, excluding external resources which account for almost 50 percent of Government revenue (Source: Interview with DADM). India is the largest donor, and hydropower resources are being developed mainly with Indian support.

4 Non-commercial organizations/authorities such as the Royal Monetary Authority of Bhutan (RMA) and the National Pension and Provident Fund (NPPF) are not included.

5 This is mainly because of the extreme seasonality of the market. It is possible that the lack of interest is in part also due to concern about competing with an existing national carrier in a very small market, but it could well be that without Druk Air, access would be limited to arduous land routes. This would hamper the tourism industry, and business travel, as well as emergency medical services.

to ensure that essential goods and services for modernization are available appears to be an important consideration in the RGoB's establishment of SOEs.

- *SOEs diversify the economy and mitigate vulnerability.* Efforts to diversify the economy away from agriculture and hydropower, and thereby mitigate vulnerability, also appear to be a key motivation for RGoB support for industrial activity. Several of the largest enterprises, like the Bhutan Ferro Alloys Limited (BFAL) and the Penden Cement Authority Limited receive substantial support also in the form of low cost electricity.[6] These circumstances raise several questions: What is the cost of the diversification and perceived reduction of vulnerability? Is there positive value added to the activity when the full cost of all inputs is accounted for? For example, are the energy intensive industries generating value added equivalent to the opportunity cost of the electricity they are consuming?[7] While outside the scope of this study, answering these questions will be critical to assessing the RGoB's support to SOEs and how effectively the RGoB is intermediating resources to lower vulnerability through this channel.

- *Private sector is small, fairly new and relatively underdeveloped*. The RGoB has been promoting the private sector as the 'engine of growth' since the launching of the 1986 Five Year Plan, yet the private sector's revenue contribution during fiscal year 2004-2005 was a mere 8.3 percent of the total national revenue of Nu 6,120.409 million.[8] Although opportunities are expanding, the private sector in Bhutan is constrained by several factors arising from the small size of the domestic market, a historic lack of private sector activities outside of basic trading, a lack of adequately skilled labor, an underdeveloped infrastructure base, weak global links, and disadvantages associated with being landlocked. Of all the private sector firms surveyed in Bhutan, 20 percent listed lack of "skilled labor" as their "number one" constraint for private sector growth and productivity; many other firms listed it within their top three constraints to doing business in Bhutan.[9] While progress in educating Bhutanese workers has been remarkable, anecdotal evidence suggests that the *managerial* and *technical* skills and experience required by the private sector clearly continue to remain in short supply, while lower and entry level personnel typically are widely available. One reason for this is that the government has, up to this point, absorbed the majority of the skilled and educated work force into the civil service. This dynamic is now slowly changing as the government absorbs increasingly fewer and fewer school-leavers and graduates.[10]

- *SOEs play a substantial role in generating employment.* The largest non-hydropower firms in Bhutan are those that were set up by the RGoB, and employment generation is a key goal of government policy.[11] With the pay scale of SOE employees set significantly above similarly qualified private sector employees, the brightest people often prefer to join the civil service and SOEs, contributing to the difficulties faced by the private sector in meeting its skills gaps. With limited scope for expansion in government employment, this may no longer be possible.

6 About 50 percent of the cost of producing ferro alloys is electricity.

7 As discussed below in Section 7 on hydropower, the domestic tariff on electricity is about half the price received when sold to India. This is also attracting more companies seeking to take advantage of cheap electricity, and the Bhutan Power Co. has received requests for new demand from energy intensive industries amounting to 400 MW, equivalent to about 40 percent of Tala's installed capacity, as noted above.

8 Source: The National Revenue Report 2004-05 of the Department of Revenue & Customs.

9 See the Bhutan Private Sector Survey 2002, conducted jointly by the Bhutan Chamber of Commerce & Industries (BCCI), the Ministry of Trade & Industry and the World Bank. The Survey, covering 100 firms, identified lack of skilled manpower, bureaucratic burdens, other regulatory concerns, problems of infrastructure, limited technology, and finance as some of the major constraints faced by the small private sector.

10 Another missing component within the skill dynamic is "experience" – an attribute not learned in an academic institution. The challenge is to create employment in semi-skilled and skilled areas of economic activity that match the qualifications of the school-leavers – while simultaneously adjusting the school system and vocational training to better match the private sector's skill demands.

11 A caveat, the data on employment is quite limited, and the labor force surveys did not distinguish between public and private sector employment.

While an in-depth review of Bhutan's SOE strategy is beyond the scope of this report, it would be useful to analyze some of the specific aspects of SOEs in the Bhutanese context from the perspective of the RGoB's efforts to channel public sector resources into long-term growth, employment generation and poverty reduction. The RGoB should be particularly cognizant of the risks involved in government support to particular industries or using SOEs as a channel for employment generation, given the myriad failures across the developing world. Although the SOE sector, even excluding hydropower rents, contributes positively to government coffers, there are a range of issues pertaining to dynamic efficiency, governance arrangements, employee compensation, privatization, and competition, to name a few, that need to be carefully scrutinized to ensure that public resources from hydropower and aid are indeed being intermediated effectively into robust development. The RGoB recognizes that, while hitherto it has been the main engine for economic development, the situation needs to evolve rapidly with the private sector assuming a much greater role in terms of economic growth and employment generation. Therefore, the RGoB is committed to creating an enabling environment for the private sector and in developing policies aimed at strengthening market forces, increasing competition, and refocusing the role of the state.

Private vs. Public Sector Enterprises

In 2005 there where 175 registered companies, of which 84 were reported as active. These include 22 companies with direct government ownership. Taken together, these are the largest companies, as measured by assets, turnover, or employment. For example, the 18 SOEs where government ownership was 50 percent or more had 6119 employees in 2005. The 34 other companies for which data was available had a total of 2998 employees.[12]

SOEs were established in the 1970s as Departmental Enterprises (DE). The biggest private sector companies in Bhutan by far are those that were started by or with the RGoB, such as Bhutan Carbide and Chemicals Limited (BCCL - now completely private) or others where the RGoB maintains a significant stake. Since the sixth FYP one of the main strategies of the RGoB has been the corporatisation of government agencies and divestment of government equity to the private sector. By the 1990s, the DEs were corporatized. The privatization of the state-owned commercial enterprises continued through divestment of shares with focus on broad based ownership.[13]

Most educated Bhutanese have a strong preference to work for the civil service, followed by SOEs, with the private sector coming out last in the hierarchy of attractive employers. The preference for *civil service careers* is greatly influenced by greater benefits and compensation including availability of pensions, and job security. Aside from prestige, civil service provides more attractive career development opportunity. *SOEs* provide employee benefits that resemble those of the civil service, including pensions, free housing, free transport, and loans at preferential terms.[14] Compared to SOEs and government employment, *private sector employment generally does not include pension benefits* and offers the least compensation, training and advancement opportunity,[15] and worker protection.[16] This is not surprising given that the bulk of the private sector in Bhutan is small-scale with nearly 98 percent of all licensed entities being cottage and small enterprises.[17] Most of these enterprises are sole proprietorships with limited scope for growth due to demand and supply side constraints.

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12 Since that time, the RGOB's stake in one company has been reduced, leaving 17 companies with 50 percent or more government ownership.

13 For instance, it reduced its stake in such entities as the Bank of Bhutan. On the other hand, the RGoB increased its share of Druk Air with the purchase of a new Airbus, which was contributed in equity.

14 Some SOEs pay bonus to their employees but the bonus is not performance related. Every employee receives it. It can be worth as much as two months salaries.

15 According to the findings of the Bhutan Private Sector Survey 2002, virtually no firms undertook any serious staff training – despite their complaints over a lack of skills. Within the entire survey, only 3 percent of the employees had received training over the preceding 12-month period.

16 For instance, the minimum wage applies only to Bhutanese public sector workers, with limited impact on private sector. This, among other things, shall change when the Labor and Employment Act is enacted by the Assembly later this year.

17 The size of establishment is determined by capital input: cottage enterprises have a capital base of Nu. 0.5 million (US$10,500) or less, small enterprises Nu. 0.5 to 5 million (US$105,000), medium Nu. 5 to 20 million (US$420,000), large greater than Nu. 20 million. The cottage and small firms are largely comprised of small family-run businesses such as restaurants, tea stalls, and rice mills.

II. Public Sector Portfolio

The SOE portfolio in Bhutan consists of 14 wholly-owned companies, and 8 companies where ownership is shared with the private sector. In the latter the RGOB has a majority stake in 3 companies and a minority stake in 5 (see table 1.1). This is counting only direct ownership. The government also has indirect stakes through the holdings of state owned financial institutions and government funds. For example, while Bhutan Carbides & Chemicals has no direct state ownership, 39 percent of its equity is held by financial institutions which in turn have some direct state ownership. For the purposes of this report, the focus will be on companies where the RGOB has direct ownership and exercises ownership rights. 16 companies in Bhutan are listed, 6 of these are SOEs. The government's direct holdings in these companies represent 25 percent of total market capitalization.

These companies operate in a variety of sectors: the manufacturing sector (3), the financial services sector (4), and the services sector (2). Six of these SOEs are listed on the Royal Stock Exchange of Bhutan (RSEB).[18] Government ownership levels vary across the sector, ranging from a 25 percent stake in Bhutan Ferro Alloys Limited (BFAL) to 100 percent government ownership of the hydropower companies. As the Bhutanese economy serves a small market, many SOEs operate in limited competitive environment. Some, such as Bhutan Power, Bhutan Telecom, Druk Air and the Royal Insurance Corporation operate in a monopolistic environment.

Financial performance varies, with about 25% of the reviewed SOEs loss-making (see table 1.1). Losses total about Nu. 163 million - equivalent to about half a percent of GDP- compared with about Nu. 4.0 billion in profits of the 15 other SOEs. One SOE, Druk Air accounts for almost half of these losses. There appears to be a direct link between corporate autonomy and profitability as all loss-making SOEs are 100% government-owned. These include Bhutan Broadcasting Services Ltd (BBS), Bhutan Postal Corporation Ltd. (BP), Bhutan Power Corporation Ltd (BPC), Druk Air Corporation Ltd, Kurichu Hydropower Corporation Ltd. (KHPC). BBS, BPC, Druk Air, and KHPC have been structurally loss-making, while Bhutan Post has been loss-making the last two years while generating a profit the previous three years. Bhutan Agro Industries Ltd. (BAIL) reported a small profit in 2005 while the previous 4 years resulted in a loss. All other SOEs have been structurally profitable over the last 4 to 5 years.

A number of SOEs fulfill non-commercial social objectives within their mandate: Bhutan Power Corporation, Bhutan Telecom Ltd, Bhutan Postal and Druk Air need to provide service to rural areas and/or worked with (subsidized) tariffs. Not surprisingly, 3 out of these 4 SOEs are not profitable. Bhutan Development Finance Corporation (BDFC) has a social responsibility to provide low interest loans to the rural population. Druk Air and Bhutan Post are the only two SOEs that fulfill a social mandate, are loss-making and receive some form of government subsidy. Druk Air receives an annual subsidy from the government (respectively 13%, 2% and 10% of income in the past three years).[19]

The next chapter reviews the corporate governance framework for SOEs in Bhutan.

18 These include Bhutan Board Products, Bhutan Ferro Alloys, Bhutan National Bank, Penden Cement, Royal Insurance Corporation of Bhutan, State Trading Corporation of Bhutan.

19 Bhutan Postal Corporation received a subsidy of around 1% of income both in 2004 and 2003. The following SOEs receive subsidies from the government: BBS (85% and 82% of total income in 2005 and 2004), WCC (7%, 9%, and 16% of income the last three years), BDFC (respectively 17%, 15% and 13% of income the last three years) and FCB (4%, 4.5% and 4.3% of income in 2004, 2003 and 2002 respectively).

Table 1.1: **Key Indicators of State Owned Enterprises in Bhutan (2005)**

(Millions of Nu)

Name	State Share	Sector	Income *(Millions of Nu)*	Expenditure *(Millions of Nu)*	Net Profit *(Millions of Nu)*	Employees	Listed ?
Total SOEs							
(as a percentage of GDP)			31.9	17.6	5.8		
Army Welfare Project (AWP)	100	Manufacturing	258.7	208.9	27	N/A	NO
Bhutan Agro Industries Ltd (BAIL)	100	Manufacturing	33.5	30.4	1.1	90	NO
Bank of Bhutan (BoB)	80	Financial	616.6	415.5	133.5	560	NO
Bhutan Board Products Ltd (BBPL)	45	Manufacturing	330.8	272.4	31.7	414	YES
Bhutan Broadcasting Services Ltd (BBS)	100	Infor. / dia	45.2	56.9	[20.5]	185	NO
Bhutan Development Finance Corp. (BDFC)	87	Financial	166.9	48.9	77.7	133	NO
Bhutan Ferro Alloys Limited (BFAL)	26	Manufacturing	667	591.5	33.2	264	YES
Basochu Hydropower Corporation (BHPC)	100	Energy	289	77.4	70.1	50	NO
Bhutan National Bank Ltd (BNB)	14	Financial	594.5	283.1	151.6	231	YES
Bhutan Postal Corporation Ltd	100	Communication	62.5	54.8	[6.7]	269	NO
Bhutan Power Corporation Ltd (BPC)	100	Energy	791	219.5	197.8	1384	NO
Bhutan Telecom Ltd	100	Communication	3,218.60	734.8	1,669.00	681	NO
Chukha Hydropower Corp. Ltd (CHPC)	100	Energy	1,012.70	685.4	[62.4]	681	NO
Druk Air Corporation Ltd	100	Transport	N/A	N/A	N/A	227	NO
Food Corporation of Bhutan Ltd (FCB)	100	Trading	N/A	N/A	N/A	173	NO
Forestry Development Corporation Ltd (FDCL)	100	Manufacturing	214.3	139.9	27.7	223	NO
Kuensel Corporation Ltd	100	Infor./ Media	73	55.4	3.7	116	NO
Kurichu Hydropower Corporation Ltd (KHPC)	100	Energy	574.1	93.9	[229.5]	177	NO
Penden Cement Authority Ltd (PCA)	47	Manufacturing	1,131.10	786.2	180.8	791	YES
Royal Insurance Corp. of Bhutan (RICB)	39	Financial	128.3	6.3	72.6	193	YES
State Trading Corporation of Bhutan Ltd (STCB)	51	Trading	535.2	527.4	4.2	93	YES
Wood Craft Center (WCC)	100	Manufacturing	24.5	22	0.8	40	NO

CHAPTER 2: **SOE CORPORATE GOVERNANCE FRAMEWORK**

This chapter surveys the corporate governance in Bhutan, focuses on the legal and institutional frameworks for ownership and control of SOEs, and concludes by highlighting key corporate governance issues.

I. Legal Framework

There is no separate legal framework governing SOEs. All SOEs have been corporatized and are primarily governed by the 2000 Companies Act (CA). Other salient government guidelines, provisions and laws governing companies are also described below.

Companies Act of 2000

The CA is the fundamental law governing all enterprises, including SOEs, whether fully state-owned or partially state-owned. Prior to 1989, all public companies were governed by their charter. In 1989, a first Companies Act was enacted and fundamentally revised in 2000.

The CA distinguishes between government, government-controlled, public, and private companies. *Government companies* are companies whose shares are 100 percent or wholly-owned by the RGoB. *Government-controlled companies* can be either private or public companies where the government directly or indirectly holds 50 percent or more of the share capital. When the government holds less then 50 percent, the company is either a private or public company and no special rules apply. Companies that are not wholly-owned may be listed on the stock exchange.

The CA is relatively comprehensive and includes provisions similar to those found in laws on securities and accounting and auditing in other common law countries. It sets forth requirements for the incorporation of companies; rules governing company share capital and debentures; disclosure standards for prospectuses and on-going disclosure obligations, including form and content of financial statements and audit reports; rights and obligations of depositories; participants and beneficial owners; the role of the Registrar; and corporate management and administrative obligations regarding compromises, arrangements, reconstructions amalgamation, statutory inspections, and company termination.

Specific clauses in the Act apply only to Government Companies. For example, Section 59 (4) allows Government Companies to conduct their GMS during a board meeting.[20] Article 96, allows the RGoB to merge (amalgamate) two or more Government Companies without having to comply with Sections 92-94 of the Act. Article 134 of the Act stipulates that, by general or special order, the RGoB may direct that any of the Act's provisions shall not apply to a Government company or with such modification as deemed fit.

The Ministry of Trade and Industry, ultimately responsible for the enforcement of the Act, is empowered to give approval, sanction, consent, confirmation, recognition, direction or exemption.[21] Revisions to the CA and implementing regulations are currently in progress.[22]

Other Salient Guidelines, Provisions and Laws

Guidelines for Boards of Government-owned Corporations and for Government Appointed Board Directors (The Guidelines) were issued by the Ministry of Finance in 2004. These guidelines apply to wholly-owned and majority-owned SOEs through *direct* ownership. Because they lack the full force of law, their implementation has been limited.

The Guidelines define the role of the Council of Ministers, the Ministry of Finance (MoF) and the administrative ministries. They set out procedures and responsibilities for the appointment and removal of board members; discuss their entitlements and their roles, including the role of the Chairman of the board; lay out the procedures for the appointment and removal of the CEO and discuss his/her role; set out the audit requirements for SOEs, and the standards of disclosure and transparency that the latter

20 "The business to be transacted in an Annual General Meeting may be conducted in a Board meting within the time frame prescribed. Notice calling the meeting shall refer it as Board cum Annual General Meeting.

21 Article 135 of the Act.

22 Source: CG ROSC 2006 for Bhutan.

must follow; and discuss performance evaluation.

Other applicable legislation includes the RSEB Listing Rules[23], the Bankruptcy Act 1999, the Negotiable Instrument Act 2000, the Prudential Guidelines of the RAA, the Moveable and Immoveable Property Act, and the National Assembly Act of the kingdom of Bhutan 2004. The 1992 Financial Institutions Act (FIA) regulates the provision of financial services, including banking and insurance as well as securities related activities. This has been supplemented by the 2002 Prudential Regulations issued by the RMA, which are applicable to bank and non-bank financial institutions. The FIA and 2002 Prudential Regulations, together with the CA, provide the legal framework for all financial institutions. These include requirements for each financial institution to have an audit committee, and they supplement the director qualification and conflict-of-interest provisions of the CA.

No law focuses exclusively on capital market regulation and oversight, but the Royal Monetary Authority is currently preparing a Financial Services Act. Neither an anti-trust law nor a labor code currently exists.

Several provisions in **Good Governance Plus** (GG+), released by the Prime Minister's office in 2005, regulate the governance of the SOEs and of the corporate sector in general. Specifically, paragraph 72 stipulates that "the Government [should] strictly implement the Guidelines for the Boards of Government Corporations, and that the recruitment for the government corporate boards shall be through open competition, and not seconded from the civil service henceforth." The GG+ document has recommended the establishment of Board of Corporate Affairs to oversee all the corporate bodies including the SOEs.

II. Institutional Framework for Ownership and Control

The institutional framework for the ownership and control of SOEs in the Kingdom of Bhutan is presented in the diagram on the following page. Key institutions include the Ministry of Finance (MoF), the Administrative/Line Ministries, the Council of Ministers, and the control bodies. The framework distinguishes between SOEs that are wholly-owned or majority-owned through *direct* ownership, and SOEs that are minority-owned (only taking direct ownership into consideration). As noted above the Guidelines and certain provisions of the CA only apply to the former.

Ownership Entities

At present, the ownership function of the State is organized under a variation of the dual model, with the MOF and Administrative Ministries playing a central role, and the Council of Ministers at the apex. The dual model is quite common worldwide. Inside the OECD, Australia, Greece, Italy, Mexico, Korea, New Zealand Turkey and the UK follow this model. Outside the OECD, Brazil, Bulgaria, India, Kenya, South Africa, and Vietnam all have variations on the dual system.

The MoF holds the share certificates of the SOEs on behalf on the State. By virtue of this function, the Finance Ministry is the government body that attends shareholders meetings and votes the Royal Government's shares. A representative of the MoF is also always on the board of wholly-owned and majority-owned SOEs. The MoF is also responsible for formulating recommendations to the Council of Ministers on the following maters: (a) foreign borrowings; (b) initial capital structure of the SOE; (c) capital expenditures involving foreign exchange exceeding USD 5 million; (d) foreign collaboration and foreign equity participation; (e) divestment of shares/privatization; and (f) pay, allowances and other incentives of the corporate staff. The MoF is also responsible for reviewing the performance of wholly-owned and majority-owned SOEs, recommending corrective measures to the Royal Government and issuing corporate assessment guidelines in consultation with sector ministries.[24]

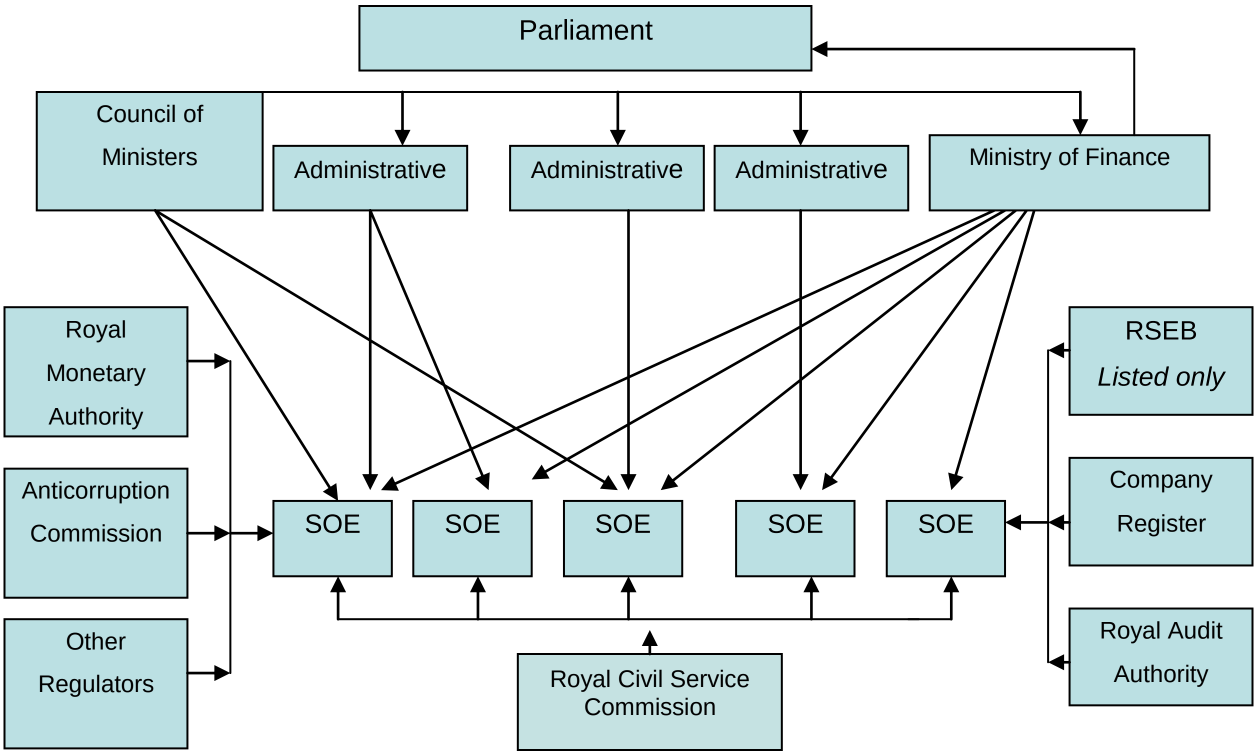
As per Section 59 (4) of the CA, there is no separation between the function of board member and the function of shareholder. The MoF representative who is appointed on the board of a SOE is also the one casting vote at the GSM. In addition, the Finance Ministry has provided guidelines on the compensation of SOE employees, and is responsible for preparing the annual report on the performance of the SOE portfolio submitted annually to Parliament.

23 Currently in the process of being revised (Source: RSEB).

24 See Section 7 of the Guidelines.

State-Owned Enterprises in Bhutan: Institutional Framework for Ownership and Control

The Current Model



The **Administrative Ministries** are responsible for setting sectoral policies, ensuring that SOEs under their oversight implement such policies, and that the SOEs' activities meet the purpose of their establishment. In the case of wholly-owned and majority-owned SOEs, the ministries are also responsible for monitoring and submitting reports to the MoF and the Council of Ministers on the performance of the SOE(s) under their annual oversight and recommending the appointment of the Chairman of the Board and the other board members.

The following matters require approval of the **Council of Ministers** for wholly-owned and majority-owned SOEs, as per Section 6 of the Guidelines:[25] (i) appointment of Government Directors including the Chairman; (ii) appointment of the CEO; (iii) capital expenditures involving foreign exchange exceeding USD 5 million; (iv) foreign collaboration agreements and foreign equity participation; (v) divestment of shares/privatization; and (vi) articles of association and any change thereto. For minority-owned SOEs, the appointment of the CEO is vested with the SOE's board of directors, as per Section 85 of the CA, 2000, although there have been instances where the provisions of the Act have not been implemented.

Control and Regulatory Bodies

The following institutions regulate SOEs:

***Parliament*.** Each year the Minister of Finance reports to Parliament on the performance of the SOE portfolio as part of the National Budget Report.

***Royal Monetary Authority (RMA)*.** The RMA regulates the financial services sector, including the functions of banking and securities. The RMA oversees certain governance and disclosure requirements of financial institutions found in the FIA and 2002 Prudential Regulations.

[25] The Guidelines supplement the provisions of the CA, 2000. In the case of a conflict between the two, the provisions of the CA, 2000 shall prevail.

Anticorruption Commission**.** This commission was set up by Royal Decree in December 2005 to curb corrupt practices in the public and private sector, in anticipation of the transformation of the Kingdom's constitution into a parliamentary democracy in 2008. Its mission is to "build an in-corruptible society, which upholds the value of Right View, Right Intention, Right Speech, Right Action, Right Livelihood, Right Effort, Right Mindfulness, Right reflection." It has a staff of eight professionals. A draft Anti-corruption Act is in preparation.

Company Registrar**.** The Registrar of Companies (Registrar) is part of the Ministry of Trade and Industry (MTI). Both are given key powers under the CA. The Registrar collects a variety of documents from companies and conducts annual inspections of most companies, including SOEs, to ensure they comply with the basic requirements of the Act.

Royal Audit Authority (RAA). The RAA conducts audits focused on procurement transactions and employee expenses, but is moving towards broader measures of performance. The RAA also reviews external audits of Bhutanese companies and maintains a list of auditors authorized to conduct them.

Royal Stock Exchange of Bhutan (RSEB). All trades in shares of listed companies, including SOEs, must go through the RSEB, the Kingdom's sole stock exchange. The RSEB is responsible for trading, clearing and settlement transactions. It oversees the central depository and Listing Rules enforcement including the latter's disclosure requirements. It can amend the Listing Rules with the approval of the RMA. The RSEB has six staff, including the head, two support staff, and one responsible for trading, one for listing and one for the depository. It belongs to the South Asian Federation of Exchanges, which seeks to promote cross border trade and listing in amongst its members.

Royal Civil Service Commission (RCSC). Until recently, the RCSC played a critical role in the nomination of CEOs of SOEs when the latter were exclusively selected from the pool of senior civil servants. The Commission continues to play a critical role in the disciplining of SOE managers when the latter retain their civil service status.

Other Institutions**.** These include the National Environment Commission**,** the regulatory agencies for the hydropower and the telecommunication sectors, and other similar government organizations which may play an oversight role.

III. Concluding Key Issues

SOE governance in Bhutan follows many aspects of good practice, and numerous OECD Guidelines recommendations have been established. These include:

- The State has largely separated the ownership and regulatory functions for SOEs.
- SOEs are generally subject to the same laws and regulations as other companies.
- All SOEs have been corporatized and fall under the comprehensive CA, 2000 provisions. The insolvency/bankruptcy regime for SOEs resembles that of private companies.
- The State is not generally involved in the day-to-day management of SOEs.
- The mandate and the responsibilities of the board of directors of SOEs are clearly set out.
- Minority shareholders of partially state-owned SOEs are largely protected by the CA, 2000.

However, there are a number of areas where the SOE governance framework diverges from international good practice, as identified in the detailed review of the *OECD Guidelines* in Annex 1. Key issues and challenges are captured below.

The State is not a strong "owner" of corporate assets. Accountability for SOE performance and exercising the state's ownership rights is currently diffused across the administrative ministries, the MoF, the Cabinet of Ministers, SOE boards, and, until recently, the Royal Civil Service Commission. There is no clear "ownership entity", as distinct from regulator or (non-ownership) policy maker.

While accountability and authority are diffused, the same MoF representative may act as both shareholder and board member, functions which should be kept separate. The first function emphasizes financial returns for the individual shareholder, while the second function ensures that all shareholders are treated equally and that the interests of stakeholders and the company as a whole are taken into account.

The current "nomenclature" for SOEs, i.e. limiting certain rules or guidelines to SOEs with majority direct government ownership, limits the government's role in companies for which it has less than a 50% stake. This further reduces the state's ownership role, although it also gives those companies greater leeway to determine their own human resource policies, as discussed in chapter 3.

Boards have limited authority and lack private sector participation. The Guidelines released by the MoF in 2004 outlined the responsibilities of the board of directors of wholly-owned and majority-owned companies. These Guidelines are broadly in line with the OECD Principles and the OECD Guidelines. However, SOE boards face a number of corporate governance challenges. which include:

- One of the fundamental responsibilities of the board is to select and if necessary, remove the CEO. In Bhutan, the board is only empowered to recommend a particular candidate, via the Sector Ministry, to the Cabinet which makes the ultimate decision. If the government wishes to appoint a civil servant to the post, the candidate is selected from the list of eligible Civil Servants candidates provided by the RSCS. A non civil-service candidate may be recommended by the board. In practice, the "appointment" of the CEO by the Cabinet places the CEO above the board of directors; de facto, the CEO is not accountable to the board but to the Cabinet and cannot be removed by the board. More recently, the RGoB has taken positive steps by announcing that CEOs of Government Companies and majority-owned SOEs who have been seconded to the corporation will henceforth be required to resign from the civil service and compete for their new post with private sector candidates.
- The MoF always has a seat on the board of directors of an SOE. Other board members are usually senior civil servants, including ministers. According to the Guidelines of 2004, directors should be highly skilled, experienced and knowledgeable people with a balance of skills in areas such as commerce, finance, accounting, marketing, management and other relevant technical fields. However, as noted earlier, no guidelines or codes of ethics have been developed for board members of state companies. Many observers express the opinion that board members of SOEs do not understand many aspects of their role. Most State representatives are appointed to the board by their Ministry. Some Ministries apparently have "pre-board" meetings for some companies during which they discuss important issues and produce specific management instructions. There is no tradition of acting in the interests of all shareholders.
- In practice, board remuneration remains very low. More autonomous SOEs will place greater demands of responsibility, involvement and professionalism on board members.
- Little to no training and guidance is provided for boards on board composition or board duties, responsibilities or functions.

Several SOEs have broad, and often opaque social mandates. Several SOEs combine commercial activity with crossed-subsidized social functions. As a result, some SOEs are barely profitable, others generate losses, and still others generate substantial profits. This situation complicates the ability of SOEs to structure employee and senior management compensation on the basis of performance..

Because subsidies are paid through profitable activities of SOEs, they are not accounted for by the government. Consequently, neither Parliament nor civil society fully understands the costs and benefits of government policy decisions. The government itself does not have a clear picture of the magnitude of the various subsidies in relation to government revenue or GDP. Given that 60% of the loss-making SOEs fulfill a social mandate, addressing issues associated with social mandates remains essential.

SOEs face numerous inconsistent and time-consuming accounting and auditing requirements. Bhutan has "de facto" accounting standards in the CA. The State has relied heavily on Indian GAAP (all audit firms used in Bhutan are based in India), but is moving toward IFRS even as it renews discussion of developing domestic standards. Some SOEs in Bhutan, as in other countries, also have to prepare information for public sector accounts, a requirement with its own standards. Of particular concern for SOE management is the audit regime, with SOEs having both external and regular RAA audits. This is addition to other possible audits, such as the tax audit.

For all these standards, SOE transparency is limited (though not particular poor when compared to other countries) and there are key weaknesses in the disclosure regime. Like other companies, SOEs often lack an internal audit function and only financial companies have audit committees. Domestic capacity for accounting and auditing is limited, both in terms of the profession and domestic oversight. Poor accounting for the use of implicit or explicit subsidies is particularly problematic. The Accounting and Auditing Report on Standards and Codes (forthcoming) for Bhutan addresses many of these issues in more detail.

Recommendations to address these challenges are discussed in Chapter 4. The focus of the next chapter is on compensation and personnel management policies of SOEs.

CHAPTER 3: **PAY AND PERSONNEL POLICIES of SOEs**

The chapter describes SOE pay and personnel policies and analyzes remuneration policies, including pay scales, and personnel management issues.

I. Review of Pay and Personnel Management Policies

Review of Pay and Personnel Management Policies

Government rules and practices heavily influence pay and personnel management policies of SOEs. Human resource management practices of each corporation are guided by manuals and regulations which often emulate those of the civil service manual. Majority and wholly-owned government SOEs are also required to adhere to specific government guidelines, often resulting in expensive or cumbersome processes and procedures.[26] In addition, boards for majority and wholly-owned government SOEs must ensure that they have a well-documented HRD policy that closely resembles that followed by the government for its non-corporate bodies.[27] A number of managing directors are civil servants (see annex 3), though other SOE employees are not.

The MoF establishes the remuneration of all employees of majority and wholly government-owned public enterprises which is linked to the civil service system. As custodian of the government's shares,[28] the MoF must review and recommend all pay, allowances, and other staff incentives, keeping in view the need to maintain parity among different SOEs given their functions, size, performance, specific market conditions, and labor market requirements.

When SOEs were corporatized in the 1990s, the pay scale of SOE employees was set 35% to 40% higher than for similarly qualified civil servants. The rationale for this differential was that SOE employees are required to work longer hours, and under greater pressure, and have limited career prospects, and face a somewhat more unstable position than that of civil servants. This allowed the managers of the SOEs to retain their civil servants status. In the mean time, salaries of civil servants were frozen until 2005.

In 2005, salaries of civil servants were raised and made roughly at par with those of SOE employees. Since then, SOE employees have favored reinstalling the prior differential. The RGoB is concerned that SOE employee salary increases will reduce SOE profitability and consequently taxes and dividends paid to the government. In 2005, the RGoB's Council of Government decreed that CEOs of SOEs who wish to retain their managerial positions must resign from the civil service and compete for their jobs in a recruitment process open to private sector candidates. CEO appointments were designated for a fixed period of time, (3 years) renewable. This decree has not take effect rapidly. One issue clouding the determination of the salary scale of SOE employees is the fact that the RGoB uses its SOEs to deliver social programs without funding such activities. The latter are financed through profits generated from the commercial activities of the enterprise. As a result, some SOEs have little scope for making profits. Therefore compensation cannot be determined in part on the basis of the operational and financial performances of the SOE, nor on the basis of supply and demand in the labor market. It is partially in this context that RGoB is keen to review the compensation of SOE employees.

SOE Remuneration and Pay Scales

SOEs are assigned one of three pay scales based on capital size, strategic importance, and seniority of the managing director. Table 3.1 illustrates how various SOEs are grouped.

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26 In addition to human resource management, this also applies to auditing, purchase and procurement.

27 As per Guidelines for Boards of Government Corporations and for Government-appointed Board Directors (Ministry of Finance)

28 As per Guidelines for Boards of Government Corporations and for Government-appointed Board Directors (Ministry of Finance)

Table 3.1: **Pay Scales for selected Majority and Wholly Government-owned SOEs**

High Pay Scale	Medium Pay Scale	Low Pay Scale
Bhutan Develop. Finance Corp.	Army Welfare Project	Bhutan Agro Industries Ltd
Bank of Bhutan	Bhutan Broadcasting Serv. Corp.	Basochu Hydro Power Corp. Ltd
Bhutan Postal Corporation	Forestry Development Corp. Ltd	Kurichu Hydro Power Corp.
Bhutan Power Corporation Ltd	State Trading Corp. of Bhutan	Wood Craft Centre
Bhutan Telecom Ltd		
Chukha Hydro Power Corp.		
Druk Air Corporation		
Food Corporation of Bhutan		
Kuensel Corporation		

Uniform and identical pay scales provide the monthly base salary (in Ngultrum), excluding bonuses, allowances and benefits. The only difference between the 3 base pay scales designed by the Ministry of Finance is the highest pay level available. For example, the highest pay level in the medium pay scale is identical to the second level in the highest pay scale. Table 3.2 provides an overview of the three pay scales for majority and wholly government-owned SOEs, with the minimum, increment and maximum payment for the various grade levels.

The highest pay structure aligns the minimum base wage for managing directors to the pay range of Level 2 civil servants. The medium pay structure aligns the pay for managing directors to Level 3 civil servants, and the low pay structure does so to Level 4 civil servants. The MoF also decreed that end-of-year bonuses may not exceed 2 months of salary, in accordance with civil service practice.

Table 3.2: **Overview of Three Pay Scales for Majority and Wholly Government-owned SOEs**

Minimum	Increment	Maximum	Grade		
			Highest Pay Scale	Medium Pay Scale	Lowest Pay Scale
29,065	725	43,565	1		
24,570	615	36,870	2	1	
19,220	480	28,820	3	2	1
16,975	425	25,475	4	3	2
14,880	370	22,280	5	4	3
13,255	330	19,855	6	5	4
10,850	270	16,250	7	6	5
9,920	250	14,920	8	7	6
8,990	225	13,490	9	8	7
8,215	205	12,315	10	9	8
7,285	180	10,885	11	10	9
6,745	170	10,145	12	11	10
6,355	160	9,555	13	12	11
5,970	150	8,970	14	13	12
5,425	135	8,125	15	14	13
5,040	125	7,540	16	15	14
5,020	120	7,420	17	16	N/A
4,885	115	7,185	GSC I	GSC I	GSC I
4,650	110	6,850	GSC II	GSC II	GSC II

SOEs with ***minority*** government ownership, in contrast, are able to set their own remuneration levels, dependent on approval by the Board of Directors. Pay scales in minority government SOEs typically vary more and often exceed pay scales set by the Ministry of Finance.[29]

II. Analysis of Pay Policies

Wage expenditures for most loss-making SOEs are high relative to the OECD average of 30 percent of expenditures. Loss-making SOEs typically have high relative wage bills and are grouped in the high pay scales (see table 3.3 below for details). A review of available information on the wage bill expenditure of various SOEs shows substantial variance in employment expenditure relative to total expenditure.

Table 3.3: **Overview Wage Bill Expenditure and Pay Scale for Loss-Making SOEs**

Name of Corporation	Wage Percentage of Total Expenditures	Pay Scale	Profitability
Bhutan Broadcasting Services Ltd	57.1%	Medium	Loss-making
Bhutan Postal Corporation Ltd	50.2%	High	Loss-making
Bhutan Development Finance Corp	49.9%	High	
Kuensel Corporation Ltd	41.6%	High	
Bhutan Telecom	41.3%	High	
Bhutan Power Corporation Ltd	40.5%	High	Loss-making
Kurichu Hydropower Corporation Ltd.	33.5%	Low	Loss-making
OECD Average	**30%**		
Basochu Hydropower Corporation	28.3%	Low	
Forestry Development Corporation Ltd	26.6%	Medium	
Wood Craft Center	22.2%	Low	
Chukha Hydropower Corporation Ltd	19.5%	High	
Bank of Bhutan	18.6%	High	
Bhutan Agro Industries Ltd	18.0%	Low	
Orissa Power (India)	**17%**		
Penden Cement Authority Ltd	12.9%		
Druk Air Corporation Ltd	10.4%	High	Loss-making
Druk Air Corporation	10.4%	High	
State Trading Corporation of Bhutan Ltd	2.1%	Medium	

Current remuneration policies do not effectively link pay to performance, productivity and efficiency of SOEs. Boards of Director are compensated with a minor sitting fee (typically between BTN 3,000 to 5,000 per board meeting). Compensation for managing directors does not change, irrespective of the performance of their corporation. Employees in most SOEs receive standard end-of-year bonuses that are not linked to individual performance.[30] Available wage data shows that 6 out of 15 SOEs paid end-of year bonuses in the 2004 and/or 2005.[31] Interestingly, among the SOEs that provide bonuses are

29 See appendix 7 for an overview of the pay scales for three minority government-owned SOEs: Bhutan Ferro Alloys Ltd, Bhutan National Bank and Royal Insurance Corporation of Bhutan Ltd.

30 End-of year bonuses for SOEs are capped at a maximum of 2 months by the Ministry of Finance.

31 Wage bill information is available for the following SOEs: BAIL, BoB, BDFC, BHPC, Bhutan Post, BPC, Bhutan Telecom, CHPC, Druk Air, FDC, Kuensel, KHPC, PCA, STCB, WCC.

two loss-makers: Bhutan Power Corporation and Kurichu Hydropower Corporation.

Pay scales in **SOEs** with minority government ownership vary substantially and provide an interesting comparison to those set by the government. Graph 3.1 provides an overview of the difference in base pay levels between minority SOEs and majority government-owned SOEs[32]. It compares both the minimum and maximum levels within each pay scale.

Graph 3.1: **Percent difference in pay scale between minority government-owned SOEs and high pay scale for majority and wholly government-owned SOEs, by employment grade.**

The minimum pay for each grade level at the minority government-owned Royal Insurance Corp. of Bhutan (RICB) is similar to those at majority and wholly-government-owned SOEs. However, the maximum pay level for each grade in RICB is approximately 16% higher than the corresponding levels for majority SOEs. In the case of the minority government-owned Bhutan Ferro Alloys Ltd. (BFAL) the starting pay scales for the higher management levels (managing director to general manager) are comparable. Yet maximum pay levels within each grade are considerably higher than the majority and wholly government-owned SOEs. For example, the maximum base salary for a managing director is approximately 80% higher than what a managing director can earn in an SOE with at least 50% government ownership. On the other hand, unskilled, semi-skilled and operational workers are provided much better compensation in majority and wholly government-owned SOEs than at BFAL. Typically these workers' pay scale starts at less than 50% offered in majority and wholly government-owned SOEs. Bhutan National Bank's (BNB) pay scale, on the other hand, shows substantial higher levels across the board for both the minimum and maximum values for the various pay levels (between 20 and 60% higher).

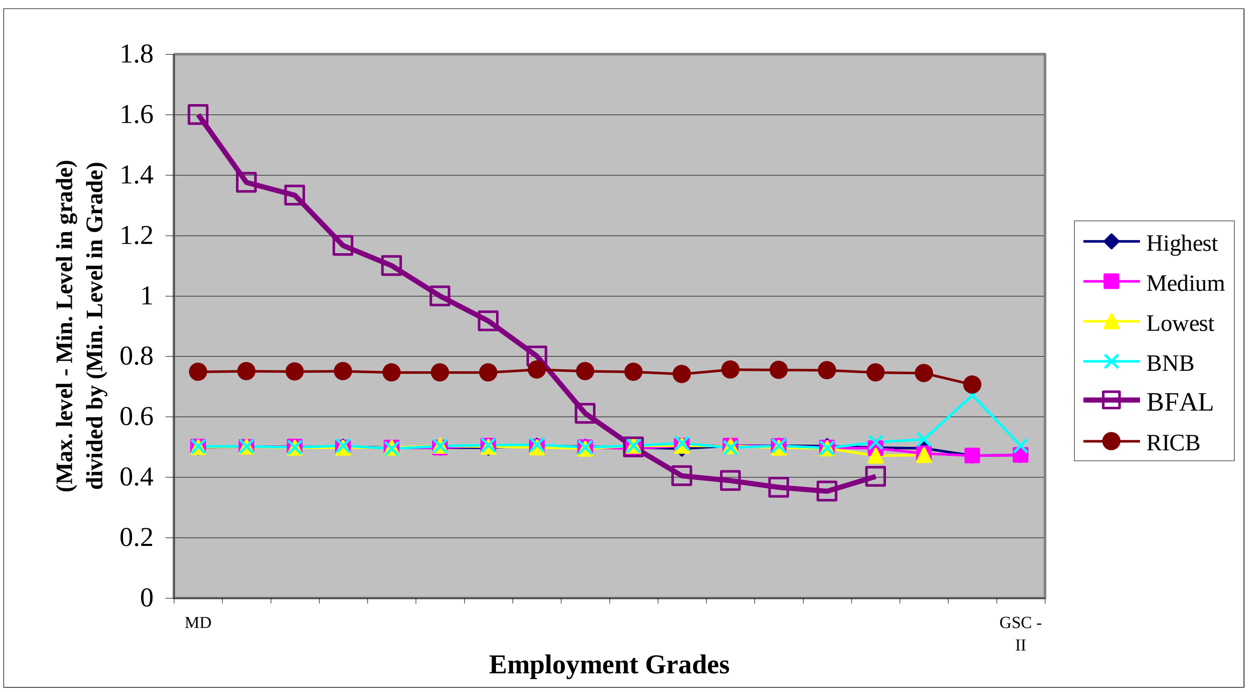
32 The comparison uses the high pay scale as set by the Ministry of Finance. The medium and low pay scale would show larger differences compared to the minority government-owned SOEs.

Table 3.4: **Vertical Compression Ratio for SOE Base Pay Structures**

	Compression Ratio
Low Pay scale	4.2
Medium pay scale	5.3
Highest pay scale	5.8
Royal Insurance Corporation of Bhutan	6.0
Bhutan National Bank	7.4
Bhutan Ferro Alloy Ltd	25.0

The base pay structure of SOEs is very compressed, especially for majority and wholly government-owned SOEs, which might reduce the incentives to attract and retain the scarcer management and specialized skilled labor. The vertical compression ratio represents the ratio between the average highest and lowest base pay. With the exception of BFAL, all SOEs show a compressed base pay structure, especially the majority and wholly government-owned SOEs (see table 3.4). A highly compressed structure reduces employees' incentive to pursue careers in the SOE by reducing the appeal of promotions. The compressed wage structures might especially cause difficulties in attracting and retaining scarce labor sources such as management and specialized skilled employees. Therefore, it is strongly recommended that the design of new pay structures aims to increase the compression ratio for SOEs to more effectively reflect these scarcities and provide greater incentives for progression.

Graph 3.2: **Range Spread Coefficient for Three Bhutan SOEs**



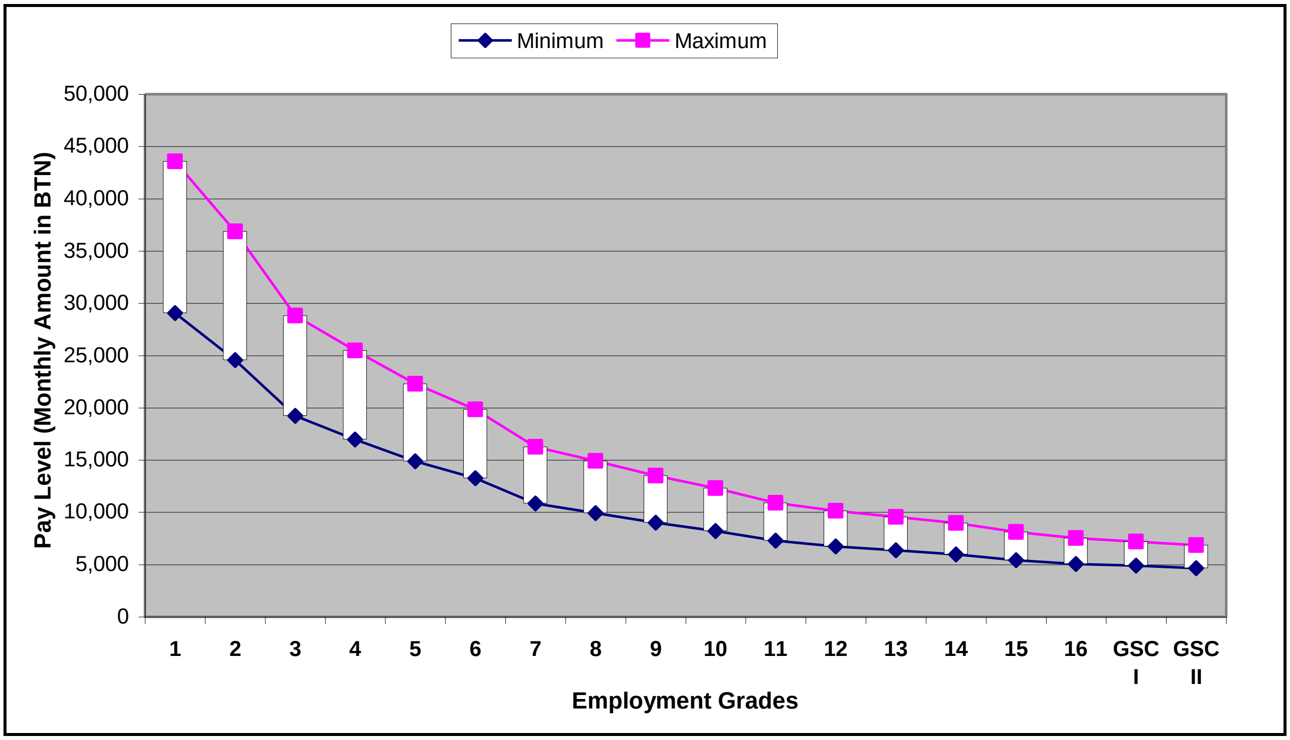
In addition, the base pay structure for most SOEs shows a compressed wage spread among grade levels. As a general rule of thumb, pay structures are expected to have a compressed wage spread coefficient[33] for grades where people with low skills and qualifications work. For those grades, where

33 The wage spread coefficient is calculated as follows: (maximum pay level in grade – minimum pay level in grade)/minimum pay level in grade.

management level or people with more qualifications are found, the spread is expected to be larger. Except for BFAL, SOEs seem to have a compressed wage spread coefficient (see Graph 3.2), as they basically have an identical wage spread coefficient between the highest and lowest pay level in each grade, irrespective of the grade throughout the wage structure. It is recommended that the design of new pay structures takes into consideration increasing the compression ratio at higher levels.

The base pay structure for all SOEs shows a substantial overlap of pay levels between subsequent grades, irrespective for the pay scale of the majority and wholly government-owned SOEs[34] (see graph 3.3) as well as the minority government SOEs. A large overlap in subsequent grade levels can reduce employees' interest in moving to higher grade levels and assuming more responsibility. Consequently, it is recommended that new pay structures be designed to reduce the overlap between pay levels.

Graph 3.3: **Base Pay Structure for Majority and Wholly Government Owned SOEs**



Available data on wage bill expenditure for various SOEs show that non-base wage pay can amount to a substantial portion of total remuneration payment. On average, for SOEs with available data, the wage bill consisted of 66.3% (2005) and 79% (2004) of base salary. However, the percentage of base pay from the wage bill typically varies between approximately 60 to 90% across SOEs. Training, traveling and bonus allowances are examples of more substantial additional payments and average at roughly 15% of the wage bill.

Wage data are available only for several SOEs. Consequently, the information in this section offers an initial indication because the available data reflect a breakdown per grade level concerning the base pay, rather than total remuneration. Analyses undertaken to design and develop a new remuneration policy should be based on the total actual compensation expenditure - including allowances, bonuses and other payments - received by employees at various levels.

In general remuneration in the private sector is less than in SOEs at both entry and higher levels.

34 The graph shows an overview of the highest pay scale. Grade 1 corresponds to the MD salary for the highest pay scale. The medium pay scale would start at grade 2 as that grade corresponds to the pay scale for a managing director. Similarly, the low pay scale would start at grade 3.

However, data limitations do not allow assessments of market competitiveness of remuneration structures. The available data only provide a broad overview of the minimum and maximum pay levels in a number of private sector companies,

Wage comparison to the market will need to consider full compensation packages to determine competitiveness of pay structures. Some of the most valuable benefits associated with public sector jobs, such as greater job security and more generous old-age pensions, are difficult to quantify. In developing countries only the "best" private sector jobs offer similar benefits.[35] It is essential from the outset that any comparison is adjusted to reflect full compensation, especially considering that the private sector typically provides less benefits and non-wage rewards.

III. Analysis of Personnel Management

Labor recruitment for SOEs where government holds a majority share requires the involvement of the Ministry of Labor and Human Resources (MoLHR) as a member of the selection committee. In contrast, SOEs with minority government ownership and private sector companies are not subject to such government involvement. MoLHR involvement creates rigidities not faced by other private sector competitors in the market. Majority and wholly government-owned SOEs also may not recruit employees terminated from the civil service and other SOEs, or who have resigned or retired from the same SOE.[36] This restriction limits effective labor market functioning. SOEs vary widely according to the job opportunities provided, and unfettered labor markets allow potential employees to work where they are most well-suited.

Management performance evaluation in most SOEs presents several challenges: evaluation criteria are typically too broad to effectively measure actual work performance;[37] limited disclosure of confidential reports[38] negates the very purpose of performance evaluation as a tool for development; and end-of-year bonuses typically do not depend on actual performance and are provided equally to all employees.

Performance rewards are not commensurate with risks and responsibilities. Incentives to managers for profit and efficiency gains are notably missing. In majority and wholly-owned government SOEs, lower level ***promotions*** tend to be automatic and based on tenure and fulfillment of the required years of service[39]. Accelerated promotion on merit (prior to fulfilling the required number of years) is allowed only in exceptional cases.

Training opportunities in Bhutan are often limited to internal, mainly procedural, training for employees. Loss-making SOEs in particular lack the financial resources to provide their employees with sufficient training opportunities. Many such training opportunities are available only abroad. Typically, the Ministry of Labor and Human Resources coordinates foreign training opportunities for both SOEs and the civil service. Anecdotal evidence suggests that the latter receives a disproportionate share of these training opportunities.

35 If SOE workers were to move to the private sector, they would therefore typically experience a larger loss than measured by the earnings gap only. Studies done for other countries estimate that the value in loss of intangible benefits at 20 to 50 percent of the SOE salary.

36 As per Guidelines for Boards of Government Corporations and for Government-appointed Board Directors (Ministry of Finance)

37 Evaluation criteria typically include categories such as work habits, attitude, conduct, knowledge of work, diligence, general intelligence, dependability, sociability, appearance, manners. These criteria are not job-specific and do not provide an effective mechanism to evaluate individual performance.

38 Confidential reports relating to the work and conduct of each employee shall be recorded every year prior to granting of annual increment, and shall invariably be taken into account on all matters relating the employee's increment, posting, transfer, promotion etc. After a confidential report has been reviewed, any adverse comments shall be communicated to the concerned employee in writing

39 Promotion to higher levels is typically based on vacancies and competence.

CHAPTER 4: **POLICY RECOMMENDATIONS**

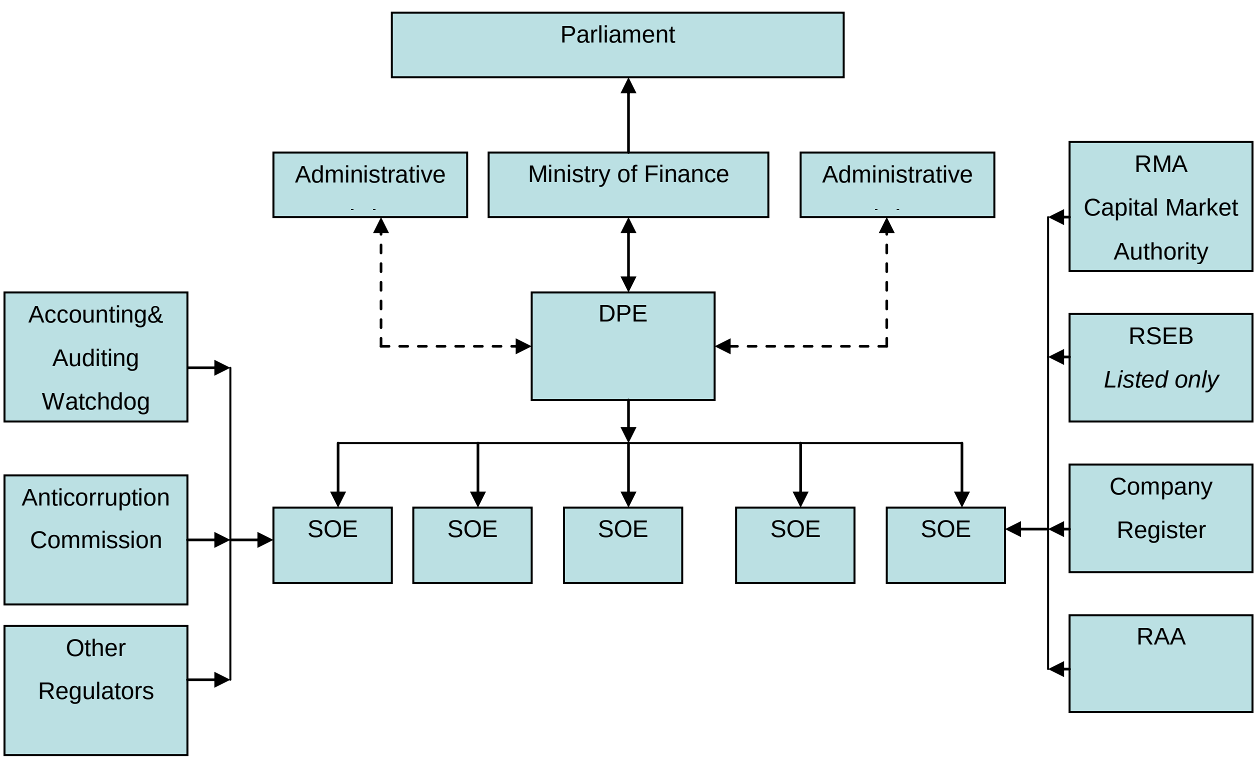
Based on the review and analysis of Corporate Governance and Pay and Personnel management, this chapter presents policy recommendations for improving state enterprise efficiency and principles for de-linking SOE employee compensation from the civil service pay scale. These draw on a detailed review of SOE governance in Bhutan relative to OECD Guidelines on SOE Governance (Annex 1), and an analysis of pay and personnel policies (Chapter 3). A summary of the recommendations is provided at the end of the chapter.

I. Improving Corporate Governance

Strengthen the ownership function

To strengthen the ownership function, it is recommended that a specialized division in the MoF - an ownership entity – be created to represent the government as a shareholder and work with the administrative ministries to improve SOE corporate governance. Over time this division could be transformed into a government agency. The new ownership entity should be held clearly accountable for the ways it carries out the state ownership function. Its accountability should be, directly or indirectly, to bodies representing the interest of the general public, such as Parliament. It should have clearly defined relationships with relevant public bodies, in particular the RAA. It should also have sufficient resources to fulfill its mandate. Further donor support, both financial and advisory, could be useful in facilitating this transition.

Proposed Model



A model for such an arrangement is shown above. Responsibilities of this centralized unit should include:

Regular monitoring and assessing SOE performance at the aggregate level. The main purpose of global reporting is to inform Cabinet, Parliament, the general public, the media, and other interested parties. Such reporting gives the Parliament the opportunity to discuss ownership issues, either at a general principle or policy level, or in connection with decisions on specific cases or decisions such as divestment or investment in a SOE. Such aggregate reporting has become standard practice in many OECD countries. Canada, Denmark, Finland, Italy the Netherlands, Poland and Sweden, table an annual report to Parliament. Sweden produces an annual report and interim aggregate reports. Denmark, France and Poland make the report available to the public. The annual reports should provide information on the state ownership policy, the role and organization of the ownership function within the state administration, an overview of the evolution of the state-owned sector and the actions taken by the state during the period, aggregate financial information, as well as individual reporting on the most significant SOEs and reporting on changes in SOEs' boards. Specific mechanisms such as ad hoc or permanent commissions could be set up to maintain the dialogue between the ownership entity and the legislature. In the context of the forthcoming constitutional changes in the Kingdom, such aggregate reporting could become an important instrument to introduce greater government accountability to the public.

Establishing well structured and transparent board nomination processes in wholly or majority-owned SOEs, and actively participating in the nomination of all SOE's boards. The ultimate selection criteria for board members should be competencies and skills. Nominees should possess industrial expertise or other knowledge that is directly relevant for the company with the intention of ensuring an effective provision of competence to the company board and management. Competence and experience requirements should also reflect an evaluation of the incumbent board and the demands aligned with the SOE's long term strategy. The vetting of board members by the Council of Ministers should be discontinued as it potentially introduces political decisions into the nomination process. The administrative ministries may still play a role by, for example, choosing one board member that meets the qualifications set by the ownership entity.

Implementing such policies would enable hiring of people with the required skill and background to improve corporate professionalism; attracting qualified people outside the government for managerial and board positions; and facilitating implementation of the decree for open and competitive recruitment of managing directors.

Encouraging active ownership and the systematic exercising of state ownership rights, including voting the state's shares. For this reason, it may be desirable to unlink the two functions by ensuring that the board member who represents the Government is not at the same time assuming the function of shareholder. The ownership entity should pay equal attention to the oversight of minority-owned companies, recognizing that the basic legislation for minority-owned company will remain the CA, 2000.

Strengthen board responsibilities, qualifications, and independence

Authority. It should be reinforced that SOE boards have the same powers as other boards under the CA. This should include the power to select and remove CEOs.

Composition. Consideration should be given to broadening the composition of boards to include individuals from the private sector with specific industry expertise relevant to the SOE and who would be able to provide valuable input in the formulation of the SOE's strategy,. In accordance with the recommendations of the GG + documents it is also imperative that ministers no longer serve as board members to avoid conflict of interest. As a general principle, boards should be composed of the best people available to carry out the job, regardless of whether they come from the private or public sector, and if they are affiliated with a particular Ministry.

Duties and Functions. All board members should act in the interest of the company and all shareholders. Large SOEs should set up audit committees, to oversee the relationship with the external and internal auditors, and manage conflicts of interest. The committee should be composed of outside (and preferably "independent") directors.

Accountability. The ownership entity should assist SOE boards to evaluate themselves on a periodic basis. Beyond this, performance evaluation and monitoring processes could be strengthened to facilitate the accountability system. Performance benchmarks could be introduced and systematically monitored. Incentives could include re-appointment being contingent on good performance. This will be most effective in conjunction with making social mandates more explicit, as noted below.

***Remuneration*.** Remuneration for board members should be increased to compensate board members for their increased responsibility and attract board members with greater qualifications. Actual compensation levels for the Board of Directors should directly reflect responsibilities and might vary between SOEs.

Training. Training and induction programs should be developed to ensure that board members understand and can perform their specific duties. These induction programs often include training in board responsibilities, the SOE's relationship with the government and Ministries concerned, board procedures, corporate governance and financial literacy. Such induction training enhances SOE board professionalism as well as accountability. This effort needs to be coordinated. At the very least, the new ownership entity should be given the responsibility to ensure that Government-appointed board members receive adequate training on a continuous basis.[40]

Clarify social mandates and subsidies

Make transparent and explicit subsidies to various categories of consumers through SOEs, and measure the efficiency of their delivery to consumers. Such policies would introduce performance-related incentives in SOE manager and employee compensation. Explicitly accounting for subsidies in the government's Budget Law should be considered. However, other alternatives are also possible, including the current practice of cross subsidization, or fixing the cost of certain transactions between enterprises so that one enterprise subsidizes the activities of another. In any case, these subsidies and the related mandates should be as transparent as possible.

Similarly, sector ministries should work with the new ownership entity to formulate high-level commercial and non-commercial goals for each company. Where SOEs are required to achieve non-commercial objectives, the latter must be clearly and explicitly identified and agreement reached between shareholders and the SOE's agents on the nature and timing of these measures.

***Focus and streamline RAA audits*.** Providing high levels of transparency to the public constitutes a basic principle of good corporate governance practice. Serious consideration should be given to streamlining the nature of the RAA mandate as an auditor of SOEs. The RAA should verify that SOEs fulfill their mandate efficiently and effectively. This will require focusing on the SOEs' non commercial objectives, and the use of any implicit or explicit subsidies.

Along these lines, steps should be taken to improve disclosure at the enterprise level, including establishment of an internal audit function in all SOEs and, as noted above, considering the establishment of audit committees in larger non-financial SOEs. See the Accounting and Auditing Report on Standards and Codes for Bhutan (forthcoming) for more detail.

II. Improving Payment and Personnel Management

As discussed earlier, pay and personnel problems have been identified as a major area of concern for the government. The following recommendations should be considered to address these issues.

***Provide SOEs greater autonomy in determining pay and personnel policies*.** Given their diverse circumstances, SOEs need increased autonomy to develop specific pay and personnel policies that best fit their individual requirements and markets. Wholly and majority owned SOEs must be given greater freedom to independently determine pay levels that can attract and retain qualified people, as is already the case in minority owned SOEs. The RGoB should fully implement the current requirement that the CEO of an SOE not be a civil servant. The current guidelines issued by the MoF for human resource management by SOEs should be phased out, as should the role currently played by the Ministry of Labor and Human Resources. Older practices inherited from an earlier era, when all SOE employees were part of the civil service, should be replaced by more market-oriented practices. The Royal Government may wish instead to adopt guidelines designed to prevent abuse of position by senior management in the context of wider corporate governance reform.

Non-funded social mandates directly affect profitability and consequently limit SOEs' pay and personnel policy options. SOEs that perform a social mandate and are loss-making will require additional reforms, as discussed above, before they can implement market-based remuneration policies based on their ability to pay. This will necessitate a phased approach for remuneration reform.

Improve human resource policies. Human resource management in SOEs should be based on the

40 The Global Corporate governance Forum of the World Bank can potentially be one possible source of technical support in this area.

merit principle of appointing the best person for any given job. This should be conducted through transparent, publicly understood, and merit-based recruitment and promotion policies that can be challenged if breached. A merit system will have a positive influence on the performance and motivation of employees. SOEs should be able to hire the people they deem qualified and should not be subject to requirements and rules that do not apply to other companies in their market, as long as they apply fair, transparent and competency-based criteria and processes.

***Develop a competitive and sustainable remuneration system*.** Current remuneration policy does not provide needed incentives or take into consideration corporate diversity. The weaknesses of current remuneration policies, especially for majority and wholly government-owned SOEs, include uniformity in pay scales despite diversity between SOEs, highly compressed and overlapping pay scales, no links between pay and performance, and no accounting for ability to pay personnel costs.

Three important criteria should be considered when developing a competitive and sustainable remuneration system:

- *Remuneration should enable SOEs to attract and retain required skills and resources to fulfill their commercial objectives efficiently.* Remuneration policies should be internally equitable: compensation should be in proportion to the job specifics and responsibilities, and should provide incentives that foster the long-term interest of the SOE.
- *Competitive remuneration policies need to be market-driven.* SOEs compete in the market for labor and as such compensation should be externally competitive. Compensation should be in proportion to the market price of specific jobs to enable SOEs to attract and retain required skills and resources.
- *SOEs are commercial entities and remuneration policies must be affordable within the limitations set by the profitability of the SOE.* SOEs should develop a remuneration policy that is competitive and attractive within financially affordable and sustainable levels. The affordability and sustainability of the compensation policy is directly determined by the financial performance of the SOEs and their ability to pay.

Remuneration for managing directors should provide incentives to enhance the SOE's value and to perform their responsibilities. It is recommended that the design of remuneration levels for management reflect the need to further decompress the pay structure. Additionally, it is recommended that a part of the remuneration of management be directly tied to corporate performance and profitability. Determining the actual pay levels and possible performance linkage should be determined by the responsibilities and work load of the specific positions, the affordability for SOEs and market comparables.

Performance evaluation policies should emphasize merit and employee development. Such policies would include the following components:

- Introduce performance management systems to link clearly defined organizational objectives to individual work objectives;
- Establish performance appraisal systems to ensure that individual officers receive consistent feedback on their performance;
- Link performance appraisal systems with clear incentives ranging from positive endorsement by the supervising officer to greater performance-related pay.[41]

SOEs are encouraged to implement comprehensive individual performance management systems through the following stages:

- Planning performance: define SMART objectives (simple, measurable, agreed, realistic, time defined)
- Managing performance
- Continuous tracking of performance against agreed performance plans
- Reviewing performance

41 BPC is designing a system that would link individual staff performance to salary increases. Rather than giving a salary increase across the board of 2 or 3%, this approach would provide increases/bonuses between 6% and 0% depending on the individual's performance.

- Rewarding performance

Anecdotal evidence suggests that many SOEs are cognizant of the need for improved performance management programs, but lack sufficient capacity to implement and operate such a system.

***Strengthening training is critical for improving the functioning and performance of SOEs*.** Effective and targeted training can help address skills scarcities (such as technical and managerial skills) and build required capacity, for example to effectively implement and apply a more comprehensive performance system. Ultimately this will help SOEs to attract and retain qualified people. However, it is recognized that SOEs are limited by the supply of training opportunities as well as the internal resources available, especially when loss-making. Donors, including the Global Corporate Governance Forum could play a key role.

Areas for further research. Additional data gathering and analysis can facilitate the design of new remuneration policies for SOEs. The World Bank, ADB, and or other donors and international agencies should consider supporting this research. The following steps are recommended:

- Ensure that complete information is available on total compensation and employment within SOEs, broken down to grade levels and individuals. This should include wages, allowances and other benefits.
- Conduct market competitiveness analyses to determine comparable compensation levels and alternative earnings for SOEs, as well the size and composition of their workforces. The challenge will be to determine relative job sizes/weights and provide maximum comparability of results despite differences in position title, organizational hierarchy and or philosophy.
- Develop cost scenarios for individual SOEs based on market competitiveness of specific position and employee characteristics.
- Design remuneration structures for individual SOEs based on internal equity, market competitiveness and ability to pay. The market competitiveness analysis should provide valuable input and a reference point for setting actual levels of pay that reflects market value and scarcity. Cost assessments of the total remuneration packages should ensure affordability in the short, medium and long term to ensure that the pay scales will be sustainable for the individual SOE and should consider the fiscal implications for the pension system.

Summary of Recommendations

Recommendation	**How to be Introduced**	**Priority/Status**
The Ownership Function		
Create an Ownership Division in MoF	Changes in relevant legislation, reform in MoF, and with donor support	Immediate
Introduce Aggregate Reporting	By MoF (new ownership entity) with changes in relevant legislation if needed	Medium-Term
Improve Board Nomination Process	By MoF (new ownership entity)	Immediate
Improve Exercise of State Ownership Rights	By MoF (new ownership entity)	Immediate
The Board		
Increase Board Authority	Current efforts and guidelines issued by MoF (new ownership entity) with changes in relevant legislation if needed	Medium-Term
Change Board Composition	Current efforts and guidelines issued by MoF (new ownership entity) with changes in relevant legislation if needed	Medium-Term
Strengthen Duties and Functions	Guidelines issued by MoF (new ownership entity) and changes in relevant legislation	Medium-Term
Improve Remuneration	Guidelines issued by MoF (new ownership entity) and SOE practice	Medium-Term
Social Mandates, Subsidies, and Transparency		
Accounting for Subsidies	Changes in relevant legislation and with donor support	Long-Term
Focus and Streamline RAA Audits	Changes in relevant legislation, RAA practice, and with donor support	Long-Term
Pay and Personnel Management		
Greater Autonomy in Pay and Personnel Issues	Current efforts and guidelines issued by MoF (new ownership entity) with changes in relevant legislation if needed	Medium-Term
Improve Human Resource Policies, including Remuneration	Guidelines issued by MoF (new ownership entity) and SOE practice	Long-Term
Increase Training Opportunities	Guidelines issued by MoF (new ownership entity), SOE practice, and possibly donor support	Long-Term
Further Research	By MoF (new ownership entity) and with donor support	Medium-Term

Annex 1: Guideline – by – Guideline Review of the Corporate Governance of State-Owned Enterprises

This section provides a guideline by guideline review of SOE corporate governance using the OECD Guidelines on Corporate Governance of State Owned Enterprises as the benchmark.

SECTION I: ENSURING AN EFFECTIVE LEGAL AND REGULATORY FRAMEWORK FOR SOES
The legal and regulatory framework for state-owned enterprises should ensure a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.
Principle IA: There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.
The conflict of interest between ownership, market regulation and policy. Market regulation has been separated from the policy and ownership functions of the government in the financial services, telecommunication and hydropower power sectors. Each of these sectors has their own regulatory agency, RMA for financial institutions, BICMA for Telecommunication and BEA for power distribution and generation companies. ***The prevention of perceived and real conflicts of interest between the ownership function and the industry/labor policy-making function of the state.*** The MTI, Ministry of Agriculture, Ministry of Information and Communications, Ministry of Finance has an oversight role in SOEs by virtue of being represented in the board of directors. Senior members of Sector Ministries including Ministers themselves seat on boards of SOEs. Such board position put them in a position of conflict of interest since the latter are responsible for setting sectoral policy. ***The means of avoiding conflict between the ownership function and other departments of the state administration that interact with the company.*** By nature of their dual function of policy setters and board members, Sector ministries are conflicted.
Principle IB. Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. The SOE legal form or arrangement should allow creditors to press their claims and to initiate insolvency procedures.
SOEs which are commercial companies. All SOEs have been corporatized and are governed by the Company's Act 2000. The financial institutions are also guided by the FIA and the Prudential Regulation issued by the RMA. ***The compatibility of SOEs' Corporate Governance with the OECD Principles of Corporate Governance*.** The Guidelines are largely compatible with the OECD Principles. The shortcomings of the Bhutanese corporate governance framework are discussed in the CG ROSC assessment 2006 for private companies (see http://www.worldbank.org/ifa/rosc_cg.html). ***State enterprises and legal forms of SOEs other than Commercial Companies.*** There are no SOEs which are not commercial companies.
Principle IC. Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.
Bhutan Power Corporation and Bhutan Telecom Company are required to provide rural electrification and rural communication and (subsidized) tariffs are fixed by their respective regulatory agencies. These obligations are not explicitly specified by law, nor are they disclosed to the general public although the general public is aware of them. Their related costs are not disclosed in a transparent manner. The RBOB sometimes funds these activities through grants and concessional loans. In other cases the SOE absorbs the costs themselves. For example by Bhutan Power Corporation's rural electrification program is financed by the company. As a result, the company generates losses recurrently.
Principle ID. SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that

their rights have been violated.

All SOEs are governed by the CA, 2000 and fall under the provisions of the Bankruptcy Act. The insolvency/bankruptcy regime for SOEs is not different than private companies There is no anti-trust law; a Labor Code is currently in the drafting mode. Stakeholders can take their grievances to the Courts. Neither the SOEs nor their board members have any special legal immunity. The CA, 2000 specifies the responsibilities of board members and the extent to which they can exercise their power. As per Part X Clause #102 of CA, 2000 courts have the power to “assess damages against delinquent directors and [assess] the conduct of the [company’s] director or officer and compel him to repay or restore the money or property”. Part XII Clause 140 further outlines the legal action against a company or any other person contravening any provisions of the CA.

Principle IE: The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.

SOEs fall under the provisions of the CA, 2000 concerning capital increases. There is no specific policy describing how and when SOEs can issue shares. However, some SOEs have raised capital in the past. There are no legal restrictions imposed on SOEs in order to prevent the dilution of the state’s ownership. In practice such dilution has not been an issue for the RGoB.

Principle IF: SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions, and other state-owned companies should be based on purely commercial grounds.

Connections with state banks and financial institutions. There are only two commercial banks (Bhutan National Bank and Bank of Bhutan) and one development bank (Bhutan Development Finance Corporation) in the RGoB. The State has a direct controlling interest in Bank of Bhutan and Bhutan Development Finance Corporation, and a direct minority position in Bhutan national Bank. However, even in Bhutan National Bank, the chairman of the board is the Minister Foreign Affairs. This suggests that SOE borrowings are not always based on purely commercial grounds. Anecdotal evidence suggests that SOEs can borrow more easily from the banks than private companies. There is no bond market in Bhutan at present.

SOE guarantees to their subsidiaries. As per the CA 2000 inter-corporate loans and investments are disallowed, except for financial institutions. However, there is no specific legislation that prevents an SOE to provide a guarantee to one of its subsidiaries.

State aid. **The Sate has on several occasions provided grants and concessional lending to SOEs.**

SECTION II: THE STATE ACTING AS OWNER

The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness.

Principle IIA: The Government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state’s role in the corporate governance of SOEs, and how it will implement its ownership policy.

There is no such document at present.

Principle IIB. The Government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.

The legal framework provides for the board of directors to select and oversee the management of the company. However, in practice, CEOs have often been nominated directly by Cabinet and government has been known to intervene in day-to-day management in addition to giving direction to SOEs on strategic issues and policies. Some SOEs continue to function as a de facto government department.

Until recently, most CEOs of SOEs were civil servants on secondment from the civil service. Recently the Council of Government issued a decree mandating that CEOs of SOEs who want to retain their position inside the SOE must resign from the civil service and compete for their jobs in a recruitment process opened to private sector candidates.

The RAA conducts proprietary audits of SOEs to ensure that they deliver the services that they have been assigned to fulfill efficiently and effectively. It monitors all SOE’s investments and cash outlays including purchases. SOE managers have complained that they spend an inordinate amount of their time responding to RAA queries.

Principle IIC: The state should let SOE boards exercise their responsibilities and respect their independence.

Training and examination of designees for SOE boards. At present board members of SOEs are not required to receive training. There is no fit and proper test for board members of financial institutions.

Independence and reporting duties of board members. No procedures have been put in place to ensure the independence of board members in the fulfillment of their board responsibilities. As per the CA, directors must oversee the preparation of an annual report which is submitted to the shareholders. Often times, the board meeting is followed by the GSM which is a symbolic affair since the board member representing the MoF is the designated shareholder.

State officials as board members. Most board members are senior civil servants.

Liability for decisions of state officials acting as SOE board members. As per the CA 2000, directors are potentially liable for violating their duties or engaging unfair or abusive practices (See section VIA of the CG ROSC Assessment 2006).

Principle IID: The exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a coordinating entity or, more appropriately, by the centralization of the ownership function.

The ownership function of the State is organized under a dual model involving the Administrative Ministries and the Finance Ministry. The Administrative Ministries are responsible for setting sectoral policies and ensuring that the SOEs under their oversight implement government's policy. They are also responsible for selecting board members, subject to Council of Ministers approval. Until recently the appointment of CEOs was the prerogative of the Royal Civil Service Commission, but this procedure is no longer in effect. As per Section 85 of the CA 2000, the appointment of CEOs is now vested with the board of directors of the SOE, although implementation is not fully operational. The Finance Ministry holds the share certificates of the SOEs on behalf on the State. By virtue of this function, the Finance Ministry is the government body that attends shareholders meetings and vote on shareholders resolutions. In addition, the Finance Ministry has provided guidelines on the compensation of SOE employees, and is responsible for preparing the report on the performance of the SOE portfolio that is submitted to Parliament by the Minister of Finance as part of the National Budget Report annually. The Good Governance Plus Report 2005 has recommended the establishment of a Board of Corporate Affairs to oversee all companies including SOEs.

Principle IIE: The coordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

Accountability to the Parliament. The MoF reports to Cabinet and Parliament on the performance of the SOE portfolio, annually. Such reporting does not extend to civil society. There is no requirement to prepare a comprehensive document on the performance of the aggregate portfolio.

Relations with the Royal Audit Authority. The MoF and the RAA do communicate with each other on an ad hoc basis.

Principle IIF: The state as an active owner should exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include:

(1) Being represented at the general shareholders meetings and voting the state shares.	The State is represented at the GSM by the MoF by virtue of all RGoB shares being under the custody of the MoF. The latter votes its shares systematically.
(2) Establishing well-structured and transparent board nomination processes in fully or majority owned SOEs, and	***Board nomination process.*** Board members are selected by their administrative ministry, subject to Council of Ministers approval. Civil servants are normally appointed without an objective nomination process. Nomination and appointment is, at the moment, widely guided by the principle of proportional representation that is not based on content or qualifications.

actively participating in the nomination of all SOE boards.	***State representation in minority state-owned companies.*** The State is always represented at the board of minority state-owned companies. In some cases, the Chair person of the board is a Cabinet member.
(3) Setting up reporting systems allowing regular monitoring and assessment of SOE performance.	By virtue of the fact that boards of directors are primarily composed of senior civil servants, including Cabinet members, the monitoring and assessment of the performance of SOEs is taking place on a continuous basis. However, no standard reporting system has been put in place to keep the ownership function abreast of development on a continuous basis.
(4) When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.	The MoF has limited contacts with external auditors and the RAA. The RAA selects the statutory auditor. The certified accounts are tabled at the GMS.
(5) Ensuring that remuneration schemes for SOE board members foster the long-term interest of the company and can attract and motivate qualified professionals.	Board members normally receive a sitting fee of about Nu 5000 (US$ 120). This is reported in company accounts. At the time of their corporatization in the 1990s, a pay differential of 35% to 40% with the civil service pay scale was introduced for SOEs employees, primarily to attract quality people in their management. However, this differential was leveled off in 2005 when the pay scale of civil servants was reviewed. SOEs do make limited use of bonus schemes for their employees but such performance related compensation schemes do not extend to board members. Typically, bonuses amount to an extra month of pay and are paid to all employees irrespective of performance. The CA allows for compensation through shares or share options. However, such compensation schemes have not been used to date.

SECTION III: EQUITABLE TREATMENT OF SHAREHOLDERS

The state and state-owned enterprises should recognize the rights of all shareholders, and in accordance with the OECD Principles of Corporate Governance, ensure their equitable treatment and equal access to corporate information.

Principle IIIA: The coordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.

The legal framework guarantees that all shareholders enjoy the same rights as the State at the GSM. Most resolutions are voted upon by means of a show of hand. In these circumstances, the state as a shareholder only has one vote, like all other shareholders. There is no golden share in the legislative landscape. To date, there has been no instance where minority shareholders have complained that they were not treated fairly and equally by the board of SOEs. However, no policy statement or guidelines has been issued to ensure that all shareholders are treated equally.

Principle IIIB: SOEs should observe a high degree of transparency toward all shareholders.

Please refer to Section III (The Equitable Treatment of Shareholders) of the CG ROSC 2006 for Bhutan. In addition, the Guidelines for Government Companies stress that the board must ensure "timely and accurate disclosure of all material matters regarding the corporation".

Principle IIIC: SOEs should develop an active policy of communication and consultation with all shareholders.

In general, few SOEs commit to an active policy of communication and consultation with stakeholders.

Principle IIID: The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.

MTI has issued "Rules and Procedures for Election of Directors" which apply to SOEs that are minority owned by the RGoB through direct ownership. The Rules require shareholders to be informed of vacancies on the board and require a candidate to be nominated by at least five shareholders up to seven days before the GMS. Voting is conducted by secret ballot in which each ordinary share has one vote. A shareholder can also propose an ordinary resolution to remove a director up to fifteen days before the GMS (CA, §81).

Cumulative voting/proportional representation. The Rules explicitly allow for proportional representation in companies with at least 50% government ownership. The RGB (through the Ministry of Finance and the “administrative ministry” for the company) directly appoint a number of board members proportional to the government’s ownership. Otherwise, the Rules do not explicitly allow for cumulative or proportional representation in other companies, however in practice some other companies do seem to use proportional representation, including those ones where the RGB holds shares, but less then 50 percent.

All minority shareholders enjoy the same rights as the state when voting on the resolutions placed before the GSM. The CA 2000 notes that every ordinary shareholder has the right to vote on every resolution, either by show of hands or poll. In the first instance, every shareholder, including the Sate, has one vote. In the latter case, he has one vote per share (CA, 2000 §26). Ordinary shareholders have equal rights to nominate and elect directors, inspect certain documents, participate in new share issues, etc. A shareholder may be denied their right to vote if his shares have not been paid for in full. Listing Rules mandate that “the issuer shall ensure the equality of treatment for all holders of securities of the same class who are in the same position”. Ten percent of shareholders can call an extraordinary meeting of the company. The board has 21 days to call the meeting.. If they fail to do so, the requesting shareholders can convene the meeting. All costs incurred are to be reimbursed by the company (CA §59).

SECTION IV: RELATIONS WITH STAKEHOLDERS

The state ownership policy should fully recognize the state-owned enterprises’ responsibilities toward stakeholders and request that they report on their relations with stakeholders.

Principle IVA: Governments, the coordinating or ownership entity and SOEs themselves should recognize and respect stakeholders’ rights established by law or through mutual agreements, and refer to the OECD Principles on Corporate Governance in this regard.

***The protections within the legal framework of SOEs*.** There are no provisions in the CA granting specific rights to stakeholders.

The protections within the legal framework of SOEs — Employees. It is mandatory for SOEs to subscribe to national pension scheme. There are no trade unions in Bhutan. A Labor Code is currently in the drafting mode. Although this is not a legal requirement, some SOEs have employees on their boards. BBPL provides subsidized rent and drinking water to its employees, as well as a company hospital which is opened to the general public living around the vicinity of the company.

Principle IVB: Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

SOEs do not usually report on stakeholders relations. One exception is BBPL which is committed to bringing “significant improvement in the living conditions of rural farmers”. The company does report on stakeholders relations in its annual report.

Principle IVC. The board of SOEs should be required to develop, implement, and communicate compliance programs for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.

Boards of financial institutions are required to formulate and implement a company code of ethics. No other companies are known to have specialized Ethics committees or a code of ethics. Directors are barred from receiving gifts or concessions on the services or products from the company. An Anti-Corruption Commission was set up in 2006. The Guidelines for Boards of Government Corporations provide for the removal of the company’s directors or its chairman “if his conduct is against the interest of the company; has or “ [he] acquires substantial interest in a business engaged in similar line or which has substantial dealings with the company”; or “if in the conduct of the business of the Board and the corporation he has used his position for personal gains or favored certain parties or manifests vested interest that go counter to the objectives of the corporation.” No provisions are provided in the CA 2000 nor in the Guidelines or the GG+ document of whistleblowers for the protection.

SECTION V: TRANSPARENCY AND DISCLOSURE

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

Principle VA: The coordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.

The MoF provides information on the performance of SOEs to Cabinet and Parliament, yearly. This information highlights the highest contains revenue contributors. However, there is no aggregate reporting published annually and made available to civil society.

Principle VB: SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.

None of the wholly-owned SOES have an internal audit function. BPC is in the process of developing one. As per the Prudential Guidelines 2004 of the Royal Monetary Authority of Bhutan, all the Financial Institutions are required to have internal audit functions in order to strengthen the internal control system and procedures on operational an financial areas of the corporation. For these SOEs, the internal audit generally attends the audit committee and board meetings, although this is not mandatory.

Principle VC: SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.

All companies governed by the CA 2000 including SOEs must be audited by an independent auditing firm. The Guidelines also insist that "an independent auditor should conduct an annual audit in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented". However, auditing standards are not fully in conformity with IFRS. The CA, 2000 sets out the minimum auditing and reporting requirements[42]. The RAA is empowered to revise these requirements. The CA, 2000 calls for auditors to use "Generally Accepted Auditing Standards" (GAAS), as does the RAA in its terms and conditions for auditors. In practice Indian GAAS is the norm. Currently all eligible auditors are based in India[43]. There are no guidelines defining the independence of auditors.

In addition, the Royal Audit Authority also carries out proprietary auditing. For its proprietary audits the RAA uses guidelines based on the standards issued by the International Organization of Supreme Audit Institutions (INTOSAI) and Asian Organization of Supreme Audit Institutions (ASOSAI).

Principle VD: SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognized standards.

SOEs are subject to the provisions of the CA, 2000 as far as accounting and auditing standards. Please refer to the CG ROCS 2006 for the Royal Kingdom of Bhutan for detailed information. The Guidelines stipulate that information disclosed to shareholders should be prepared, audited and disclosed in accordance with high quality standards of accounting, financial and non financial disclosure, and audit.

Principle VE: SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public. Examples of such information include;

A clear statement to the public of the company objectives and their fulfillment;

The ownership and voting structure of the company;

Any material risk factors and measures taken to manage such risks;

Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE;

42 CA, 2000, Article 75

43 The 2004 Accounting and Auditing ROSC for India notes that "Indian Auditing and Assurance Standards (GAAS) are broadly in line with ISA (International Standards of Auditing)". It also notes however that compliance with GAAS for Indian audits is uneven

Any material transactions with related entities.

In addition to the provisions of the CA, 2000 for all companies (refer to the CG ROCS 2006 for the Royal Kingdom of Bhutan), Section 16 of the Guidelines emphasize the need for timely and accurate disclosure of all material matters regarding the SOE, including the financial situation, performance, ownership, and governance of the corporation and vest the responsibility firmly with the board. Most SOEs' annual report contains a mission statement. However, the assessment of how they have fulfilled their mission, though conducted by the RAA, is not disclosed to the public. The Guidelines stipulate that SOEs must disclose major share ownership and voting rights and material risk factors. Guaranties, subsidies, grants, and other direct transfers are disclosed in the annual report. The Guidelines specify that the scope of the audit must include a review of any related party transaction of a material nature involving management, directors and their relatives etc. that may have potential conflict with the interests of the corporation. Such review is disclosed to the board but not to the shareholders.

SECTION VI: THE RESPONSIBILITIES OF THE BOARDS OF STATE-OWNED ENTERPRISES

The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

Principle VIA: The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equitably.

The Guidelines specify that the Board shall ensure that the policy objectives of the Government are attained and that companies operate in an efficient and effective manner. The board, as the apex body for the governance of the corporation, shall (a) ensure growth and expansion in business value and respond to business opportunities; (b) establish formal procedures to govern the conduct of its business; (c) maintain minutes of board meetings; (d) ensure compliance with the provisions of the CA, 2000; (e) ensure compliance with the rules and regulations formulated by the management of the corporation; (f) ensure compliance with the directives of the government; (g) ensure that the policies formulated are not detrimental to the interest of the government and the corporation; (h) ensure that the corporation and its employees maintain the highest standards of integrity, accountability and responsibility; (i) ensure that required processes and standards of disclosure are established and satisfied, in particular timely disclosure of information; (j) ensure that the MoF and/or the sector ministry are consulted on matters of significance especially with regard to implications government-wide. In particular the board should review and submit to the MoF and the sector ministry pricing policy when the SOE has monopoly power. In addition, (k) the board should review and guide corporate strategy, major plans of action, risk policy, annual budgets and business plans, set performance objectives; monitor implementation and corporate performance; and oversee major capital expenditures, acquisitions and divestitures; (i) select compensate, monitor and when necessary, replace key executives and oversee succession panning; (m) review and recommend reasonable levels of remuneration commensurate with the size of the corporation; (n) evaluate the performance of the CEO annually and submit the same to the sector ministry and other relevant agencies through the chairman; (o) review annually the performance of the senior officers and staff; (p) monitor and manage potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions; (q) ensure the integrity of the corporation's accounting and financial reporting system, including an independent audit, and that appropriate systems of control are in place; (r) monitor the effectiveness of the governance practices; (s) exercise objective judgment on corporate affairs; (t) formulate the Service Rules and Financial Management system; (u) approve annual budget and business plan; (v) ensure that the corporation does retain or build excessive reserves; (w) submit annual report on the operation of the corporation to the sector ministry and the MoF; (x) institute an audit committee; (y) where cases of gross misconduct and improprietaries have been observed on the part of the senior managers, ensure that the matter is dealt forthwith in accordance with the rules. And bring the matter to the notice of the Royal Civil Service Commission (RCSC) in case of a civil servant deputation to the corporation.[44]

Principle VIB: SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the Government and the ownership entity. They should have the power to appoint and remove the CEO.

[44] Source: Guidelines for Boards of Government Corporations and for Government-appointed Board Directors.

See above for the monitoring of management and strategic guidance. As far as the nomination of the CEO, the board makes a recommendation through the administrative ministry from among the list of eligible civil servants candidates provided by the RSCS, if the government wishes to appoint a civil servant to the post. Cabinet ultimately approves the nomination. A non civil-service candidate may be recommended by the board, in which case the appointment shall be for a fixed contract period with clear terms and conditions for performance-linked remuneration package. The CEO's appointment must be approved by the Government on a term of five years renewable for one more term of five years only subject to satisfactory past performance, based on an evaluation system recommended by the Government. Recently the Council of Government issued a decree mandating that CEOs of SOEs who want to retain their position inside the SOE must resign from the civil service and compete for their jobs in a recruitment process opened to private sector candidates.

The CEO can be removed from office if the board or the shareholders have lost confidence in him.

Recently a decree has been approved that stipulates that CEO recruitment shall be through open competition, and not seconded from the civil service. Starting from July 1, 2006 this became effective and the nomination and recruitment of the management should be based on an open and competitive process. Civil servants will have to resign from civil service if they are appointed as Managing Director (MD). The implementation of this new decree will be a phased approach as the current seconded MDs will have to go through the competitive recruitment process once their current term ends.

Principle VIC: The boards of SOEs should be composed so that they can exercise objective and independent judgment. Good practice calls for the Chair to be separate from the CEO.

Independent board members. The concept of independent director does not exist in Bhutan at present. This state of affairs needs to be put in the context of the scarcity of qualified professionals in the country.

Separation of Chairman and CEO. The chairperson is usually separate from the CEO.

Reappointments. The CEO can be reappointed for an additional term of five years only subject to satisfactory past performance, based on an evaluation system recommended by the Government.

Remuneration**.** It is the responsibility of the board to select, fix compensation, monitor and when necessary, replace key executives and oversee succession planning.

Board composition**.** The Companies Act does not specify the exact number of directors although it lays down the minimum requirement of having at least three directors for a Public Company and two for a Private Company. As per the Prudential Guidelines of the Royal Monetary Authority of Bhutan the Financial Institutions are required to have at least five directors, including the Chairman on their board. In practice the Board of Directors depends heavily on representation of civil servants, including ministers, directors and secretaries.

For wholly-owned SOEs, a typical board consists of: (1) chairperson-RGoB; (2) three Directors-RGoB officials from different ministries; (3) one Director -representative from the public; and (4) Board secretary who is the COE of the SOE.

For partially-owned SOEs, the typical board consists of (1) chairperson-RGoB; (2) two Directors RGoB officials from different ministries; (3) one Director from an NGO; and (4) three Directors - representing the public.

In the majority of the cases the respective Minister is chairman of the board, irrespective of the percentage of government ownership (see appendix 1 for an overview of the composition of the board of directors[45]). Currently, 14 out of 22 managing directors for SOEs are seconded civil servants (see appendix 2).

The heavy reliance on civil service representation in management and boards has clouded the distinction and accountability between the government as shareholder and the SOE as autonomous commercial companies. The close linkage between many of the SOEs and the government limits the extent to which SOEs can be run on a commercial basis and can create a competitive disadvantage.

Principle VID: If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

Employee representation on the board is not mandated although some SOE have invited employees on their

45 Information on Bhutan National Bank Ltd and Bhutan Power Corporation was not provided by MoF.

board.
Principle VIE: When necessary, SOE boards should set up specialized committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.
Apart from financial services companies which are mandated to have an audit committee, SOEs do not have specialized committees attached to their board.
Principle VIF: SOE boards should carry out an annual evaluation to appraise their performance.
Boards do not as a matter of practice carry out an annual evaluation to appraise their performance.

Annex 2: Composition of the Board of Directors

	Board Members 2006		**RGoB Share holding**
	Financial Institutions		**%**
	Bank of Bhutan		**80**
1	Lyonpo Wangdi Norbu, Finance Minister	Chairman	
2	Dasho Karma Dorji, Secretary, MTI	Member	
3	Mr. Namgye Lhendup, Director, Dept. of Immigration, MoHCA	Member	
4	Mr. Thering Dorji, Secretary. MoWHSi,	Member	
5	2 members from State Bank of India	Member	
6	Mr. Tshering Dorji, M.D. Bank of Bhutan	Member Secretary	
	Royal Insurance Corporation of Bhutan		**39.25**
1	Lyonpo Wangdi Norbu, Finance Minister	Chairman	
2	Dasho Tashi Phuntshog, Secretary, MoIC	Member	
3	Mr. Dubthob Wangchuk, Director, NPPF	Member	
4	Dasho Tobgyel Dorji, TCC	Member	
5	Dasho Wangchuk Dorji, TCC	Member	
6	Mr. Dasho Tobgyel S. Dorji, Rep. Small shareholders	Member	
7	Mr. Lhamkey Tshering, M.D, RICB	Member Secretary	
	Bhutan Development Finance Corporation		**87**
1	Aum Yanki. T. Wangchuk, Finance Secretary	Chairman	
2	Dasho Karma Dorji, Secretary, MTI	Member	
3	Dasho Chencho Tshering, Dzongda, Thimphu	Member	
4	Mr. Pema Chophel, Officiating Director, CORB, MoA	Member	
5	Mr. Kanjur, Chang Gup, Thimphu**	Member	
6	Mr. Nawang Gyetse, MD, BDFC	Member Secretary	
	OTHER SOES		
	Penden Cement Authority Ltd.		**47.1**
1	Lyonpo Yeshey Zimba, Minister, MTI	Chairman	
2	Brig. Dhendup Tshering, Commandant, RBG, Thimphu	Member	
3	Dasho Ugyen Dorji, Chairman, Lhaki Group of Cos., Thimphu	Member	
4	Ms. Sangay Zam, Director, DRC	Member	
5	Dasho Tobgay.S Dorji, Langjophaka	Member	
6	Ven. Lopen Tshering Phuntsho, CMB, Thimphu	Member	
7	Dzongdag, Samtse	Member	
8	Mr. Sangay Khandu, Director General, Dept. of Industry	Member	
9	Mr. Tshendhok Thinley, MD, Tashi Tours & Travels, Thimphu	Member	
10	Mr Dubthob Wangchuk, Director, NPPF	Member	
11	Mr. Tshering Phuntsho, MD, PCAL	Member Secretary	

	Board Members 2006		RGoB Share holding
	Chukha Hydro Power Corporation Ltd.		**100**
1	Lyonpo Yeshey Zimba, Minister, MTI	Chairman	
2	Mr. Sonam Wangchuk, Director General, DADM, MoF	Member	
3	Secretary, RCSC	Member	
4	Dzongdag Chukha	Member	
5	Mr. Sonam Tshering, Director General, DoE	Member	
6	Mr. Yeshey Wangdi, M.D. CHPC	Member Secretary	

	Bhutan Ferro Alloys Ltd.		**25**
1	Lyonpo Yeshey Zimba, Minister, MTI,	Chairman	
2	Dasho Tobgyel Dorji, M.D. BFAL	Member Secretary	
3	Dasho Wangchuk Dorji, TCC	Member	
4	Mr. Sonam Wangchuk, Director General, DADM, MoF	Member	
5	Mr. Tshering Dorji, M.D. Bank of Bhutan	Member	
6	Mr. Dorji Wangda, Director, Geology & Mines	Member	
7	Mr. Tshenchok Thinley, TCC	Member	
8	Two Members from Marubeni, Japan	Member	

	State Trading Corporation of Bhutan Ltd.		**51**
1	Dasho Karma Dorji, Secretary, MTI,	Chairman	
2	Dasho Ugyen Dorji, Chairman, Lhaki Group of Cos., Thimphu	Member	
3	Mr. Tshering Dorji, M. D. Bank of Bhutan	Member	
4	Mr. Phenphey R.Dukpa, Head AFD, MoF	Member	
5	Mr. Lamkay Tshering, Managing Director, RICB	Member	
6	Mr. Dophu Tshering, Joint Director, MTI		
7	Mr. Samdrup Thinlry, Managing Director	Member Secretary	

	Food Corporation of Bhutan		**100**
1	Dasho Sangay Thinley, Secretary, MoA.	Chairman	
2	Mr. Sonam P. Wangdi, Director, Dept. of Trade	Member	
3	Mr. Choiten Wangchuk, Head PPD, MoF	Member	
	Mr. Sangay Tshewang, Ministry of Agriculture		
4	Mr. Sherub Gyeltshen, Director, REID	Member	
5	Dasho Kunzang Namgyel, M.D. FCB	Member Secretary	

	Forestry Development Corporation		**100**
1	Dasho Sangay Thinley, Secretary, MoA	Chairman	
2	Mr. Kapil M. Sharma, Head, PED, MoF	Member	
3	Dsaho Dawan Tshering, DG, Dept, of Forest	Member	
4	Mr. Karma Phuntsho, Head PPD, MoA	Member	
5	Mr. Karma Dukpa, Managing Director	Member Secretary	

	Board Members 2006		RGoB Share holding
	Bhutan Agro Industries Ltd.		**100**
1	Dasho Sangay Thinley, Secretary, MoA.	Chairman	
2	Mr. Choiten Wangchuk, Head PPD, MoF	Member	
3	Dasho Chench Tshering, Dzongdag, Thimphu	Member	
4	Mr. Sonam P. Wangdi, Director, Dept of Trade, MTI,	Member	
5	Mr. Sherub Gyeltshen, Director, REID	Member	
6	Mr. Gem Dorji, MD	Member Secretary	

	Wood Craft Centre		**100**
1	Dasho Sangay Thinley, Secretary, MoA	Chairman	
2	Mr. Sangay Khandu, Director General. DoI, MTI	Member	
3	Mr. Dhonden Dhendup. Rule Section, MoF	Member	
4	Mr. Sangay Wangdi, Managing Director	Member Secretary	

	Druk Air Corporation		**100**
1	Lyonpo Jigme Y. Thinley, Minister for Home Affairs	Chairman	
2	Aum Yanki. T. Wangchuk. Finance Secretary	Member	
3	Mr. Daw Tenzink, M.D. RMA	Member	
4	Mr. Lhatu Wangchuk, Director General, Dept. of Tourism	Member	
5	Mr. Ugen Rinzin, Yangphel Tours and Travels	Member	
6	Mr. Sangay Thinley, M.D.	Member Secretary	

	Bhutan Board Products Ltd.		**45.62**
1	Lyonpo Leki Dorji, Minister for Communications	Chairman	
2	Dasho Dawa Tshering, DG, Dept of Forest, MoA	Member	
3	Mr. Sangay Khandu, Director General. DoI, MTI	Member	
4	Mr. Lham Nidup, Director, DBA, MoF	Member	
5	Mr. Pasang Tshering, D. M.D. Bank of Bhutan	Member	
6	Mr. Nwang Gyetse, MD,.BDFCl	Member	
7	Mrs. Phubzam Penjore	Member	
8	Mr. Chimmi Dorji, H& K	Member	
9	Mr. Dawa Penjore, Yoedsal Tours	Member	
10	Ven. Lopen Tshering Phuntsho, CMB,	Member	
11	Mr. Sigay Dorji, M.D.	Member Secretary	

	Bhutan Post		**100**
1	Lyonpo Leki Dorji, Minister for Communications	Chairman	
2	Mr. Lham Nidup, Director, DNB	Member	
3	Mr. Sonam P. Wangdi, Head PPD, MTI.	Member	

	Board Members 2006		**RGoB Share holding**
4	Mr. Achyut Bhandar, Managing Director	Member Secretary	

	Bhutan Telecom		**100**
1	Lyonpo Leki Dorji, Minister for Communications	Chairman	
2	Lyonpo Ugen Tshering	Member	
3	Dasho Ugen Tshechup, Singye Group	Member	
4	Mrs. Sangay Zami, Director, DRC, MoF	Member	
5	Mr. Thinley Dorji, Telecom Regulatory Authority	Member	
6	Mr. Thinley Dorji, Managing Director	Member Secretary	

	Army Welfare Project		**100**
1	Goonglon Wogma, Batoo Tshering, RBA	Chairman	
2	Col. Kipchu Dorji, RBG	Member	
3	Lt. Col. Dorji Khandu, RBA	Member	
4	Lt. Col. Kipchu Namgyel, RBP	Member	
5	Mr. Sonam P. Wangdi, Director, DoT, MTI	Member	
6	Mr. Phenphay R. Dukpa, Head AFD, MoF	Member	
7	Mr. Kuenga Tenzin, MD	Member	

	Kurichu Hydro Power Corporation		**100**
1	Lyonpo Yehey Zimba, Minister, MTI	Chairman	
2	Dzongkhag Administration, Mongar	Member	
3	Mr. Thinley Namgye, CPO, DADM. MoF	Member	
4	Mr. Yeshey Wangdi, MD, CHPC	Member	
5	Mr. Sonam Tshering, Director General, DoE	Member	
6	Mr. Thinley Dorji, Chief Engineer KHPC	Member Secretary	

	Basochu Hydro Power Corporation		**100**
1	Mr. Sonam Tshering, Director General, DoE, MTI	Chairman	
2	Dzongda, Dzongkhag Administration, Wangdue	Member	
3	Mr. Yeshey Wangdi, MD, CHPC	Member	
4	Mr. Kapil M Sharma. Head, PED. MoF	Member	
5	Mr. Dawa Sangay, GM, BHPC	Member Secretary	

	Kuensel Corporation		**100**
1	Aum Yanki T. Wangchuk, Secretary, MoF	Chairman	
2	Dasho Meghrai Gurung Redt)	Director	
3	Mr. Yehey Dorji, Secretary, Ministry of Foreign Affairs	Director	
4	Mr. Pema Wangda, Director, DEL	Director	
5	Mr. Kinley Dorji, MD	Member Secretary	

	Board Members 2006		RGoB Share holding
	Bhutan Broadcasting Service Corporation		**100**
1	Lyonpo Leki Dorji, Minister, Ministry of Information and Communications	Chairman	
2	Mr. Karma Ura, CBS	Director	
3	Mr. Kinley Dorji, Director, Dept of Youth, Culture and Sports	Director	
4	Pema Lhamo, Head RNR Information and Communications Services, MoA	Director	
5	Mr. Phuntsho, Joint Director, Department of Culture	Director	
6	Ms. Siok Sian Pek Dorji, Private Sector	Director	
7	Dasho Mingbo Dukpa, Managing Director, BBS	Member Secretary	

Annex 3: Overview of Managing Directors

	Name	Percentage of Government Ownership	Civil Servant as Managing Director
1	Army Welfare Project	100%	No
2	Bhutan Agro Industries Ltd	100%	No
3	Bank of Bhutan	80%	No
4	Bhutan Board Products Ltd	45%	No
5	Bhutan Broadcasting Services Ltd	100%	Yes
6	Bhutan Development Finance Corporation	87%	Yes
7	Bhutan Ferro Alloys Limited	25%	No
8	Basochu Hydropower Corporation	100%	Yes
9	Bhutan National Bank Ltd	13%	No
10	Bhutan Postal Corporation Ltd	100%	Yes
11	Bhutan Power Corporation Ltd	100%	Yes
12	Bhutan Telecom Ltd	100%	Yes
13	Chukha Hydropower Corporation Ltd	100%	Yes
14	Druk Air Corporation Ltd	100%	Yes
15	Food Corporation of Bhutan Ltd	100%	Yes
16	Forestry Development Corporation Ltd	100%	Yes
17	Kuensel Corporation Ltd	100%[46]	Yes
18	Kurichu Hydropower Corporation Ltd	100%	Yes
19	Penden Cement Authority Ltd	47%	Yes
20	Royal Insurance Corporation of Bhutan	39%	No
21	State Trading Corporation of Bhutan Ltd	51%	No
22	Wood Craft Center	100%	Yes

46 Percentage of government ownership in Kuensel Corporation Ltd is changing.

Annex 4: Overview of Enterprise Classification
(Ministry Of Trade and Industry)

INVESTMENT CLASSIFICATION OF TRADE AND INDUSTRIAL VENTURES:

I. TRADE

Category	Investment Range
Large	More than Nu. 10 million
Medium	Between Nu. 5 - 10 million
Small	Between Nu. 1 - 5 million
Micro	Less than 1 million

II. MANUFACTURING AND SERVICE INDUSTRY

Category	Investment Range
Large	More than Nu. 100 million
Medium	Between Nu. 10 - 100 million
Small	Between Nu. 1 - 10 million
Micro	Less than 1 million

Annex 5: Indicative Overview of Grades in SOEs

Grade	Description
1	Managing Director (MD)
2	Deputy Managing Director
3	General Manager
4	Deputy General Manager
5	Manager/ Regional Manager
6	Deputy Manager
7	Officers
8	Supervisor-I
9	Supervisor-II
10	Supervisor-III
11	Sr. Assistant
12	Jr. Assistant-I
13	Jr. Assistant-II
14	Office Assistant
15	General Support Staff
16	Drivers
GSC I (18)	Messengers
GSC II (19)	Guards/ Cleaners

Annex 6: Overview of Pay Structure of Minority Government-owned SOEs

Bhutan Ferro Alloys Ltd.						
Grade	**Designation**	**Pay Scale**				
1	Managing Director	30,000	2,400	42,000	3,600	78,000
2	Dy. Managing Director	24,000	1,800	33,000	2,400	57,000
3	General Manager	18,000	1,200	24,000	1,800	42,000
4	Dy. General Manager	14,400	960	19,200	1,200	31,200
5	Sr. Manager	12,000	720	15,600	960	25,200
6	Manager	9,600	480	12,000	720	19,200
7	Dy. Manager	7,200	360	9,000	480	13,800
8	Asstt. Manager	6,000	240	7,200	360	10,800
9	Sr. Supervisor	5,400	180	6,300	240	8,700
10	Operator 'A'	4,800	120	5,400	180	7,200
11	Operator 'B'	4,200	100	4,700	120	5,900
12	Operator 'C'	3,600	80	4,000	100	5,000
13	Operator 'D'	3,000	60	3,300	80	4,100
14	Semi Skilled	2,400	50	2,650	60	3,250
15	Un-Skilled	1,800	35	2,050	50	2,525

Bhutan National Bank				
Grade	**Designation**	**Pay Scale**		
1	Managing Director	43,020	1,080	64,620
2	Dy. Managing Director	36,085	905	54,185
3	General Manager	30,465	760	45,665
4	Dy. General Manager	23,815	600	35,815
5	Manager	21,040	520	31,440
6	Dy. Manager	18,475	465	27,775
7	Assistant Manager	16,385	415	24,685
8	Officers	13,400	340	20,200
9	Supervisors – I	12,225	305	18,325
10	Supervisors – II	11,110	280	16,710
11	Senior Assistant – I	10,150	260	15,350

12	Senior Assistant – II	9,035	225	13,535
13	Junior Assistant – I	8,330	210	12,530
14	Junior Assistant – II	7,850	195	11,750
15	Drivers	7,375	190	11,175
16	General Support Staff	6,670	175	10,170
17	Security Guard (contract employee)	6,255	210	10,455
18	Care Takers/ Sweepers (contract)	5,555	140	8,355

Royal Insurance Corporation of Bhutan Limited				
Grade	**Designation**	**Revised Pay Scale (2005)**		
1	Managing Director	29,065	725	50,815
2	Executive Director/ Equivalent	24,570	615	43,020
3	General Manager/ Equivalent	19,220	480	33,620
4	Asst. General Manager	16,975	425	29,725
5	Manager	14,880	370	25,980
6	Deputy Manager	13,255	330	23,155
7	Asst. Manager	10,850	270	18,950
8	Development Officer	9,920	250	17,420
9	Asstt. Development Officer	8,990	225	15,740
10	Supervisor	8,215	205	14,365
11	Sr. Asst-II	7,285	180	12,685
12	Sr. Asstt-I	6,745	170	11,845
13	Jr. Asst-III	6,355	160	11,155
14	Jr. Asst-II	5,970	150	10,470
15	Jr. Asst-I	5,425	135	9,475
16	Driver	5,040	125	8,790
17	Sub-Staff	4,885	115	8,335

Annex 7: Overview of Compensation Ranges in the Private Sector

Name of Company	Sector	Basic Salary Range
Rainbow Tours	Service Sector	5,500 – 20,000
Chhundu Travel & Tours	Service Sector	2,500 – 30,000
Bhutan Tourism Corporation	Service Sector	2,600 – 33,000
Singye Group of Co Stone & Sand Factory	Manufacturing	3,120 – 25,000
Nwang Wood Work	Manufacturing	3,000 – 10,000
Galing Printing	Manufacturing	3,000 – 15,000
Pelwang Colour lab	Trading	4,000 – 14,000
Karma Tschongkhang	Trading	4,000 – 32,500
Nima Tschongkhang	Trading	1,500 – 7,500
Bhutan Carbide & Chemicals Ltd	Trading	3,000 – 97,000
Peljorkhang Pvt Ltd	Trading	1,500 – 53,000
Dolma Enterprise	Trading	3,000 – 30,000
Cargo and Courier	Trading	2,800 – 13,314
Leko Packers	Trading	2,650 – 15,000
Dhoensum H&L	Trading	2,500 – 30,000
Bhutan International	Trading	4,000 – 30,000
JD Construction	Construction	1,600 – 18,000
Rinson Construction	Construction	1,000 – 15,000
Lhaki Construction	Construction	3,150 – 14,500
Lhojong Construction	Construction	1,000 – 26,000
Phuensum Builders	Construction	4,250 – 16,000
Rigsar School	Education	2,200 – 5,720
Phuensum primary School	Education	2,500 – 14,000
Druk School	Education	2,500 – 20,000
Nima High School	Education	3,200 – 20,000
Kelki High School	Education	3,500 – 25,000
Ugyen Academy	Education	1,800 – 25,000
Hotel Riverview	Hotel	1,500 – 20,000
Dragon Nest Hotel	Hotel	1,980 – 7,920
Hotel Jumolhari	Hotel	1,000 – 20,000
Sonam Automobile Workshop	Workshop	1,000 – 10,000
Tobgay Auto Engineering Works	Workshop	1,100 – 5,000
Yangki Automobiles	Workshop	700 – 25,000