

Thematic  
Evaluation

# State-Owned Enterprise Engagement and Reform



Independent  
Evaluation 

*Raising development impact through evaluation*

## Thematic Evaluation

October 2018

# State-Owned Enterprise Engagement and Reform

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## NOTE

In this report, "\$" refers to United States dollars.

<b>Director General</b>	Marvin Taylor-Dormond, Independent Evaluation Department (IED)
<b>Deputy Director General</b>	Véronique Salze-Lozac'h, IED
<b>Director</b>	Nathan Subramaniam, Sector and Project Division, IED
<b>Team leader</b>	Kapil Thukral, Principal Evaluation Specialist, IED
<b>Team members</b>	Lauren Hauck, Senior Evaluation Specialist, IED Srinivasan Palle Venkata, Senior Evaluation Specialist, IED Mitzirose Legal, Senior Evaluation Officer, IED Charina Regodon, Senior Evaluation Assistant, IED

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The guidelines formally adopted by IED on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. To the knowledge of the management of IED, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.

# Abbreviations

ADB	–	Asian Development Bank
CPS	–	country partnership strategy
DMC	–	developing member country
DMF	–	design and monitoring framework
EBRD	–	European Bank for Reconstruction and Development
FSD	–	financial sector development
IADB	–	Inter-American Development Bank
IED	–	Independent Evaluation Department
IMF	–	International Monetary Fund
MDB	–	multilateral development bank
NPL	–	nonperforming loan
NSO	–	nonsovereign operations
OECD	–	Organisation for Economic Co-operation and Development
PBL	–	policy-based lending
PCR	–	project completion report
PFM	–	Public Financial Management
PNG	–	Papua New Guinea
PPP	–	public–private partnership
PRC	–	People’s Republic of China
PSD	–	private sector development
PSDI	–	Private Sector Development Initiative
PSM	–	Public Sector Management
PSO	–	public service obligation
PSOD	–	Private Sector Operations Department
RBL	–	results-based lending
RRP	–	report and recommendation of the President
SASAC	–	State-owned Assets Supervision and Administration Commission
SOE	–	state-owned enterprise
SPV	–	special purpose vehicle
TA	–	technical assistance
TCR	–	technical assistance completion report
WTO	–	World Trade Organization

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IED remains fully responsible for the report.

## State-Owned Enterprise Engagement and Reform

ADB has supported SOE engagement and reforms in numerous ways, through three areas of operations: (i) indirect interventions through macro-level approaches that aimed to improve governance and affected SOE reforms indirectly; (ii) targeted interventions through sovereign investments with accompanying measures for improving governance at the sector level and in specific SOEs; and (iii) targeted investments through nonsovereign modalities supporting direct and indirect SOE clients, as well as sovereign projects that propagated public-private partnerships for infrastructure development. The SOE reform related portfolio accounts for about 21% of all ADB operations during the evaluation period (2005–2017).

Overall, 61% of interventions in the portfolio of evaluation were rated successful or highly successful. Indirect interventions through macro-level approaches recorded the lowest success rate of 54%, while combined, the targeted interventions recorded a success rate of 68%. About 61% of sovereign investments with accompanying measures to improve governance at the sector level and in specific SOEs were rated successful or highly successful. Success rate of 86% was recorded through targeted nonsovereign operations and sovereign operations that propagated public-private partnerships.

Macro-level approaches showed modest results in terms of both Reform outcomes and Sustained and Improved Performance outcomes, while the targeted interventions showed mixed results.

Among the reasons for these levels of performance and results are that ADB support was not sufficiently strategic or well-articulated, and ADB's organizational mechanisms did not allow delivery of a more strategic reform program.

### RECOMMENDATIONS

This evaluation makes four recommendations to provide guidance to the ADB Board and Management to improve ADB performance and results from its support for SOE Reforms and Sustained and Improved Performance, and to contribute toward implementing Strategy 2030.

1. Address SOE reform issues more comprehensively, strengthen the provision of well-articulated strategic direction to governments, and use the country partnership strategies process for articulating country relevant approaches in project design.
2. Strengthen the capacity of the existing SOE Working Group to enable proper articulation of strategic approaches to SOE reforms and guide bank-wide SOE engagements for effective implementation.
3. Improve significantly the monitoring and reporting of ADB supported SOE reform measures.
4. Refine the project classification system to enable better tagging of SOE reforms in all sectors and enhance ADB's knowledge base.

State-owned enterprises (SOEs) have a presence in important economic sectors and are important to governments. Pressures to reform SOEs have built up in many countries and governments have pursued multi-faceted reform measures to varying degrees. The Asian Development Bank (ADB) has responded by supporting government efforts in numerous ways over several decades.

### THE PORTFOLIO

SOE reform has not been the primary focus of most sovereign, nonsovereign and technical assistance operations. It has been challenging to identify the SOE reform portfolio, as support for SOE reforms has not been systematically tagged during the evaluation period 2005–2017.

The Independent Evaluation Department (IED) identified a SOE reform portfolio comprising about 21% of ADB's total approvals of sovereign loans and grants, nonsovereign operations (NSO) and technical assistance (TA) projects during the study period. This includes \$37.0 billion in sovereign loans and grants and \$154 million in TA projects in 13 countries; and \$8.0 billion in NSO projects and \$4.6 million in accompanying TA projects.

This SOE engagement and reform portfolio included 273 loans and grants, and 132 TA projects in five sectors (public sector management, finance, energy, transport, and water), as well as 57 NSO projects that supported SOEs directly or indirectly and 5 accompanying TA projects. The portfolio covered three areas of operations: (i) macro-level approaches that aimed to improve governance and affected SOE reforms indirectly (\$10.7 billion); (ii) sovereign investments that were targeted at SOEs with accompanying measures for improving governance at the sector level and in specific SOEs (\$21.1 billion); and (iii) investments through nonsovereign modalities supporting direct and indirect SOE clients, as well as sovereign projects that propagated public-private partnerships for infrastructure development (\$13.2 billion).

The People's Republic of China, India, Papua New Guinea, Uzbekistan and Viet Nam were selected for conducting case assessments. They accounted for more than 40% of the SOE reform portfolio.



The portfolio of evaluation comprised more than 85 sovereign loans and grants, and 12 NSO projects that had been independently validated or evaluated by June 2018. Collectively, the country case assessments, key stakeholder discussions, and the portfolio of evaluation informed the discussion on ADB performance and results.

## PERFORMANCE

While recognizing that SOE reform measures are few of many components of projects in the portfolio of evaluation, the evaluation notes that the underlying project validations and/or evaluations do not provide more granular ratings.

Overall, 59% of sovereign loans and grants used to support SOEs are rated successful or highly successful. This is significantly below the overall success rate of loans and grants closed in recent years (76% in 2014–2016; 74% in 2015–2017). The success rate of the NSO portfolio of evaluation is significantly higher at more than 92%.

Operations intended to influence macro-level approaches to improving governance, which affected SOE reforms indirectly, recorded a 54% success rate by number and 57% by approved amount. The success rates in the targeted areas of operations were higher, the combined success rates being 68% by number and 75% by approved amount. Interventions for sovereign investment and improving governance at the sector level and in specific SOEs showed a success rate of 61% by number and 67% by approved amount. The highest performance levels were recorded in investments through NSO instruments and through sovereign operations for propagating the public–private partnership (PPP) modality (86% by number and 90% by approved amount).

## RESULTS

The time slice for observing results from ADB support captures a subset of the continuum of SOE reforms.

Regarding contribution of ADB engagement and support to SOE Reforms, ADB support has contributed modestly to improving governance in SOEs in all three areas of operations. With respect to addressing governments’ SOE-related fiscal problems, the contribution of ADB support for macro-level approaches has been modest, while it has been positive for sector-level and SOE-specific interventions, as well as for NSO interventions and sovereign projects that support infrastructure development using the PPP modality. However, this positive result was due largely to the investment component, which effectively reduced the need for financial support from governments, although not necessarily in a sustainable manner.

Regarding contribution of ADB engagement and support to Sustained and Improved Performance of SOEs, ADB support contributed modestly to improving operational efficiency and commercial viability of SOEs in all three areas of operations. Toward improving access to affordable and quality services, however, the contribution of ADB support for macro-level approaches was modest, while it was significant for sector-level and SOE-specific interventions as well as for NSO projects. This is related to the investment components of these interventions and not necessarily to Reform outcomes.

## CONCLUSION

SOE engagement and reform is challenging but critical. Reform is necessary because several inefficient and loss-making SOEs continue to be subsidized in the Asia and Pacific region, which is not sustainable. Reforms have progressed at an uneven pace even when governments have remained committed over prolonged periods.

## Performance and Results of ADB’s Interventions in SOE’s

Categories of Engagement		Macro-level		Sector-level and State-Owned Enterprise Specific		Nonsovereign Operations and Sovereign Operations for Public-Private Partnership	
		Performance	Results	Performance	Results	Performance	Results
Reform	Governance	●	●	●	●	●	●
	Fiscal management	●	●	●	●	●	●
Sustained and Improved Performance	Operational efficiency and commercial viability	●	●	●	●	●	●
	Access and quality	●	●	●	●	●	●

Note: Performance refers to the evaluation criteria (relevance, effectiveness, efficiency, sustainability) while results pertain to ADB’s contribution toward achieving the Reform outcomes and the Sustained and Improved Performance outcome in three areas of operations (macro-level approaches, sector governance and SOE-specific inputs, and PPP modality and other NSO projects).

### Legend:

#### Performance

- Less than 60% success
- Less than 70% but more than 60% success
- More than 70% success

#### Results

- Marginal
- Significant/Positive

Source: Asian Development Bank (Independent Evaluation Department).

While ADB support tends to be within the parameters defined by governments and in line with its own strategies and policies, ADB has not emphasized several aspects. These include improving government oversight of SOEs, addressing board issues, improving accountability mechanisms in infrastructure SOEs, making SOEs eligible for raising long-term capital on commercial terms, conducting SOE diagnostics, and reforming SOEs engaged in manufacturing.

## ISSUES

ADB would need to address several issues, both external and internal, as it strives to improve its performance and implement Strategy 2030. The key external issues are related to the political-economy of countries, which ADB should recognize as part of its risk management framework. The key internal issues refer to ADB systems and practices that need to be improved, such as for articulating and delivering sufficiently strategic SOE reform programs.

## LESSONS

A key lesson is that well-coordinated operations across the three areas of operations can improve ADB’s effectiveness in supporting SOE reforms. Additionally, appropriately designed monitoring and reporting systems contribute to the success in implementing reform measures, strong sector regulatory framework and oversight are important for sustained and improved SOE performance, ADB’s additionality is important for ADB’s direct and indirect SOE clients that borrow without sovereign guarantees, and good risk management systems in executive and implementing agencies are necessary for developing infrastructure projects using the PPP modality.



# Executive Summary

The Asian Development Bank (ADB) recognizes the importance of state-owned enterprises (SOEs) to its developing member countries, and the need to support the strengthening of their governance, mitigate their fiscal impact, improve their operational efficiency and commercial viability, and improve consumers' access to quality and affordable services.

The evaluation developed a framework to understand the logic of ADB engagement with and support for SOE reforms. The framework identified three areas of operations. In one area, ADB has provided indirect support for SOE reforms through macro-level approaches. The two other areas of operations provided targeted support through sovereign investments with accompanying measures for improving governance at the sector-level and in specific SOEs; and nonsovereign operations (NSO) support that was targeted at direct and indirect SOE clients, and sovereign projects that propagated public-private partnerships (PPPs) for infrastructure development and where an SOE was one of the equity participants in PPP projects and subprojects. ADB has been providing support in these three areas of operations through a mix of sovereign loans and grants, technical assistance (TA) and NSO projects. Sovereign loans and grants accounted for the bulk of the SOE reform-related interventions in the evaluation period (2005–2017). NSO projects and the policy, advisory and capacity development TA projects were also useful in advancing the reform agenda.

Overall, 61% of interventions in the portfolio of evaluation were rated successful or highly successful. Indirect interventions through macro-level approaches recorded the lowest success rate of 54%, while combined, the targeted interventions recorded a success rate of 68%. About 61% of sovereign investments with accompanying measures to improve governance at the sector level and in specific SOEs were rated successful or highly successful. Success rate of 86% was recorded through targeted nonsovereign operations and sovereign operations that propagated public-private partnerships.

The macro-level approaches showed modest results in terms of both Reform outcomes and Sustained and Improved Performance outcomes. However, the results of targeted areas of operations were mixed. They showed positive outcomes regarding governments' SOE related fiscal management and significant improvements in access to quality and affordable services, but modest outcomes regarding governance and operational efficiency.

ADB has paid insufficient attention to government oversight mechanisms, board issues, accountability mechanisms in infrastructure SOEs, governance risk assessments in target SOEs, making SOEs eligible for commercial financing, and reforming SOEs engaged in manufacturing.

ADB's three areas of operations and their intended outcomes have not necessarily been well articulated, and the interventions in these areas of operations have not necessarily been well coordinated. This is because ADB's existing organizational mechanisms do not allow it to articulate and deliver a more strategic SOE reform program.

The following recommendations are intended to improve ADB's performance in these areas in light of Strategy 2030: (i) address SOE reform issues more comprehensively, strengthen the provision of well-articulated strategic direction to governments, and use the country partnership strategies process for articulating country relevant approaches in project design; (ii) strengthen the capacity of the existing SOE Working Group to enable proper articulation of strategic approaches to SOE reforms and guide bank-wide SOE engagements for effective implementation; (iii) improve significantly the monitoring and reporting of ADB supported SOE reform measures; and (iv) refine the project classification system to enable better tagging of SOE reforms in all sectors and enhance ADB's knowledge base.

**The Asian Development Bank (ADB) recognizes the importance of reforming state-owned enterprises (SOEs) and this evaluation focuses on SOE reforms.** ADB has supported several aspects of SOE reforms in its developing member countries (DMCs) over several decades. This support was intended to strengthen fiscal management and SOEs' governance, operational efficiency, and sustained ability to deliver services.

**The purpose of this evaluation is to inform the ADB Board and Management of ADB's experience to date with SOE reforms and to guide ADB's engagement with SOEs as it implements the corporate Strategy 2030.** The evaluation provides an independent assessment of ADB's engagements in SOE reforms, and draws lessons for future engagement with SOEs through sovereign loans and grants, through nonsovereign operations (NSO), and through technical assistance (TA) projects.

**There is no commonly accepted definition of SOEs.** International organizations and country governments have tended to define SOEs differently. The Organisation for Economic Co-operation and Development (OECD) explicitly acknowledges that SOEs have been defined differently by different country governments.

**ADB defines SOE as "a legal entity established to undertake commercial activities and owned fully or largely by the sovereign."** This ADB definition fits the purposes of applying the nonsovereign public sector financing policy and implies that NSO support to a client entity which has a state shareholding of less than 50% will not be considered as nonsovereign public sector financing. This definition is aligned closely with the OECD definition: an enterprise that is directly or indirectly owned or controlled by the state and has an underlying commercial focus. Regarding sovereign operations, in addition to supporting legal entities established to undertake commercial activities and with majority or minority state ownership, ADB has also engaged with and supported reforms in bodies that are commercially oriented but may not be corporatized. ADB support to these bodies is also considered in this evaluation.

**ADB recognizes that there are a growing number of opportunities to invest in SOEs directly and**

**indirectly.** Direct investment can take place when the client itself is an SOE, and indirect investment can occur when the client is owned by a government authority through an intermediary entity or is a special purpose vehicle (SPV) with an SOE as one of the shareholders. Indirect SOE clients operate on a commercial basis, and the government can continue to influence their decision-making through its majority or minority shareholding interests.

**SOEs have a presence in important economic sectors and are important to governments.** They deliver critical services in important economic sectors, including utilities, finance, and natural resources. Additionally, SOEs also engage in large-scale manufacturing and provide services in competitive sectors in many countries. Governments see SOEs as tools for meeting their political and social objectives (such as job creation), and in some cases, for accelerated development and global expansion.

**Pressures to reform SOEs have built up in many countries in the Asia and the Pacific region, and governments have initiated numerous measures to address the reform challenge.** In addition to increasing the nation's resilience to withstand external shocks and reduce SOEs' fiscal impact, peoples' demand for reliable and affordable services have also increased pressure on reforming SOEs and improving their performance. Numerous measures are required to reform SOEs, which can be a challenging task for many governments as well as ADB. The Asian experience to date shows the importance of governments' commitment to reform and that reforming of SOEs remains a work in progress in all countries.

## Evaluation Approach

**The evaluation period was from 2005 to 2017.** The start date (2005) coincides with the start of the period for which ADB had previously compiled a preliminary database on its engagement with SOEs.

**The underlying objective of reforming SOEs is to sustainably improve their performance.** ADB has sought (among other measures) to reduce the differences between rules that govern SOEs and other enterprises, and close the performance gap between SOEs and other enterprises (where both

SOEs and other enterprises have a presence and compete) so as to produce economy-wide benefits.

**SOE reforms are measures that address the challenges posed by inadequate governance at corporate and sector levels, and the governments' SOE-related fiscal management problems.** These challenges are intertwined. Corporate governance can be improved through a broad range of measures at the SOE level, and at the macro and sector levels. Many of these very same measures also help reduce explicit and contingent liabilities of governments.

**The Independent Evaluation Department (IED) developed a Theory of Change to explain the logic of ADB's interventions to engage with and support SOE reforms. The theory of change shows that ADB has supported SOE reforms in numerous ways to achieve the intended outcomes.** There were three critical areas of ADB operations, of which one affected SOE reforms indirectly, while the other two provided targeted support. These included:

- (i) Indirect support through macro-level approaches to improving governance by supporting legal, regulatory and institutional frameworks, advocacy and education, and government SOE oversight mechanisms. These operations affected SOE reforms indirectly.
- (ii) Targeted support through (a) Sovereign investments that had accompanying measures for improving governance at the sector-level and in specific SOEs. ADB leveraged these investments to advance the reform effort; and (b) NSO investment support to direct and indirect SOE clients, and sovereign projects that propagated infrastructure development through the public-private partnership (PPP) modality where an SOE was one of the equity participants.

**The intended outcomes from ADB support through the three areas of operations are at two levels.**

- (i) A set of Reform (intermediate) outcomes including improved SOE governance at the corporate and sector levels; and reduced governments' SOE related fiscal problems.

- (ii) A set of Sustained and Improved Performance (higher level) outcomes resulting from SOE reforms, in terms of improved operational efficiency and commercial viability, as well as improved consumer access to quality and affordable services. Progress in implementing Reforms is essential to sustain performance improvements.

**Progress in achieving intended outcomes is influenced by many factors.** These include the country's political and economic landscape, whether government support for SOE reforms is adequate and sustained, whether SOE managements are supportive of the reform program and act decisively to improve capacity, increase transparency, manage and mitigate risks, and communicate their reform strategies to employees. Other factors that influence SOE reforms include the extent to which there is a capable private sector and an enabling environment for the national and foreign private sector to expand its role in the economy, the extent and effectiveness of PPPs to deliver services and concurrently compete with incumbent SOEs, the strength of the banking sector, whether capital markets are developed and provide an avenue for listing SOEs, and the extent to which other development partners support the SOE reform agenda.

**The evaluation sought to assess ADB support and to understand the extent to which it helped achieve the intended Reform (intermediate) outcomes and Performance (higher level) outcomes. Accordingly, the overarching question for this evaluation is:** to what extent ADB support for SOE reforms contributed to achieving the Reform outcomes of improved governance at the corporate and sector levels, as well as reduced the governments' SOE related fiscal problems, and to achieving the Sustained and Improved Performance outcomes resulting from reforms, in terms of improved SOEs' long-term operational efficiency and commercial viability, and improved consumers' long-term access to quality and affordable services?

**The evaluation also sought to understand the issues associated with the delivery of ADB support and the reasons for the success and failure of interventions.** Three subsidiary questions helped

to answer the overarching question: What is the relevance of ADB support targeting SOE reforms? What is ADB's institutional efficiency in supporting SOE reforms? To what extent did ADB support achieve the intended results?

## ADB Strategy

SOE engagement and reforms were embedded in the ADB's corporate strategies that were in effect during the evaluation period. Strategy 2020 came into effect in 2009 and sought to refocus ADB's operations into five core areas that included infrastructure and financial sectors. SOEs are integral to these sectors. The strategy called for ADB to support governments in the various areas that can contribute to SOE reforms, such as strengthening institutions and policies, addressing governance challenges in public sector institutions, scaling up private sector development and private sector operations. However, Strategy 2020 did not provide guidance on SOE reform objectives, the contexts in which ADB must pursue reforms in the diverse Asia and Pacific region, or the most appropriate modalities for ADB support. This was left to individual country partnership strategies (CPSs) which provide guidance on such matters for a 5-year period. ADB's Long Term Strategic Framework in effect prior to 2009 contained similar gaps.

**ADB's Strategy 2030 came into effect in July 2018 and fills some of these gaps at the strategic level.** It sets the course for ADB to respond effectively to the changing needs of the Asia and Pacific region and advocates a differentiated approach in supporting the development of different groups of countries. Regarding SOE reforms, for example, in small island developing states, Strategy 2030 states that ADB's support for SOE reforms should complement other support to improve the business environment, enhance PPPs, improve quality of public service delivery, and promote private sector led growth. In low-income and lower middle-income countries, ADB support for SOE reforms is seen in the context of the broader structural and systemic reforms that are required to enhance productivity and competitiveness, and that ADB should support SOE reforms as well as private sector operations. In upper middle-income countries, ADB should provide targeted support for reforms in the financial sector and SOEs, enhance countries' resilience to shocks, and

expand private sector operations and PPP. Strategy 2030 recognizes that ADB's public sector operations can complement private sector operations by preparing SOEs for commercial financing and that improving governance and financial management capacities of SOEs, as well as policy and regulatory reforms (including tariff related reforms) will help strengthen service delivery.

## Portfolio of Operations

**Identifying the portfolio of sovereign loans and grants as well as TA projects during the evaluation period (2015–2017) was a challenging task.** ADB support for SOE reforms has not been systematically tagged. The project classification system was revised in 2014 to recognize SOE reforms as a subsector under the public sector management (PSM) sector. However, projects classified under financial, infrastructure and other sectors are still not tagged and it is difficult to identify SOE reform supporting projects classified under these sectors. In compiling this portfolio, IED consulted mostly with the Sustainable Development and Climate Change Department as well as the Private Sector Operations Department (PSOD).

IED identified an SOE engagement and reform portfolio comprising about 21% of ADB's total operations of sovereign loans and grants, TA and NSO during the evaluation period, which includes \$37.0 billion in sovereign loans and grants and \$154 million in TA projects in 13 countries; and \$8.0 billion in NSO projects and \$4.6 million in accompanying TA projects. This portfolio covers the three areas of operations and is the subject of this evaluation. It includes 273 loans and grants that consist mostly of policy-based and investment-based modalities, as well as 132 TA projects in five sectors (PSM, finance, energy, transport, and water). ADB's sovereign portfolio has relied mostly on the investment-based and policy-based lending modalities; given that the results-based modality was introduced in 2013, there are a few projects using this modality for supporting government programs with clear expenditure frameworks that incorporate small governance and capacity development programs. The portfolio also includes 57 NSO projects that support SOEs directly or indirectly and

5 accompanying TA projects. About 70% of the NSO projects are in the 13 selected countries.

**Sovereign loans and grants and NSO investment projects in this portfolio cover a broad canvass, across all three areas of operation.** They are distributed as follows:

- (i) \$10.7 billion (24% of approved \$ amount) for influencing macro-level approaches that affected SOE reforms indirectly;
- (ii) \$21.1 billion (47% of approved amount) in projects that supported sovereign investment targeted at SOEs and which also incorporated measures for improving governance at the sector-level and in specific SOEs; and
- (iii) \$8.0 billion (18% of approved amount) for investment support through NSO modalities targeted at direct and indirect SOE clients, and \$5.2 billion (12% of approved amount) for sovereign projects propagating the PPP modality for developing new infrastructure.

**Similarly, TA projects in this portfolio also cover a broad canvass.** They are distributed as follows:

- (i) \$82.0 million (52% of approved amount) for influencing macro-level approaches that affected SOE reforms indirectly;
- (ii) \$38.9 million (24% of the approved amount) targeted for improving governance at the sector level and in specific SOEs; and
- (iii) \$4.6 million (3% of the approved amount) associated with investments through NSO in direct and indirect SOE clients, and \$33.2 million (21% of approved amount) for sovereign projects propagating the PPP modality for developing new infrastructure.

**Five countries, one under each ADB regional department, were selected for conducting in-depth case assessments.** These are: the People's Republic of China (PRC), India, Papua New Guinea (PNG), Uzbekistan, and Viet Nam. Together these countries received approvals of about \$16.9 billion in 113 loans and grants during the evaluation period. About two-thirds of the nonsovereign portfolio is also in these five countries.

## ADB Experience of Supporting SOE Reforms

Governments have pursued SOE reforms from various directions and ADB responded by implementing initiatives in all three areas of operations. The specific reform areas that ADB had mostly supported are:

- (i) **Macro-level approaches which affected SOE reforms indirectly.** ADB approved projects that aimed to: (a) modernize and improve practices at the country level through better public financial management systems, improved financial accountability and transparency, anti-money-laundering and anti-corruption measures; (b) foster an environment conducive to private sector development and growth by for example, advising on harmonization of regulations for public and private sectors; (c) establish a legal framework for PPP; and (d) develop strategies for the financial sector, provide inputs for legal frameworks to support continued expansion and innovation in capital markets as well as banking, insurance and bond markets.
- (ii) **Sovereign investments that were targeted at SOEs and which ADB leveraged the investments for improving governance at the sector level and in specific SOEs.** ADB supported: (a) sector level reforms in infrastructure sectors, through improved regulatory mechanisms and tariff rationalizations, and the unbundling of vertically integrated infrastructure utilities; (b) sector level reforms in the financial sector by strengthening capabilities of the insurance and securities regulators; and (c) SOE-specific reforms such as for improving corporate governance in financial intermediaries, alignment with internationally accepted accounting and reporting standards in banking and nonbanking financial institutions and listed entities, accountability systems and financial management systems in infrastructure SOEs, as well as closure or restructuring or partial privatization of selected SOEs across all sectors. ADB projects for addressing these objectives also supported investment in infrastructure and financial services, which ADB leveraged to further the reform effort.



- (iii) **Investments through NSO modalities that were targeted at direct and indirect SOE clients, and through sovereign projects propagating the PPP modality for infrastructure development.** Some investments through NSO modalities which were targeted at direct and indirect SOE clients were accompanied by TA support to advance the reform effort in the client. Sovereign investments that propagated the PPP modality for infrastructure development had SOEs as one of the equity participants in the PPP projects and subprojects.

**Several aspects of the ADB portfolio are worth highlighting.** First, only one ADB project supported a central government oversight body in promoting consistency and coherence in governance across SOEs although oversight is a critical ownership function. Second, ADB has not paid adequate attention to addressing board issues, although the board of directors plays a central role in advancing good corporate governance. Third, less than 15% of infrastructure projects supported improvements in accountability mechanisms—a building block of good corporate governance. Fourth, governance risk assessments and SOE diagnostic analyses have not been in sufficient depth. Fifth, few sovereign operations specifically aimed to make SOEs eligible for raising long-term capital on commercial terms and on the strength of their balance sheets. Sixth, there was little support for reforming manufacturing SOEs, although the manufacturing sector is the key engine of growth for middle-income countries, and the performance of SOEs in specific industrial segments (where governments allow competition from the private sector) remains below that of their private sector counterparts. Several governments attempted, and continue to attempt, restructuring and privatizing these SOEs, which indicates that they regard improving productivity and performance in this sector as an important issue.

### **ADB Performance in Supporting SOE Reforms**

The discussion on ADB performance is based on the portfolio of evaluation, which consists of completed and independently validated and/or evaluated sovereign loans and grants as well as NSO projects.

**ADB performance ratings reflect the entire scope of ADB interventions in the portfolio of evaluation.** This could include broad macro-level policy changes that affected SOE reforms indirectly or investments in physical projects in the targeted interventions. While recognizing that SOE reform measures are one or few components of these interventions, the evaluation notes that the underlying project validations and/or evaluations do not provide more granular ratings,

**Overall, 61% of all sovereign and nonsovereign projects in the portfolio were rated successful or highly successful. The success rates of sovereign loans and grants were 59% and of NSO projects were 92%.** The success rate for sovereign loans and grants is significantly below the overall success rate of loans and grants closed in recent years and independently assessed (76% in 2014–2016; 74% in 2015–2017). The success rate of the NSO portfolio of evaluation exceeds the overall success rates during recent years (58% in 2015–2017).

**The poorest performance was registered at the macro-level, where interventions were intended to indirectly influence SOE reforms.** These operations, which recorded SOE reforms indirectly, recorded a 54% success rate.

**The performance of the targeted group of interventions was better, with the combined success rates being 68%.** Interventions for sovereign investments that were targeted at SOEs with accompanying measures for improving governance at the sector level and in specific SOEs showed a success rate of 61%. NSO investments targeted at direct and indirect SOE clients recorded the highest success rate of 92%, and sovereign operations that propagated the PPP modality for infrastructure development with an SOE as one of the key stakeholders in the PPP project or subproject, showed a success rate of 78%.

### **Relevance**

**Overall, more than 80% sovereign and NSO projects in support of SOEs are relevant or highly relevant.** This comprised of: (i) about 70% of projects that supported macro-level approaches; (ii) 87% of projects that provided investment support used to leverage the reform effort and

aimed to improve governance at the sector level and in specific SOEs; and (iii) 100% of sovereign projects propagating the PPP modality for infrastructure development.

**ADB has responded adequately to support governments in their reform efforts.** Governments appreciate ADB's broad-based approach to further SOE reforms. ADB support was consistent with government strategies and priorities, and with its own corporate strategies. ADB support was also in line with its country partnership strategies. Nonetheless, as a result of its focus on the infrastructure and financial sectors during the evaluation period, ADB has tended to focus on reforming SOEs in these sectors.

**SOE reform is by nature a long-term process which requires long-term monitoring, unlike for typical investment projects. It would have been desirable for ADB to have taken special measures to track ADB supported SOE reform measures that extended beyond the typical project timeline. This applies to all three areas of operations.** Each sovereign project is monitored during the implementation period and regular updates are produced, the last of these being at completion. The extent to which SOE reform measures have progressed is not recorded in any central database. ADB has done no follow-up monitoring, making it difficult for ADB to ascertain the extent to which the reform measures it supported during the implementation period were sustained and replicated. NSO projects were monitored for financial and development outcomes until the end of the assistance.

**PSOD's SOE clients are well-governed, commercially operated, and financially sustainable and are required to follow the same standards for financial viability, governance and integrity as any other NSO client.** This limits the universe of potential direct and indirect SOE clients, as well as the nature and extent of governance improvements that can be reasonably expected. Nonetheless, PSOD has supported these clients to introduce other measures that improve performance.

### Efficiency

**Overall, about 59% of ADB supported sovereign loans and grants are efficient or highly efficient.** By area of operations, the share of loans and

grants rated efficient or highly efficient are: (i) 58% of projects that aimed to influence macro-level approaches to improving governance; (ii) 57% of projects that provided sovereign investment support used to leverage the reform effort and aimed to improve governance at the sector level and in specific SOEs; and (iii) 78% of sovereign projects that aimed to propagate the PPP modality. Independent assessments of NSO did not provide any insight on ADB's efficiency in supporting reform.

**There is significant scope for improving ADB's efficiency in delivering technical assistance.** Less than 3% of TA projects to support SOE reform were completed on schedule. The time taken to complete a TA project was on average 80% more than originally envisaged (both for TA projects that aimed to influence governance at the macro, as well as at the sector level and in specific SOEs). Where time overruns were for reasons attributable to ADB, they usually occurred because ADB had chosen to pursue aggressive timelines for meeting inherently unpredictable objectives, it had not appropriately gauged the amount of time required to identify and recruit suitable consultants, or it had encountered delays in processing vendor bids.

**Apart from policy-based lending (PBL), time overruns of sovereign loans and grants to improve governance at the sector-level and in specific SOEs were significant and frequent.** Of the 45 non-PBL loans and grants in the portfolio of evaluation, 43 aimed to improve governance at the sector level and in specific SOEs. These included eight of the nine sovereign projects to support PPPs. Two projects (a TA loan in Bangladesh, and a project loan in Indonesia) aimed to influence macro-level approaches to governance. The actual time to completion of all these non-PBL projects exceeded the originally planned time by about 35% on average. Project completion reports (PCRs) and PCR validation reports for these loans seldom provided reasons for the delays in implementing reform components.

**The cancellation ratio of NSO projects supporting SOEs directly or indirectly is significantly higher than for sovereign loans and grants.** IED acknowledges that all NSO projects must compete on commercial terms with market alternatives and are, thus, prone to cancellations. Nonetheless, it is noted that 10 of the 57 NSO projects have been



cancelled. This cancellation ratio is substantially higher than for sovereign operations in the studied portfolio (3 of 273). This comparison helps to explain differences in time and resource allocation in sovereign and NSO.

### Effectiveness and Sustainability

**Overall, 61% of sovereign loans and grants are effective or highly effective.** Macro-level approaches that affected SOE reforms indirectly recorded 54% of operations as effective or highly effective. The other areas of operations that were targeted at SOEs recorded higher proportions of effective and highly effective interventions. Those that provided investment support to SOEs and aimed to improve governance at the sector level and in specific SOEs recorded 65% of interventions as effective or highly effective. Sovereign projects that propagated the PPP modality for infrastructure development recorded 78% of interventions as effective or highly effective. For NSO support for direct and indirect investment in SOEs, the development results (considered as surrogate for effectiveness) showed 92% success.

**Overall, 58% of sovereign loans and grants are likely or mostly likely sustainable.** Macro-level approaches that affected SOE reforms indirectly, recorded 65% of interventions as likely or most likely sustainable. In the other areas of operations, the share of loans and grants rated likely or most likely sustainable are: (i) 54% of projects that provided investment support used to leverage the reform effort and aimed to improve governance at the sector level and in specific SOEs; and (ii) 44% for sovereign projects that propagate the PPP modality for infrastructure development.

**Some ADB supported reform measures were able to demonstrate that the intended outcomes had been achieved and sustained in the three areas of operations in various country contexts.** These included about 50% of loans and grants that aimed to influence macro-level approaches to improving governance; e.g., introducing broad-based reforms including SOE equitization and restructuring in Viet Nam. About 50% of sovereign loans and grants that supported investments and aimed at improving governance at the sector level and in specific SOEs achieved their outcomes and were sustained; e.g., by establishing an autonomous company and awarding a

concessions contract to implement construction as well as to operate and maintain highways in the PRC. About 50% of sovereign loans and grants that propagated the PPP modality with SOEs for infrastructure development had sustainable outcomes: e.g., financial intermediation loans of \$1.2 billion in India catalyzed investment of \$14.6 billion from the private sector under a PPP modality, and an accompanying TA project improved the financial intermediary's risk management systems. Through the NSO modality, corporate governance systems were improved in at least two direct SOE client entities.

**However, there were also examples where ADB supported reform measures were effective or highly effective, but less likely to be sustained.** These included about 20% loans and grants that had investment components and aimed to improve governance at the sector and corporate levels. In Georgia, ADB helped set up a fund for improving municipal services, but insufficient attention was paid to strengthening the fund's capacity to assess credit risk. This precluded it from functioning as a normal financial intermediary. In Viet Nam, ADB provided investment support for expressway projects, but continued low road toll charges prevented the SOE responsible for expressways from becoming commercially viable.

**Appropriately designed monitoring and reporting systems tended to improve success rates in implementing SOE reforms.** About 70% of ADB projects were rated successful or highly successful when some measures to monitor reform progress were introduced, or when efforts were made to institutionalize monitoring. The share of successful or highly successful ratings fell to about 55% when the ADB project paid no attention to monitoring of reform components. TA completion reports show a similar trend: more than 90% of TA projects were rated successful or highly successful if they paid attention to monitoring, compared with less than 75% when monitoring was not considered.

## Results

**Sustained and Improved Performance of SOEs have required numerous reform measures over several years.** The results of ADB supported SOE reforms normally become discernable after several years, as decisions on improving governance (for

example financial accounting and reporting as per international standards) can only be implemented gradually.

### Results from ADB Support for Macro-Level Approaches

**These ADB interventions made a modest contribution to Reform outcomes, and a modest contribution to Sustained and Improved Performance of SOEs. ADB projects that supported macro-level approaches embodied a high reform component, but few of many policy actions, outcomes or outputs related to SOE reforms.** To the extent policy actions and design and monitoring frameworks referred to SOE reforms, the extent of ADB support for SOE reforms was limited to formulation and issuance of regulations, and activity that helped implement those regulations was limited to planning. These projects affected reforms in SOEs only indirectly.

**With regard to contributions to Reform outcomes, ADB's support through macro-level approaches contributed modestly to improving governance in SOEs.** Even when projects were rated successful, the SOE reform outcomes were not achieved. For example, in Viet Nam, a series of policy-based loans were implemented from 2007 to 2011. These incorporated a modern governance pillar and policy actions to improve governance and financial management in SOEs, and were rated successful. ADB support was focused on the issuance of regulations for improved corporate governance in state economic groups and large SOEs combined with the piloting of restructuring plans for selected SOEs. However, a joint World Bank and IMF assessment showed that by 2014, large SOEs had defaulted on their obligations and several other SOEs appeared to be overleveraged—which might suggest that the government had begun to impose hard budget constraints on these SOEs. However, corporate governance of some of these SOEs had not improved significantly, and borrowing decisions were probably still being made without due regard to their debt servicing capacity.

**ADB support at the macro-level contributed modestly toward improving the government's SOE-related fiscal problems.** ADB supported several PSM and financial sector development projects that had been designed to address the

government's SOE-related fiscal concerns. However, even when the projects were rated successful and the associated SOE reform agenda was explicitly articulated, its implementation was not supported or later dropped. For example, in Pakistan, ADB supported capacity development of the Securities and Exchange Commission of Pakistan, strengthened governance of stock exchanges, improved external audit and disclosure by public companies, and provided policy inputs for sequenced sales of SOE shares through capital markets. However, of the intended 10 primary and/or secondary offerings by March 2009, only two additional offerings were made.

**As for contribution to Sustained and Improved Performance of SOEs, ADB support through macro-level approaches for SOE reform contributed modestly to improving the operational efficiency and commercial viability of SOEs.** This is a consequence of the modest contribution of ADB support on Reform outcomes. In this area of operations, no projects included any specific activities to directly improve operational efficiency or commercial viability of SOEs.

**The contribution of ADB supported projects using macro-level approaches to increase access to quality and affordable services in the near term was modest.** Improved access to quality and affordable services was not the intended result of projects in this area of operations. These projects did not include an investment component for expanding infrastructure. However, to the extent they sought to develop capital markets or strengthen the financial sector, some improved access to financial services was seen.

### Results from ADB Sector-Level and SOE Specific Interventions

**While SOE reform was not the primary objective of ADB projects that financed investments, ADB leveraged these investments to advance the reform effort.** Interventions that aimed to influence changes at the sector level and in specific SOEs provided a relatively mixed picture on contributions to Reform outcomes and to Sustained and Improved Performance of SOEs.

**The reform components of these ADB supported projects contributed modestly in improving governance at the sector level and in specific SOEs,**

**and in some cases have had to be buttressed with further investment support.** At the sector level, ADB provided significant support for strengthening financial and infrastructure sector regulations and regulators but the intended measures were seldom fully implemented. For example, as part of a program to improve the sustainability of the Bangladesh power sector, ADB supported a PBL and project loans that became effective in 2007. The PBL closed in 2008 and the project loans closed in 2014. The Bangladesh government approved a three-year reform roadmap (which has been subsequently revised), prepared a financial restructuring plan for power sector entities, constituted a board of directors for two newly corporatized power sector entities, and listed two power entities on the local stock exchange. The government also approved an organizational chart for the power sector regulatory body, and the regulatory commission began functioning before the project loan closed. Since then, tariffs have been raised periodically, which indicates the working of the regulatory mechanism of tariff revisions. However, while these measures indicate improved governance at the sector level and of power sector entities, the fact remains that outstanding electricity dues from the government and its autonomous and semi-autonomous bodies have remained significant. ADB is providing further investment support to reduce cost of service (and the need to increase tariffs) as well as introduce pre-paid meters and technology solutions to curb non-payment for electricity consumption.

**ADB support through sovereign investments contributed positively to improving the governments' fiscal positions.** ADB supported the closure of loss-making SOEs, or restructuring or privatization, and this contributed positively to improving the fiscal health of the concerned government (and that in the absence of this ADB support, the government's fiscal position might have been worse). For example, ADB supported the closure of more than 10 loss-making or inoperative state-level SOEs in India and created fiscal space for the state government.

**Regarding contribution of sovereign investments to Sustained and Improved Performance outcome, the reform component of ADB support contributed modestly to improving operational efficiency and enhancing the commercial viability**

**of SOEs.** In most sovereign operations, operational efficiency improvements are linked to investment related components. For example, in the PRC, equipment procured for improving traffic management and road maintenance most likely helped reduce accidents on tolled expressways managed by newly created SOEs with long-term concession agreements. However, if there was no clear associated reform that provided operational autonomy, it is uncertain whether these performance improvements can be sustained over the long term.

**ADB's sovereign investment projects helped to significantly increase access to quality and affordable services, and this is primarily related to investments in expansion and upgrading of infrastructure and financial services.** Investment support provided ADB a key leverage in advancing the reform effort. For example, in Viet Nam a loan project financed the physical investment to improve rail passenger and freight flows through a border-crossing point, and at completion, noted that traffic throughput on the rehabilitated sections can be optimized if the rail SOE's rolling stock is modernized (which means further investment). The fact that the accompanying institutional reforms component for improving financial management in the rail SOE, had been implemented only at the rail SOE's headquarters (and not at the border-crossing point or other parts of the network) was not considered among the primary reasons for not achieving the anticipated improvement in traffic flows.

**In the longer term, when more reform related benefits are likely to become apparent, it is likely that access to quality and affordable services will improve.** For example, the benefits from increased autonomy that enable a public utility in Viet Nam to charge full cost recovery tariffs and to adopt measures to reduce public health risks were not realized during the project implementation period but will become evident when consumers begin to see the benefit to public health of installing septic tanks and improved drainage. It is anticipated that this will increase consumers' willingness-to-pay and enable the utility to implement full cost recovery tariffs.

### Results from ADB NSO Interventions and Sovereign Projects that Propagate the PPP Modality

NSO projects and sovereign projects that propagated the PPP modality for developing new infrastructure recorded high success rates. More than 90% for NSO and 75% for projects that aimed to develop infrastructure using the PPP modality were rated successful or better. Nearly two-thirds of PSOD projects in the portfolio of operations invested in SOEs indirectly, and whether governance improvements that resulted from ADB support benefited the parent SOE was not a consideration at the project design stage.

With regard to contribution to Reform outcomes, PSOD's direct or indirect SOE clients are normally well governed and provide ADB with only limited opportunities for improving governance. Hence, ADB support contributed modestly to improving governance in the concerned SOEs. However, some examples show that this improvement is possible. PSOD supported governance improvements in two direct SOE clients in the PRC through training and TA support. PSOD also influences governance improvements when it acquires an equity stake in the client company and takes a board position (as for two direct and one indirect SOE clients). The extent PSOD helped improve governance in its indirect SOE clients, and whether or not any improvements flowed back to the parent SOE, was not well captured in the results framework design.

ADB support in this area of operations contributed positively to improving the governments' fiscal positions. These included projects where PSOD helped raise equity and mobilize cofinancing on parallel or lender-of-record basis. Where PSOD facilitated transactions, it may have also been supporting subsequent financings from the market. Additionally, some NSO projects that have demonstrated their value may also be replicated by SOEs that seek to raise funding without government guarantees or budgetary assistance, and thus may further contribute to improving governments' fiscal positions.

With regard to contribution to Sustained and Improved Performance of SOEs, ADB supported NSO projects contributed modestly to improving SOEs' operational efficiency or enhancing their

commercial viability. For NSO, where the clients are normally well governed, and efficiently operated, ADB support through investments to improve their operational efficiency and commercial viability was modest from a portfolio perspective. However, there are few examples where ADB made a significant contribution, one being PSOD assistance for reducing energy consumption in pilot wastewater treatment and reuse plants.

NSO projects contributed significantly to increasing access to quality and affordable services. These improvements were directly related to investment support and not to Reform efforts. Given the stronger governance systems of these clients, the performance is likely sustainable. NSO projects that demonstrated new technologies (not previously tried in the country) and helped to improve air and water quality, reduce wastage and increased recycling, and introduce climate friendly clean technologies contributed to improved access of quality services. NSO projects that demonstrated the viability of long tenor financing for infrastructure development, and the benefits of compliance to higher standards for environment and social safeguards also had a positive impact. These have included several ADB investments notably in the PRC and India.

Results of sovereign loans that supported a wide variety of infrastructure projects using the PPP modality can be inferred from project documents only for the Reform outcome of improving the governments' fiscal positions. The fact that financial intermediaries and executive agencies have leveraged significant amounts of private capital in developing PPP projects indicates prima facie their positive contribution to improving the government's fiscal position. However, project documents provide no insights into contingent liabilities that might arise for governments. For example, in India, \$1.2 billion from ADB catalyzed private sector investments of about \$14.6 billion to finance 50 subprojects, but project documents provided no information on subproject structures and risk-sharing arrangements, or an assessment of the governments' contingent liabilities. For positive results from these loans to be sustained and multiplied, it will be important to address the underlying risks of weak regulation, insufficient autonomy, poor project supervision capability and market risks, as well as develop the long-term

domestic debt market. Project documents also did not provide information on governance improvements and the extent to which PPP projects or subprojects improved access to quality and affordable services.

### ADB's Delivery Mechanism

Although as part of the One-ADB approach, ADB is in the process of improving coordination within and between departments, there is no efficient coordination mechanism for strategizing and guiding ADB's engagement with and reform of SOEs at the macro-level, sovereign investments, as well as NSO support. Many divisions within the operations departments support projects that are not primarily intended to reform SOEs, although they support specific reform measures at the macro and sector levels as well as for specific SOEs. While the one-ADB approach has helped improve coordination within and between departments, the present system does not facilitate articulation of a strategic approach to reforms in a given country context. An efficient coordination mechanism with a dedicated group of experts on SOE reforms could guide ADB operations departments toward a more strategic approach, have the mandate for doing so, take ownership of articulating a strategic approach, be headed by an expert of sufficient seniority, be backed by a knowledge base and partnerships with other centers of excellence on SOE reforms, participate in the CPS process, and provide advice on specific operations.

### Conclusions

**SOE reform is challenging but critical.** Even where governments have shown a high level of commitment over the past 2 or 3 decades and have made significant progress in reforming SOEs, entrenched interests have often intervened. The resources and capacity required for good corporate governance can be daunting in many countries. Nevertheless, reform is necessary because several inefficient and loss-making SOEs continue to be subsidized in the Asia and Pacific region, and this is not sustainable.

**Reforms are influenced by many factors and have progressed at an uneven pace even when governments have remained committed over**

**prolonged periods.** Positive outcomes from the reform effort are often discernable only in the medium-to-long terms, which makes it difficult for governments to sustain high commitment levels and aggressive approaches to reform. The willingness of governments to undertake SOE reforms is heightened during crisis periods, and when governments consider that reformed SOEs can help them to achieve their other overarching objectives.

**The results-based lending (RBL) modality, which was introduced in 2013, can be considered for furthering SOE reforms.** ADB has used the RBL modality where there are clearly defined expenditure frameworks, and the accompanying governance and capacity development frameworks are small. As RBL disbursements are linked to progress in reaching intermediate or final milestones, the RBL modality could be considered for supporting government investment programs that have a significant component for maintenance and upkeep of existing SOE assets, to improve their operational efficiency and commercial viability.

### ADB Performance

**Although ADB support tended to be within the parameters defined by governments and in line with its own broad strategies and policies, ADB's performance in supporting SOE reforms is mixed.** ADB's interventions were relevant in most cases, and effective, efficient and sustainable in about 60% of cases. The following broad conclusions can be drawn:

- (i) Even where intended outputs and outcomes for influencing macro-level approaches to improving governance were achieved and sustained, the link to improved SOE governance and performance improvement was difficult to establish, in part due to a lack of proper results indicators.
- (ii) While ADB's investments to leverage the reform effort and to support governance improvements at the sector level and in specific SOEs have influenced SOEs' performance, it is not clear how sustainable these gains are. In most cases, SOE performance was closely linked to direct investment that did not address the reform



components which are indispensable for the sustainability of the intended outcomes.

- (iii) ADB's NSO clients are normally well governed and efficient, although ADB has supported corporate governance improvements in a few cases. Therefore, NSO investments have had a positive and likely sustainable impact on fiscal positions and Sustained Performance.
- (iv) SOE reforms become discernable over a time horizon that extends beyond a typical project timeline. However, as ADB does not monitor progress of its interventions beyond project closing, it is difficult to ascertain whether ADB supported reform measures have been replicated by the beneficiary SOEs or by other SOEs in the same sector. Similarly, it is difficult to ascertain whether the reform measures have been sustained.

### Results from ADB Support

The time slice for observing results from ADB interventions captures a subset of the continuum of SOE reforms.

**Regarding contribution of ADB support to SOE Reforms,** ADB support has contributed modestly to improving governance in SOEs in all three areas of operations. With respect to addressing governments' SOE-related fiscal problems, the contribution of ADB support for macro-level approaches has been modest, while it has been positive for sector-level and SOE-specific interventions, as well as for NSO interventions and sovereign projects that support infrastructure development using the PPP modality. However, this positive result was due largely to the investment component, which effectively reduced the need for financial support from governments, although not necessarily in a sustainable manner.

**Regarding contribution of ADB support to Sustained and Improved Performance of SOEs,** ADB support contributed modestly to improving operational efficiency and commercial viability of SOEs in all three areas of operations. Toward improving access to affordable and quality services, however, the contribution of ADB support for macro-level approaches was modest, while it was significant for sector-level and SOE-specific interventions as well as for NSO projects. This is related to the investment components of these

interventions and not necessarily to Reform outcomes.

### Issues

ADB would need to consider several issues, both external and internal, as it strives to improve its SOE reform interventions and implement the corporate strategy 2030.

#### External Issues

**The key external issues are related to the political economies of countries and these need to be recognized as part of ADB's risk management framework.** Even if a government demonstrates an overall commitment to reform, resistance and vested interests within governments and SOEs can slow the progress in implementing reforms. The vast range of measures required to reform SOEs and improve their performance poses a big challenge to governments and SOEs. Soft budget constraints—no matter how justifiable they are for SOEs in infrastructure and other public goods sectors—reduce the incentive of these SOEs to reform.

#### Internal Issues

**The key internal issues refer to ADB systems and practices that need to be improved.** Internal issues tend to influence ADB's performance across all areas of operations.

- (i) **Project completion documents do not provide sufficiently granular information to enable assessment of the SOE reform component alone.** This issue cascades down to IED's validation and evaluation documents. It is noted that: (a) the ratings of projects that support macro-level approaches to improving governance reflect performance of all ADB supported reform measures and not just those pertaining to reform of SOEs; (b) the ratings of sovereign projects that largely support investments and also incorporate measures for improving governance at the sector level and in specific SOEs are a composite for the entire scope of the project, which is largely investment related; and (c) similarly, the ratings of sovereign projects that support infrastructure development using the PPP

modality, as well as ratings of NSO projects that support SOEs directly and indirectly, are largely related to the investment component.

- (ii) **ADB support is not sufficiently strategic or well-articulated.** While this evaluation has developed a framework to understand the logic of ADB's interventions, the reality is that the three areas of operations explained here and their intended outcomes are not clearly spelled out or articulated to DMC governments and other stakeholders. Nor are interventions in the three areas of operations deployed in a coordinated manner.
- (iii) **ADB's organizational mechanisms do not allow it to articulate and deliver a more strategic reform program.** There is no efficient mechanism with a mandate for strategizing and formulating a coordinated approach to delivering reforms.
- (iv) **ADB has not paid adequate attention to important and strategic issues.** These include the strengthening of governments' oversight mechanisms and addressing concerns about SOEs' boards of directors.
- (v) **ADB has not paid sufficient attention to reforming SOEs engaged in manufacturing.** Manufacturing remains an engine of growth in middle-income countries. Where governments allow competition, the performance of manufacturing SOEs remains below that of private sector counterparts. Governments continue to attempt to restructure and privatize these SOEs to improve their productivity and competitiveness. These SOEs are also less encumbered by public service obligations, and ADB could begin by assessing the opportunity for supporting manufacturing SOEs for reform (sovereign modalities), and investments (both sovereign and NSO modalities).
- (vi) **ADB has not emphasized the need to improve accountability mechanisms in infrastructure SOEs.** This is despite the fact that accountability measures are a basic building block for good governance.
- (vii) **ADB has not emphasized governance risk assessments in target SOEs.** Governance risk assessments at the country, sector and project levels focus largely on public financial management, procurement and corruption. Besides, project documents provide high-level information such as government's major concerns and approach to reforming SOEs, and issues faced by SOEs. Issues related to board composition and functioning, and to accountability mechanisms are not analyzed for target SOEs.
- (viii) **ADB does not tag projects for SOE reform in finance, infrastructure and other sectors apart from PSM.** This makes it difficult to identify operations that support and seek to advance SOE reforms. Tagging for SOE reforms will be an important part of creating an in-house knowledge base. ADB is now in the initial stages of creating a knowledge base on SOE reforms.
- (ix) **ADB does not record the progress of implementing reforms during project implementation periods in a central database.** Although ADB has a central database covering progress in implementing project based sovereign loans and grants, it does not cover reform components. Likewise, there is no system of recording the progress of reforms that were supported through policy-based loans and TA projects in a central database.
- (x) **ADB does not track outputs and outcomes of reform measures beyond project closing dates.** Given that SOE reform is a process that goes far beyond typical ADB project implementation periods, tracking of reform progress beyond project closing dates—although difficult—can be useful for gauging the extent to which reforms have been achieved and sustained, and also replicated and mainstreamed.
- (xi) **The extent to which PSOD has helped improve governance in SPVs, and whether any gains made have flowed back to the parent SOE has not been well captured in results frameworks.** The flow-back of institutional systems and practices from a



well-governed SPV to the parent SOE is a development objective worthy of pursuit.

## Lessons

Lessons are drawn from the viewpoint of improving ADB's performance in supporting SOE reforms across all areas of operations.

**Well-coordinated operations at the macro-level, sovereign investments which leverage SOE reforms, and NSO support to SOE clients can improve ADB's effectiveness in supporting SOE reforms.** A coordinated approach, which can be facilitated by a central unit, will enable ADB to address SOE reform issues more comprehensively and provide well-articulated strategic direction to governments.

**Improved government oversight mechanisms tend to improve the governance and performance of SOEs.** A government's SOE oversight mechanism reflects the way it prefers to exercise its ownership rights; and governments have been trying to find workable mechanisms given their specific political and economic landscapes, and institutional and historical factors. The improvement in oversight mechanisms need not necessarily involve instituting a new oversight mechanism, but rather improving upon the existing skill-sets, performance monitoring metrics, database management systems and coordination among organizations that are engaged in the oversight responsibility.

**Addressing board issues can help to improve the governance and performance of SOEs.** Improving accountability mechanisms is a necessary but not sufficient condition for improving SOE governance and performance. This reflects the centrality of the role played by the board of directors of an SOE. Board level issues can be addressed both at the macro-level as well as in specific SOEs. These board level issues are related to independence of boards, presence of requisite skills sets at the board level, functioning of board committees, and quality of information provided to and available to boards for decision-making.

**Appropriately designed monitoring and reporting systems contribute to the success in implementing SOE reform measures.** The success rates of projects with attention to monitoring and reporting was

higher than for projects that did not emphasize monitoring and reporting. This is seen for projects that aimed to improve governance through macro-level approaches, at the sector-level and in specific SOEs.

**Strengthening sector regulatory framework and oversight is important for sustained and improved performance of infrastructure and financial sectors.** The design of sector regulations, the strengthening of regulatory capacity and enabling regulatory compliance are all measures that help improve governance and performance of regulators and sector institutions, including SOEs in the sector.

**ADB's additionality is important for ADB's direct and indirect SOE clients that borrow without sovereign guarantees.** In line with ADB's developmental role, the desired ADB additionality can come from better corporate governance as well as demonstration of new technology, processes and financing structures/modalities.

**Good risk management systems in executive and implementing agencies are necessary for developing infrastructure projects using the PPP modality.** This is in line with the basic justification and rationale for developing and investing in infrastructure through the PPP modality (i.e. reducing public sector investment needs, for which it is necessary to keep contingent liabilities on the government within manageable limits).

## Recommendations

Given below are four recommendations for ADB to consider. These recommendations are intended to provide guidance to the ADB Board and Management to improve ADB performance as well as results from its support for SOE Reforms and Sustained and Improved Performance, and to contribute toward implementing the corporate strategy to 2030.

**Recommendation 1: Address SOE reform issues more comprehensively, strengthen the provision of well-articulated strategic direction to governments, and use the country partnership strategies process for articulating country relevant approaches in project design.** Reforms call for interventions at the macro level, sector level and in specific SOEs, and are inherently complex and

sensitive issues for governments, SOEs and other stakeholders. The discussion on SOE reform with governments at a high level will require continuous and intensive policy dialogue that is supported by analysis of issues relevant to fiscal management, competition policy, corporate governance practices as well as SOE operational and financial performance. It is anticipated that the proposed high-level engagement with the government will go beyond the traditional CPS country programming process and also cover program / project design aspects.

**Recommendation 2: Strengthen the capacity of the existing SOE Working Group to enable proper articulation of strategic approaches to SOE reforms and guide bank-wide SOE engagements for effective implementation.** This will require dedicated SOE reform experts that are facilitated and enabled by inhouse knowledge bases, and access to sector expertise through partnership arrangements with centers of excellence. The Working Group will provide knowledge inputs to operations departments, guide operations departments in project design, and participate in high-level policy dialogue with governments.

**Recommendation 3: Improve significantly the monitoring and reporting of ADB supported SOE reform measures.** At present, ADB records progress in implementing only investment components of project-based loans and grants until project closing; and reform components of project-based loans and grants are not covered adequately in their completion reports. ADB should record in a central database, progress on reform components of project-based loans, policy-based loans, results-based loans and TA projects until project closing. Significant improvements

(such as by designing suitable indicators for various reform areas) are also required to enable ADB to monitor reform outcomes that normally become discernable after project closing. Where such monitoring is difficult for each and every specific project, it is suggested that a macro-level or sector-wise approach be adopted. The CPS country programming and policy dialogue processes can be used to gauge the extent ADB supported reforms have been sustained, replicated and mainstreamed. By incorporating SOE reform indicators in the corporate results framework, ADB will be able to better monitor at the corporate level, its contribution to reforming SOEs in line with Strategy 2030.

**Recommendation 4: Refine the project classification system to enable better tagging of SOE reforms in all sectors and enhance ADB's knowledge base.** The introduction of SOE reform as a subsector under PSM in the project classification system that came into effect in 2014, enabled tagging of projects classified under PSM sector. A further revision to enable tagging for SOE reform in finance, infrastructure and other non-PSM sectors would be a useful building block for expanding ADB's knowledge base on SOE reforms. This knowledge base should provide easy access to knowledge embedded in project design and completion documents, as well as consultant reports, and should enable collation and analysis. It should help ADB in preparing specific knowledge products that enable high-level policy dialogue with governments, and for knowledge dissemination amongst governments and project beneficiaries. Some such knowledge products could be benchmarking studies and lessons from ADB support for SOE reforms in given macro and sector contexts.

### Linkage between Findings and Recommendations

Finding	Recommendation
<p>This evaluation has developed a framework to understand the logic of ADB support to SOE reforms. The reality however, is that the three areas of operations and their intended outcomes are not articulated well, and the interventions in these areas of operations are not well coordinated.</p>	<p><b>Address SOE reform issues more comprehensively, strengthen the provision of well-articulated strategic direction to governments, and use the country partnership strategies process for articulating country relevant approaches in project design.</b></p>
<p>ADB's existing organizational mechanisms do not allow it to articulate and deliver a more strategic SOE reform program.</p>	<p><b>Strengthen the capacity of the existing SOE Working Group to enable proper articulation of strategic approaches to SOE reforms and guide bank-wide SOE engagements for effective implementation.</b></p>
<p>Progress of ADB supported reform measures that are ongoing at project closing is not monitored. ADB's centralized databases do not track progress in the implementation of reform components of loans and grants, and TA projects during project implementation period. The status of ADB supported reform measures may or may not be reported in completion reports.</p> <p>These are integral to creating an organization that can articulate and deliver a strategic reform program.</p>	<p><b>Improve significantly the monitoring and reporting of ADB supported SOE reform measures.</b></p>
<p>SOE reform projects are not tagged in all sectors, and ADB is in the initial stages of creating a knowledge base.</p> <p>These are integral to creating an organization that can articulate and deliver a strategic reform program.</p>	<p><b>Refine the project classification system to enable better tagging of SOE reforms in all sectors and enhance ADB's knowledge base.</b></p>

# 1

## INTRODUCTION



## Highlights

- The Asian Development Bank (ADB) recognizes the importance of reforming state-owned enterprises (SOEs) and this evaluation focuses on SOE reforms. The purpose of this evaluation is to inform the ADB Board and Management of ADB's experience to date with SOE reforms and to guide ADB's engagement with SOEs as it implements the corporate strategy 2030.
- The evaluation seeks to assess ADB support and understand the extent to which this support has helped achieve the intended Reform (intermediate) outcomes and Sustained and Improved Performance (higher level) outcomes. Accordingly, the overarching question is: to what extent has ADB support for SOE reforms contributed to achieving the Reform outcomes of improved governance at the corporate and sector levels, as well as reduced the government's SOE related fiscal problems, and to achieving the Sustained and Improved Performance outcomes resulting from reforms, in terms of improved SOE long-term operational efficiency and commercial viability, and improved long-term consumers' access to quality and affordable services?
- Pressures to reform SOEs have built up in many developing, emerging market and transition economies since the 1980s. The Asian experience also shows the importance of government commitment to reform SOEs, and that reforming of SOEs remains a work in progress in all countries.

1. **The Asian Development Bank (ADB) recognizes the importance of reforming state-owned enterprises (SOEs), and this evaluation focuses on SOE reforms.** ADB has supported several aspects of SOE reforms in its developing member countries (DMCs) over several decades. This support was intended to strengthen SOEs' governance, fiscal management, operational efficiency and sustained ability to deliver goods and services. ADB set up an SOE Working Group in December 2016, with the following premise: "the key objective of ADB SOE engagement should be to support a SOE's ability to achieve financial and operational independence, in line with private sector operators, and provide services efficiently and effectively."<sup>1</sup> The SOE Working Group includes members from various knowledge and operations departments and offices. ADB's corporate Strategy 2030, which is being implemented from July 2018, is explicit about supporting SOE reforms across the Asia and Pacific region (including in small island developing states, low-income and lower middle-income countries and upper-middle-income countries).<sup>2</sup>

2. **The purpose of the evaluation is to inform the ADB Board and Management of ADB's experience to date with SOE reforms and to guide ADB's engagement with SOEs as it implements Strategy 2030.** The evaluation provides an independent assessment of ADB's engagement in SOE reforms, and draws lessons for future engagement with SOEs, through sovereign loans and grants, nonsovereign operations (NSO), and through technical assistance (TA) projects.

### A. Definition of State-Owned Enterprise

3. **There is no commonly accepted definition of an SOE.** International organizations and country governments have tended to define SOEs differently. The Organisation for Economic Co-operation and Development (OECD) explicitly acknowledges that SOEs can be defined differently by different country governments.<sup>3</sup> In some cases, the definition of SOE has been articulated during the last 10 years (e.g., the Viet Nam definition).

<sup>1</sup> Internal memo from the Strategy and Policy Department and the Sustainable Development and Climate Change Department to Vice President (Knowledge Management and Sustainable Development), 14 December 2016: *Establishment of a Working Group to Address State-Owned Enterprise Reform*.

<sup>2</sup> ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

<sup>3</sup> Organisation for Economic Co-operation and Development (OECD). 2011. *OECD Corporate Governance Working Paper No.5: The Size and Composition of the SOE Sector in OECD Countries*. Paris.

4. **ADB defines SOE as “a legal entity established to undertake commercial activities and owned fully or largely by the sovereign.”<sup>4</sup> This ADB definition fits the purposes of applying the nonsovereign public sector financing policy.** It is aligned with the OECD definition: an enterprise that is directly or indirectly owned or controlled by the state and has an underlying commercial focus.<sup>5</sup> The ADB definition implies that NSO support to a client entity which has a state shareholding of up to 50% will not be considered under the nonsovereign public sector financing policy. Regarding sovereign operations, in addition to supporting legal entities established to undertake commercial activities and with 100% majority or minority state ownership, ADB has also engaged with and supported reforms in bodies that are commercially oriented but may not be corporatized. It is noteworthy that the World Bank recognizes the diversity of SOEs and views that typically in any country, SOEs are in the form of public enterprises that may or may not be corporatized or government departments that fall under an SOE or enterprise law; and also that some SOEs can be statutory corporations with their own legislative act or a distinctive legal foundation.<sup>6</sup>

5. **ADB recognizes that there are a growing number of opportunities for investing in SOEs directly and indirectly; directly when the client itself is an SOE, and indirectly when the client is owned by a government authority through an intermediary entity, or is a special purpose vehicle (SPV) with an SOE as one of the shareholders.** Indirect SOE clients operate on a commercial basis, and the government can continue to influence their decision-making through its majority or minority shareholding interests.

## B. Evaluation Approach

6. **The evaluation period was 2005–2017.** The start date (2005) coincides with the start of the period for which ADB had previously compiled a preliminary database on its engagement with SOEs. The end date is the most recent year for which a complete list of ADB’s sovereign operations and NSO is available. However, the SOE reform process normally takes longer than this 13-year time-period. Therefore, where relevant, this evaluation also refers to projects, policies, strategies and operational plans that ADB approved before 2005.

### 1. Conceptual Framework

7. **The evaluation recognizes that the underlying objective of reforming SOEs is to sustainably improve their performance.** ADB has sought (among other measures) to reduce the differences between rules that govern SOEs and other enterprises, and close the performance gap between SOEs and other enterprises (where both SOEs and other enterprises have a presence and compete) so as to produce economy-wide benefits.

8. **For purposes of this evaluation, SOE reforms are defined as measures to address the challenges posed by inadequate governance at corporate and sector levels, and governments’ SOE-related fiscal management problems.** These challenges are intertwined. Corporate governance can be improved through a broad range of measures at the country level or sector level and at the SOE level. Many of these very same measures can also help reduce the explicit and contingent liabilities of the governments. More specifically:

- (i) Corporate governance can be advanced by (among other) separating ownership functions from regulatory and policy making functions; instituting SOE oversight arrangements; having skilled directors on SOE boards and with no conflict of interest; and establishing accountability mechanisms.

<sup>4</sup> ADB. 2011. *Mainstreaming Nonsovereign Public Sector Financing*. Manila.

<sup>5</sup> For further information on what according to OECD, is an SOE, refer to OECD. 2015. *OECD Guidelines for Corporate Governance of State-Owned Enterprises*. Paris.

<sup>6</sup> World Bank Group. 2014. *Corporate Governance of State-Owned Enterprises: A Toolkit*. Washington, DC.

- (ii) Sector governance refers to the creation of a competitive market in a sector or subsector, or independent regulation when competition is limited. It may involve the unbundling of a vertically integrated entity. Measures listed under corporate governance are also relevant to all sector entities.
- (iii) SOE-related fiscal management problems can be addressed by instilling better financial discipline in SOEs. Although hard budget constraints can help address the governments' fiscal governance problems and enable governments to better gauge their fiscal liabilities from SOEs, governments seldom impose such hard budget constraints on SOEs. Better financial management systems in SOEs and more effective public financial management (PFM) can contribute to better government monitoring of overall and SOE related budget and expenditure.

9. **The term "SOE reform" as used in this evaluation, includes corporate and/or financial restructuring and capital diversification, transformation for operations under commercial law as well as ownership change (including full or partial privatization).** SOE reforms improve corporate governance and contribute to addressing fiscal governance issues. Besides, financial sector development (FSD), private sector development (PSD), and public-private partnership (PPP) are also considered as additional areas that nudge the reform effort forward. A strong financial sector that is unencumbered by its portfolio of nonperforming loans (NPLs) to SOEs will tend not to crowd out the private sector. A well-developed capital market will not only be an alternative source of finance for private sector, but also provide avenues for full or partial privatization of SOEs. A strong private sector can provide a competitive environment to SOEs in sectors and subsectors where governments permit private players. Where governments intend to improve overall economic competitiveness, governments and private players also put pressure on SOEs to provide affordable and reliable public goods services. Legal, regulatory, and institutional changes to facilitate growth and expansion of the private sector, encourage PPP and support fair competition, are among the measures often considered by governments and supported by ADB.

10. **This evaluation refers to PPP as a modality to develop new infrastructure with an SOE as one of the involved parties.**<sup>7</sup> The PPP modality crowds in private sector financing for infrastructure development. In so doing, it can ease the government's SOE-related financial problems provided user charges recover full costs and the project does not increase contingent liabilities on the government. The PPP modality helps improve access to infrastructure and provides competition to or demonstrates new management systems to SOEs engaged in the same sector. The Independent Evaluation Department (IED) reviewed information provided in ADB project documents; but did not assess the risk-sharing arrangements of specific ADB supported infrastructure projects and subprojects under the PPP modality.

11. **This evaluation recognizes that SOEs in ADBs DMCs have diverse characteristics.** A part of this diversity reflects the evolution of an SOE from being a department in a government ministry to an entity that is fully financed through budget allocations and then to a 100% governed owned SOE with profit expectations. The diversity in the Asia and Pacific region reflects the countries' historical preferences for state involvement in infrastructure and other sectors, the extent to which commercial orientation is dominant (i.e., the emphasis on seeking profits versus recognizing and addressing equity concerns), and the legal form of the SOE (whether corporatized or an unincorporated association). The diversity also reflects the legal and regulatory framework under which an SOE functions (public or private or mixed, and whether an SOE is established by an act of parliament and governed by a special statute), the ownership structure which itself can be influenced by the strength of the private sector and capital markets in the country (an SOE can be listed or unlisted, can be a joint stock and/or limited liability company), the different levels of operational autonomy and financial viability of the SOE, the extent of government ownership and the level of the government involved (national, provincial or municipal), and

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<sup>7</sup> Or one of the parties is a public enterprise that may or may not be corporatized or a government department that falls under an SOE or enterprise law; or a statutory corporation with its own legislative act or a distinctive legal foundation.



the extent to which governments consider certain SOEs as tools for meeting their social and other political objectives.

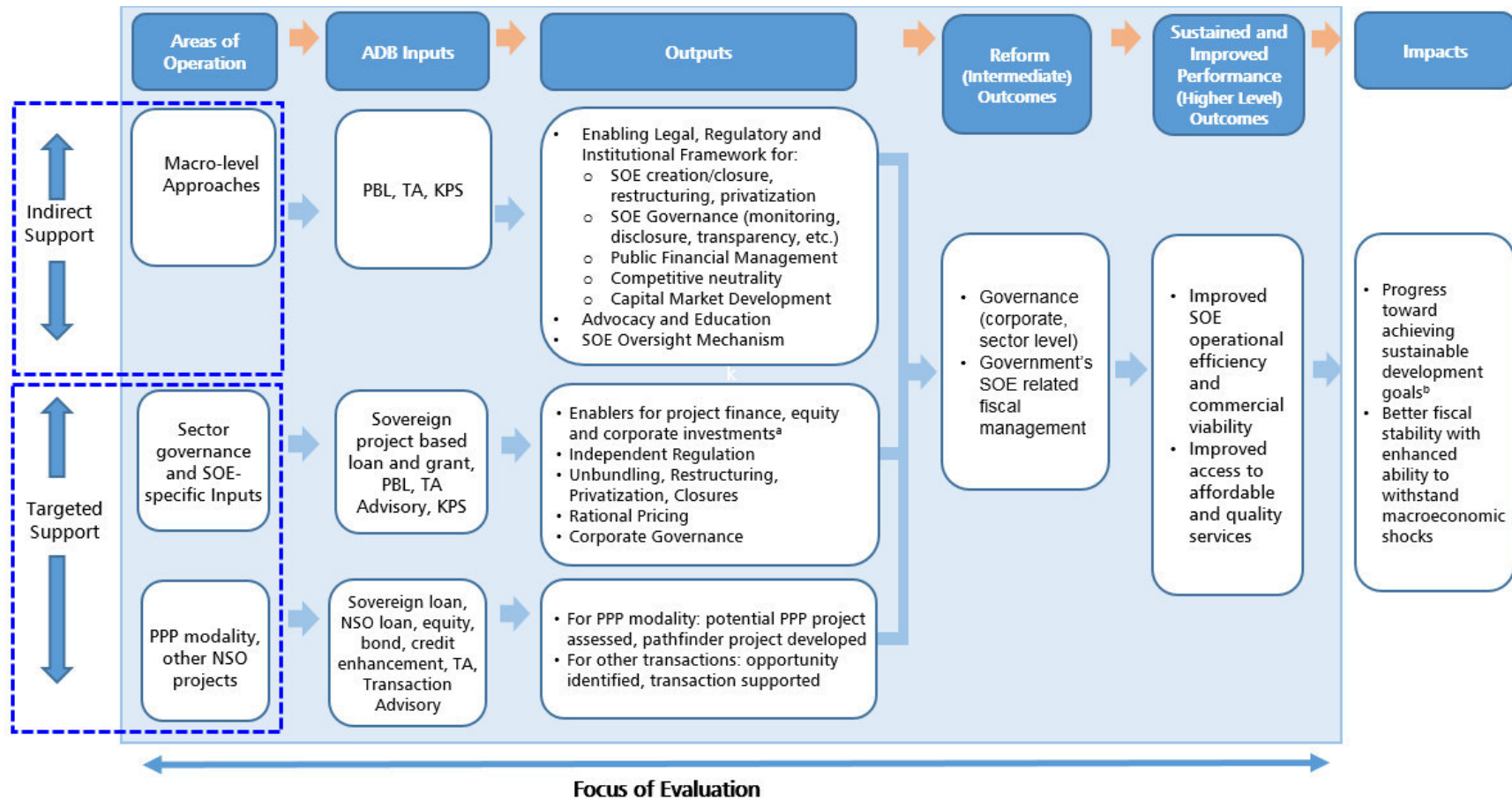
12. **IED has developed a Theory of Change to explain the logic of ADB's interventions to engage with and support SOE reforms. The theory of change shows that ADB has supported SOE reforms in numerous ways to achieve the intended outcomes.** There were three critical areas of ADB operations, of which one affected SOE reforms indirectly, while the other two provided targeted support. These includes:

- (i) Indirect support through macro-level approaches to improving governance through enabling legal, regulatory and institutional frameworks, advocacy and education, and government SOE oversight mechanisms. These operations affected SOE reforms indirectly.
- (ii) Targeted support through: (a) Sovereign investments that had accompanying measures for improving governance at the sector level and in specific SOEs. ADB leveraged these investments to advance the reform effort; and (b) NSO investment support to direct and indirect SOE clients, and sovereign projects that propagated infrastructure development through the PPP modality where an SOE was one of the key stakeholders.

13. **The intended outcomes from ADB support through the three areas of operations are at two levels.**

- (i) A set of Reform (intermediate) outcomes including improved SOE governance at the corporate and sector levels; and reduced governments' SOE related fiscal problems.
- (ii) A set of Sustained and Improved Performance (higher level) outcomes resulting from SOE reforms, in terms of improved operational efficiency and commercial viability, as well as improved consumer access to quality and affordable services. Progress in implementing Reforms is essential to sustain performance improvements.

Figure 1: Theory of Change for ADB Engagement and Reform of SOEs



KPS = knowledge products and services, NSO = nonsovereign operations, PBL = policy-based lending, PPP = public-private partnership, SOE = state-owned enterprise, TA = technical assistance.

<sup>a</sup> Such as advisory services to SOE to obtain and improve credit rating.

<sup>b</sup> Include large number of socially, environmentally, and financially sustainable goals and target areas.

Source: Asian Development Bank (Independent Evaluation Department).

14. **Progress in achieving intended outcomes is influenced by the fact that SOE reform is not the sole or even primary objective of most ADB supported projects. Many other factors also influence progress in achieving the intended outcomes.** These include:

- (i) The country's political and economic landscape, including whether government support for SOE reforms is adequate and sustained, and whether SOE managements are supportive of the reform program and act decisively to improve capacity, increase transparency, manage and mitigate risks, and communicate their reform strategies to employees. The risks associated with the political and economic landscape are that it can become difficult for ADB to engage in a policy dialogue and to advocate for reform. They can also make it difficult for ADB to come to an agreement with the government and other stakeholders on suitable entry points.
- (ii) Other factors that influence SOE reforms, such as: (a) the extent to which there is a capable private sector and an enabling environment for the national and foreign private sector to expand its role in the economy; (b) the extent and effectiveness of PPPs to deliver services and concurrently compete with incumbent SOEs; (c) the strength of the banking sector so that even with its portfolio of directed loans to SOEs it does not crowd out the private sector, and the extent to which capital markets are developed and provide an avenue for listing SOEs; and (d) the extent to which other development partners support the reform agenda.

## 2. Evaluation Objective and Components

15. **The overarching question for this evaluation is: to what extent has ADB support for SOE reforms contributed to achieving the Reform outcomes of improved governance at the corporate and sector levels, as well as reduced the governments' SOE related fiscal problems, and to achieving the Sustained and Improved Performance outcomes resulting from reforms, in terms of improved SOEs' long-term operational efficiency and commercial viability, and improved consumers' long-term access to quality and affordable services?** These components of the overarching question are inter-related, as evident from the following examples: (i) as commercial viability of SOEs improves, the drain on government's budget tends to reduce; (ii) as performance efficiency improves (e.g., power system losses reduce), service quality tends to improve (e.g., there are fewer power cuts) or access increases (i.e., more people can be served with the same generating capacity); and (iii) as more well-structured PPP projects are established that increase access while contingent liabilities remain within manageable limits, the need for public funds for infrastructure reduces.

16. **The evaluation also sought to understand the associated issues regarding delivery of ADB support and the reasons for the success and failure of interventions.** Three subsidiary questions that helped to answer the overarching question were:

- (i) **What is the relevance of ADB support targeting SOE reforms?** The evaluation examines three broad aspects. First, what is the strategic positioning of SOEs in ADB's client countries (i.e., what roles are they expected to perform now and in the foreseeable future, and what is the extent of government ownership and management)? Second, what strategies and policies guide ADB's engagement for SOEs reforms? And third, what has been ADB's approach—in terms of targeting, identifying entry points and project design—at the operational level in engaging with SOEs for reforms?
- (ii) **What is ADB's institutional efficiency in supporting SOE reforms?** The evaluation examines two key aspects. One relates to resource allocation (as evident from implementation time and cost overruns), and the other to ADB's internal coordination among various departments and offices across various locations.
- (iii) **To what extent did ADB support achieve the intended results?** The evaluation examines the extent to which ADB has contributed towards achieving and possibly catalyzing SOE

reform. It also examines the extent to which ADB has contributed to improved SOE operational efficiencies, rationalized tariffs, improved access to affordable and quality services, and reduced budgetary implications and liabilities for infrastructure development (e.g., through reduced subsidies and revenues from PPP projects).

17. **This evaluation gathered evidence through portfolio analysis, case assessments in selected countries, interviews with stakeholders in countries selected for case assessment and within ADB, a literature review, and a review of ADB’s directional and project documents (see Linked Document 1).** The portfolio analysis covered interventions that spanned all three areas of operations and involved two types of analyses: (i) a descriptive analysis of the portfolio of operations i.e., all sovereign loan and grant, TA and NSO interventions approved during the evaluation period; and (ii) an assessment of the portfolio of evaluation which consisted of completed, self-evaluated and independently validated and evaluated operations. IED appreciates that supporting SOE reform was not the prime objective of most of the projects in the identified portfolio; all projects in the identified portfolio incorporate some aspects of reform, and this evaluation focuses on these aspects of reform. Five countries were selected for case assessments, i.e., one each served by each ADB regional department. These countries are: (i) the People’s Republic of China (PRC) in the East Asia region; (ii) India in the South Asia region; (iii) Papua New Guinea (PNG) in the Pacific region; (iv) Uzbekistan in the Central and West Asia region; and (v) Viet Nam in the Southeast Asia region. Key findings from the SOE reform experience globally and in the Asia and Pacific region are discussed below.

### C. Global Experience of Reforming SOEs

18. **From the end of the Second World War until the 1980s, SOEs were developed and expanded in most developing countries throughout the world and in virtually every sector.** In the socialist or command economies of central and eastern Europe, the former Soviet Union and the PRC, SOEs were prevalent in all sectors, including small-scale retail and service establishments. SOEs were originally created because it was thought that they would be better at providing basic goods and services than a non-existent, embryonic or socially unresponsive private sector. Until the 1970s, these SOEs were financed by government allocations, supplier credits, directed credits through state-owned development banks, and development partners.<sup>8</sup>

19. **Many SOEs were developed under import substitution industrialization policies with high tariffs, other forms of trade protection, exchange controls and tax incentives to protect them.** In many infrastructure and other sectors—such as utilities, transport, oil and gas, mining, petrochemicals, steel and fertilizers—these firms operated as state-owned monopolies.<sup>9</sup>

20. **Since the 1980s, pressures to reform SOEs and improve their performance have mounted world-wide.** By the 1980s, SOEs in many developing and emerging market countries had contributed to their government’s fiscal crisis and national debt crisis, which called for SOE reform and debt rescheduling. Devoid of Soviet era subsidies, particularly since 1991 following the break-up of the Soviet Union, Central and Eastern European nations and the former Soviet Union countries of Central and West Asia could no longer sustain their SOEs.

21. **Other factors also contributed to increasing pressure on reforming SOEs and improving their performance.** First, the realization that once having developed infrastructure and other sectors through state-owned monopolies and with substantial subsidies, the governments had to continue protecting them. The anti-export bias of these developing country regimes and trade restrictions meant that most enterprises (SOEs and others) did not compete in export markets. Moreover, if these SOEs sectors were

<sup>8</sup> Supplier credits were often guaranteed by credit insurance agencies in the developed industrial economies. They were often short-term and did not match well with the maturity profiles of large and capital intensive SOEs, and defaults on trade credit were frequent.

<sup>9</sup> W. Baer, ed. 1994. Privatisation in Latin America. *World Economy*. Volume 17 (No. 4). Oxford U.K. and Cambridge, U.S.A.

uncompetitive, it was difficult for downstream private enterprises in these markets to be competitive.<sup>10</sup> On the other hand, the sound economic performance of Japan and Asia's newly industrialized countries in the 1980s, showed the advantages of an outward orientation and emphasis on exports.<sup>11</sup> The pressures for improving SOE performance also came from the need to provide essential infrastructure and other services more efficiently and cost effectively to improve the quality of life of peoples and enhance the country's overall economic competitiveness.<sup>12</sup> Another major factor was the adoption of technology-enabled practices that increased productivity in advanced economies. The absence of such practices in the inwardly-looking developing and transition economics also accelerated the need for reforms.<sup>13</sup>

**22. Although the Asian Financial Crisis of 1997 resulted from bold corporate spending and large public infrastructure projects in many rapidly growing Asian economies coupled with increased interest rates in the United States,<sup>14</sup> a sustained solution to the crisis required these countries to carry out numerous reforms that also led to the reforming of SOEs.** The International Monetary Fund (IMF), which provided loans to stabilize Indonesia, the Republic of Korea, and Thailand required them to undertake reforms; the reform programs were formulated in collaboration with the respective governments, the World Bank, and ADB. Given the origins of the crisis, financial sector reform was necessary and entailed the closure of insolvent financial institutions, recapitalization of potentially viable financial institutions and strengthened financial supervision and regulation.<sup>15</sup> The IMF also proposed structural reforms that included measures to increase transparency in the corporate sector, improve efficiency of markets and increase competition—all of which resulted in SOE reforms to varying degrees in these countries. A sustained solution to the Asian financial crisis called for a state takeover of the management of significant banking assets, until the banks could be restructured and sold to private buyers. The workout of the bad debts and disposal of distressed assets thus became one of the major tasks for policy makers for several years thereafter, with success at reforming SOEs varying significantly among these countries.<sup>16</sup> The Republic of Korea appears to have been the most successful in reforming its SOEs, as the government began to reduce its role in economic management to enable SOEs to respond better to the changing economic environment domestically and globally, as well as to reduce SOE monopolies and their unsound investment decisions.<sup>17</sup>

**23. Governments see SOEs as tools for meeting their social and other political objectives.** These objectives include job creation and other public service obligations (PSOs), and in some cases, also accelerated development and global expansion. Infrastructure SOEs are required to perform PSOs in many countries; so might SOEs in other sectors, but less so. Globally, SOEs account for 20% of investment and 5% of employment. SOEs also account for up to 40% of output in some countries. They continue to

<sup>10</sup> I. Lieberman, and D. Kopf, eds. 2007. "Introduction," *Privatization in Transition Economies: The On-Going Story*. Amsterdam, Heidelberg and New York: Elsevier.

<sup>11</sup> J. Roumasset, and S. Barr, eds. 1992. *The Economics of Cooperation: East Asian Development and the Case for Pro-Market Intervention*. Boulder, San Francisco and Oxford: Westview Press.

<sup>12</sup> R. Sharma. 2016. *The Rise and Fall of Nations: Forces of Change in the Post-Crisis World*. New York and London: W.W. Norton.

<sup>13</sup> Such practices encompass management and manufacturing systems, such as just-on-time manufacturing and total quality control, as well as extensive use of computer-aided design and computer-aided manufacturing. Lieberman, Ira W. and Kopf, eds. "Introduction," *Privatization in Transition Economies: The On-Going Story*, (Amsterdam, Heidelberg and New York: Elsevier, 2007).

<sup>14</sup> Growth in the region's export commodities had led to high levels of foreign direct investment, which in turn soared real estate values, and led to bold corporate spending and large public infrastructure projects—all funded by heavy bank borrowings. And when the United States Federal Reserve began to raise interest rates, exports became less attractive for countries whose currencies had been pegged to the dollar. The Thai baht was the first one to be floated and devalued, followed by the Indonesian rupiah, the Malaysian ringgit and the Korean won (among others).

<sup>15</sup> The IMF also required these countries to impose higher tax rates and increase interest rates to cool the overheated economies. IMF. 2000. *Recovery from the Asian Crisis and the Role of the IMF*. Washington, DC. See <https://www.imf.org/external/np/exr/ib/2000/062300.htm>.

<sup>16</sup> World Bank. 1996. *World Development Report: From Plan to Market*. Washington, DC; World Bank. 1993. *The East Asian Miracle: Economic Growth and Public Policy*. Washington, DC; I. Lieberman and C. Kirkness, eds. 1998. *Privatization and Emerging Equity Markets*, Washington, DC, World Bank and Flemings.

<sup>17</sup> Korea Development Institute. 2009. *Lessons from SOE Management and Privatization in Korea*. Korea Development Institute School Working Paper Series. Seoul. <https://www.slideshare.net/gdlnkdis/lessons-from-soe-management-and-privatization-in-korea>.

deliver critical services in important economic sectors such as utilities, finance and natural resources. Additionally, large-scale manufacturing and services in competitive sectors also remain in state hands in many countries.<sup>18</sup> Global experience in reforming SOEs is summarized below and elaborated in Linked Document 2.

### 1. The Challenge of and Lessons from Reforming SOEs

24. **Many state-owned entities lacked a defined legal structure and were (and are to this day) simply owned by the state.** Hence, the starting point for reform has invariably been corporatization i.e., giving the SOE a legal form, most often as a joint stock company with the state as 100% shareholder (for a start). Corporatization provided the SOE with an initial number of issued and authorized shares as well as an initial share value. In principle, corporatization placed the SOE under the country's commercial or company law, and if the SOE was listed then under the securities law. If done well, corporatization paved the way for further reform. For example, corporatization allowed the government to allocate ownership rights in whole or in part to a state management agency, a holding company, a fund, or to workers. In time, it also allowed governments to privatize all or a minority of shares to a strategic investor or to float those shares via an initial public offering. The corporatized SOE could also set up subsidiary holdings such as downstream production units which could be divested or in time floated independently of the parent entity, with the parent generally maintaining a stake in the subsidiary.<sup>19</sup>

25. **SOE reforms require a comprehensive approach.** The SOE reform effort is based on the premise that any commercial enterprise, whether public or private, functions most efficiently when it seeks to maximize profits, operates in a competitive market,<sup>20</sup> is accountable to shareholders and for the use of resources, and reports in accordance with established and accepted financial standards. Its managers should have the requisite autonomy and capacity and motivation to respond to market signals. An added requirement is that enterprises that are not able to compete should go bankrupt and be closed.<sup>21</sup> Although lack of market discipline or competition is considered a primary cause for SOE under-performance, many problems stem from the exercise of political influence that interferes with operational and commercial decision-making in many ways.<sup>22</sup> Improvements in transparency and disclosure of financial and non-financial information, performance management systems, and in the SOE boards and management are among the necessary conditions for improving corporate governance but may not be sufficient. Five dimensions of corporate governance reform are correlated with operational performance improvement: legal and ownership framework, board composition, the SOE's performance management system, degree of transparency and disclosure of financial and nonfinancial information, and staff characteristics (in terms of education, skill base, compensation levels).<sup>23</sup>

26. **Although various stakeholders share the responsibility for corporate governance, the board of directors plays a central role.** In overseeing SOEs, governments interface with SOE board of directors; important measures carried out at the board level for good corporate governance include: (i) depoliticizing boards by recruiting external board members who are independent and bring a diversity

<sup>18</sup> World Bank Group. 2014. *Corporate Governance of State-Owned Enterprises: A Toolkit*. Washington, DC.

<sup>19</sup> I. Lieberman, M. Gobbo, I. Kessides and W. Megginson. 2018. *A Review of State-Owned Enterprises in Developing, Emerging Market and Transition Countries: Lessons Learned and Policy Suggestions for the Future*. Washington, DC. Unpublished.

<sup>20</sup> This requirement of operating in a competitive market (and closure if not competitive) does not apply to SOEs operating in natural monopoly sectors.

<sup>21</sup> These requirements mean there should be no external political influences on SOE management, governments should compensate SOEs for the public service obligations they perform, and governments should impose hard budget constraints. These requirements are seldom fully met in any country, and a comprehensive approach is needed to address impediments to SOE reforms.

<sup>22</sup> In other words, the SOE owners often have multiple and often conflicting objectives wherein profit and loss are not the only consideration. So the SOE managers are expected to cover costs but employ more labor, make a profit but reduce prices, reduce costs and purchase inputs from national suppliers to the maximum possible extent, have a good management team and an effective board yet appoint people who are politically connected.

<sup>23</sup> L. Andrés, J. Guasch, and S. Azumendi. 2011. *Governance in State-Owned Enterprises Revisited: The Cases of Water and Electricity in Latin America and the Caribbean*. Policy Research Working Paper No. 5747. Washington, DC: World Bank.

of skills;<sup>24</sup> (ii) establishing board committees that do a major part of the board's work outside the formal board meetings and report to the full board;<sup>25</sup> and (iii) overseeing the development of a mission for the SOE, including a medium-term strategy, a short-term business plan, and an annual budget. At the heart of board oversight is the quality of the information and reporting system, which requires a good management information system, and qualified accounting, financial and other teams. The board should also be able to ensure orderly succession in appointing a new chief executive officer and ensuring that a chief executive officer recruits or appoints senior staff with the skills and experience necessary to fulfill their responsibilities.<sup>26</sup>

27. **Many SOEs have been restructured in developing countries.** Restructuring measures have included the shedding of excess labor, closure or spin-off of non-viable or non-core assets and financial restructuring (including debt rescheduling and/or write-off) and have been normally adopted pursuant to privatization (full or partial). However, governments that have mismanaged their SOEs in the first place, generally lack the skills or capacity to restructure large and complex SOEs, or more than a few SOEs in the short to medium term.

28. **While privatization programs have led to improved SOE performance, public disenchantment with privatization experience has led governments in developing countries to take a more balanced view of the effectiveness of privatization.** Compared to SOEs, private enterprises are generally in a better position to keep pace with new technological developments. However, privatizations can lead to problems in the short-term when labor is laid off and prices increased. Nonetheless, the public at large can derive benefit in the medium term when the privatized entities begin adding to employment, and the benefits of improved services quality become noticeable; and the state can also benefit as fiscal losses are reduced, external debt is retired, and tax revenues increase with improved performance.<sup>27</sup>

29. **A well-developed policy, regulatory and institutional regime is required for PPP models to work well. PPP modalities and other ways of engaging the private sector in offering public services do not provide long-term alternative solutions to managing SOEs.** For most part, these measures are complementary to privatization, can lead to efficiency gain, reduce pressure on the government's fiscal situation, and increase transparency. However, the need for continued efforts to improve SOE performance remains unabated.<sup>28</sup>

30. **Although reform of infrastructure utility SOEs and sector restructuring is complex, it has often improved performance.** When a vertically integrated utility is unbundled into a number of successor entities, there are potential losses of coordination and potential increases in transaction costs. However, these are offset by potential efficiency gains from competition and increased transparency. Restructuring of infrastructure utility SOEs needs to be multifaceted and to consider both the advantages and disadvantages of restructuring. While experiences have varied across countries, infrastructure SOE unbundling and associated reforms have often improved several aspects of performance, both in

<sup>24</sup> Although it is naïve to expect most governments, line ministries or finance ministries to give up all their power and influence over a SOE, governments could ensure that majority of board members are recruited externally.

<sup>25</sup> The following board committees can be set up: (i) an audit committee, to work with the SOE's external auditors and to whom the internal auditors report; (ii) a compensation committee, to approve increases in salaries and benefits to all employees and specially the top and senior managements, set the standard for management performance targets, and tie incentives to performance benchmarks; (iii) a finance committee, to provide oversight on the SOE's financial and operational performance, and to examine proposed borrowings and capital raises; (iv) a governance committee to select new board members as appropriate. In addition, state-owned banks may also need specialized risk and credit committees, and all boards may also appoint ad hoc committees as necessary to consider such issues as expansion, adoption of new technologies, and expansion outside the country.

<sup>26</sup> OECD. 2015. *OECD Guidelines on Corporate Governance of State-Owned Enterprises*. Paris. <http://dx.doi.org/10.1787/9787264244160-en>.

<sup>27</sup> J. Nellis. 2012. *The International Experience with Privatization: Its Rapid Rise, Partial Fall, and Uncertain Future*. University of Calgary, School of Public Policy, SPP Research Paper, Volume .5. Issue 3. Calgary.

<sup>28</sup> I. Lieberman. 1990. *Industrial Restructuring Policy and Practice. Policy and Research Series No.9*. Washington, DC: World Bank.



enterprises that involve the private sector and those without private participation.<sup>29</sup> Policy and other reforms have also catalyzed private investment in infrastructure: in 2017, total private investment commitment in more than 300 energy, transport, information and communication technology backbone and water infrastructure projects in 52 low-and middle-income countries was about \$93 billion. The East Asia and Pacific region accounted for more than half of the investment commitment in 2017; and three of ADB's DMCs (the PRC, Indonesia and Pakistan) were among the top five countries to have received investment commitments in 2017.<sup>30</sup>

**31. Proper sequencing of reform measures is required for the unbundling of infrastructure utility SOEs.** Structural changes in the sector need to take account of the fact that some unbundled components are amenable to competitive restructuring (such as power generation) while others are natural monopolies (such as power transmission). Attention needs to be paid upfront to regulatory frameworks, regulatory capacity, the corporatization of the unbundled entities, a competitive environment for certain unbundled entities, and economic and business viability for all unbundled entities. Although the precise roadmap for such sector level restructuring will vary by country, an appropriate sequencing normally entails the technical assessments and physical inspections of assets that precede detailed planning for the new sector structure, including the legal and technical interfaces amongst the unbundled entities.<sup>31</sup> Sector regulations and institutional arrangements are needed before the actual unbundling and corporatization of the unbundled entities. The assets, liabilities and personnel that are to be transferred to the unbundled entities also need to be clearly delineated before the actual unbundling.

**32. Liberalizing and reforming the financial sector requires appropriate mechanisms for regulatory oversight.** Regulatory oversight instills discipline in financial sector institutions. Efforts to liberalize and reform financial sectors with inadequate regulation and supervision has contributed substantially to financial crises in emerging market countries.<sup>32</sup> An efficient and effective banking sector requires adequate regulatory and supervisory capacity, and an insolvency and bankruptcy regime that is capable of dealing with firm failure and NPLs. Capital markets also need to be appropriately regulated since they often list SOEs and other enterprises and are important politically for supporting economic reforms. However, in most developing, emerging market and transition economies, the capital markets are still small and do not provide governments a ready exit strategy for many SOEs (or provide a way to raise funds for private companies with high growth potential).

**33. SOEs in manufacturing and tradeable services sectors have often been among the first to be corporatized and privatized by governments that have opened their economies to trade and competition.** The emphasis on trade and competition has often resulted in withdrawal of benefits to SOEs in manufacturing and tradeable sectors; for example, subsidies, easy credit and favorable environmental and other regulations. Where such SOEs have been privatized, the privatization process has often been made easier by allowing greenfield entry into business and industrial sectors, which has created jobs and allowed large SOEs to shed redundant workers somewhat more easily. The World Bank's experience in reforming, restructuring and privatizing SOEs in manufacturing shows that: (i) comprehensive restructuring efforts are better than one-dimensional industrial rehabilitation projects; and (ii) industrial restructuring programs often need to consider the complex dynamics of rehabilitation, managerial change and financial engineering.<sup>33</sup>

<sup>29</sup> W. Megginson and N. Sutter. 2006. Privatisation in Developing Countries. *Corporate Governance*. Volume 14. (issue no. 4).

<sup>30</sup> [http://ppi.worldbank.org/~media/GIAWB/PPI/Documents/Global-Notes/PPI\\_2017\\_AnnualReport.pdf](http://ppi.worldbank.org/~media/GIAWB/PPI/Documents/Global-Notes/PPI_2017_AnnualReport.pdf).

<sup>31</sup> Y. Zhang, D. Parker, and C. Kirkpatrick. 2008. Competition, Regulation and Privatisation of Electricity Generation in Developing Countries: Does the Sequencing of the Reforms Matter? *The Quarterly Review of Economics and Finance*. Volume 45. (issue nos. 2-3). pp. 358-379.

<sup>32</sup> J. Stiglitz. 2010. *Freefall: America, Free Markets, and the Sinking of the World Economy*. New York and London: W.W. Norton.

<sup>33</sup> <http://projects.worldbank.org/P007660/steel-sector-restructuring-project?lang=en>;  
<http://documents.worldbank.org/curated/en/644481493241537124/Hungary-First-and-Second-Industrial-Restructuring-Projects>;  
<http://documents.worldbank.org/curated/en/620181468914345359/Tunisia-SOGITEX-Textile-Rehabilitation-Project>.

34. **Governance of SOEs engaged in the extraction of natural resources continues to be a significant challenge in many countries.** Countries have faced difficulties regardless of their government's stance on exports and extraction. National wealth is not a pre-condition for good governance in the natural resource extraction industries.<sup>34</sup> Additionally, climate change concerns that make renewable energy sources and electric cars attractive, call for a massive reduction in investments in fossil fuels and other high carbon emission sectors, and reinforce the need for reforming national oil and gas companies and coal extracting SOEs to remain competitive.<sup>35</sup>

## 2. SOE Reform Experience in Countries Selected for Case Assessments

35. SOE reforms have progressed in many countries in the Asia and Pacific region. The discussion below draws largely from experience in countries selected for case assessments (further details are in Linked Document 3).

36. **During the evaluation period, many governments showed commitment to and interest in reforming SOEs and improving their performance.** They recognized that SOE reforms was a means to improve their operational and financial performance. However, many governments have also preferred to avoid confrontation with vested interests and have limited themselves to less controversial—often small and incremental—reform steps. Their commitment reflected their broader and overarching objectives, and their perception that improving SOE performance will contribute to achieving these objectives. During the evaluation period, the most salient of these overarching objectives included: (i) the PRC's moves to play a greater role on the world stage, including in economic governance and combating climate change; (ii) India's need to sustain growth and increase employment to accommodate the large workforce that enters the job market each year; (iii) Viet Nam's membership of the World Trade Organization (WTO) since January 2007, which required it to adjust tariff and non-tariff trade barriers; and (iv) Uzbekistan's efforts to transform its economy since late 2016.

37. **Governments have considered reforms of SOEs across all sectors in infrastructure, finance, manufacturing and other tradeable sectors, and natural resource extraction.** The PRC has increased managerial autonomy of SOEs in all sectors since the early 1990s (when SOE managements were accorded specific rights). Since the late 1990s, it has also taken steps to transform ownership,<sup>36</sup> although insider-led ownership transformation resulted in many SOEs being sold at less than fair value and then being subject to asset stripping. The centralization of the PRC's fragmented system of corporate governance in 2003 affected SOEs across all sectors.<sup>37</sup> In Viet Nam, the government began to equitize SOEs in all sectors and by 2016, 96.5% had been equitized. In India, the government has been negotiating performance contracts with SOEs owned by the central government and has listed and partially privatized SOEs across all sectors. In PNG, to the extent there has been progress to reform SOEs, it applies to all major SOEs. In Uzbekistan, where the government is moving from a planned to a market-driven economy, it has developed a corporate governance code that applies to all SOEs and state-controlled firms across all sectors.

38. **Irrespective of governments' commitment to SOE reforms, the SOE reform agenda remains work-in-progress in all countries selected for case assessments.** Although the governments in the PRC, India, and Viet Nam have by-and-large sustained their commitment toward reforming SOEs for more than

<sup>34</sup> Brazil, Chile, Colombia and India are ranked in the top 10 Natural Resource Governance Index 2017, along with Australia, Canada, UK and USA.

<sup>35</sup> A. Doyle. 2017. Put price on carbon, stop bad bets on fossil fuels—UN's Guterres. *Reuters*. 15 November. <https://www.reuters.com/article/climatechange-accord-guterres/put-price-on-carbon-stop-bad-bets-on-fossil-fuels-uns-guterres-idUSL8N1NL4S4>.

<sup>36</sup> Whether insider-led or strategic sales or joint ventures with foreign equity, or initial public offerings.

<sup>37</sup> Prior to the creation of the State-Owned Asset Supervision and Administration Commission (SASAC) in 2003, SOEs were subjected to financial oversight by the Ministry of Finance, capital expenditure approvals by the State Development and Planning Commission, and technology upgrade decisions by the State Economic and Trade Commission. In addition, they were audited by authorities reporting to the State Council.

25 years, they have tended to focus more on reforming and improving performance of those under central government ownership. Reform of these SOEs continues to date. Reforms of SOEs owned by lower levels of government in these countries have taken a back-seat. In Uzbekistan where government commitment was not forthcoming until 2016, and in PNG where government commitment has not been consistent over the years, SOE reforms have progressed even less.

39. **Some governments have identified SOEs that they consider to be of strategic importance.** Among the salient reasons that governments have preferred to retain controlling or influencing stakes in some SOEs are that they consider SOEs as a means for: (i) macro-management to complement fiscal and monetary policies (the PRC and Viet Nam), (ii) increasing the country's presence internationally (the PRC and India), (iii) preserving social stability through affirmative action that benefits certain sections of society (India and Uzbekistan), and (iv) achieving more balanced regional development objectives within the country (India and PNG). Although the PRC government has divested itself of small and medium sized SOEs, it has retained more than one large SOEs in specific sectors and encourages competition among them. In Viet Nam, of the 240 SOEs as of May 2017 (all 100% state-owned), the government plans to equitize 137, but retain 100% ownership in the foreseeable future in the remaining 103—which include some energy SOEs that the government considers strategic. In India, although successive governments have endorsed partial privatizations and have transferred management control of 12 SOEs to the private sector, in general the line ministries do not wish to give up control. In Uzbekistan, where the government intends to accelerate economic reforms, it prefers to retain 100% ownership in enterprises engaged in certain strategic and socially important sectors (such as mining companies and infrastructure utilities).

40. **Governments have preferred to adopt a broad range of measures to improve corporate governance of SOEs.** All countries selected for case assessments had large numbers of statutory authorities and other bodies which were financed from the government budget and faced no hard budget constraints. They were subject to considerable influence and controls, as government representatives not only made policy but also implemented operational decisions. Many such statutory authorities have been corporatized in all countries selected for case assessments. Although neither of these five countries can claim to have achieved the objective of complete operational and financial autonomy of SOEs, four of the five countries (the PRC, India, PNG and Viet Nam) have taken some steps to separate ownership related and policy-making functions and move toward a centralized system of SOE oversight and management. In their endeavor to improve SOE corporate governance and curb corruption, all five country governments have sought increased transparency in the functioning of SOEs, and mandated disclosure of certain financial and other information. In four of the five countries (the PRC, India, Uzbekistan, Viet Nam), accounting practices are moving closer to international financial reporting standards. Governments also believe that other development policies can provide impetus to SOE reforms and spur performance improvement. These policies include further opening of their economies to trade and finance, improving PFM systems, strengthening the financial sector, creating a policy environment that provides fair terms for the private sector, and encouraging PPP.

41. **Privatization (or ownership transformation) of SOEs has been attempted in all five countries selected for case assessments.** Privatization has policy, political, economic and business undertones. The focus on and pursuit of privatization has varied significantly in the five countries over the past 2 or 3 decades, and has depended on many factors. The experience to date is as follows:

- (i) In the PRC, various approaches have been tried, including forming joint ventures with foreign partners and listing on stock exchanges. As a result, the SOE share of total industrial assets fell from about 69% in 1998 to 42% in 2010, and employment fell from about 61% in 1998 to less than 20% by 2010.
- (ii) In India, privatization has been on the agenda of all governments elected since 1991, and the overall ratio of SOE asset share to gross domestic product has declined from 35% in 1990 to 20% in 2016. While many SOEs have been listed within India, the government

- continues to retain majority control in most. In the 12 SOEs that were privatized between 1999 and 2004 and management control passed into private hands, their weighted average return on capital has nearly tripled by 2015.<sup>38</sup>
- (iii) In PNG, there has been one notable successful privatization. In 2001, the government sold its majority stake in the PNG Banking Corporation to the Bank of South Pacific. This is now one of the most successful banks in PNG.
  - (iv) In Uzbekistan, where the local stock exchange is small, and only about 600 joint stock companies can issue shares and trade, the securities market has a long way to go.
  - (v) In Viet Nam, there have been few divestments to date through listings or strategic sale. In these cases, the selection process has been faulty as SOEs have been sold to favored or influential parties and divestment planning has been poor.<sup>39</sup>

42. **Managing SOE related fiscal problems is a challenging and ongoing task for the central governments, as well as for lower levels of government.** In part, this reflects the governments' requirements for SOEs to serve some social and political objectives which usually have financial implications. In the PRC, the relatively poor performance of some SOEs can be attributed partly to demands for meeting government's social obligations (providing basic infrastructure and utility, health and education services) at affordable prices. In India, many SOEs under state governments have been making losses given the continued access to soft loans from government (in addition to government equity, and continued borrowings from the financial sector and development partners). In Viet Nam, capital efficiency (as measured by capital to turnover ratio) among central SOEs is lower than for other types of enterprises, partly because these SOEs serve some social objectives and are capital intensive. Difficult reforms are required and remain a work in progress in all countries selected for case assessments. Assessing explicit and contingent liabilities arising from SOEs, achieving sustainable ratios for public and publicly guaranteed debt, tracking of SOE budgets and subsidies, switching to new (typically accrual based) accounting systems, upgrading information technology systems to interface with a vast number of budget organizations, and capacity development are some of the challenges that the five countries face to varying degrees.

### 3. Lessons from Multilateral Institutions

43. **Multilateral development banks (MDBs) recognize the continued importance of SOEs in their countries of operations.** Their approaches to supporting SOE reforms are embedded in their corporate strategies. The Inter-American Development Bank (IADB) notes that even after 3 decades of support for privatization and reform, many Latin American governments still own and control a large number of SOEs and continue to try to tackle the issue of how to better influence and control the operations of their SOEs.<sup>40</sup> The European Bank for Reconstruction and Development (EBRD), which was established to foster the transition of its client countries towards open market-oriented economies and promote private and entrepreneurial initiatives, notes that continued state domination of the economy remains a major issue for many Central Asian countries.<sup>41</sup> The World Bank Group (WBG) recognizes the importance of SOEs to the economies and welfare of emerging countries in Africa, Asia, the Middle East and Latin America as well as to Russia, and notes that even though SOEs may have been created for the benefit of the citizenry, the reality can be quite different. It also notes that well run SOEs can contribute to the health, welfare, education and infrastructure improvements, poverty reduction and inclusive economic growth.<sup>42</sup>

<sup>38</sup> Government of India. Various. *Annual Public Enterprise Surveys*. New Delhi.

<sup>39</sup> The government divested 100% stake in six water supply companies in Tier II cities. The Ministry of Construction (MOC) acknowledges that the experience to date has not been encouraging. The new owners do not see water as a public good and do not give priority to meeting the water needs of small and poor consumers. Additionally, neither the water company management nor the shareholding line ministry nor the Provincial Peoples Committee have sufficient expertise in planning divestments.

<sup>40</sup> IADB. 2015. *State-Owned Enterprise Reform in Latin America: Issues and Possible Solutions*. Washington, DC.

<sup>41</sup> EBRD. 2016. *Strategy Implementation Plan (2017–2019)*. London.

<sup>42</sup> [http://www.ifc.org/wps/wcm/connect/1299668047f4ee8bae58ff299ede9589/EB\\_IFC\\_Phil\\_Armstrong.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/1299668047f4ee8bae58ff299ede9589/EB_IFC_Phil_Armstrong.pdf?MOD=AJPERES).

44. **MDBs have provided other useful lessons in supporting SOE reforms.** For example, the WBG pursued with SOE reforms in the 1960s and 1970s, but as reform objectives were often not met,<sup>43</sup> it began supporting private participation towards the end of the 1970s and in the early 1980s. Following the collapse of the Soviet Union in 1991, the WBG began to support privatization of large conglomerates in Eastern Europe and Central Asia without unbundling them.<sup>44</sup> Alongside privatization, WBG now supports SOE reform under state ownership along with supporting a reduction of the differences between the rules that govern SOEs and other enterprises. This is in line with the WBG view that trade competitiveness involves (among other) the availability of modern and quality services—where SOEs continue to dominate in most countries—as inputs for tradeable goods and services.<sup>45</sup> The IADB recognizes that the mechanisms to deal with SOE problems need to be designed on a case-by-case basis, taking into account the specific problems of the particular SOE and the economic and political environment that affects it. IADB advocates a mix of approaches that include privatization, listing on a stock exchange, governance reforms, improved financial and operational reporting and other administrative measures. EBRD considers that multiple or repeat transactions with a SOE (accompanied by restructuring or regulatory reform) can be an effective tool for improving their performance, and that engaging with the public sector (including SOEs) helps develop the private sector.<sup>46</sup>

45. **Other multilateral institutions have also contributed to understanding the problems associated with supporting SOEs.** The United Nations Department of Economic and Social Affairs notes two main reasons that many SOEs are not well-run—the principal-agent problem and the free-rider problem.<sup>47</sup> Yet it appears to indicate that organizational, political and administrative reforms and a competitive environment can help reduce these problems and can be alternatives to SOE privatization.<sup>48</sup> Although OECD’s long-standing position is that policy works better when aligned with market principles, it notes that some Asian governments have succeeded in realizing their development goals while relying on state-interventionist practices. It also notes that SOEs from these emerging economies continue to have the backing of their respective governments while they compete internationally (often on unfair terms) with private companies from advanced economies. This prompts it to raise a broader concern about how SOEs can continue to be used as vehicles for development without compromising the global competitive landscape.<sup>49</sup> The WTO considers the treatment of SOEs as one of the big issues facing the international trading system.<sup>50</sup>

## D. Exclusions and Limitations of the Evaluation

46. **Exclusions.** No loans and TA projects with capacity development components that pertained only to the specific ADB project (such as improving project management unit capacity) are included in the evaluation portfolio. Nor were interventions where governance or financial management aspects are covered only in covenants. Given time and resource limitations, and the fact that ADB has supported

<sup>43</sup> For example, SOE financial and operational performance did not improve, the financial burden first overwhelmed national budgets and then the country’s banking system in some cases. See World Bank Operations Evaluation Department. 2002. *The World Bank, Privatization and Enterprise Reform in Transition Economies: A Retrospective Analysis*, Washington, DC.

<sup>44</sup> Under the assumptions that: (i) import competition would prevent abuse of monopoly power of the privatized entities, and (ii) private sector owners and shareholders would lobby for further liberalizing reforms and supporting institutions. Neither of these assumptions held true.

<sup>45</sup> International flows of capital, investment and know-how also help improve trade competitiveness. See <http://www.worldbank.org/en/topic/trade/brief/trade-competitiveness>.

<sup>46</sup> EBRD Evaluation Department. 2016. *Transactions with State-Owned Enterprises (Special Study)*. London.

<sup>47</sup> The principal-agent problem refers to the fact that the agents (SOE managers) have more information on SOE performance and financials than do the principals (the government or citizens), and it is difficult for the principals to verify whether poor SOE performance is due to insufficient competence or neglect of the agents (SOE managers) or due to circumstances beyond their control. The free-rider problem refers to the fact that individual citizens and government officials have no incentive to monitor the agents (SOE managers). For if they do so, they would incur the cost alone, while the benefits would accrue to all owners—which means that in the end no one monitors the agents.

<sup>48</sup> United Nations Department for Economic and Social Affairs. 2007. *State-Owned Enterprise Reform (National Development Strategies: Policy Notes)*. New York.

<sup>49</sup> OECD. 2015. *State-Owned Enterprises in the Development Process*. France.

<sup>50</sup> The Commonwealth Secretariat. 2016. *The Treatment of State Enterprises in the WTO and Plurilateral Trade Agreements*. London.

mostly infrastructure and financial sectors, ADB interventions classified under industry and trade, agriculture and natural resources, and health and education sectors are not considered. This evaluation did not consider whether ADB supported reforms had contributed to enhancing the ability of SOEs to compete with other non-state-owned enterprises and to participate in ADB-funded and administered contracts for goods, works and services.

47. **Limitations.** The key limitations of this evaluation are: (i) difficulty in compiling a list of projects to be studied. Except for public sector management (PSM) sector projects that have been approved since or were being implemented at the time the 2014 project classification system took effect, interventions with SOE reforms are not systematically tagged. Consequently, it is difficult to compile a list of sovereign loans and grants and TA projects that are relevant to this evaluation; it is quite likely that some interventions may have been inadvertently missed out; (ii) the limited veracity of the assessment of intermediate Reform outcomes and the higher level Sustained and Improved Performance outcomes from ADB supported projects, given the availability of few self-evaluations and even fewer independent validation or evaluation reports. Besides, these self and independent assessments are for the entire scope of the project, not the SOE reform component alone, and the benefits from reform also take significantly more time (than a typical project timeline) to become noticeable; (iii) ADB's central databases, which trace the progress of ongoing sovereign project based loans and grants, but not for policy-based and results-based loans, TA projects and NSO; (iv) performance of project-based loans and grants is tracked basically for investment related components;<sup>51</sup> and (v) the inadequacies of SOE diagnostics in project documents.

## E. Report Layout

48. Relevant ADB strategies, policies and other directional documents are discussed in Chapter 2, along with the portfolio of sovereign loans and grants, TA and NSO. Chapter 2 also discusses the selection of countries selected for case assessments, and ADB's experience in support of SOE reforms. Chapter 3 assesses the performance of the portfolio of evaluation (in terms of relevance, efficiency, effectiveness and sustainability), and the achievement of intermediate outcomes and of higher level outcomes. Finally, Chapter 4 provides conclusions, recaps key issues, identifies lessons, and offers recommendations.

## F. Summary

49. ADB recognizes the importance of reforming SOEs. The purpose of this evaluation is to inform the ADB Board and Management on ADB's experience to date with SOE reforms and guide ADB's engagement with SOEs as ADB implements the corporate Strategy 2030.

50. There is no commonly accepted definition of SOE. In the nonsovereign public sector financing policy document, ADB defines SOE as "a legal entity established to undertake commercial activities and owned fully or largely by the sovereign." It is aligned closely with the OECD definition.

51. SOE reforms are defined as measures that address the challenges posed by inadequate governance at corporate and sector levels, and the government's SOE related fiscal management problems.

52. The theory of change shows that ADB can support SOE reforms in multiple ways; the three main areas of operations being: indirect support through macro-level approaches to improving governance; targeted support through sovereign investment with accompanying measures for improving governance at the sector level and in specific SOEs; and targeted NSO support for direct and indirect investment in

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<sup>51</sup> ADB's Procurement, Portfolio and Financial Management Department has a database that records the status of contract awards, disbursements, financial management (essentially compliance with financial covenants), safeguards compliance and documentation, and technical aspects (such as project conditions, implementation arrangements, cost overruns). Reform related components are not recorded in this database.

SOEs, and sovereign projects that propagate infrastructure development through the PPP modality. The intended outcomes from ADB support through the three areas of operations are at two levels: (i) a set of Reform (intermediate) outcomes in terms of improved SOE governance at the corporate and sector levels; and reduced governments' SOE related fiscal problems; and (ii) a set of Sustained and Improved Performance (higher level) outcomes resulting from SOE reforms, in terms of improved operational efficiency and commercial viability, as well as improved consumers' access to quality and affordable services. It is recognized that progress in implementing Reforms is essential to sustain Performance improvements.

53. The evaluation seeks to assess ADB support and understand the extent to which this support has helped achieve the intended Reform (intermediate) outcomes and Sustained and Improved Performance (higher level) outcomes. Accordingly, the overarching question for this evaluation is: to what extent has ADB support for SOE reforms contributed to achieving the Reform outcomes of improved governance at the corporate and sector levels, as well as reduced the governments' SOE related fiscal problems, and to achieving the Sustained and Improved Performance outcomes resulting from reforms, in terms of improved SOEs' long-term operational efficiency and commercial viability, and improved consumers' long-term access to quality and affordable services?

54. Pressures to reform SOEs have built up in many developing, emerging market and transition economies since the 1980s. Numerous measures are required to reform SOEs across all sectors and improve their performance. The experience in the Asia and Pacific region also shows the importance of government commitment, and that reforming of SOEs remains a work in progress in all countries.





**SOE REFORMS STRATEGIES,  
POLICIES, OPERATIONS,  
AND EXPERIENCE**



## Highlights

- Strategy 2030 states that improving the governance and financial management capacities of SOEs, combined with policy and regulatory reforms, will help strengthen service delivery. The strategy also recognizes that ADB's public sector operations can complement private sector operations by preparing SOEs for commercial financing.
- Overall, ADB's combined sovereign plus NSO portfolio accounted for about 21% of ADB's sovereign operations and NSO during the evaluation period (2005–2017).
- Five countries, one under each ADB regional department, were selected for detailed assessments. Together, 113 loans and grants were approved for these countries, with a value of \$16.9 billion during the evaluation period. Most of the NSO portfolio was also in these five countries.
- Governments have pursued SOE reforms from various directions and ADB has responded by implementing initiatives in all three areas of operations (macro-level approaches to improve governance, sovereign investments that incorporate measures to improve governance at the sector level and in specific SOEs, and investments through sovereign projects that propagate the PPP modality for infrastructure development and through NSO). However, the ADB portfolio devoted less attention to government oversight mechanisms, issues related to boards of directors, accountability mechanisms in infrastructure projects, SOE diagnostic analyses, making SOEs eligible for raising long term capital on commercial terms, and reform of SOEs engaged in manufacturing. Besides, it appears prima facie that the results-based lending (RBL) modality can be considered for supporting a government investment program that has a significant reform component.

55. ADB's strategies and policies that guide its engagement for SOE reforms and the relevant operations are discussed in this chapter.

### A. ADB Strategy and Policies

56. **SOE engagement and reforms were embedded in the ADB's corporate strategies that were in effect during the evaluation period.** Strategy 2020<sup>52</sup> came into effect in 2009 and identified social inclusion, environmental sustainability and regional integration as three complementary strategic agendas for ADB. The strategy sought to refocus ADB's operations into five core areas that best supported these agendas and identified infrastructure and financial sectors as two of the five core operational areas. SOEs are integral to these sectors. The strategy called for ADB to support governments in the various areas that contribute to SOE reforms, such as strengthening institutions and policies, addressing governance challenges in public sector institutions, scaling up PSD and private sector operations. The mid-term review<sup>53</sup> of Strategy 2020 concluded that while Strategy 2020 remained valid and relevant in a broad strategic sense, ADB needed to adjust to the rapidly changing Asia and Pacific region. It suggested a suite of priorities to sharpen and rebalance ADB operations, as well as to increase ADB's capacity and effectiveness. Many of these priorities can be linked to SOE reforms, such as emphasizing the operational and financial sustainability of infrastructure projects; promoting financially sustainable infrastructure through policy, regulatory, tariff related and other governance reforms; improving service delivery from infrastructure assets; strengthening institutions to improve public infrastructure management; and enabling the private sector and PPP to support infrastructure development. However, neither Strategy 2020 nor its mid-term review provided guidance on SOE reform objectives, the contexts in which ADB must pursue reforms in the diverse Asia and Pacific region, or the most appropriate modalities for ADB support. This was left to individual country partnership strategies (CPSs) which provide guidance on such

<sup>52</sup> ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020*. Manila.

<sup>53</sup> ADB. 2014. *Mid-term Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

matters for a 5-year period. ADB's Long Term Strategic Framework in effect prior to 2009 contained similar gaps.<sup>54</sup>

57. **ADB's sector and thematic policies and operational plans incorporate many aspects that contribute to the engaging with and reforming SOEs.** However, like Strategy 2020 these directional documents do not provide any strategic guidance on SOE reforms, although they refer to many aspects related to such reforms.

58. **ADB's Strategy 2030 came into effect in July 2018 and fills some of these gaps at the strategic level.** It sets the course for ADB to respond effectively to the changing needs of the Asia and Pacific region and advocates a differentiated approach in supporting the development of different groups of countries. This differentiated approach is designed to provide guidance during CPS formulation. Regarding SOE reforms, for example, in small island developing states, Strategy 2030 states that ADB's support for SOE reforms should complement other support to improve the business environment, enhance public-private partnerships, improve quality of public service delivery, and promote private sector-led growth. In low-income and lower middle-income countries, ADB support for SOE reforms is seen in the context of the broader structural and systemic reforms that are required to enhance productivity and competitiveness, and that ADB should support SOE reforms as well as private sector operations. In upper middle-income countries, ADB should provide targeted support for reforms in the financial sector and SOEs, enhance countries' resilience to shocks, and expand private sector operations and PPP. Strategy 2030 recognizes that ADB's public sector operations can complement private sector operations by preparing SOEs for commercial financing, and considers that improving governance and financial management capacities of SOEs, as well as policy and regulatory reforms (including tariff-related reforms for better financial sustainability) will help strengthen service delivery.

## B. Portfolio of Operations

59. **ADB has engaged with SOEs and extended support for SOE reforms over several decades.** However, SOE reforms have not been the primary focus of most sovereign, nonsovereign and TA operations.

60. **ADB operations have supported SOE reforms in many ways, and this support has been in line with ADB's corporate, sector and thematic directional documents.** ADB operations for SOE reforms have sought to: (i) address the challenges posed by inadequate corporate governance and governments' SOE-related fiscal problems; and (ii) reinforce the need for and facilitate SOE reforms through PPP, PSD and FSD. In so doing, ADB support has spanned all three areas of operations. ADB has also engaged with and supported reforms of bodies that are commercially oriented but may not be corporatized. ADB support to introducing reforms in these bodies structures is also considered in this evaluation.

### 1. Sovereign Loans and Grants

61. Identifying the portfolio of sovereign loans and grants as well as TA projects that were approved during the evaluation period was a challenging task. This section therefore discusses the approach to identifying the portfolio of operations before presenting the portfolio itself.

62. **ADB support for SOE reforms has not been systematically tagged during the evaluation period 2005–2017.** The project classification system was revised in 2014 to recognize SOE reforms as a subsector under PSM. However, projects classified under the finance, energy, transport, water and other sectors are still not tagged for supporting SOE reforms, and it was difficult to identify SOE reform supporting projects classified under these sectors.

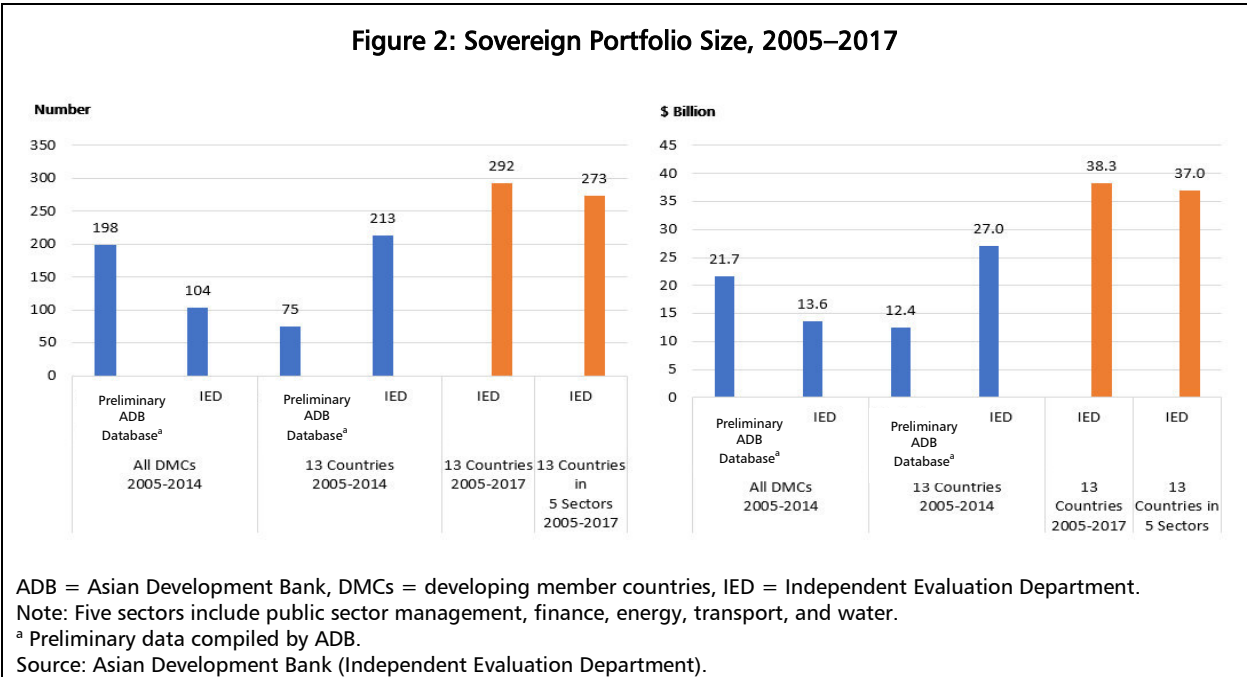
<sup>54</sup> ADB. 2001. *Moving the Poverty Reduction Agenda Forward in Asia and the Pacific: The Long-Term Strategic Framework of the Asian Development Bank*. Manila.

63. **In sectors other than PSM, it is useful to define a threshold for considering an intervention as supporting SOE reforms.** This is particularly important given that more than 1,300 loans and 690 grants were approved during the evaluation period. For the purposes of this evaluation, loans and grants are included in the portfolio subject to the criteria that some aspect of SOE reform is included in the design and monitoring framework (DMF) and/or discussion of project outcomes and outputs in the main text of a report and recommendation of the President (RRP) and/or policy actions and is explicitly stated to apply to one or more SOEs. Also included in the portfolio are loans and grants where the DMF and/or discussion of project outcomes and outputs in the main text of an RRP and/or policy actions point to legal and institutional frameworks for propagating PPP for infrastructure development (as in the case of PPP, an SOE is one of the involved parties). The portfolio does not include the following: (i) when SOE reform is referred to as part of the project context or project background or project rationale but no reform related component is included in the DMF or discussion of project outcomes and outputs in the main text of the RRP or as a policy action; (ii) when capacity development pertains only to the administration of the ADB support project; and (iii) when some aspect of SOE reform is stated in the loan agreement or other project agreements but not included in the RRP document.

64. **A preliminary list of sovereign loans and grants obtained from the Sustainable Development and Climate Change Department provided a good starting point for IED to identify the loans and grants portfolio for SOE reforms.** This list consisted of 198 loans and grants approved during 2005–2014. IED reviewed the RRP of these loans and grants and identified 104 of these 198 loans and grants that met the threshold. Loans and grant approvals in 13 countries—two or three countries served by each ADB regional department, and with the highest \$ value of approvals—comprised a bulk of these 104 loans and grants; i.e., 75 (72% by number) of approvals, and \$12.4 billion (91% by approved \$ value). These 13 countries are: (i) Georgia, Pakistan and Uzbekistan from Central and West Asia; (ii) the PRC and Mongolia from East Asia; (iii) Fiji, PNG and Tonga from the Pacific; (iv) Bangladesh and India from South Asia; and (v) Indonesia, the Philippines and Viet Nam from Southeast Asia.

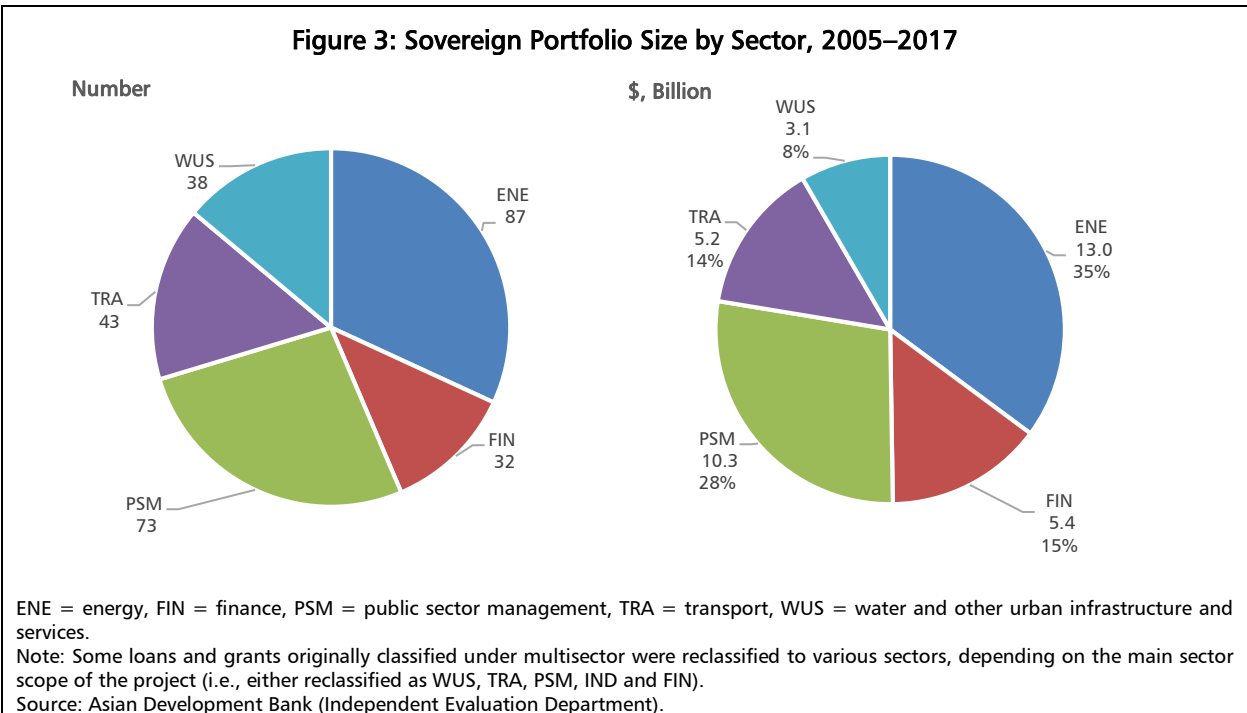
65. **Other loans and grants supporting SOE reforms from these 13 countries were also identified.** Using the same criteria, IED built on the list of 104 loans and grants approvals for these 13 countries. Further to identifying more loan and grant approvals during 2005 to 2014 that included some SOE reform component, loan and grant approvals from 2015 to 2017 were also included for the same 13 countries. This raised the relevant SOE reform related portfolio for these 13 countries to 292 loan and grant approvals worth \$38.3 billion. Linked Document 4 provides a listing of relevant loan and grant approvals. Figure 2 shows the various stages of building the portfolio.

Figure 2: Sovereign Portfolio Size, 2005–2017



66. **The bulk of the 292 sovereign loans and grants were under five sectors (PSM, finance, energy, transport, and water).** These sectors accounted for 273 loans and grants (93% by number) and \$37.0 billion (97% of approved amount). To the extent they included loans and grants classified under PSM sector (Figure 3; about 27% by number and 28% by value), they could potentially support reform of SOEs across all sectors. These loans and grants have relied mostly on the investment-based and policy-based lending modalities; given that the results-based modality was introduced in 2013, there are few projects using this modality for supporting government programs with clear expenditure frameworks that incorporate small governance and capacity development programs.

Figure 3: Sovereign Portfolio Size by Sector, 2005–2017

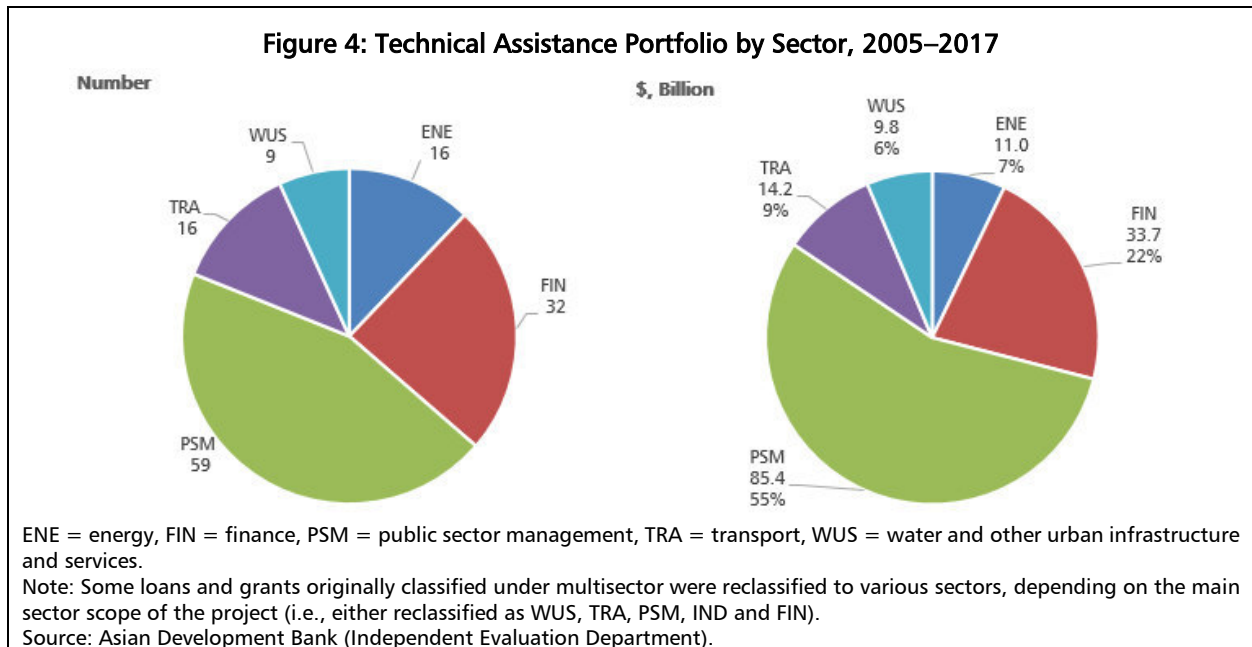


67. **Three of ADB’s regional departments accounted for more than 80% of loans and grants by number and approval amounts.** The Central and West Asia Department accounted for around 32% of loans and grants by number and amount approved; the corresponding shares of both the South Asia Department and Southeast Asia Department were between 20% and 30%. While countries in the Pacific Department accounted for about 8% of loan and grants supporting SOE reforms by number, they accounted for less than 2.5% by value.

68. **The year on year variation in approvals of policy-based lending (PBLs) was significantly higher than for other modalities.** This is evident from a comparison of 3-year averages of number and approved amounts of PBLs and project-based loans. The average varies within a fairly narrow range of 11 to 15 (by number) and \$1.2 billion to \$2.1 billion (by approved amount) for project-based loans,<sup>55</sup> but in a significantly wider range for PBLs (3 to 12 by number, and of \$0.3 billion to \$2.1 billion by amount approved). A dip in the number and approved amounts of PBLs from 2011 to 2013 probably reflects the fact that priorities of many governments had shifted away from public sector management—including SOE reforms—when growth rates had stabilized after the 2008 global economic crisis. As the results-based lending (RBL) modality was introduced in June 2013, four loans using this modality appear in the portfolio of operations.

## 2. Technical Assistance

69. **Approved TA projects classified under the same five sectors and supporting SOE reforms were also identified for the same 13 countries.** Given the large number of TAs approved during the evaluation period, the relevant TA projects were identified only for the 13 selected countries under the five major sectors: PSM, finance, energy, transport, and water. Identifying TA projects to be included in the portfolio review is a lengthy process.<sup>56</sup> The criteria for selecting TA projects in the portfolio of evaluation is analogous to that for loans and grants (para. 63). A total of 132 TA projects were thus identified, with a total approval volume of \$154 million. PSM accounted for about 55% of the total approved amount, the finance sector for more than 20% and the three infrastructure sectors combined, for also more than 20% (Figure 4). Linked Document 4 provides a listing of relevant TA projects.



<sup>55</sup> Includes multitranches financing facility tranches and all other project-based modalities.

<sup>56</sup> The initial set of candidate TA projects is based on those piggy-backed to or referenced in the reports and recommendations of the President (RRPs) of portfolio loans and grants in the thirteen selected countries, plus in the TA listings available in the ADB databases. This long list of candidate TA projects is used to identify TA projects which support some reform component.

### 3. Nonsovereign Operations

70. **The NSO portfolio was easily identified.** A portfolio of 57 interventions was compiled from the list of approved and candidate projects given in the policy paper for nonsovereign public sector financing; list of projects obtained from the Sustainable Development and Climate Change Department; and a more recent list from the Private Sector Operations Department (PSOD).<sup>57</sup> This portfolio of NSO projects includes: (i) 20 projects where the client is a SOE (i.e., direct, with majority state shareholding); and (ii) 37 projects where ADB invested indirectly in an SOE. These 37 projects with a combined approved amount of \$4.1 billion are studied to understand the extent to which the benefits of reforms supported through NSO projects flow back to the parent SOE. The 20 projects where the client is a SOE, have a combined approved amount of \$3.9 billion. Five investments have been accompanied by TA projects, with a total approved amount of about \$4.6 million. About 70% of the NSO projects are in the 13 selected countries. Ten of these 57 projects have been cancelled, of which 6 were to have supported SOEs directly and 4 indirectly. One investment supporting an SOE indirectly is slated for cancellation as of October 2018. For further details, refer to Linked Document 5.

### 4. Portfolio by Areas of Operations

71. **Overall, IED identified a portfolio comprising about 21% of ADB's total operations of sovereign loans and grants, TA and NSO during the evaluation period.** However, SOE reforms was not the primary objective of most projects in the portfolio. This included \$37.0 billion in sovereign loans and grants and \$154 million in TA projects in 13 countries that accounted for a bulk of operations; and \$8.0 billion in NSO projects and \$4.6 million in accompanying TA projects.

72. **Sovereign loans and grants and NSO investment projects in this portfolio cover a broad canvass, across all three areas of operations.** They are distributed as follows:<sup>58</sup>

- (i) \$10.7 billion (24% of approved \$ amount) for influencing macro-level approaches that affected SOE reforms indirectly;
- (ii) \$21.1 billion (47% of approved amount) in projects that supported sovereign investments targeted at SOEs and which also incorporated measures for improving governance at the sector level and in specific SOEs; and
- (iii) \$8.0 billion (18% of approved amount) for investment support through NSO modalities targeted at direct and indirect SOE clients, and \$5.2 billion (12% of approved amount) for sovereign projects propagating the PPP modality for developing new infrastructure.

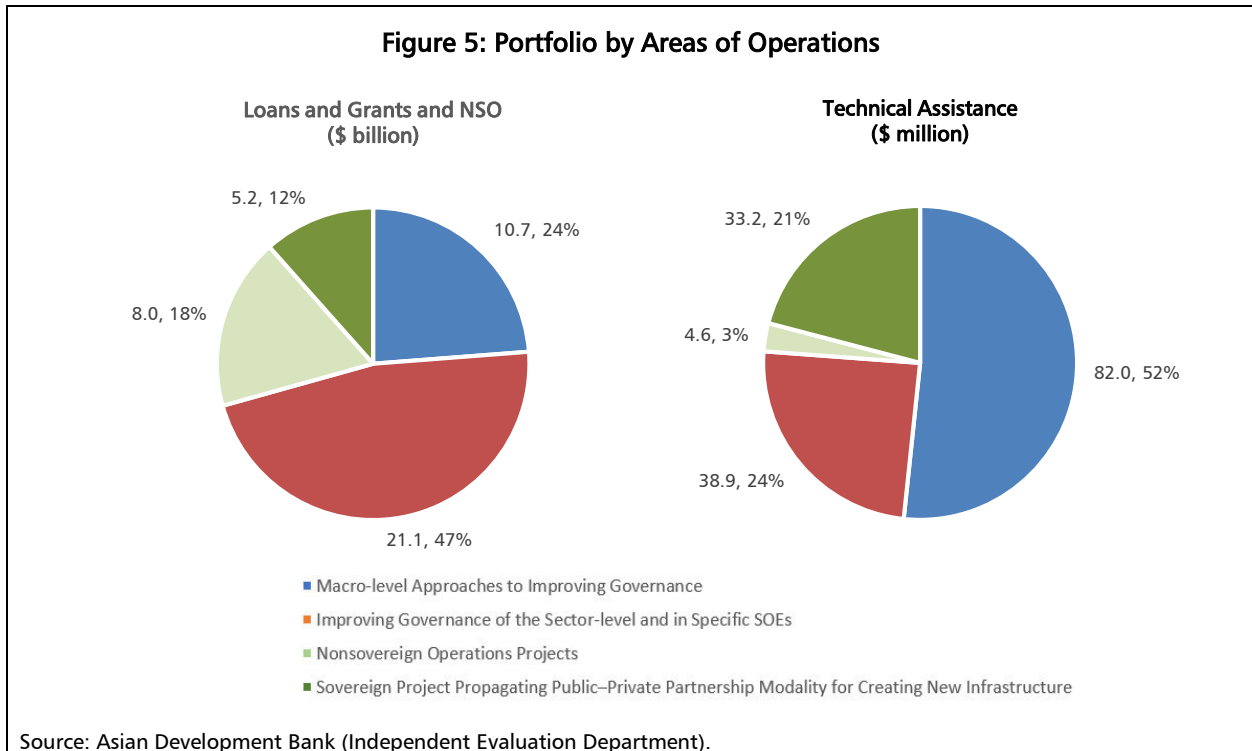
73. **TA projects in this portfolio also cover a broad canvass across all three areas of operations.** They are distributed as follows:

- (i) \$82.0 million (52% of approved amount) for influencing macro-level approaches affected SOE reforms indirectly;
- (ii) \$38.9 million (24% of the approved amount) for improving governance at the sector level and in specific SOEs; and
- (iii) \$4.6 million (3% of the approved amount) associated with investments through NSO in direct and indirect SOE clients, and \$33.2 million (21% of approved amount) for sovereign projects propagating the PPP modality for developing new infrastructure.

<sup>57</sup> The list so compiled excludes five projects targeted at direct SOE clients with state shareholding of less than 50%.

<sup>58</sup> For loans and grants where the stated outcomes, outputs or policy actions cover two areas of operations, the approved amount is apportioned equally between these two.





### C. ADB Support in the Three Areas of Operations

74. Further to the broad definition of SOE reform (Chapter 1), this section presents the type of reform measures that ADB has sought to support through its portfolio of operations.

75. **SOE Reform outcomes depend on and are influenced by several factors, both from within an SOE and from the external environment.** Types of ADB supported measures in the three areas of operations in the identified portfolio are discussed below. These reform measures are listed from project documents in the portfolio of operations.

76. **ADB has sought to improve the corporate governance of SOEs at various levels. These include government oversight, the board level and the organizational level. ADB has also supported the strengthening of accountability mechanisms in SOEs.** Table 1 lists the reform measures that ADB has supported at various levels, and indicates their area of operations. Regarding government oversight, ADB has sought to improve the existing oversight mechanism, rather than institute a new or more effective mechanism. Regarding board level issues, ADB has supported macro-level changes (e.g., policy to limit the number of government appointees on SOE boards) as well as in specific SOEs. Regarding organizational level changes and accountability mechanisms, ADB has supported a broad range of measures both at the macro level and in specific SOEs. Where relevant, ADB has also supported capacity development.

**Table 1: Corporate Governance Measures Supported through Portfolio of Operations**

Corporate Governance Measures	Macro-level approaches	Sector-level and specific SOEs	NSO and Sovereign PPP
Government Oversight - Improved state-owned enterprise performance oversight	x		
Board level issues - Composition - Improved functioning	x	x x	x
Organizational level - Separation of policy-making and regulatory functions from operational responsibilities - Improving financing management - Closure - Corporatization, Restructuring, Divestment, Listing, Privatization - Anti-money laundering, Anti-corruption	x x x x x	x x x x x	
Accountability Mechanisms - Financial reporting standards and disclosure - Non-financial disclosures on organizational structure, governance system, operational performance - Control environment in place, i.e., internal controls, internal audit, risk management, compliance	x x x	x x x	

NSO = nonsovereign operations, PPP = public-private partnership.  
Source: Asian Development Bank (Independent Evaluation Department).

77. **ADB has sought to improve governance at the sector level and provided inputs for sustained performance and quality decision-making by boards and managements.** Table 2 shows that ADB has supported sector-level reforms through (among other) policy advice, sector level regulations, capacity development of regulatory bodies, and strengthening of sector institutions as they are restructured and/or unbundled and corporatized and/or undergo other transformations. ADB has supported sector institutions in complying with sector regulations, rationalizing tariffs (not just seeking tariff revisions from regulators, but also reducing operating costs), and measures that enable the SOE boards and managements to make rational decisions regarding investments, borrowings, technology upgrades, and other aspects of operations (including maintenance) that improve operational efficiencies. Additionally, ADB has also supported capacity development for better governance at the sector level and in specific SOEs.

**Table 2: Sector Governance Measures Supported through Portfolio of Operations**

Sector Governance Measures	Macro-level approaches	Sector-level and specific SOEs	NSO and Sovereign PPP
Sector-wide measures - Sector policy - Sector regulation (regulatory framework, regulatory bodies) - Sector restructuring - Sector road map	x x x	x x x	
State-owned enterprise-specific measures - Regulatory compliance - Tariff rationalization - Long term planning - Annual business plans - Asset maintenance systems		x x x x x	

NSO = nonsovereign operations, PPP = public-private partnership.  
Source: Asian Development Bank (Independent Evaluation Department).

78. **ADB has sought to improve public financial management and to address governments' SOE related fiscal concerns through numerous measures.** Table 3 shows that ADB has sought to support expenditure management, debt management, revenue management and other areas of fiscal management. Where the objective of an ADB intervention was to create more fiscal space for governments, ADB supported the mitigation of fiscal risk that originated from selected SOEs, along with these measures. Most of these measures fall under macro-level approaches, and might influence SOEs only indirectly. However, in the portfolio of operations, financial aspects of SOEs are explicitly considered along with these other aspects of PFM. ADB has also supported capacity development for improving PFM as well as supported specific SOEs for strengthening their procurement systems.

**Table 3: Public Financial Management Measures Supported through Portfolio of Operations**

Public Financial Management Measures	Macro-level approaches	Sector-level and specific SOEs	NSO and Sovereign PPP
Expenditure Management			
- Medium term expenditure framework	x		
- Sector level subsidy management	x	x	
- Management of contingent liabilities	x		x
- Emergency expenditure management	x		
Debt Management			
- Public debt management policy, law	x		
- Managing risk exposure to debt obligations	x		
- Debt restructuring (rescheduling, reduce average borrowing cost, write-off)	x	x	
- Sector level debt repayment plan	x	x	
Revenue Management			
- Tax revenue (rationalizing tax rates and structure, tax system reform)	x		
- Non-tax revenue	x		
Fiscal Management			
- Establishing fiscal policy management unit	x		
- Consolidation of public sector deficits	x		
- Fiscal transfers	x		
- Financial management information systems	x		
Public procurement		x	

NSO = nonsovereign operations, PPP = public-private partnership.

Source: Asian Development Bank (Independent Evaluation Department).

79. **ADB has sought to support PPP through both macro-level approaches and investment support through NSO and sovereign modalities.** Recognizing that the PPP modality can be deployed to reduce pressures on government to finance public infrastructure projects, and that if well-structured, such projects keep contingent liabilities on governments within reasonable limits, ADB has advised governments on PPP related issues and supported investments under a PPP framework (Table 4). ADB has advised on policy, legal and regulatory frameworks for advancing PPP for infrastructure development, and helped set up institutional mechanisms and improve capacities for developing infrastructure projects using the PPP modality. ADB has supported investments in such projects through sovereign and NSO modalities (for sake of clarity, it is noted that not all NSO projects are of the PPP type).

**Table 4: Public-Private Partnerships Supported through Portfolio of Operations**

Public-Private Partnerships Support	Macro-level approaches	Sector-level and specific SOEs	NSO and Sovereign PPP
Policy, legal and regulatory framework for PPP	x		
Institutional set up			
- Guidelines, manuals, toolkits	x		
- Project structuring capacity	x		
- Project pipeline development	x		
Project development and financing			
- Nonsovereign operations			x
- Sovereign modalities			x

PPP = public-private partnership.

Source: Asian Development Bank (Independent Evaluation Department).

80. **ADB has supported competitive neutrality and reduction of the gap between rules that govern SOEs and other enterprises.** In addition to PPP, which allows for some privately managed infrastructure facilities to compete with SOE or public sector managed infrastructure in certain segments (e.g., power generation), ADB has sought to instill competitive neutrality at a broader level. ADB has advised on competition policies and investment laws and other measures that are aimed at improving the business environment, providing a conducive investment climate and creating a competitive market. All these are macro-level approaches that can influence SOE reform pathways.

81. **ADB has sought to strengthen the financial sector through macro- and sector-level approaches, as well as specific state-owned banks.** ADB has supported capital market development, which might enable the listing of SOEs, bond issues by SOEs, and the insurance subsector. Table 5 provides an overview of the type of ADB support for FSD through its portfolio of operations.

**Table 5: Financial Sector Development Supported through Portfolio of Operations**

Financial Sector Development Support	Macro-level approaches	Sector-level and specific SOEs	NSO and Sovereign PPP
Capital Market Development			
- Legal and regulatory framework	x		
- Institutional support	x		
- Effective monitoring and supervision	x		
- Enhanced consumer protection	x		
- Pipeline of SOEs for listing		x	
Banking			
- Restructuring to achieve sustainability	x	x	
- Public disclosure of financial statements by state-owned commercial banks	x	x	
- Non-performing loans	x	x	
Insurance			
- Insurance regulations, Institutions	x		
- Consolidation of insurance industry	x	x	
- Insurance industry customer protection	x		
Bond market development			
- Government bond market development	x		
- Corporate bond market development	x		
- Municipal bond development	x		
- Bond guarantee fund	x		
- Issuance of corporate bonds		x	

NSO = nonsovereign operations, PPP = public-private partnership.

Source: Asian Development Bank (Independent Evaluation Department).

## D. ADB Experience in Supporting SOE Reforms

82. Many Asian governments have pursued SOE reforms since the 1980s and 1990s, have adopted numerous approaches for doing so, and ADB has responded by supporting initiatives in all three areas of operations. For example, in the power sector, where governments have decided to unbundle vertically integrated power utilities, ADB has supported these measures since before the evaluation period. Salient examples are from the Philippines<sup>59</sup> and India.<sup>60</sup>

### 1. Macro-level Approaches to Improving SOE Governance

83. Many ADB interventions aim to improve governance in SOEs across all sectors and can therefore indirectly affect their performance and commercial viability. About 40 loans and grants, and an equal number of TA projects classified under PSM sector included corporate governance components that are intended to improve the performance of SOEs across many sectors. These interventions supported various governance improvement measures such as framing regulations, developing capacity and providing implementation support for enhancing transparency and disclosure. For example, a series of loans to Viet Nam (Loans 2194, 2262, 2352, 2490, 2570, and 2827) aimed to introduce modern governance practices in the country and support its transition to a market economy by helping improve PFM, strengthening financial accountability and transparency, reforming public administration, fostering an environment conducive to private sector development, and accelerating divestiture of SOEs. A TA project in Bangladesh (TA 8553) sought to strengthen capacity for conducting performance and procurement audits; and a TA project in India (TA 4989) sought to improve the legal, regulatory and institutional framework for expanding e-governance systems.<sup>61</sup> Through PSDI, ADB has engaged in policy dialogue to improve government oversight of SOEs and address shortcomings (Box 1).

#### Box 1: The Challenge of Improving Government Oversight of SOEs in Papua New Guinea

Since the early 1990s, successive governments have made efforts to improve SOE governance and performance, and to privatize them. At various points in time during the 1990s and early 2000s, the prime responsibility has been entrusted to the Department of Finance (DOF), the PNG Holdings Corporation and the Privatization Commission. In 2002, the government gave the SOE policy approach a new direction and established the Independent Pacific Business Corporation (IPBC) under the IPBC Act of 2002. The IPBC took over the powers and functions of the Privatization Commission. Concurrently, and to protect the consumer interests (regarding price, quality and reliability of public goods and services provided by commercially oriented SOEs), the government also established the Independent Consumer and Competition Commission (ICCC) as a statutory body. The IPBC was renamed as Kumul in 2015.<sup>a</sup>

<sup>59</sup> In 1998, ADB approved a power sector restructuring loan to create competitive electricity markets by unbundling generation and transmission, providing open and equal access for power transmission and distribution, restoring the financial sustainability of the National Power Corporation, and improving the operational efficiency of the distribution subsector. This was followed by another ADB program loan approved in 2006. The first subprogram was to enable the government meet part of the costs of power sector restructuring, create conditions necessary for substantial progress in privatization, boost confidence in regulatory performance and smooth the transition to competitive markets. Although ADB envisaged a second subprogram to support debt management of the power sector, the government decided not to pursue it, and the state-run Power Sector Assets and Liabilities Management Corporation still has massive concerns regarding debt liabilities. However, substantial progress was made in creating a wholesale electricity market and in the privatization program.

<sup>60</sup> After ADB revised its operational strategy for India in the mid-1990s and decided to direct a portion of its assistance to state governments, ADB has supported power sector restructuring in Assam, Gujarat and Madhya Pradesh. Gujarat was the first state where ADB approved a power sector development program in 2000. The program was designed to unbundle the state's power utility, improve the sector's operational efficiencies and reduce operating costs, rationalize tariffs and improve revenue realization, and move toward eliminating the need for fiscal transfers from the state government's budget. The program achieved its immediate objectives; and state power regulator has developed the necessary regulatory framework aimed at facilitating, strengthening and improving power sector management and governance. This power sector development program was accompanied by TA projects that focused on preparing the power system master plan, providing inputs to electricity legislation and regulations, preparing a framework for rationalizing electricity tariffs, and assessing financial support necessary for formation of two distribution entities.

<sup>61</sup> For further relevant information on these and numerous other ADB supported projects, refer to project documents.

Through the ongoing Private Sector Development Initiative (PSDI), which has SOE reforms as one of its focus areas, ADB has maintained a policy dialogue with the objective of addressing shortcomings in implementing the IPBC/Kumul Act. Yet the shortcomings exist to date and relate to continued political interference (including in selection of directors on SOE boards), the consequent low level of autonomy for SOE managements, lack of transparency by not requiring SOEs to disclose their annual financial statements, delayed finalization of SOE annual accounts, and the fact that violations of the IPBC/Kumul Act do not result in sanctions.

<sup>a</sup> Kumul means bird of paradise, the national bird of PNG.  
Source: Asian Development Bank (Independent Evaluation Department).

**84. With the objective of improving governance, ADB has supported anti-money laundering and anti-corruption measures in many countries.** Anti-money laundering measures are often viewed in conjunction with efforts to curb corruption and combat financing of terrorism. Towards these objectives, ADB supported capacity development (Bangladesh, the Philippines, Viet Nam), strengthening legal frameworks and/or addressing legal constraints in money laundering investigations (Bangladesh, the PRC, Mongolia, PNG, the Philippines), strengthening legal framework for implementing financial sanctions (the PRC, the Philippines), establishing IT-based anti-money laundering information systems (Viet Nam), and introducing new management concepts and early-warning systems for enhanced anti-corruption and anti-fraud capabilities (the PRC).

**85. ADB has supported DMC governments in improving their PFM systems.** ADB support has covered a broad canvass, from information technology applications to public debt management systems, including contingent liabilities. In Uzbekistan, along with other development partners, ADB has supported the government take significant steps in the last 10 years towards improving accountability, transparency and efficiency of budget planning and execution by moving toward zero balance budgeting, a single treasury account, and multi-year expenditure framework to support long-term investment (Loan 2338 and TA 4946). ADB supported the strengthening of government capacity in accounting and fund flow management across various sectors and ministries (TA 8449). In Bangladesh, ADB helped the government roll out a medium-term budget planning framework to all ministries (Loans 2566, 2567, 2568, and 2569). In India, ADB supported state governments in creating fiscal space through numerous measures, some of them being closure of loss-making SOEs (Assam: Loans 2141, 2142, and 2442), closure or restructuring of selected SOEs (Mizoram: Loans 2536 and 2537), requiring medium term expenditure frameworks based on long-term sector strategies for public works and other departments, as well as rationalizing expenditures of selected SOEs (West Bengal: Loans 2926 and 3563), and rationalizing subsidies for power supply to agriculture, and restructuring the debt of the state power distribution company (Punjab: Loan 3187 and TA 8759).<sup>62</sup>

**86. ADB has supported FSD in many countries through (among other) governance improvements in both banking and non-banking financial sector institutions.** Many loans and grants and TA projects classified under financial sector included governance and/or financial management improvement components. These interventions were spread across many countries and included: (i) in Bangladesh, toward improving governance, efficiency and investor confidence in capital market and insurance sectors, by (among other) strengthening surveillance capabilities of the securities regulator, and enhancing governance and management capacities of stock exchanges and insurance sector players (Loan 2232); (ii) in Pakistan, towards improving governance of securities markets, market professionals and issuers by requiring stock exchanges to disclose plans for self-regulation (Loan 2340); and (iii) in Uzbekistan, a comprehensive diagnostic of the country's financial sector, which led to the FSD strategy that the government adopted (TA 4565).

<sup>62</sup> A large component of Loan 3187 supported the financial turnaround and revival of the Punjab power distribution company (DISCOM), as part of the Government of India's national program, Ujwal DISCOM Assurance Yojana (UDAY). As a result, the transmission and distribution losses in the state declined from 16.8% in 2012/13 to 14.6% in 2015/16 (when the national average was about 23%).



87. **ADB projects have aimed to improve the business environment and create fair terms for the private sector.** ADB projects intended to directly support PSD included: (i) advising on harmonization of regulations for public and private sectors (Viet Nam; Loans 2194 and 2262); (ii) providing inputs for the creation of a more enabling business environment that emphasizes access to finance, SOE reform, and legal and institutional changes (Fiji, TA 4704);<sup>63</sup> (iii) increasing private sector role for providing services to poor and vulnerable households, thereby, helping create a stable macro-economic environment (Bangladesh; Loans 2566, 2567, 2568, and 2569); (iv) providing inputs for a competition law, and incentivizing local government units to reduce business regulatory costs (Philippines; TA 7870); (v) advising on modification to the industrial policy to lower entry and exit barriers (the PRC; TA 8895, ongoing); (vi) advising on tax incentives to promote private investment (Philippines; TA 4920); (vii) providing capacity development support to the competition regulator to support implementation of a manual on trade practice investigations, and for the regulation of the newly liberalized mobile telecommunications sector (PNG; TA 4722); and (viii) advising on the creation of a competitive power generation market (Viet Nam; TA 4768).

88. **ADB has also supported the management of fiscal implications arising from PPP projects.** Many governments tended to pursue PPP projects in infrastructure sectors to supplement availability of public investment funds, and ADB has supported efforts to address contingent liabilities in multiple ways. With the objective of strengthening fiscal oversight of the government's PPP activities, ADB has supported: (i) establishing or strengthening fiscal risk management units in relevant ministries (Bangladesh: TA 7691; Georgia: Loans 3190, 3191, 3282, 3283, 3417, and 3418); (ii) developing tools and frameworks for PPP project appraisal and risk assessment (India: TA 8799); (iii) improving PPP risk sharing arrangements with private investors (Indonesia: TA 4872); (iv) analyzing contingent liabilities from build-operate-transfer and other private participation agreements to help improve the government's debt and risk management function (Philippines: TA 4717; Georgia: TA 8716); (v) contributing to the development of an operational framework for PPP, which incorporates criteria for assessing fiscal affordability (PRC: TA 8940); and (vi) advising on or establishing financing and risk guarantee mechanisms (Philippines: TA 7796).

## 2. Improving Governance at the Sector Level and in Specific SOEs

89. ADB projects supported investments in infrastructure and financial services, which ADB leveraged to further the reform effort.

90. **ADB has supported SOEs and state-owned banks on improving their accountability systems.** Such ADB interventions include the following: (i) in India, for improving credit-risk management in financial institutions (Loans 3186, 2404, 2509, 2586, 2717, 2822, 3048, and 3307); (ii) in the PRC, for increasing disclosure and strengthening internal dispute review mechanisms in a power sector enterprise (Loan 2616), (iii) in Uzbekistan, for supporting the power utility in adopting international auditing standards and accounting practices (Loans 2629, 2630, and 8244); (iv) in Viet Nam, for corporatization and greater managerial autonomy of public operating entities in the water sector (Loan 2272); (v) in Fiji, for corporatization of the water utility (Loan 3512); and (vi) in Pakistan, for strengthening the internal audit department and transparency of the procurement process in the country's railway system (Loans 3398 and 3399).

91. **In infrastructure sectors, large number of TA projects and sovereign operations sought to improve commercial viability at the sector level through the formulation of tariff petitions, tariff reviews, and analysis of subsidy implications for provision of infrastructure services.** Besides retail tariffs, ADB supported rationalization of prices for power generation and transmission, and for waste-water management services.<sup>64</sup> ADB has supported such tariff rationalization measures since well before the beginning of the evaluation period. ADB has also supported improvements in billing, collections and

<sup>63</sup> Albeit, in this particular TA, the government preferred to focus essentially on PPP related matters.

<sup>64</sup> The basis for tariff related support normally is that tariffs cover all operation and maintenance expenses, depreciation, cost of financing and allow for an acceptable return (say, on net fixed assets).

receivables management. In some DMCs such as India, power tariff related support has virtually vanished during the evaluation period as independent electricity regulatory commissions were set up at the central level and in several states and which have focused on rationalizing tariffs and reducing system losses. In some other countries such as Uzbekistan, tariff setting has become more relevant since the government initiated economic liberalization in late 2016. Of the 13 selected countries, ADB interventions in India, Mongolia and PNG did not have any tariff related support during the evaluation period. Yet, in the other 10 countries, there were nearly 50 operations containing some tariff-related components.

92. **ADB has sought to improve regulatory mechanisms for infrastructure sectors and to strengthen institutional capacities for improving governance and performance of SOEs in those sectors.** ADB has supported wide-ranging measures affecting sector governance and regulation along with strengthening SOE capacities: (i) restructuring and unbundling an existing civil aviation entity into multiple SOEs each with a distinct role in PNG (Loans 2588, 2589, and 2590); (ii) advising sector regulators on utility service standards, financial management regulations, and customer service regulations in Bangladesh power and water sectors (Loans 2332, 2333, and 2334; Loans 2382 and 2383); (iii) advising on water sector strategy and roadmap along with policy and institutional roadmap and investment plan in Georgia (Loans 2749, 2807, 3078, 3238, 3291, and 3292); (iv) strengthening institutional capacities of infrastructure service providers in various ways, including asset management and tariff proposals in the Viet Nam water sector (Loans 2272, 2754, 2961, 3251, and 3373); (v) streamlining operations by implementing enterprise-wide resource planning software in an unbundled power entity in India (Loans 3140 and 3327); and (vi) separating policy making functions from construction and service delivery roles in the PRC rail subsector (Loans 2274 and 2181), and supporting rail subsector reforms in the PRC (Box 2).

**Box 2: Successful Support for Reform of Rail subsector in the People's Republic of China<sup>a</sup>**

ADB's lending program in the rail subsector focused on the expansion of the rail network to cover poorer regions of the PRC. In addition to construction, ADB projects included features linked to sector reforms in operational management. All projects beginning in 1997 included full-cost tariffs, commercialization (marketing, business development, accounting, and management information systems), as well as development of link roads and stations to extend the access to railways. In 2003, developing the areas around the railway stations was included in the Yichang-Wanzhou Railway project. In line with the TA work, beginning in 2004, rail safety and private sector participation elements (container terminals for private logistics operations; outsourcing of ancillary services) were added. In 2005, the first dedicated passenger line was introduced, separating passenger traffic from the freight lines to increase the efficiency of passenger services and the capacity for freight haulage. These features are incorporated into ADB supported projects as part of the physical design of the network expansion (for example, by including requirements for link/local roads), other non-infrastructure investment in equipment, and/or as covenants in loan documents.

By consistently requiring railways to incorporate full-cost tariffs and improved commercial practices, ADB contributed to the gradual change in the thinking of the PRC authorities—which has led to railways being run increasingly along commercial lines. With increased emphasis on operational efficiency and safety, the rail system incorporated improved technology (modern signaling, communications, dispatch systems, freight yard operations, mechanized maintenance, and e-governance) and safety equipment. Development of separate passenger and freight rail corridors and introduction of private sector participation reflected the governments increasingly sophisticated agenda for railway development and reform.

<sup>a</sup> Further information is provided in Supplementary Appendix 1.

Source: Asian Development Bank (Independent Evaluation Department).

93. **Reforming of SOEs in the power sector is a long-drawn process and ADB has broadly followed an appropriately sequenced approach and helped address problems that arise while the reform program is underway.** The approach to reforming SOEs in a given sector in any DMC is strongly influenced by the government's approach to addressing the underlying problems and various other factors (including political, social and cultural). Yet there are general rules, which ADB has broadly followed over the past decades. For example, in the power sector, ADB supported the unbundling of vertically integrated entities

(in some states in India, the Philippines and Viet Nam), after supporting or at least ascertaining that: (i) the initial preparatory technical and financial advisory work had been carried out,<sup>65</sup> and (ii) the legal and regulatory frameworks had been established along with the necessary institutions. ADB has also provided support to address issues that arise while the reform program is underway, or problems that have arisen when the reform program has not gone through to completion. The latter however, is more a reflection of government commitment and priorities; for example, when the power sector's stranded debt and cost are not addressed (Philippines; Loan 2282). In another case, ADB has supported the improvement in performance of unbundled power distribution companies which continue to remain state-owned and dependent on government support (Pakistan, Loans 3126, 3321, 3322, and 3538).

94. **ADB supported specific SOEs to improve their financial management systems.** This included: (i) setting targets for financial indicators, say for debt service coverage ratio, operating ratio or debt-equity ratio in the design and monitoring framework (Loans 2181 and 2339); and/or (ii) setting targets for operational performance, say for revenue collection efficiency (Loans 2749 and 2807); and/or capacity development (Loan 3285). In some cases, similar requirements are covenanted, for example in the PRC, where the client provincial water supply company established financial control and management arrangements compatible with ADB guidelines (Loan 2388).<sup>66</sup> In Bangladesh the implementing agency sought a new financial management system, which required the asset registers to be completed and updated and assets revalued (Loans 2316 and 2317).

95. **ADB has supported governance improvements in both banking and non-banking institutions including regulators, banks and other financial sector entities.** For example: (i) in India, for enhancing the insurance regulator's capacity to regulate and supervise the insurance industry (TA 3460)<sup>67</sup>, and for issuance of accounting standards by a national level bank which were to be followed by all subnational entities engaged in financing agriculture and rural infrastructure (Loan 2281); (ii) in Mongolia, for strengthening corporate governance in financial intermediaries and securities issuers, appointing independent members on their board of directors, enforcing an improved corporate governance code, and making audited financial statements publicly available (Loan 2218); and (iii) in Viet Nam, for supporting gradual alignment of national accounting standards with international accounting standards which were to be adopted by the non-bank financial sector and listed entities (Loans 3081 and 3335). This alignment of accounting standards, however, is not required for 100% government owned SOEs.<sup>68</sup>

### 3. Investments through NSO and through Sovereign Projects Propagating PPP Modality for Developing Infrastructure

96. Two broad types of ADB projects are included in this category: (i) targeted investments through NSO instruments to support direct and indirect SOE clients, along with technical assistance for these projects; and (ii) sovereign loans and grants that support infrastructure development through PPP modes, where a SOE is involved.

<sup>65</sup> For example, in India, for establishing legal and physical interfaces between the unbundled entities, updating and verifying asset registers, making a realistic determination of system losses, assessing unrecoverable receivables for one-time write-offs, revaluing assets and creating opening balance sheets for the unbundled entities, strategy and action plan for a personnel transfer scheme (among others).

<sup>66</sup> The project documents refer to ADB guidelines on "Financial Governance and Management of Investment Projects Financed by ADB and ADB's Loan Disbursement Handbook (2007)."

<sup>67</sup> ADB. 2000. *Technical Assistance to India for Policy and Operational Support and Capacity Building for the Insurance Regulatory and Development Authority*. Manila

<sup>68</sup> After the new Enterprise Law (2014) became effective in 2015, the Government of Viet Nam classifies only 100% wholly government owned entities as SOEs. Accordingly, there are 240 SOEs as of 2017. In May 2017, the government announced plans to equitize 137 additional SOEs by 2020. This would leave 103 SOEs (100% state owned) that are not equitized, and as per the Central Institute of Economic Management, a think-tank under Ministry of Planning and Investment, the government does not intend to dilute its equity in them. Many of these can augment GVN's revenue base but not all can be considered as strategic (such as 70 lottery companies and 12 publishing companies). These 103 SOEs also include two that are important for energy security reasons: PetroVietNam and Electricite' de Viet Nam. The petroleum company is profitable, and with the trend in recent years of increasing electricity tariffs to full cost recovery levels, it is expected that the electricity company will also become profitable in the coming years.

97. **ADB's NSO projects have supported corporate governance improvements in some clients, although NSO clients are relatively well-governed to begin with.** ADB has sought to improve corporate governance by requiring the client company to adhere to good international practices, conducting training for the client's Board, and providing an independent director to the client's Board during the period of ADB's equity investment (PRC; Investment 7316), or establishing various board committees and have more independent directors (Sri Lanka; Investment 7269). PSOD has implemented a corporate governance TA to assess and evaluate the client's existing corporate governance structure and internal risk management systems, and to enhance the corporate governance system (PRC; Investment 7377). Additionally, ADB is in position to influence governance improvements where it has acquired an equity stake in the client company and taken a board position (as for two direct and one indirect SOE clients; Investments 7240, 7310, and 7227).

98. **ADB's NSO projects have also targeted improved performance.** With these investment interventions, ADB has sought to provide support which has material reform value. For example, PSOD acquired equity in the client company engaged in city gas distribution systems in selected urban areas in India, to improve urban air quality and support the government's reform objective of making the natural gas industry competitive and market oriented (Investment 7227). Following reduction of pollution levels in the target urban centers, and the overall success of this project, the sector regulator proceeded to set up a competitive regulatory environment for city gas distribution.<sup>69</sup> In the PRC, PSOD support for municipal gas infrastructure (Investments 7244 and 7316) and waste-to-energy (Investments 7368, 7369, 7377, and 7512) projects helped improve urban air quality through expanded use of clean fuels and expanded clean energy generation, respectively. PSOD also supported improved and expanded water supply and wastewater management in the PRC's less-developed towns and rural communities (Investment 7455), integrated wastewater management concessions (Investment 7491),<sup>70</sup> and river clean up and increase reuse of wastewater (Loan 7310 and Loan 7375). Additionally, PSOD has supported the introduction of climate friendly clean energy options (the PRC, India, Thailand), demonstrated PPP for infrastructure development and/or increasing space for private sector (the PRC, India, Uzbekistan); and demonstrated the viability of long tenor financing for infrastructure projects (India, Indonesia).

99. **Through sovereign operations, ADB has sought to provide financing for using PPP modality for developing new infrastructure.** About 20 loans and grants have supported PPP projects and leveraged private sector finance for infrastructure development and creation, where the private sector has partnered with a SOE. These loans and grants helped strengthen governance in financial intermediaries, raise long term capital and facilitate leveraging of private capital for clean energy and other infrastructure projects. ADB supported the establishment of the Indonesian Infrastructure Financing Facility to provide long tenor loans for infrastructure development, including through the PPP modality (Indonesia; Loan 2516). By the end of 2016, 2 years after project closing, the Financing Facility had provided advisory services for 13 projects, and its project advisory skills were getting recognized in the market. These interventions have provided a wide range of support, that includes: (i) inputs towards a regulatory framework and institutional mechanism for promoting PPP (Indonesia: Loans 2263, 2264, 2475, and 2708 and Grant 0064; Philippines: TA 7796); and (ii) capacity development for design and structuring of PPP projects plus feasibility studies for PPP projects, which included design and structuring aspects (Pakistan, Loan 2178). In India, ADB has provided a series of loans through three multitranche financing facilities (MFFs). Two loans with a total approved amount of \$500 million from the first multi-tranche facility (\$500 million) catalyzed private sector investments of about \$5.5 billion to finance 30 PPP subprojects (Loans 2404 and 2509). Three loans from the second MFF, with a total approved amount of \$700 million, leveraged about \$9.1 billion of private capital for 20 PPP projects (Loans 2586, 2717, and 2822). In Bangladesh, ADB has supported a \$165 million facility for development of 15 or more renewable energy projects using the PPP modality and leveraging \$600 million from the private sector

<sup>69</sup> This has prompted investments in city gas distribution systems in several other cities in India, by other private sector (or joint ventures between private and public sector) players.

<sup>70</sup> With wastewater treatment plants, sludge treatment plants, sewage conveyance and interceptor pipelines as well as civil works such as dredging of rivers and lakes, construction of riverbank reinforcements, provision of odor treatment, and landscaping.

((Bangladesh, Loans 2453 and 2454). In Pakistan, three loans of a MFF with a total approved amount of about \$410 million aimed to transform a highway developer to a network operator responsible for managing the PPP process (Loans 2210, 2231, and 2540).

## E. Selection of Countries for Case Assessments

100. **Five countries that together received approvals for \$16.9 billion in 113 loans and grants supporting SOE reforms during the evaluation period (2005–2017) are selected for conducting detailed assessments.** These countries accounted for 40% of sovereign loans and grants with SOE reform components, and 54% of TA projects in the portfolio of operations. The five countries included one country each served by each ADB regional department. These countries are: (i) the PRC in the East Asia region, (ii) India in the South Asia region, (iii) PNG in the Pacific region, (iv) Uzbekistan in the Central and West Asia region, and (v) Viet Nam in the Southeast Asia region.

101. **The five countries illustrate a broad sweep of reform approaches that ADB has supported in its developing member countries.** The PRC, with the largest portfolio in the East Asia region, had the largest number of loans that supported corporatization during the evaluation period. India had the largest portfolio in the South Asia region, where ADB supported the closure of several provincial level SOEs. PNG had the largest portfolio in the Pacific region in terms of asset size; and the findings from this evaluation have been complemented by the evaluation of the Private Sector Development Initiative (PSDI) published in 2018, which also covered PNG and focused on SOE reform and PPPs. Although Pakistan had the largest portfolio in the central and west Asia region, Uzbekistan was selected as it is a country in transition, like several other DMCs in the region. Viet Nam was preferred in the Southeast Asia region, as ADB's support to reforming SOEs in Viet Nam covered a wide canvass that considers SOE reform in the contexts of reducing poverty, managing government liabilities, and increasing private sector participation in infrastructure development.<sup>71</sup> Loan and grant, and TA project approvals in the five countries are listed in Linked Document 4.

102. **Most of the NSO portfolio was also in these five countries selected for case assessments.** Combined, 28 of the 39 NSO projects were in these countries and accounted for more than 75% of approvals during the evaluation period. Linked Document 5 shows the relevant NSO approvals during the evaluation period in these five countries. Salient findings from these country case assessments are presented in Supplementary Appendixes 1 to 5.

103. **SOE reform is an ongoing process in all five countries selected for case assessments.** By the 1990s, governments in four of these five countries had recognized that corporatization of statutory authorities was an essential first step in the reform process.<sup>72</sup> During the last 3 decades, these governments have adopted different approaches to reforming their SOEs. With the objective of improving corporate governance, the PRC government moved decisively to a centralized form of government oversight in 2003, and Viet Nam has taken a step in this direction in February 2018. However, government oversight in the other three countries remains fragmented to varying degrees. The issue that underlies SOE-related fiscal management problems for all five governments is their unwillingness to impose "hard budget constraints" and managing SOE related fiscal problems remains an important objective in all these countries. Key aspects of the respective governments' approach regarding governance improvements and SOE-related financial management problems are highlighted in Table 6.

<sup>71</sup> Pakistan and the Philippines are subjects of detailed investigation in the evaluation of the PBL modality.

<sup>72</sup> The exception is Uzbekistan.

**Table 6: Salient Aspects of State-Owned Enterprise Reform in Five Countries Selected for Case Assessments**

	People's Republic of China	India	Papua New Guinea	Uzbekistan	Viet Nam
Oversight mechanisms in place	The central State-owned Assets Supervision and Administration Commission was created in 2003. It exercises state ownership rights over central state-owned enterprises (SOEs). Similar Commissions were created at the provincial level.	The Department of Public Enterprises in the Ministry of Heavy Industries has an advisory role for improving governance; it focuses mostly on the 24 largest central SOEs. Memoranda of understanding are in place between all central SOEs and their respective line ministries.	Kumul Consolidated Holdings oversees many SOEs, while the National Executive Council approves SOE annual business and financial plans	Through Ministry of Finance and other government institutions	A new Committee was established in February 2018 to take over ownership functions from line ministries <sup>a</sup>
Transparency mechanisms in place	All central SOEs are monitored on financial management matters; and listed SOEs are mandated to disclose financial and non-financial information.	All central SOEs are monitored against performance targets in their respective memoranda of understanding. Listed SOEs are mandated to disclose financial and non-financial information.	External accounting audits of SOE financial statements are delayed. SOEs are not mandated to disclose financial statements.	As of October 2017, the government was preparing () a master plan for increasing accountability and reengineering business processes, key aspects of which include transparency and timely data gathering for reporting financial performance.	SOEs are mandated to publicly disclose financial statements, organizational structures, business plans and other information on their websites.
SOE-related Financial Management problems	Over-capacity in some areas, in part because SOEs have better and more stable access to bank credit and government allocated resources. Some SOEs also serve social obligations.	Because of continued availability of government soft loans and easy access to credit from the financial sector. Some SOEs also serve social obligations.	Because SOE financial statements are not available in a timely manner, they operate in a monopolistic environment, and have no incentive to reform or improve their performance.	Problems surfaced after currency devaluation in 2017, specially from SOEs with hard currency borrowings.	Because of taking on too much debt, and in some cases, making investments outside their core areas of expertise.

<sup>a</sup> The government oversight mechanism has been fragmented until February 2018: Ministry of Finance reviewed SOE financial position and performance; Ministry of Planning and Investment approved SOE investment projects; line ministries approved SOE business plans and development strategies; and Ministry of Internal Affairs and Labor was engaged in human resource issues.

Source: Asian Development Bank (Independent Evaluation Department).



## F. Reform Aspects Not Sufficiently Addressed

104. Although ADB has supported a broad range of SOE reform measures over several decades, it has not paid enough attention to some important aspects.

### 1. Government Oversight of SOEs

105. Most governments do not consider SOEs as mere investments from which financial returns are to be maximized but prefer to be involved directly or indirectly in managing the SOEs.

106. **Governments have used different approaches to oversee SOEs and monitor their performance, ranging from completely decentralized to fully centralized models.** The best approach for any country depends on government commitment to SOE reforms, governance systems in place, and other political economy factors. Table 7 provides a brief overview of oversight mechanisms of governments that prefer not to maximize financial returns from SOEs.

**Table 7: Overview of State-Owned Enterprise Oversight Mechanisms**

Model	Key Features
Decentralized	<ul style="list-style-type: none"> <li>• Each state-owned enterprise (SOE) reports to its line ministry</li> <li>• There is an inherent conflict between the line ministry's ownership role and policy-making role.</li> <li>• Line ministries often dominate boards of directors, seldom have the requisite skills sets, and tend to deviate from merit-based appointments of top SOE managers.</li> <li>• Interference from other ministries, such as Ministry of Finance or an equivalent ministry.</li> <li>• Provides no overall oversight and vision of the SOE sector as a whole.</li> </ul>
Dual	<ul style="list-style-type: none"> <li>• The SOEs report to a line ministry as well as a second ministry, usually the ministry of finance (or an equivalent ministry).</li> <li>• The second ministry approves SOE budgets, borrowings, capital expenditures and asset acquisitions.</li> <li>• Board positions are shared between line ministry and second ministry.</li> <li>• The potential for conflict remains but compared to the decentralized model, this arrangement provides the government a better idea of SOE related financial management problems.</li> </ul>
Advisory	<ul style="list-style-type: none"> <li>• A unit with analytical and consulting skills serves as an advisor to SOEs.</li> <li>• This unit monitors SOE performance and advises them on (for example), corporate or financial restructuring, initial public offerings, partial sale to strategic investors and other areas such as acquisition of new technology or plant and equipment.</li> <li>• This model provides better guidance on improving SOE governance.</li> <li>• Cannot cover all SOEs across all sectors.</li> <li>• A key weakness of this model is that the advising unit is not a decision maker.</li> <li>• Hence, this model works well if this unit is located within a powerful ministry.</li> </ul>
Centralized	<ul style="list-style-type: none"> <li>• An entity is established outside the government, and mandated to manage state ownership functions.</li> <li>• This separates state ownership from policy making and regulatory functions, minimizes the scope for political interference, and promotes consistency and coherence in SOE governance and information standards across SOE sectors.</li> <li>• Cannot cover all SOEs across all sectors.</li> </ul>

Source: World Bank Group. 2014. *Corporate Governance of State-Owned Enterprises: A Toolkit*. Washington, DC.

107. **Most DMCs have adopted one of these or some variant of these models.** For example, Viet Nam had a very decentralized model where four ministries jointly provided SOE oversight until early 2018,<sup>73</sup>

<sup>73</sup> The government oversight mechanism has been fragmented until February 2018: Ministry of Finance reviewed SOE financial position and performance; Ministry of Planning and Investment approved SOE investment projects; line ministries approved SOE business plans and development strategies; and Ministry of Internal Affairs and Labor was engaged in human resource issues.

when the government set up a central committee to take over all these oversight and ownership functions. In Indonesia, the government has followed a dual model, with the Ministry of State-Owned Enterprises overseeing about 118 central SOEs and other special purpose entities. India and Thailand have adopted an advisory model, where the advisory unit is located within India's Ministry of Heavy Industry and in Thailand's Ministry of Finance. In India, this advisory unit focuses mainly on about 10% of the largest central SOEs; and similar units are also set up at the state level. The PRC had moved to a centralized system of government oversight by 2003 when it established the State-owned Assets Supervision and Administration Commission (SASAC) at the center, and similar units at the provincial level. Among other measures to improve SOE performance, SASAC ties management compensation to SOE performance. The number of central SOEs under SASAC has reduced, from about 200 initially to less than 100 by 2017.

108. **Many DMC governments have found SOE oversight a challenging task.** The drawbacks of the decentralized and dual systems are clear (Table 7). In the advisory and centralized models, the units that are involved in monitoring SOEs need to have sufficiently broad and deep skill sets, with well-defined performance monitoring metrics, database management systems, and coordination with concerned government departments. All these aspects can present significant challenges. For example, India which has relied on the advisory model for oversight, introduced a performance monitoring system more than two decades back. Since then, the performance monitoring metric has undergone change and SOE performance is now monitored against a mix of dynamic, sector-specific and enterprise-specific parameters in addition to financial parameters.<sup>74</sup> However, it appears that performance monitoring system has not contributed significantly to improving SOE productivity to date.<sup>75</sup> It might be that the SOEs only agree to benchmarks and targets that are easily achievable and use their relationships with their respective line ministries to ensure good ratings even when their productivity parameters are low or declining.<sup>76</sup>

109. **Although government oversight of SOEs is a critical ownership function, IED is aware of only one ADB project that supported improvements in government oversight.** ADB prepared a knowledge product on the balanced scorecard, which has been used by the PRC's central SASAC to guide SOEs in achieving better performance. It appears that ADB has not explored similar opportunities in other countries.

## 2. SOE Board Issues

110. **Although various stakeholders share the responsibility for corporate governance, the board of directors plays a central role.** Important measures that need to be carried out at the board level for good corporate governance include: (i) depoliticizing boards by recruiting external board members who are independent and bring a diversity of skills;<sup>77</sup> (ii) establishing board committees that do a major part of the board's work outside the formal board meetings and report to the full board;<sup>78</sup> and (iii) overseeing

<sup>74</sup> Dynamic parameters refer to efficacy of project implementation, and research and development expenditure; sector-specific parameters refer to macro- factors such as variations in interest rates, or prices of inputs and outputs; and enterprise-specific parameters refer to issues such as safety and pollution.

<sup>75</sup> A. Chhibber and S. Gupta. 2017. "*Bolder Disinvestment or Better Performance Contracts? Which Way Forward for India's State-Owned Enterprises*" Working Paper Series No. 17/205. National Institute of Public Finance and Policy (NIPFP).

<sup>76</sup> A. Chhibber. 2018. *India's Public Sector Enterprises: The Political Economy, History and Calculus of Reforms*. New Delhi. Unpublished.

<sup>77</sup> Although it is naïve to expect most governments, line ministries or finance ministries to give up all their power and influence over a SOE, governments could ensure that majority of board members are recruited externally.

<sup>78</sup> Some board committees that can be set up include: (i) an audit committee, to work with the SOE's external auditors and to whom the internal auditors report; (ii) a compensation committee, to approve increases in salaries and benefits to all employees and specially the top and senior managements, set the standard for management performance targets, and tie incentives to performance benchmarks; (iii) a finance committee, to provide oversight on the SOE's financial and operational performance, and to examine proposed borrowings and capital raises; (iv) a governance committee to select new board members as appropriate. In addition, state-owned banks may also need specialized risk and credit committees, and all boards may also appoint ad hoc committees as necessary to consider such issues as expansion, adoption of new technologies, and expansion outside the country.

the development of a mission for the SOE, including a medium-term strategy, a short-term business plan, and an annual budget. At the heart of board oversight is the quality of the information and reporting system, which requires a good management information system, and qualified accounting, financial and other teams. The board should also be able to ensure orderly succession in appointing a new chief executive officer and ensuring that a chief executive officer recruits or appoints senior staff with the skills and experience necessary to fulfill their responsibilities.<sup>79</sup>

111. **ADB has not paid sufficient attention to addressing board issues.** ADB provided support to ascertain the proper constitution and functioning of SOE board of directors in less than 5% of projects. Examples include: (i) as part of the ADB supported governance and public resource management program in India, a major achievement was the approval and notification of rules and regulations governing the relationships between the state government, line departments, the department of public enterprises, and SOE boards of directors (Loan 2442); (ii) in Pakistan, the ADB supported growth and revitalization program called for amending the Act under which a provincial SOE was established, to allow for an empowered and independent board of directors (Loan 2484); and (iii) in Uzbekistan, to improve governance of the affordable rural housing program, one of the performance indicators is to have by 2020, at least two independent directors on the supervisory boards of at least two of the three participating banks (Loan 3535). PSDI has also engaged in reforming SOE Boards to reduce the number of government officials (Samoa); and train Directors in Fiji, Samoa and Tonga. No project documents explicitly refer to the following aspects for improving corporate governance: (i) whether stakeholders can obtain effective redress in the event they are not able to exercise their legitimate ownership rights, and (ii) whether employees can participate in decision-making (including board representations) and can communicate their concerns about integrity and unethical practices to relevant public authorities.

### 3. Accountability Mechanisms in Infrastructure SOEs

112. **The accountability mechanism is a key building block of good corporate governance.** It involves: (i) monitoring and reporting performance on financial parameters as per established financial accounting standards, (ii) transparency and disclosure of financial and operational performance as well as governance systems, and (iii) internal systems that help manage risk and regulatory compliance.

113. **Few sovereign loans and grants or TA projects classified under infrastructure sectors supported improvements in accountability measures.** Of about 150 infrastructure loans and grants in the portfolio of operations, less than 20 included measures for improving accountability of the concerned SOE. ADB has supported such measures in the PRC as part of: (i) separation of construction, operation and maintenance responsibilities (by creating new SOEs) from the government's policy making functions for road and rail projects (e.g. Loan 2274);<sup>80</sup> and (ii) establishment of independent and autonomous internal audit departments or internal dispute review mechanisms in existing SOEs (Loan 2616). As part of the corporatization objective to give greater managerial autonomy to public entities in the water sector in Viet Nam (Loan 2272) and a water utility in Fiji (Loan 3512), ADB supported the adoption of accountability measures. Other examples included: (i) in Uzbekistan, for supporting the power utility in adopting international auditing standards and accounting practices (Loans 2629, 2630, and 8244); and (ii) in Pakistan, for strengthening the internal audit department and transparency of the procurement process in the country's railway system (Loans 3398 and 3399). As for loans and grants, most of the nearly 50 TA projects classified under infrastructure sectors do not support accountability improvement measures.

<sup>79</sup> OECD. 2015. *OECD Guidelines on Corporate Governance of State-Owned Enterprises*. Paris. <http://dx.doi.org/10.1787/9787264244160-en>.

<sup>80</sup> In this rail subsector project, the project design included commercialization aspects (business development, accounting, management information systems) for the newly created SOE, rail safety features, private sector participation (container terminals for private logistics operations, outsourcing of ancillary services), and tariffs based on full-cost recovery. Improvements in accountability, transparency and disclosure were achieved through project design and accompanying loan covenants, which incorporated suitable measures that ADB had supported through previous TA projects. For more information on other ADB supported rail and road subsector projects, refer to Supplementary Appendix 1.

#### 4. Governance Risk Assessments and SOE Diagnostic Analysis

114. **Governance risk assessments at the country, sector and project levels have a narrow focus.** ADB has traditionally focused on assessing risks related to public financial management, procurement and corruption.

115. **Several aspects of governance are not covered sufficiently well in governance risk assessments and project documents.** RRP normally include macro-level and background information as well as sector assessments. For projects that are aimed at creating fiscal space for a government, the RRP typically cover broad issues related to fiscal management problems (including expenditure, revenue, debt and fiscal transfers). Similarly, for projects that mainly support investment in infrastructure, the typical RRP provides an overview of the institutional framework, the government's approach to reforms in that sector, roles of SOEs and other types of sector entities and issues faced by these SOEs and other entities. Project documents do not provide adequate information for the targeted SOE(s) on the following: (i) board-level issues; (ii) financial performance, PSOs and various aspects of soft or hard budget constraints; and (iii) other governance related matters such as internal audit and risk management functions, financial management systems, accounting systems and disclosure practices. Such diagnostic analyses are not available in project documents. Where the target SOE operates in a competitive environment, the extent to which it can compete in the market for public goods and services is also not adequately diagnosed.<sup>81</sup>

#### 5. Eligibility for Nonsovereign Operations

116. An underlying premise of ADB support for SOE reforms is to improve their performance to the point that the SOEs can begin raising long term finance on commercial terms on the strength of their balance sheets.

117. Where ADB has made significant contribution to enabling SOEs raise long-term finance on **commercial terms, it involved a series of TA and sovereign loan projects which preceded NSO projects.** These included ADB support for expanding the power transmission system in India (Box 3) and for implementing a masterplan for pollution control in the Songhua River Basin in the PRC (Box 4). Further details are in Linked Document 6. Another example is ADB support to K-Electric (the erstwhile Karachi Electric Supply Corporation, KESC) since the early 1970s through sovereign loan and TA projects. These ADB projects contributed to the privatization of K-Electric in 2005; and later in 2007, ADB provided an NSO loan with an equity conversion option.

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<sup>81</sup> Where necessary for the investment component of a project, it may be useful for ADB to simultaneously assess other aspects such as technological prowess (or obsolescence), corporate social responsibility and environmental management.

**Box 3: Enabling Powergrid to Raise Long-term Finance on Commercial Terms**

Power Grid Corporation of India (Powergrid) is a transmission utility in India that the Asian Development Bank (ADB) has supported since 1995. ADB has helped strengthen Powergrid's procurement policy, environmental and social safeguards policy and financial management systems. ADB has also supported Powergrid in preparing investment projects that follow environmental and social safeguards policies acceptable to international lenders. Additionally, ADB has engaged in policy dialogue with the government to ensure that policies and price regulations are in place for ensuring the viability of the Powergrid's investments. Support from ADB for more than 15 years contributed to Powergrid's increased comfort level in the market for financing investments.

ADB approved \$1.6 billion through six sovereign loans between 1995 and 2011, to support Powergrid's transmission capacity expansion projects. ADB approved the first nonsovereign operations (NSO) loan of \$250 million in 2011 along with a \$250 million sovereign loan and a technical assistance (TA) project. Following this, Powergrid was successful in the issuance of its first bond in the international market. It raised \$500 million through an international bond issue in 2013 (a 10-year note with a coupon rate of 3.875% annually and listed in the Singapore Stock Exchange). Subsequently, ADB approved another NSO loan of \$500 million in 2015 (and signed in 2017) along with a \$500 million sovereign loan and a TA project.

Source: Independent Evaluation Department (Asian Development Bank).

**Box 4: Support for Pollution Control in the Songhua River Basin**

From 2002 to 2008, Asian Development Bank (ADB) approved \$550 million through four sovereign loans for flood management and water pollution control in the Songhua River Basin. ADB also approved six technical assistance (TA) projects from 1994 to 2007. The most salient outcome of the TAs was a master plan for pollution control.

In 2010, ADB approved about \$146 million NSO loan and equity investment to Tongfang (Harbin) Water Engineering (TWE) to continue to expand its water supply and wastewater treatment projects in Heilongjiang province. The projects were implemented under 25- to 30-year public-private partnership (PPP) concessions to rehabilitate or build new projects that expanded and upgraded wastewater treatment and water supply facilities. All the planned PPP projects for TWE relied on either local government or state-owned water companies backed by local governments for payments on water supply and wastewater treatment services. End-user payments for water services were made to the municipalities or water companies and supplemented by municipal budgets. These undertakings were further supported by the Heilongjiang provincial government, which signed a memorandum of understanding to procure, supervise, and inspect the local governments to pay all water supply and wastewater treatment tariffs under all concession agreements in June 2009 (prior to ADB's approval). ADB's financing structure used TWE's guarantee to lend to TWE subsidiaries and enabled these subsidiaries to make equity investments in individual PPPs.

ADB's equity investment was a strategic investment made in advance of TWE's planned initial public offering to increase its capital base, diversify its shareholding structure, and improve its independence. ADB's specific focus with its equity stakeholding was to assist TWE in improving its environmental and social management system. ADB was entitled to nominate a nonexecutive director on the TWE board.

In 2012, ADB maintained its equity investment and approved an additional loan to TWE's successor entity to finance sludge treatment and disposal subprojects and upgrades to existing wastewater treatment plants (separate to the wastewater treatment plants financed through the 2010 loan).

Both loans were prepaid in 2016; and ADB exited its equity investment in 2017.

Source: Independent Evaluation Department (Asian Development Bank).

118. **Few sovereign operations specifically aimed to make SOEs eligible for raising long-term capital.** Although many sovereign operations aim to improve corporate governance for one or more SOEs, which can contribute to making the SOEs eligible for raising long-term private capital in the medium term, few project documents explicitly mention this outcome. Projects for which the upfront documentation

explicitly targeted eligibility for long-term finance include: (i) loan and grant projects that facilitate a financial institution that provides long-term debt finance for infrastructure to be rated by an internationally-accepted credit rating agency (Bangladesh, Loans 2453 and 2454 and Grants 0253 and 0254); (ii) a TA project that exposes a water utility to risk management practices, cash flow management, business planning, credit rating requirements, bond issuance covenants, as well as public disclosure and other corporate governance requirements as practiced internationally (PRC, TA 4604); and (iii) a loan project with the objective of making an expressway SOE commercially oriented and viable; and which sought to (among other measures) revise the organizational structure of the SOE, identify legal and regulatory constraints to its commercial orientation and assess training needs (Viet Nam, Loan 2374).

## 6. Reforming of SOEs Engaged in Manufacturing

119. **Manufacturing is the key engine of growth for middle-income countries.** An analysis of long time-series data on employment and value addition by sector from more than 100 countries across the globe shows that for middle-income countries: (i) manufacturing pulls along services with a decline in the growth rate of manufacturing negatively affecting the growth rate of services sector in both the short and medium terms; (ii) increasing the share of manufacturing accelerates the pace of technological accumulation; and (iii) an increased share of manufacturing enhances the utilization of human capital as technology transfer mainly takes place in manufacturing sector, and economic institutions (such as for higher education and stronger protection of intellectual property rights) encourage domestic firms to absorb superior technology and create demand for innovation.<sup>82</sup> Along with other factors, such as increased competition in the domestic market and extent of competition from foreign sources (which relates to tariff and non-tariff barriers, prevalence of foreign ownership and foreign direct investment) manufacturing contributes to improving competitiveness of the economy.<sup>83</sup>

120. **The performance gap between SOE and private or non-state enterprises in middle-income countries needs to be closed.** Although IED has not conducted a detailed analysis of the profitability of specific SOEs and specific private or non-state enterprises in manufacturing sectors of DMCs, IED has gathered relevant aggregate information from multiple sources for the five countries selected for case assessments. This information indicates that performance of SOEs in manufacturing falls short of private or non-state enterprises in at least four of these five countries.<sup>84</sup> For example:

- (i) In the PRC, continued state ownership in the manufacturing sectors has been associated with lower return on equity for SOEs compared to non-state enterprises. From 1998, the difference has varied from a low of 2% (in 2006) to a high of 11% (in 2015).<sup>85</sup> Although SOEs engaged in manufacture of white goods and fast-moving consumer goods compete with non-state enterprises and the performance gap has gradually closed over the years, it still falls short of private enterprises.<sup>86</sup> Additionally, in the state-designated “pillar” industries, which include machinery, automobiles, steel, base metals, and chemicals, potential private competitors face a range of entry barriers, which precludes performance improvements.<sup>87</sup>

<sup>82</sup> D. Su and Y. Yao. 2016. Manufacturing as the Key Engine of Economic Growth for Middle-Income Economies. *ADB Working Paper Series*. No. 573. Tokyo: Asian Development Bank Institute.

<sup>83</sup> K. Schwab, ed. 2017. *Insight Report: The Global Competitiveness Report 2017–2018*. World Economic Forum. Geneva.

<sup>84</sup> In PNG, SOEs contribute 1.8% to gross national product (2010) and a \$ invested in SOE returns only \$0.12, while the private sector returns \$0.82. However, there are many capital-intensive infrastructure SOEs, while private enterprises are engaged in other less capital-intensive sectors. See ADB. 2012. *Finding Balance: Benchmarking the Performance of State-Owned Enterprises in Papua New Guinea*. Manila.

<sup>85</sup> National Bureau of Statistics, China 2030.

<sup>86</sup> World Bank and the Development Research Center of the State Council, and P. R. China. 2013. *China 2030. Building a Modern, Harmonious, and Creative Society*. Washington, DC: World Bank.

<sup>87</sup> W. Mako. 2017. Political Economy of State Enterprise Reform. Korea. Unpublished.



- (ii) In India, the overall performance of central SOEs (other than the maharatnas)<sup>88</sup> and state-level SOEs does not match the performance of their private sector counterparts. These include a large number of SOEs engaged in manufacturing (such as electronics, engineering, paper, petroleum, textiles industries) as well as tradeable services (construction and consulting);<sup>89</sup>
- (iii) In Uzbekistan, SOEs dominate in metallurgy, cotton processing and automotive machinery—sectors that the government considers to be of national strategic interest. Although private sector or foreign companies could be more competitive than these manufacturing SOEs, the government restricts private enterprise in these sectors;<sup>90</sup> and
- (iv) In Viet Nam, the pre-tax profitability of central SOEs has remained below the level of foreign invested enterprises in 5 of the 8 years since 2008 for which data are available.<sup>91</sup> SOEs retained a significant share in several manufacturing sectors at least until 2010. In fertilizer and cement, SOEs accounted for more than 50% of the output in 2010; while in textiles, chemicals, steel and rubber and plastics, SOEs accounted for 10–20% of the output.<sup>92</sup>

121. **Privatization (or ownership transformation) of SOEs has been and continues to be attempted in three of the five countries selected for case assessments.** Privatization has policy, political, economic and business undertones and the pursuit of privatization has varied significantly in these countries over the past two or three decades. Privatization objectives have reinforced the need for improving SOE performance. A key factor has been the recognition that private companies tend to perform better financially and operationally.

- (i) In the PRC, several approaches to privatization have been tried, including forming joint ventures with foreign partners and listing SOEs on stock exchanges.<sup>93</sup> As a result, the SOE share in total industrial assets has fallen from about 69% in 1998 to 42% in 2010, and their employment share has reduced from about 61% in 1998 to less than 20% by 2010.<sup>94</sup>
- (ii) In India, although privatization was not part of the economic liberalization package of 1991, it has been on the agenda of all successive governments elected since then. While many SOEs have been listed within India (with the government continuing to retain majority control) 12 SOEs were privatized between 1999 and 2004 with management control passing into private hands. The weighted average return on capital of these companies had nearly tripled by 2015.<sup>95</sup> Nonetheless, several hundred state-level manufacturing SOEs continue to function inefficiently, and about 300 are non-functional.<sup>96</sup>

<sup>88</sup> There are seven central SOEs designated as “maharatna” that meet the following criteria: (i) significant global presence and international operations; (ii) minimum annual average turnover of INR25,000 crore (\$3.8 billion) during the last three years, net worth of INR15,000 crore (\$2.3 billion) and net after-tax profit of INR5,000 crore (\$0.77 billion). Their Boards have powers to make equity investments to establish joint ventures and wholly owned subsidiaries in India or overseas, and undertake mergers and acquisitions in India or overseas, subject to an overall ceiling of 30% of their net worth. For further information: Government of India, 2016. *Public Enterprise Survey 2014–2015*, New Delhi.

<sup>89</sup> A. Chhibber. 2018. *India’s Public Sector Enterprises: The Political Economy, History and Calculus of Reforms*, New Delhi. Unpublished.

<sup>90</sup> Export.Gov. <https://www.export.gov/article?id=Uzbekistan-7-State-Owned-Enterprises>.

<sup>91</sup> Compiled from website of the General Statistics Office of Viet Nam; [https://www.gso.gov.vn/Default\\_en.aspx?tabid=766](https://www.gso.gov.vn/Default_en.aspx?tabid=766).

<sup>92</sup> World Bank. 2011. *Viet Nam Development Report 2012*, Washington, DC.; <http://documents.worldbank.org/curated/en/49572168327934602/Vietnam-development-report-2012-market-economy-for-a-middle-income-Vietnam>. Although further updates on the shares of outputs from SOEs in these manufacturing sectors are not available, it can be reasonably assumed that the shares remain significant to date, in view of the trend observed since 2000.

<sup>93</sup> Other approaches have included management and employee buyouts. Problems related with sale at less than fair value, and asset stripping by insiders were experienced and attempts have been made to address these problems.

<sup>94</sup> World Bank and the Development Research Center of the State Council, and P. R. China. 2013. *China 2030. Building a Modern, Harmonious, and Creative Society*. Washington, DC: World Bank.

<sup>95</sup> Government of India. Various. *Annual Public Enterprise Surveys*. New Delhi.

<sup>96</sup> A. Chhibber. 2018. *India’s Public Sector Enterprises: The Political Economy, History and Calculus of Reforms*, New Delhi. Unpublished.

- (iii) In Viet Nam, although 96.5% of SOEs had been equitized by early 2017, only 8% of their stocks had been sold to private investors. The government acknowledges that most equitized entities have not yet achieved significant commercial orientation in their operations, and there have been few divestments to date through listings or strategic sales. Viet Nam's limited experience in this area has been negatively affected by the selection process (selling to a favored or influential party) and the poor quality of divestment planning.<sup>97</sup> Nonetheless, given that the public and publicly guaranteed debt is approaching the ceiling of 65% of gross domestic product, the government appears to be increasingly willing to find ways to divest itself of SOEs.

122. **During the evaluation period, less than 2% of sovereign and NSO projects supported the reform, restructuring and closure of manufacturing and tradeable sector enterprises..** Examples include: (i) for demonstrating the Uzbekistan government's commitment to doing structural reforms in strategic sectors through the NSO modality by supporting the construction of a petrochemical facility for producing polyethylene and polypropylene through a joint venture between a SOE (Uzbek Neftgas) with a 50% share, and non-state foreign enterprises (KorGas, Lotte and GS Chemicals) with a combined share of 50% (Investment 7351); (ii) for supporting debt restructuring, management restructuring, institutional development and governance improvements in a 100% state-owned textile and garments SOE in Viet Nam through the MFF modality, to enable state ownership to be reduced to 55% (Loans 2613, 2614, 3240, and 3242; see Box 5); and (iii) for supporting the closure and restructuring of state-level manufacturing SOEs in India (Loans 2442, 2536, and 2537), and by restructuring a statutory body<sup>98</sup> and strengthening its IT and e-governance systems with the objective of revitalizing village level micro and small-scale manufacturing units (Loan 2452, TA 7142).

#### Box 5: SOE Reform and Corporate Governance Facilitation Program in Viet Nam

Through the ongoing state-owned enterprise (SOE) Reform and Corporate Governance Facilitation Program, a multitranche financing facility (Tranche 1: Loans 2613 and 2614; and Tranche 2: Loans 3240 and 3242), Asian Development Bank (ADB) is supporting the equitization process of general corporations and large SOEs through debt restructuring, management restructuring and institutional development. Originally, Tranche 1 was to support Song Da Corporation (SDC), SOWATCO, and DATC, but DATC withdrew from the program.<sup>a</sup> Tranche 2 included three SOEs (CC1, SDC, and Vinatex). By August 2017, the project had progressed well.

- (i) SOWATCO was 100% equitized and listed on the Ho Chi Min City Stock Exchange. Its corporate governance system followed the market standard in Vietnam. It had surplus cashflow and preferred to prepay its ADB loan.
- (ii) Song Do Corporation (SDC) which is the main subject of the MFF loans and was a group of construction companies, had been restructured to a general corporation to focus on hydropower plant construction. Its corporate structure had been streamlined, and the number of subholding companies reduced from 28 to 14. This helped reduce management cost. SDC has had good cash flows and had completed hydropower plants in Viet Nam and Lao PDR. Ministry of Finance considered it well on track to go through 100% equitization by end of 2017.
- (iii) Construction Company 1 (CC1) joined the program in 2013 (Tranche 2) when it was a 100% SOE. It was equitized and had a 44% state share-holding as of August 2017, and it was close to achieving the financial ratios as required by ADB.
- (iv) Similarly, Vinatex joined the MFF program in Tranche 2 when it was 100% SOE. It had also been equitized since then, and the state share reduced to 55%. Its financial ratios exceed those required by ADB. Ministry of Finance had asked Vinatex to begin adopting OECD's corporate governance standards.

<sup>a</sup> The Ministry of Finance informed the IED Mission that DATC withdrew from the program.

Source: Asian Development Bank. (Independent Evaluation Department).

<sup>97</sup> The government divested its 100% stake in six water supply companies in Tier II cities. The Ministry of Construction acknowledges that the experience to date has not been encouraging. The new owners do not see water as a public good and do not give priority to meeting the water needs of small and poor consumers. Additionally, there is insufficient expertise in planning divestments in the water company management, the line ministry, and the provincial people's committee.

<sup>98</sup> The statutory body is the Khadi and Village Industries Commission (KVIC), which was created in 1956 through an Act of Parliament.

123. Prior to the evaluation period, ADB had supported more manufacturing sector projects, but this was largely discontinued after the Asian Financial Crisis of the late 1990s. These included projects lending directly to manufacturing SOEs (and non-state enterprises) as well as through financial intermediation loans.<sup>99</sup> The need for ADB to support DMCs in closing demand-supply gaps of specific commodities (such as nitrogenous fertilizers, synthetic fibers, cement and steel) was acknowledged upfront in the RRP. Some of these RRP also noted the need to introduce managerial expertise that emphasized efficiency, commercialization, and accountability. ADB extended lines of credit to financial institutions in several DMCs (Bangladesh, the PRC, India, Indonesia, Pakistan, the Philippines, Sri Lanka). The primary aim was to extend subloans in foreign exchange for modernization and equipment rehabilitation, and capacity expansion of industrial enterprises. Subloans for greenfield industrial units were also considered for support in some cases, provided they showed special economic merit—such as introduction of new technology, and/or a strong export orientation. The direct lending projects were a mix of new installations and plant modernizations along with significant capacity expansions. Consulting services for detailed design and training were also part of the ADB assistance for some projects in the PRC.<sup>100</sup> ADB discontinued such lending when with the Asian financial crisis in the late-1990s, commodity prices got depressed, and enterprises with large loan amounts found it difficult to service their debt.

## G. Summary

124. ADB's Strategy 2030 is explicit about supporting SOE reforms across all country classifications. The strategy considers that improving governance and financial management capacities of SOEs, as well as policy and regulatory reforms (including tariff related reforms for better financial sustainability) will help strengthen service delivery. The strategy also recognizes that ADB's public sector operations can complement private sector operations by preparing SOEs for commercial financing.

125. Identifying the portfolio of sovereign loans and grants as well as TA projects during the evaluation period (2015–2017) was a challenging task, as ADB support for SOE reforms has not been systematically tagged. Overall, IED identified a SOE reform portfolio comprising about 21% of ADB's total operations of sovereign loans and grants, technical assistance and NSO during the evaluation period. This includes \$37.0 billion in sovereign loans and grants and \$154 million in TA projects in five main sectors (PSM, finance, energy, transport, and water) in 13 countries that accounted for a bulk of operations; and \$8.0 billion in NSO projects and \$4.6 million in accompanying TA projects.

126. Five countries, one under each ADB regional department, that together received approvals for \$16.9 billion in 113 loans and grants during the evaluation period were selected for conducting detailed assessments. A majority of the nonsovereign portfolio was also in these five countries.

127. Governments have pursued SOE reforms from various directions and ADB has responded by implementing initiatives in all three areas of operations.

<sup>99</sup> Although all projects classified as "large and medium enterprises" under the industry and trade sector may not be SOEs, it is noted that during the 13-year evaluation period, large and medium enterprises accounted for 20% of approval (by \$ value) of sovereign loans and grants classified under industry and trade sector, compared to 26% in the previous 13 years (1992–2004). For TA projects, large and medium enterprises accounted for 1% during the evaluation period compared to 38% during the previous 13 years. NSO projects continue to be aimed at large and medium enterprises, which include those with significant state shareholding.

<sup>100</sup> Various project risks were assessed, such as: (i) consistency of the project/subproject in implementing the government's strategy for the particular manufacturing subsector (e.g., steel or cement); (ii) technical risks associated with the proposed project; (iii) enterprise-specific issues, including enterprise history of financial performance, operational performance, arrangements for financial audits, capacity development and technology infusions; and (iv) consistency of the enterprise's environmental performance and the proposed project's performance with government policies and guidelines, and mitigations proposed as part of the proposed project. Implementation risks of time and cost overruns were also recognized upfront, and risks associated with a decrease in output prices and/or an increase in input prices were simply mentioned.

128. With regard to macro-level approaches to improving SOE governance, ADB extended policy-based loans and policy and advisory TA projects that aimed to: (i) modernize and improve practices at the country level through better PFM systems, improved financial accountability and transparency, anti-money-laundering and anti-corruption measures; (ii) foster an environment conducive to PSD and growth by, for example, advising on harmonization of regulations for public and private sectors, (iii) establish a legal framework for PPP; and (iv) develop strategies for the financial sector, provide inputs for legal frameworks to support continued expansion and innovation in capital markets as well as consumer protection, entry and exit of financial sector institutions.

129. To strengthen sovereign investment for improving governance at the sector level and in specific SOEs, ADB supported: (i) sector level reforms in infrastructure sectors, through improved regulatory mechanisms and tariff rationalizations, and unbundling of vertically integrated infrastructure utilities, (ii) sector level reforms in the financial sector by strengthening capabilities of the insurance and securities regulators, and (iii) SOE-specific reforms such as for improving corporate governance in financial intermediaries, alignment with internationally accepted accounting and reporting standards in banking and non-banking financial institutions and listed entities, accountability systems and financial management systems in infrastructure SOEs, as well as closure or restructuring or partial privatization of selected SOEs across all sectors. ADB projects for addressing these objectives also supported investment in infrastructure and financial services, which ADB leveraged for furthering the reform effort.

130. With regard to investments through NSO and through sovereign projects propagating the PPP modality, ADB supported project investments through NSO instruments to support SOEs directly or indirectly, along with technical assistance for these projects. ADB's sovereign loans and TA projects also supported infrastructure development through PPP modes.

131. Several aspects of the ADB portfolio are worth highlighting. First, only one ADB project supported a central government oversight body in promoting consistency and coherence in governance across SOEs although oversight is a critical ownership function. Second, ADB has not paid adequate attention to addressing board issues, although the board of directors plays a central role in advancing good corporate governance. Third, less than 15% of infrastructure projects supported improvements in accountability mechanisms—a building block of good corporate governance. Fourth, governance risk assessments and SOE diagnostic analyses have not been in sufficient depth. Fifth, few sovereign operations specifically aimed to make SOEs eligible for raising long-term capital on commercial terms and on the strength of their balance sheets. Sixth, there was little support for reforming manufacturing SOEs, although the manufacturing sector is the key engine of growth for middle-income countries, and the performance of SOEs in specific industrial segments (where governments allow competition from the private sector) remains below that of their private sector counterparts. Several governments attempted, and continue to attempt, restructuring and privatizing these SOEs, which indicates that they regard improving productivity and performance in this sector as an important issue.

# 3



**PERFORMANCE AND RESULTS  
FROM ADB SUPPORT TO  
SOE REFORM**

## Highlights

- Overall, 61% of interventions in the portfolio of evaluation were rated successful or highly successful. These comprised 59% of sovereign loans and grants and 92% of NSO projects that were rated successful or highly successful in independent assessments.
- Macro-level approaches showed modest results in terms of both Reform outcomes and Sustained and Improved Performance outcomes, while the targeted interventions showed mixed results.

132. This chapter presents the portfolio of evaluation, evaluates ADB's performance and discusses the results from ADB support in the three areas of operations.

### A. Portfolio of Evaluation

133. **More than 50% of the identified portfolio of operations (Chapter 2) had been self-evaluated by June 2018, and about 20% had been independently evaluated or validated.** However, nearly 90 sovereign loans and grants have been independently assessed (i.e., about 75% of those for which project completion reports [PCRs] are available). Twelve NSO projects have been independently assessed, which covers about two-thirds of those self-evaluated by PSOD, but about one-fifth of the approvals during the evaluation period. Regarding TA projects, none have been independently assessed, although, two-thirds have been self-evaluated. Table 8 provides further details.

**Table 8: Number of Approvals, Closures, Self and Independent Assessments of Portfolio of Operations (as of June 2018)**

Interventions	Approvals	Closed	Self-Evaluations	Independent Validations	Independent Evaluations
Sovereign loans and grants	273	150	118	88	7
Nonsovereign	57	33 <sup>a</sup>	18	11	3
Technical assistance	132	113	86	-	-
<b>Total</b>	<b>462</b>	<b>296</b>	<b>222</b>	<b>99</b>	<b>10</b>

Note: Six loans and grants were independently evaluated after conducting independent validations; one grant was independently evaluated but not independently validated. For nonsovereign projects, 2 of 11 independently validated projects were also independently evaluated.

<sup>a</sup> Includes fully disbursed, prepaid, exited, and closed project investments.

Source: Asian Development Bank (Independent Evaluation Department).

134. **The share of interventions rated successful or highly successful in independent assessments was significantly lower than in self evaluations, particularly for sovereign loans and grants.** This share dropped from 73% in self-evaluations of completed sovereign loans and grants, to 59% in independent evaluations and validations (Table 9). The downgrades were due largely to concerns about the project's financial sustainability, cancellation of some project components, time and cost overruns, and insufficient attention upfront to the implementing agency's capacity development needs. In project-based loans, these ratings refer to ADB support for the entire scope of the project, which included a small share of total ADB support for the reform component. About 70% of TA completion reports (TCRs) rated the TA projects as successful or highly successful. All but one NSO were rated successful or highly successful in self evaluations, as well as in independent assessments. However, four self-evaluations were downgraded from highly successful to successful and one from successful to less than successful, because they showed poor real economic returns on invested capital. Detailed ratings are provided in Linked Document 7.



**Table 9: Distribution of Ratings of Portfolio of Evaluation as of December 2017**

Ratings	PCR	PVR and PPER	TCR	XARR	XVR and PPER
Highly Successful	15	2	6	7	1
Successful	78	51	54	11	10
Less than Successful	25	31	24	-	1
Unsuccessful	9	5	2	-	-
<b>Total</b>	<b>127</b>	<b>89</b>	<b>86</b>	<b>18</b>	<b>12</b>

PCR = project completion report, PPER = project performance evaluation report, PVR = project completion report validation report, TCR = technical assistance completion report, XARR = extended annual evaluation report, XVR = extended annual review validation report.

Source: Asian Development Bank (Independent Evaluation Department).

## B. ADB Performance in Supporting SOE Reforms

135. **Independently validated and/or evaluated projects are considered in assessing ADB's performance in supporting SOE reforms. ADB performance ratings on these projects reflect the entire scope of the project (which can include broad macro-level policy changes or investments in physical projects).** While recognizing that SOE reform measures are one or few components of these interventions, the evaluation notes that the underlying project validations and/or evaluations do not provide more granular ratings. Additionally, although TA operations are not normally independently assessed, TCRs are referred to, as many TA projects embody reform components.

136. **Overall, 61% of all sovereign and nonsovereign projects in the portfolio were rated successful or highly successful. The success rates of sovereign loans and grants were 59% and of NSO projects were 92%.** The success rate for sovereign loans and grants was significantly below the overall success rate of loans and grants closed in recent years and independently assessed (76% in 2014–2016; 74% in 2015–2017). The success rate of the NSO portfolio of evaluation exceeded the overall success rates during recent years (58% in 2015–2017).

137. **The poorest performance was registered at the macro-level, where interventions were intended to indirectly influence SOE reforms.** These operations, which affected SOE reforms indirectly, recorded a success rate of 54% by number and 57% by approved amount.

138. **The performance of the targeted group of interventions was better, with combined success rates of 68% by number and 75% by approved amount.** Interventions for sovereign investments that were targeted at SOEs with accompanying measures for improving governance at the sector level and in specific SOEs showed a success rate of 61% by number and 67% by approved amount. NSO investments targeted at direct and indirect SOE clients recorded the highest success rates of 92% by number at 99% by approved amount. Sovereign operations that propagated the PPP modality for infrastructure development with an SOE as one of the equity participants in the PPP project or subproject, also showed high success rates of 78% by number and 76% by approved amount.

### 1. Relevance of ADB Support for SOE reforms

139. **Overall, more than 80% sovereign and NSO projects in support of SOEs were relevant or highly relevant.** This overall rating is broken down as follows: (i) about 70% by number and 75% by approved amount of projects that supported macro-level approaches; (ii) 87% by number and 85% by approved amount, of projects that provided investment support used to leverage the reform effort and that aimed to improve governance at the sector level and in specific SOEs; and (iii) 100% by number and approved amount, of sovereign projects propagating the PPP modality for infrastructure development.

### a. Contextual Relevance

140. **Government interest in pursuing SOE reforms is enhanced when expected benefits from SOE reforms reinforce the government's other higher objectives.** In addition to improving their resilience to external shocks, the most salient such higher level government objectives in some countries are: (i) in the PRC, playing a greater role on the world stage, including economic governance and climate change; (ii) in India, increasing employment and accommodating large numbers of young people that enters the job market each year; (iii) in Viet Nam, adjusting tariff and non-tariff trade barriers since gaining membership of the WTO in January 2007; and (iv) in Uzbekistan, transforming the economy, which has been the government's top priority since late 2016.

141. **Governments are not averse to reforming and improving the performance of SOEs across all sectors.** The level of government commitment to SOE reform varies from one country to another, and it can also vary over time in any country. Governments (notably the ministry of finance, or an equivalent ministry) and think-tanks recognize that SOE reforms can be pursued from various directions and generally adopt pragmatic approaches to avoid confrontation with entrenched vested interests. Hence, the speed of reforms has tended to vary across SOEs engaged in different sectors. Achieving significant and noticeable improvements in corporate governance of SOEs and managing SOE related fiscal problems have been challenging objectives for all governments, and to date, remain a work in progress for all governments.

142. **For many reasons, governments are likely to want to retain control and influence over some SOEs but some governments have also encouraged one or more of their SOEs to raise investment capital without sovereign guarantees.** For example, in the PRC, the designated strategic or pillar sectors (such as airlines and telecom) remain largely or fully closed to competition from non-state firms—while the government encourages SOEs in certain other sectors (such as white goods manufacturing) to compete directly with non-state enterprises, match their levels of performance, and raise investment capital on their own strength. In Viet Nam, while the government has identified 103 SOEs where it intends to retain full control, it is also encouraging other SOEs to improve their governance systems, become more competitive, divest, and begin raising investment capital on the strength of their balance sheets. In India, many SOEs that continue to underperform will remain under state control in the foreseeable future, while on the other hand, the government has pressed selected SOEs<sup>101</sup> to raise investment capital without sovereign guarantees.

### b. Asian Development Bank Positioning

143. **Governments appreciate ADB's broad-based approach in furthering SOE reforms through the three areas of operations.** ADB support across the three areas of operations includes: (i) macro-level approaches to improving governance, (ii) sovereign investments which also incorporate measures for improving governance at the sector level and in specific SOEs, and (iii) sovereign projects that propagate the PPP modality with SOEs for infrastructure development, and NSO projects that support investments in SOEs directly or indirectly.

144. **ADB support for SOE reforms is consistent with government strategies and priorities, and ADB's own corporate strategy, the country partnership strategies, and ADB's various sector and thematic policies and operational plans.** Given the prominence of SOEs in all DMCs, and that CPSs are designed with the objective of supporting them in addressing their development challenges, the issue of SOE reforms does find a place in all CPSs. However, the ADB portfolio is in keeping with the country context and does vary significantly across countries. Notably, some projects are unique to a country or are supported in only few countries, such as: (i) regarding macro-level approaches, support to local governments for PFM in Indonesia; (ii) regarding improving governance at sector level and in specific

<sup>101</sup> These include at least the seven maharatna SOEs (in manufacturing, extractive industries and infrastructure sectors).

SOEs, the separation of highway and rail construction, operation and maintenance responsibility from policy-making functions in the PRC; and closures of some perpetually loss-making or inoperative state-level SOEs in India; and (iii) regarding NSO, supporting a petrochemical plant to help increase opportunities for further foreign direct investment in Uzbekistan's manufacturing sector.

145. **In view of ADB's focus on the infrastructure and financial sectors during the evaluation period, it has tended to focus on reforming SOEs in these sectors and in FSD.** In other sectors, ADB support in the three areas of operations has been: (i) regarding macro-level approaches, in PSM, which can potentially be relevant to SOEs in all sectors; (ii) regarding improving governance at the sector level and in specific SOEs, limited mostly to closure, financial restructuring and partial privatization of some SOEs engaged in manufacturing and tradeable sectors (sovereign operations); and (iii) regarding NSO, investments in manufacturing and natural resource extraction.

146. **As government commitment and priorities for SOE reforms is a key determinant for progress in this area, the scope of assistance governments has sought from various development partners tends to be similar at any point in time in any country.** The modality of coordination amongst development partners and the government is influenced by the latter's approach to managing development assistance. Amongst the countries selected for case assessments, the PRC is unique, in that the government tends to assume the prime role of development partner coordination: it tends to seek regulatory and policy advice on the same or similar topics from multiple sources (typically ADB, World Bank, United Nations bodies, local research institutes and thinktanks) from time to time; and it also prioritizes projects for investment support and other financial assistance from MDBs and/or other sources. In India, the government holds separate bilateral meetings regularly with most development partners, to review portfolio performance and set priorities going forward. This avoids duplication. ADB and World Bank have supported similar projects in different parts of the country, including some that are part of national flagship programs. In Viet Nam, the government takes the lead in organizing regular meetings with development partners; ADB and World Bank have partnered to pilot the development of a competitive wholesale electricity market and support tariff reforms. In Uzbekistan, the formal aid coordination mechanism appears to focus on large and strategically important investment projects and humanitarian assistance. However, ADB has coordinated informally with other development partners to date, and all development partners (including ADB) are monitoring the economic reform program that began in late 2016. In PNG, where bilateral assistance from Australia and New Zealand is significant, in addition to ADB and World Bank, the aid coordination mechanism has evolved from being essentially development partner driven to becoming more participatory. The PSDI illustrates that demand-based support has become the norm not only in PNG, but for all other Pacific DMCs.

147. **In line with its commitment to become the main source for development knowledge in the Asia and Pacific region, ADB has taken initial steps to become a knowledge center for SOE reforms.** From a broader perspective, most DMCs have attained middle-income status, and it is highly likely that SOEs will remain important players in these countries in the foreseeable future. Some DMCs already have SOEs that compete internationally. ADB recognizes that its continued relevance will increasingly depend on its role as a knowledge institution. This means that ADB would be increasingly required not only to provide financial support to SOEs for investments, but also value adding knowledge solutions to help improve their performance. While ADB has been creating (over several years) inhouse knowledge bases that capture knowledge from within ADB and its partner organizations as well as facilitate knowledge sharing across ADB, it is in the initial stages of creating databases on SOEs and SOE reforms. In addition to the SOE Working Group (which is compiling a database on SOE reform supporting loans and grants), the Knowledge Sharing and Services Center of the Sustainable Development and Climate Change Department has included some SOE reform related knowledge products in its searchable K-Nexus database. However, access to many relevant knowledge products mentioned in TCRs is still difficult.<sup>102</sup>

<sup>102</sup>Some TCRs mention the topic area of a knowledge product but not the exact title; and some that mention the precise title may not provide links. Only in a few cases are web links provided and the knowledge product can be readily accessed.

### c. Tracking SOE Reforms

148. SOE reform is by nature a long-term process which requires long-term monitoring, unlike for typical investment projects. It would have been desirable for ADB to have taken special measures to track ADB supported SOE reform measures that extended beyond the typical project timeline. Each project is monitored during its implementation period with regular updates, with the last update being at completion.<sup>103</sup> However, the extent to which SOE reform measures have progressed is not recorded in any central database. ADB has done no follow-up monitoring, making it difficult for ADB to ascertain the extent to which reform measures it supported during the implementation period were sustained and replicated. For loans and grants and TA projects that support a specific SOE, there is no system for ADB to track whether a pilot reform measure (for example, financial management system implemented in one SOE unit) gets rolled out to other units of the same SOE, and whether that reform has been replicated in other SOEs in the same or other sectors. Likewise, for sovereign operations that are not targeted at specific SOEs, there is no system for ADB to track the extent to which these reform measures have been pursued and mainstreamed. However, continued policy dialogue can provide insights into the extent ADB supported reform measures have been sustained and replicated. In exceptional cases, ADB has agreed to a post-completion partnership framework with the government to continue tracking progress in implementing reform measures.<sup>104</sup> Besides, NSO projects are monitored by ADB for financial and developmental outcomes until the end of assistance.

### d. Project Design and Scope

149. ADB has not given sufficient emphasis to improving government oversight of SOEs, addressing SOE board issues, improving accountability mechanisms in infrastructure SOEs, or to diagnosing governance risk in target SOEs. Improvements in government SOE oversight pertains to macro-level approaches to improving governance. Addressing board issues, improving accountability mechanisms in infrastructure SOEs, and analyzing governance risks and hence reform opportunities in target SOEs pertain to governance improvements at the sector level and in specific SOEs. These project design issues are elaborated in chapter 2. It is noteworthy that ADB prepared a knowledge product that the PRC's central SASAC has relied upon for driving governance and performance improvements in various SOEs it oversees (Box 6).<sup>105</sup>

#### Box 6: Successful Delivery of a Balanced Scorecard for State-Owned Enterprises in the People's Republic of China <sup>a</sup>

The balanced scorecard methodology provides a roadmap for governments and state-owned enterprise (SOE) managers to adopt a performance management system to drive improvements in performance management and corporate governance in their SOEs.

The balanced scorecard measures performance from different perspectives—financial, market and customers, internal business processes, and innovation and learning.

The balanced scorecard captures both leading and lagging performance indicators relevant to these perspectives, thereby providing a more “balanced” view of SOE performance. Leading indicators include measures such as customer satisfaction, on-time delivery, new product development and staff competency development. The lagging indicators used include financial measures such as revenue growth and profitability.

<sup>103</sup>ADB. 2011. *Project Administration Instruction 5.08 (revised in June 2011)*. Manila.

<sup>104</sup>For example, for PBL 2872, 3233 (to Philippines).

<sup>105</sup>There are more than 60 SOEs under the central SASAC supervision.

The People's Republic of China's central State-Owned Assets Supervision and Administration Commission (SASAC) has deployed the balanced scorecard methodology for driving governance and performance improvements in the SOEs it oversees.

<sup>a</sup> Supported through Asian Development Bank. 2002. *Technical Assistance to the People's Republic of China for Improving Corporate Governance and Financial Performance of State-owned Enterprises*. Manila  
Source: ADB. 2007. *Balanced Scorecard for State-Owned Enterprises: Driving Performance and Corporate Governance*. Manila.

150. **Other key aspects that have received less emphasis to date are ADB support for making SOEs eligible for NSO and support for reforming SOEs engaged in manufacturing.** There are few cases where ADB investment support to SOEs that leveraged reform for improving governance at the sector-level and in the beneficiary SOEs, has led to further ADB support through NSO. Likewise, there are few cases where ADB has supported reform in manufacturing SOEs. Both aspects are discussed in Chapter 2.

151. **NSOs require clients that are well-governed, commercially operated, and financially sustainable.** PSOD's direct and indirect clients are required to follow the same standards for financial viability, governance and integrity as any other NSO client. This limits the universe of potential direct and indirect SOE clients, as well as the nature and extent of governance improvements that can be reasonably expected. Nonetheless, PSOD has supported these clients to introduce other measures that improve performance. Further information is provided in Chapter 2.

## 2. ADB's Efficiency in Supporting SOE Reforms

152. ADB's efficiency is discussed based on independent validations and evaluations of completed sovereign loans and grants. Independent assessments of NSO do not provide any insight on ADB's efficiency in supporting measures that have a reform value. Independent assessments of TA projects are not prepared, but information on time overruns and the underlying causes (an efficiency issue) is available from TA completion reports and is considered.

153. **Overall, about 59% of ADB supported sovereign loans and grants by number, and 63% by approved amount were efficient or highly efficient.** By area of operations, the share of loans and grants rated efficient or highly efficient are: (i) 58% by number and 60% by approved amount, of projects that aimed to influence macro-level approaches to improving governance; (ii) 57% by number and 63% by approved amount, of projects that provided sovereign investment support used to leverage the reform effort and aimed to improve governance at the sector level and in specific SOEs; and (iii) 78% by number and 76% by approved amount, of sovereign projects that aimed to propagate the PPP modality. Independent assessments of NSO do not provide any insight on ADB's efficiency in supporting reform.

### a. Responsiveness

154. **Stakeholders in the countries selected for case assessments indicated that ADB has responded well to their strategies and priorities with some suggesting ways for further improvement.** In the PRC, the government emphasized the benefit of ADB's long-term engagement for policy support and capacity building for SOE reform through regulatory and other practical changes; it also noted that the establishment of the PRC resident mission helped strengthen policy dialogue and implementation support. In India, while ADB has been responsive in terms of aligning its partnership strategies with the government's strategic priorities, some beneficiary SOEs were of the view that ADB systems and procedures are bureaucratic and adversely affect the efficiency of operations. In PNG, most notably, the PSDI provides a need-based rapid response facility and is a vehicle for (among others) preparing PPP projects in infrastructure and healthcare sectors—although there remains a need for greater flexibility in ADB's project administration processes. In Uzbekistan, the government is generally appreciative of ADB support, although some executing agencies point out the need for ADB to be more flexible in the coming years as economic reforms unfold; they suggest that ADB can accelerate approval processes and further

empower the resident mission. In Viet Nam, while the government noted the faster communication and turnaround times since project coordination was delegated to the resident mission, it raised concern over long delays in the bidding processes (for procurement) which can be streamlined.

#### b. Resource Allocation

155. **There is significant scope to improve ADB efficiency in delivering technical assistance.** TCRs show that less than 3% of TAs in the studied portfolio were completed on schedule. For the remainder, the actual time to completion was on average about 80% more than originally envisaged—both for TA projects that aimed to influence governance at the macro-level, and at the sector level or in specific SOEs. Where time overruns were for reasons attributable to ADB, it was seen that ADB had: (i) chosen to pursue aggressive timelines for meeting some inherently unpredictable objectives, such as enacting legislation or conducting necessary public consultation on draft legislation, or securing endorsement of proposed actions from government, or establishing a new center or cell and making it operational; (ii) not appropriately gauged the amount of time required for identifying and recruiting suitable consultants, for example, due to additional administration required to revise implementation through recruitment of a firm rather than individual experts (as originally envisaged), extended timeframe for the subsequent recruitment of a firm, or otherwise took longer than anticipated to identify and recruit consultants;<sup>106</sup> and (iii) encountered delays in processing vendor bids. Additionally, ADB's own staffing issues—such as changes in project monitoring staff—have also resulted in delays in implementing some TA projects.

156. **Apart from PBLs, time overruns of sovereign loans and grants to improve governance at the sector-level and in specific SOEs were significant and frequent.** Of the 45 non-PBL loans and grants in the portfolio of evaluation, 43 aimed to improve governance at the sector-level and in specific SOEs. These 39 included 8 of the 9 sovereign projects that also propagate the PPP modality. Two (a TA loan in Bangladesh, and a project loan in Indonesia) aimed to influence macro-level approaches to governance. Actual time for completion of all these non-PBL projects exceeded the originally planned time by about 35% on average. PCRs and PCR validation reports of these loans seldom provided reasons for delays in implementing the reform components. While time overruns that occurred for reasons attributable to ADB suggest scope for increasing ADB's institutional efficiency, time overruns largely attributable to counterpart agencies and/or consultants and/or other reasons (changing government policies and/or political turmoil) suggested ADB's willingness to accommodate and be responsive to on-the-ground circumstances as they unfolded. Regarding PBLs, while changing government priorities caused delays in some cases, it appears that ADB was not able to gauge well the time required for executing and implementing agencies in going through long winded procedures before new policy could be adopted or legislation enacted.

157. **By themselves, cost overruns for SOE reform related operations are not a major concern for loan and grant projects.** In the case of project-based loans, cost overruns or underruns were largely associated with the investment components; the reform component was normally a small share and the reasons provided in PCRs for cost overruns normally referred only to investment components. Resources allocated to PBLs had in most cases been used 100%,<sup>107</sup> although, the government share in the reform program could change significantly. Regarding TA projects, low utilization levels of approved TA amounts can lead to non-achievement of stated outcomes and outputs. Amounts approved for implementing TA projects have been mostly underutilized; but additional financing was approved when needed (mostly on account of additions to the scope of work). Where the TA utilized less than 75% of the original allocation,<sup>108</sup> it was usually associated with reduced activities (less advisory work, workshops and seminars), reduced

<sup>106</sup>In the PRC, implementing agencies are beginning to assume a greater responsibility in selecting consultants for TA projects.

<sup>107</sup>PCRs for PBLs completed in Bangladesh and Viet Nam indicate that minor cost overruns of PBLs is due to exchange rate fluctuations.

<sup>108</sup>Where more than 75% of the approved TA amount is utilized, the difference between approved and actual amounts is on account of exchange rate fluctuations, differences in actual (versus planned) consulting fees and out-of-pocket expenses, or minor scope changes that need less consulting inputs.



consultant inputs (in line with reduced scope), engaging individual consultants instead of consulting firms (as originally envisaged), and increased government's in-kind contribution.

158. **The cancellation ratio of NSO projects supporting SOEs directly or indirectly was significantly higher than for sovereign loans and grants across all areas of operations.** IED acknowledges that all NSO projects must compete on commercial terms with market alternatives and are thus prone to cancellations, such as when clients or other participating institutions do not agree to loan pricing or other terms and conditions, or clients do not meet the conditions precedent, or otherwise defer capital expenditures (on their other projects), obtain concessional financing from other development partners or are able to generate strong cashflows owing to changed market conditions. Nonetheless, it is noted that 10 of the 57 NSO projects had been cancelled. This cancellation ratio for NSO projects was substantially higher than for sovereign operations in the studied portfolio (3 of 273). This comparison might be useful for understanding the differences in time and resource allocation issues for sovereign and nonsovereign operations.

### 3. Effectiveness and Sustainability of ADB Supported SOE Reforms

159. **Overall, 61% of sovereign loans and grants by number and 62% by approved amount are effective or highly effective.** Macro-level approaches that were not targeted specifically at SOEs and affected SOE reforms indirectly recorded 54% of operations by number as effective or highly effective, and 57% by approved amount. The other areas of operations that were targeted at SOEs recorded higher proportions of effective and highly effective interventions. Those that provided investment support to SOEs and aimed to improve governance at the sector level and in specific SOEs recorded 65% of interventions by number and 66% by approved amount as effective or highly effective. Sovereign projects that propagated the PPP modality for infrastructure development recorded 78% of interventions by number and 76% by approved amount as effective or highly effective. For NSO support for direct and indirect investment in SOEs, the development results (considered as surrogate for effectiveness) showed 92% success rate by number and 99% by value.

160. **Overall, 58% of sovereign loans and grants by number, and 66% by approved \$ amount are likely or mostly likely sustainable.** Macro-level approaches that were not targeted specifically at SOEs and affected SOE reforms indirectly, recorded 65% of interventions by number and by approved amount as likely or most likely sustainable. In the other areas of operations, the share of loans and grants rated likely or most likely sustainable are: (i) 54% by number and 70% by amount, of projects that provided investment support used to leverage the reform effort and aimed to improve governance at the sector level and in specific SOEs; and (ii) 44% by number and 52% by approved amount, for sovereign projects that propagated the PPP modality for infrastructure development.

161. **The low success rates for effectiveness and sustainability indicate the challenges that ADB has encountered in supporting SOE reforms to date.** The commitment to reform at the highest levels in governments may not be shared at the lower levels of governments and in SOE managements. Capacity limitations also represent a major challenge. Distorted capital structures, weak financial accounting and reporting systems, burden of non-core assets, and PSOs were other challenges to ADB.

162. **The outputs and outcomes of about 50% loans and grants that supported macro-level approaches to improving governance, were effective and sustained in various country contexts.** ADB adopted a programmatic approach in some countries, including Indonesia and Viet Nam. In Indonesia, ADB supported a series of PBLs and TA projects to promote pro-poor growth and broad structural and institutional reforms. Among other measures, the PBLs implemented good corporate governance and risk management standards, particularly in state-owned banks. ADB also helped establish anti-corruption institutions with considerable authority and autonomy; which led to corruption investigations against

government and SOE personnel (Loans 2305 and 2394).<sup>109</sup> In Viet Nam, ADB supported a series of PBLs aimed to reduce poverty, and promote sustainable economic growth by reducing structural weaknesses, promoting private sector engagement, and modernizing governance. One of the key development outcomes of this series of loans was to reform SOEs. Further details are provided in Box 7.

#### Box 7: Successful Support for the Poverty Reduction Program in Viet Nam

Initiated in 2002 by the World Bank, the Poverty Reduction Support Credit (PRSC) was an annual multisector program collectively supported by many development partners, aimed to reduce poverty and promote sustainable growth through economic policies and sector-level measures (i.e., strategies, laws, regulations, and regulatory guidelines). These measures aimed to reduce structural weaknesses, promote private sector engagement, and modernize governance, among others. Asian Development Bank (ADB) joined the PRSC process in 2003, and in 2004, the first ADB policy-based loan to support the PRSC was approved (Loan 2123). Thereafter, ADB provided annual support to the PRSC process. ADB's total estimated contribution was about \$201 million (Loans 2123, 2194, 2262, 2352, 2490, 2570, and 2827).

One of the key development outcomes of ADB support was to reform state-owned enterprises (SOEs). By the end of June 2007, the government was able to reduce its number of SOEs to 2,000, which exceeded the targeted reduction to 2,100 (from around 12,000 in the early 1990s). SOE restructuring plans were implemented, and a decree and an accompanying guideline were issued to transform SOEs to joint stock companies. Several decrees were also issued to support the government's plan to equitize SOEs. In October 2009, the government issued regulations relating to the management of state-owned economic groups (SEGs), which comprised several loosely linked SOEs to a parent company (the SEG). The corporate governance of SEGs was strengthened by introducing a profit-oriented element and stipulating that general directors of loss-making SEGs can be dismissed. Restrictions were also imposed on allowing blood relatives to hold key positions, and remunerations of board of directors. Annual data on SOE performance was to be made publicly available.

There was a significant reduction in the share of bank credit going to SOEs (from 42% in 2001 to 27% in 2007) although it fell short of the target (of 25%). Despite the equitization process, SOE profitability remains low.

Source: ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Socialist Republic of Viet Nam for Support to Implementation of Poverty Reduction Program*. Manila; ADB. 2008. *Completion Report: Support for the Implementation of the Poverty Reduction Program II in Viet Nam*. Manila; ADB. 2008. *Support the Implementation of the Poverty Reduction Program III in Viet Nam*. Manila; ADB. 2009. *Validation Report: Support the Implementation of the Poverty Reduction Program II in Viet Nam*. Manila; ADB. 2013. *Completion Report: Support the Implementation of the Poverty Reduction Programs IV and V in Viet Nam*. Manila; ADB. 2014. *Validation Report: Support the Implementation of the Poverty Reduction Programs IV and V*. Manila.

163. **The outputs and outcomes of about 50% of the loans and grants that supported governance improvements at the sector level and in specific SOEs, were effective and sustained in various country contexts.** ADB has adopted mostly project-based loan and grant modalities, but also deployed PBLs in this area of operations. For example, ADB supported two PBLs to a state government in India, which led to the closure of 15 SOEs and created fiscal space for the state government. (Box 8). In the PRC, ADB extended project loans to support the separation of the government's policy-making and regulatory functions for the railway system from ownership functions of railway line construction, operation and maintenance. With improved commercial practices and cost recovery in these autonomous corporatized entities, ADB thus contributed to a gradual change in government thinking that has led the railway system being run increasingly on commercial lines.<sup>110</sup>

<sup>109</sup> These PBLs were part of the government implemented series of development policy support program, with support from Government of Japan, World Bank and ADB. Other ADB projects in this series are: Loans 2126, 2127, 2488, 2595 and 2723. ADB approved a total of about \$1 billion.

<sup>110</sup> IED. 2007. *Sector Assistance Program Evaluation: Asian Development Bank Assistance for Roads and Railways in the People's Republic of China*. Manila: ADB.

### Box 8: Successful Support for Closures of State-Owned Enterprise in India

India's Government of Assam had been experiencing governance problems, with fiscal drains caused by large subsidies to loss-making state-owned enterprises (SOEs), among others. To help the government address these challenges, Asian Development Bank (ADB) approved a sector development program in 2004, with two subprograms amounting to \$225 million, in total. The program aimed for fiscal consolidation and improved fiscal governance through legal, regulatory, and institutional reforms. Under Subprogram I (Loan 2141, approved in December 2004), the Assam Fiscal Responsibility and Budget Management Act 2005 was passed. This signified the government's strong commitment to eliminate revenue deficits and reduce fiscal deficits.

In 2008, Subprogram II (Loan 2442), with an accompanying technical assistance (TA) project (TA 7129), was approved to further assist the government improve its fiscal management and service delivery through revenue administration, expenditure management, debt management, and SOE closure. With focus on settling SOE-related debt and liabilities, a task force for SOE closure and an asset management cell (AMC) were established. The AMC was responsible for the valuations of SOEs, which helped in the bidding process and disposal of assets. Under the program, 15 SOEs were closed. The government's Department of Public Enterprises offered retirement compensation as per the voluntary retirement scheme (VRS) compensation disbursement guidelines to employees of SOEs that were to be closed. In addition to VRS compensation, with the support of the TA, the program offered counselling, retraining, placement assistance, and business management training to those employees. This labor rehabilitation component of the program helped mitigate the impact of unemployment after the SOE closure and ensured its smooth implementation.

The SOE closure, complemented by other fiscal-related reforms, helped reduce the recurring budget support and improved the overall macroeconomic and fiscal performance of the government. For example, because of the one-time settlement of guaranteed debts of SOEs identified for closure, the government's debt ratio declined significantly.

Source: ADB. 2013. *Completion Report: Assam Governance and Public Resource Management Sector Development Program in India*. Manila; ADB. 2014. *Validation Report: Assam Governance and Public Resource Management Sector Development Program in India*. Manila

164. **However, the outputs and outcomes of about 20% of the effective or highly effective loans and grants that aimed to improve governance at the sector level and in specific SOEs, were less likely to be sustained.** The cases of project loans in Georgia and a TA loan in Viet Nam are illustrative. In Georgia, ADB contributed to setting up a fund for improving municipal services, but insufficient attention to strengthening the fund's capacity to assess credit risk precluded it from functioning as a normal financial intermediary (Box 9). In Viet Nam, ADB provided investment support for expressway projects, but continued low road toll charges prevented the SOE responsible for expressways from becoming commercially viable (TA Loan 2374).

### Box 9: The Challenge of Making Georgia's Municipal Services Fund Financially Sustainable

The Asian Development Bank (ADB) supported the government's strategy for regional development, which included municipal services and infrastructure development. ADB approved two loans with a combined approved amount of \$70 million, in 2008 and 2009 (Loans 2441 and 2534).

The loans were used to fund cost-recovery oriented investments through the central government, and in turn from the municipal development fund (MDF) to municipal governments. The first loan benefited 315,000 people in 30 municipalities. The second loan supported another 38 municipal infrastructure sub-projects. All the subprojects were efficiently executed.

As of 2017, MDF continued to channel government funds and development partner loans and grants to municipalities. This is despite the fact that MDF's long-term strategy was approved in 2011, which intended to make MDF a standard financial intermediary institution that assesses financial soundness of investments, the borrowing entity's financial strength, and other project related risks. Besides, at the time of approving the second loan in 2009, the objective of making MDF financially sustainable was articulated. MDF was thus required to

gradually become less dependent on development partner financing. However, sufficient attention was not paid to capacity development needs of MDF.

Source: ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Georgia for the Municipal Services Development Project*. Manila; ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Georgia for the Municipal Services Development Project-Phase 2*. Manila; and IED. 2017. *Performance Evaluation Report: Municipal Services Development Project and Municipal Services Development Project Phase 2*. Manila: ADB:

165. **The outputs and outcomes of about 50% of the loans and grants that supported infrastructure development using the PPP modality were effective and sustained. Support to NSO clients which are well governed have shown good development outcomes.** ADB provided financial intermediation loans and other project-based loans aimed at supporting the development of PPP projects with SOEs. ADB also supported SOE directly and indirectly (through SPVs) in developing infrastructure projects. For example, in India, ADB supported mainstreaming of PPPs through a series of TA projects, and further on through a series of financial intermediation loans through three MFFs (Box 10). Through NSO modalities, in addition to supporting improved corporate governance standards and other measures that improve performance in its direct and indirect SOE clients, ADB's lending requirements have helped client banks become familiar with international loan documentation standards (Indonesia, Investment 7282), or improved their governance as they increase lending to small and medium-sized enterprises (Sri Lanka, Investment 7269).

#### Box 10: Successful Support to the India Infrastructure Project Financing Facility

To help address the growing demand for long-term resources for India's infrastructure investment needs and catalyze financing for public-private partnership (PPP) projects, the government established the India Infrastructure Finance Company Limited (IIFCL) in January 2006 as a government-owned special purpose vehicle. The government expected IIFCL to be the lead agency for infrastructure financing.

In December 2007, Asian Development Bank (ADB) approved a multitranche financing facility (MFF) comprising two financial intermediation loans to IIFCL (Loans 2404 and 2509) with a total approved amount of \$500 million. ADB approved three additional financial intermediation loans to IIFCL through a second MFF starting in 2009, amounting to \$700 million in total (Loans 2586, 2717, and 2822). These loans were supported by a technical assistance (TA) project (TA 7030) on capacity development for IIFCL. The TA strengthened IIFCL's capacity to undertake independent credit risk assessments of projects, develop an internal credit rating system and continuously improve its risk models. IIFCL also improved risk management frameworks and due diligence processes for subprojects. To continue its support through 2019, ADB approved another MFF with two financial intermediation loans to IIFCL amounting to \$700 million (Loans 3048 and 3307).

By the end of 2014, IIFCL was able to catalyze investments of around \$14.6 billion from the private sector to finance 50 subprojects using the PPP modality.

ADB support to IIFCL benefited from strong partnership among the stakeholders—the government, IIFCL, development partners, banks and financial institutions, and project sponsors, among others. IIFCL's stronger safeguard practices helped ensure effective project implementation, disbursements, as well as reduced subproject risks. IIFCL also reached out to the banks and financial institutions to discuss the environmental and social safeguard framework approach for addressing safeguard issues under the PPP modality. While ADB support helped increase long-term financing for infrastructure projects in India, there is still a need for more innovation in infrastructure financing.

Source: ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to India for the India Infrastructure Project Financing Facility*. Manila; ADB. 2012. *Completion Report: India Infrastructure Project Financing Facility in India*. Manila; ADB. 2013. *Technical Assistance Completion Report: Mainstreaming Public-Private Partnerships at State Level in India*. Manila; ADB. 2013. *Technical Assistance Completion Report: Mainstreaming Public-Private Partnerships at Central Line Ministries of the Government in India*. Manila; ADB. 2013. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to India for the Accelerating Infrastructure Investment Facility*. Manila; ADB. 2014. *Validation Report: India Infrastructure Project Financing Facility*. Manila; ADB. 2014. *Completion Report: Second India Infrastructure Project Financing Facility*. Manila.

166. **Overall, about 30% of sovereign loans and grants were neither effective nor sustainable.** These were mostly loans and grants that aimed to influence macro-level approaches to improving governance, and those that provided sovereign investment support and leveraged governance improvements at the sector level and in specific SOEs. An example is the ADB support to a state government in India, approved in 2009. The state government was facing macro-economic challenges and sought to (among other measures) close three loss-making SOEs, as well as restructure and privatize one SOE each. By project closing in 2015, the restructuring and privatization objectives had not been achieved. The intended outcome of greater fiscal space was also not achieved owing to external factors<sup>111</sup> and the fact that the project design did not consider the limited capacity of the state government (Loans 2536 and 2537).

167. **Appropriately designed monitoring and reporting systems tended to improve the success rates in projects that involve SOE reform measures.** About 70% of ADB projects were rated successful or highly successful when some measures to monitor reform progress were introduced, or when efforts were made to institutionalize monitoring. The share of successful or highly successful ratings fell to about 55% when the ADB project paid no attention to monitoring of reform components.<sup>112</sup> TCRs showed a similar trend: more than 90% of TA projects were rated successful or highly successful if they paid attention to monitoring, compared to less than 75% when monitoring was not considered.<sup>113</sup> This trend can be illustrated by the following operations:

- (i) Projects rated successful or better and where monitoring and reporting systems were set up include: for reporting to donors and management on the status and progress of earthquake relief operations in Pakistan (TA 4730), for improving the stability of the capital market in Bangladesh by strengthening its regulator's surveillance capability to (among other) ensure adequate disclosure and curb insider trading (Loan 2232), for enforcing rules on anti-money laundering and on combating the financing of terrorism in PNG (TA 8515), for strengthening planning and budgeting capacity at the city level in the Philippines (TA 4601), and for monitoring the performance of water supply companies in Viet Nam and thereby prompting these companies to improve their performance (Loan 2272).
- (ii) Projects rated less than successful and where there was insufficient attention to monitoring systems in project design include: a cancelled TA grant component intended to strengthen monitoring of the cooperative credit structure reform to improve its financial sustainability (India: TA 4887 piggy-backed to Loan 2281), the observed need to monitor and follow-up on institutional strengthening of an expressway SOE (Viet Nam, Loan 2374).

<sup>111</sup> Such as: (i) substantial increases in salaries and pensions in keeping with a decision of the central government; (ii) massive food grain subsidy bill; and (iii) continued need to subsidize the poorly performing power utility.

<sup>112</sup> For the purposes of this evaluation, a sovereign loan and grant project is considered to have a monitoring system when it incorporates one or more of the following: the concerned institution conducts regular (mostly annual) reviews and monitoring of its policies, a strategy is developed to help supervise and monitor performance, financial control and full cost recovery mechanisms are among the project activities, improved monitoring is one of the capacity development components, a formal monitoring group or unit is established, internal controls and internal audit departments get involved in the institution's existing monitoring system, and the risk management framework includes the establishment of a committee for measuring or monitoring risks. The success rates are based on: 19 project completion report validation reports (PVRs) of which 13 showed successful or highly successful ratings with a monitoring system, versus 44 without monitoring system, of which 24 were successful or highly successful.

<sup>113</sup> For the purposes of this evaluation, a TA project is considered to have a monitoring system when it incorporates one or more of the following: a study is conducted on resource management and evaluation system, a framework is developed to promote monitoring in real time, capacity is developed for such real time monitoring, a new financial management system is implemented and requisite capacity is developed, a unit is set up for monitoring and enforcing rules on anti-money laundering and combating financing of terrorism, anti-money laundering issues uncovered by internal or external audits are tended to, a comprehensive project appraisal system and risk assessment system is established. The success rates are based on: 11 of 12 TA projects in the five countries selected for case assessments showing successful or highly successful ratings with monitoring system; and 36 of 49 TA projects in the same five countries showing successful or highly successful ratings without monitoring system.

## C. Results

168. ADB's contribution to achieving Reform outcomes and the higher level Sustained and Improved Performance outcomes is discussed for the three areas of operations.

169. **Sustained and Improved Performance of SOEs have required numerous reform measures over several years.** The requisite building blocks, such as legal and regulatory frameworks, and the institutions to successfully implement Reform measures may not be in place or sufficiently strong. Additionally, short-term considerations of governments and other in-country stakeholders and entrenched vested interests have also impeded progress of Reform measures.

170. **The time slice for observing results from ADB interventions captures a subset of the continuum of SOE reforms.** SOE reforms progress unevenly and unfold over several decades. The results of ADB supported SOE reforms normally become discernable after several years, as decisions on improving governance (for example financial accounting and reporting as per international standards) can only be implemented gradually. In this evaluation, however, the results of ADB supported projects are viewed at the time of project closing. IED recognizes that the results could possibly change over a longer time-frame. For example, improved access to financial and infrastructure services, and rising operational efficiencies in providing these services is evident for many (but not all) ADB DMCs from the readily available global databases (Linked Document 8). Whether or not increasing operational efficiencies translate to improved financial performance of the service providers however, depends on many factors—including some that influence the pace and scope of SOE reforms.

### 1. Results from ADB Support for Macro-Level Approaches

171. **ADB projects that supported macro-level approaches embodied a high reform component, but in most projects, few of many policy actions, outcomes, or outputs related to SOE reforms.** To the extent policy actions and design and monitoring frameworks referred to SOE reforms, the extent of ADB support for SOE reforms was limited to formulation and issuance of regulations, and activity that helped implement those regulations was limited to planning. These projects affected reforms in SOEs only indirectly.

172. **ADB interventions that aimed to influence macro-level approaches to improving governance made a modest contribution to Reform outcomes, and a modest contribution to Sustained and Improved Performance of SOEs.** As noted above, the success rate of these projects was around 55%. These projects mostly sought to deliver enabling legal, regulatory and institutional frameworks and capacity development. They supported governments in improving their PFM systems, strengthened anti-money-laundering, helped create an enabling environment for SOE closure, restructuring, privatization, public-private partnerships as well as for moving toward competitive neutrality.

173. **ADB support through macro-level approaches contributed modestly toward improving governance in SOEs.** Even when projects had been rated successful, the stated SOE reform outcomes had not been achieved. The stated SOE reform outcomes were also not achieved for projects rated less than successful. The following examples are illustrative:

- (i) A series of PBLs implemented in Viet Nam from 2007 to 2011, that incorporated a modern governance pillar and policy actions to improve governance and financial management in SOEs was rated successful (Loans 2194, 2262, 2352, 2490, 2570, and 2827). ADB support was focused on the issuance of regulations for improved corporate governance in state economic groups and large SOEs as well as piloting of restructuring plans for selected SOEs. However, a joint World Bank and IMF assessment showed that by 2013, large SOEs had defaulted on their obligations and several other SOEs appeared



to be overleveraged<sup>114</sup>—which might suggest that the government had begun to impose hard budget constraints on these SOEs. However, corporate governance of some of these SOEs had not improved significantly, and borrowing decisions were probably still being made without due regard to their debt servicing capacity.

- (ii) A PBL that aimed to improve governance in the Mongolian banking sector, enhance the role of the non-bank financial sector, reduce the cost of borrowing and improve investor confidence was approved in 2005 and closed in 2010 (Loan 2218). It was rated less than successful because by project closing, regulations and legislations concerning corporate governance of banks and anti-money laundering (among other areas) had either not been implemented or remained weak. In this situation, corporate governance improvements in the state-owned banking sector can be marginal at best (Box 11).

#### Box 11: Modest Progress in Reforming Mongolia's Financial Sector

The Asian Development Bank (ADB) began supporting Mongolia's financial sector in the 1990s. In 1996, ADB supported bank restructuring and development of market-oriented banking sector. This was followed by another loan approved in 2000, which focused on the non-bank financial sector.<sup>a</sup>

Strong growth in the agriculture and mining sectors enabled Mongolia's gross domestic product (GDP) to grow by 10.6% in 2004. To sustain high growth rates over the medium term, the government recognized it was important to continue with financial sector reforms, increase financial outreach and reduce borrowing costs. In response, ADB approved a policy-based loan in 2005 for strengthening the financial sector (Loan 2218), which was accompanied by a technical assistance (TA) project of (TA 4737).<sup>b</sup>

However, by the end of the program in 2010, several legislations and regulatory framework to support corporate governance of banks and the Mongolia Stock Exchange, and anti-money laundering were pending. Consolidated supervision of the banking and nonbank financial sectors by the central bank and the regulator also remained weak. Some of these reforms had been included in previous ADB loan programs as well. The program did not recognize that institutional and human capacities to implement these reforms were limited and the level of ownership low.

<sup>a</sup> Loan 1509/1510: Financial Sector Reform Program (1996) and Loan 1743: Second Financial Sector Program (2000). Both loans were validated as successful.

<sup>b</sup> Attached to ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant to Mongolia for the Financial Regulation and Governance Program*. Manila.  
Source: ADB. 2003. *Program Performance Audit Report: Financial Sector Program in Mongolia*. Manila; ADB. 2007. *Project Performance Evaluation Report: Second Financial Sector Program in Mongolia*. Manila; ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant to Mongolia for the Financial Regulation and Governance Program*. Manila. ADB. 2012. *Completion Report: Financial Regulation and Governance Program in Mongolia*. Manila; ADB. 2013. *Validation Report: Financial Regulation and Governance Program*. Manila;

174. **ADB support at the macro-level contributed modestly toward improving the government's SOE-related financial problems.** ADB supported several PSM and FSD projects that could contribute to addressing the government's SOE-related fiscal concerns. However, even when the projects have been rated successful and the associated SOE reform agenda is explicitly articulated, it has not been supported for implementation or later dropped. For example, in Pakistan, ADB supported capacity development of the Securities and Exchange Commission of Pakistan, strengthened governance of stock exchanges, improved external audit and disclosure by public companies, and provided policy inputs for sequenced sales of SOE shares through capital markets. However, of the intended 10 primary and/or secondary offerings by March 2009, only two additional offerings were made (Loan 2340). In Indonesia, ADB was to initially support the development of a pipeline of SOEs for listing along with deepening of the capital

<sup>114</sup> World Bank. 2014. *Financial Sector Assessment: Viet Nam*. Washington, DC. This assessment was based on joint World Bank and IMF missions to Viet Nam in October 2012 and January 2013.

market from 2007 to 2010, improving market liquidity, improving market surveillance, strengthening overall financial sector risk management, and strengthening governance of stock exchanges. Although the policy action for developing an SOE pipeline for listing was accomplished under subprogram 1 (Loan 2379), no IPOs were conducted under subprogram 2 (Loan 2577). These policy actions were not among the prior action for either subprograms and eventually dropped.

175. **ADB support through macro-level approaches for SOE reform contributed modestly to improving operational efficiency and commercial viability of SOEs.** This is a consequence of the modest contribution of ADB support on Reform outcomes. In this area of operations, projects did not include any specific activities to directly improve operational efficiency or commercial viability of SOEs. For example, in Mongolia, as part of the financial regulation and governance program implemented from 2006 to 2010 (Loan 2218), the capacity development component was aimed at the non-bank finance regulator and a newly established unit in the central Bank which was set up to mitigate risks from money laundering.<sup>115</sup>

176. **The contribution of ADB supported projects through macro-level approaches to increase access to quality and affordable services in the near term was modest.** Improved access to quality and affordable services was not the intended result of projects in this area of operations. These projects did not include an investment component for expanding infrastructure. However, to the extent they sought to develop capital markets or strengthen the financial sector, some improved access to financial services was seen. For example, when surveillance capacity of the securities regulator was strengthened, market manipulation was reduced and listings increased by about 10% over 4 years (Bangladesh, Loans 2232 and 2951).

## 2. Results from ADB Sector-Level and SOE Specific Interventions

177. **While SOE reform was not the primary objective of ADB interventions that financed investments, ADB leveraged these investments to advance the reform effort. These interventions that aimed to influence changes at the sector level and in specific SOEs provided a relatively mixed picture on contributions to Reform outcomes and toward Sustained and Improved Performance of SOEs.** As noted above, more than 60% of these projects are successful. Many of these projects supported investments in expansion and/or strengthening infrastructure and improving the quality and reach of their services. They also sought to deliver in most cases, strengthened independent regulation, rational pricing of public goods services, sector-level restructuring (unbundling), closure or restructuring or partial privatization of specific SOEs. It has taken a long time to create the requisite regulatory capacity in any sector; and given the various social and other political objectives of governments, rationalization of prices to improve financial sustainability of utility services has been a key issue in many countries. Regarding Reform outcomes, the contribution towards improved governance at the corporate and sector level has been modest, while the contribution to improving government's fiscal position has been positive. Regarding Sustained and Improved Performance of SOEs, the contribution to improved operational efficiency and commercial viability has been modest, while to increased access to quality and affordable services has been significant.

178. **The reform component of ADB support contributed modestly to improving governance at the sector level and in specific SOEs and in some cases have had to be buttressed with further investment support.** At the sector level, ADB provided significant support for strengthening financial and infrastructure sector regulations and regulators but the intended measures were seldom fully implemented. For example, as part of a program to improve the sustainability of the Bangladesh power sector, ADB supported a PBL and project loans that became effective in 2007. The PBL closed in 2008 and the project loans closed in 2014 (Loans 2332, 2333, and 2334). The Bangladesh government approved a three-year reform roadmap (which has been subsequently revised), prepared a financial restructuring

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<sup>115</sup> The capacity development component included training on financial regulation, on-site and off-site supervision, on accounting and reporting standards, as well as management information systems that were developed with ADB support.

plan for power sector entities, constituted a board of directors for two newly corporatized power sector entities, and listed two power entities on the local stock exchange. The government also approved an organizational chart for the power sector regulatory body, and the regulatory commission began functioning before the project loan closed. Since then, tariffs have been raised periodically,<sup>116</sup> which indicates the working of the regulatory mechanism of tariff revisions. However, while these measures indicate improved governance at the sector level and of power sector entities, the fact remains that outstanding electricity dues from the government and its autonomous and semi-autonomous bodies have remained significant. To reduce cost of service (and the need to increase tariffs) and to curb non-payment for electricity consumption (such as through pre-paid metering and technology solutions), ADB is providing further investment support. In Pakistan, the concerned provincial government and city government avoided the challenging governance and institutional issues and thus did not find a way to grant independence and autonomy to institutions engaged in improving a megacity's infrastructure. The priorities of the two governments also kept shifting and they could not reach a consensus on a way forward (Loan 2229).

179. **ADB support through sovereign investments contributed positively to improving governments' fiscal positions.** ADB supported the closure of loss-making SOEs, or restructuring or privatization, and this contributed positively to improving the fiscal health of the concerned government. For example, ADB supported the closure of more than 10 loss-making or inoperative state-level SOEs in India and created fiscal space for the state government (India, PBL 2442, TA 7129). In some other cases, although ADB successfully supported closure of one or more loss-making SOEs, it did not achieve the intended outcome of improved fiscal space owing to external factors (Loans 2536 and 2537)—even though it is reasonable to surmise that the government's fiscal position would have been worse without these SOE closures.

180. **Regarding contribution of sovereign investments to Sustained and Improved Performance outcome, the reform component of ADB support contributed modestly to improving operational efficiency and enhancing the commercial viability of SOEs.** In most sovereign operations, operational efficiency improvements are linked to non-reform components; and the contribution of reforms to improving operational efficiency and commercial viability of SOEs is modest on a portfolio basis. Operational efficiency improvements are closely linked to investment in equipment that facilitates the institution of better management practices. For example, in the PRC, equipment procured for improving traffic management and road maintenance and the associated capacity development most likely helped reduce accidents on tolled expressways managed by newly created SOEs with long-term concession agreements (PRC, Loans 2181, 2219, and 2339) (Box 12). Similarly, procurement of modern technology and equipment for signaling, communication, automatic train control, and training in the use and maintenance of this equipment most likely helped improve safety records of newly created rail SOEs (the PRC: Loans 2182, 2274, and 2481). However, if there were no clear associated reforms that provided operational autonomy, it is uncertain whether these performance improvements can be sustained over the long term. In a few exceptional cases, it is highly likely that reform components contributed to improving the SOE's operational efficiency and commercial viability. One is a project where newly corporatized SOEs were granted managerial autonomy that enabled them to make adequate and timely tariff adjustments for water supply as well as increase collection efficiency (Viet Nam; Loan 2272).

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<sup>116</sup> Partly because of the increasing reliance on high cost furnace oil and diesel oil fired generation.

### Box 12: ADB Support for the People's Republic of China's Eastern Sichuan Roads Development

Despite considerable investment in roads in Sichuan province during the 10<sup>th</sup> Five-Year Plan period (2001–2005), Sichuan's road network allowed limited transport access to markets and social services in the mid-2000's. The operational efficiency of the road transport industry remained low, management and maintenance practices of road transport operators needed to be improved. The policy and regulatory frameworks for road transport also needed to be modernized. ADB supported policy reform through a technical assistance (TA) project approved in 2004.<sup>a</sup>

In 2007, ADB approved loan financing of \$200 million for road development in Sichuan province (Loan 2339). The Sichuan Provincial Transport Department (SPTD) was the executing agency responsible for the overall implementation of the project and guiding the local roads component through local governments.<sup>b</sup> The Sichuan Dashaan Expressway Company (SDEC), a state-owned enterprise, was the implementing agency responsible for construction, operation and maintenance of the project expressway. In 2008, SPTD and SDEC signed a concession agreement that ensured the operational autonomy of SDEC.

Staff were trained in expressway commercialization, highway operations and management, tunnel operations and management, intelligent transport systems, financial management, highway maintenance and asset management, tunnel construction and technology, traffic engineering and road safety, and construction risk management. Equipment was procured and installed for road safety, toll collection, communications, traffic management, and vehicle weighing stations.

Road accidents and fatalities in the project area were targeted to reduce by 30% by 2015. The target was exceeded, as injuries and fatalities caused by traffic accidents in the project areas were reduced by about 70% from 2007 to 2012.

By the beginning of 2014, financial performance indicators, such as debt-equity ratio and working ratio targets were achieved. The debt-service coverage ratio of 1.2 was likely to be achieved by 2020 (rather than by 2017, the fifth full year of operations as originally envisaged).

<sup>a</sup> ADB. 2004. *Technical Assistance to the People's Republic of China for Policy Reform in Road Transport*. Manila. ADB has also provided several TAs to the road sector, including advisory TAs on policy and institutional reforms, rural road development strategy, transport pricing, commercialization and corporatization, and mobilization of private financial resources, among others.

<sup>b</sup> The Sichuan Provincial Communications Department, the executing agency was renamed as Sichuan Provincial Transport Department during project implementation.

Sources: ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Eastern Sichuan Roads and Development Project in the People's Republic of China*. Manila; ADB. 2014. *Completion Report: Eastern Sichuan Roads Development Project in the People's Republic of China*. Manila; ADB. 2014. *Validation Report: Eastern Sichuan Roads Development Project in the People's Republic of China*. Manila.

181. **ADB's sovereign investment projects helped to significantly increase access to quality and affordable services, and this is primarily related to investments in expansion and the upgrading of infrastructure and financial services.** Investment support provides ADB a key leverage in advancing the reform effort. For example, in Viet Nam a loan project financed the physical investment to improve rail passenger and freight flows through a border-crossing point, and at completion, noted that traffic throughput on the rehabilitated sections can be optimized if the rail SOE's rolling stock is modernized (which means further investment). The fact that the accompanying institutional reforms component for improving financial management in the rail SOE had been implemented only at the rail SOE's headquarters (and not at the border-crossing point or other parts of the network) was not considered among the primary reasons for not achieving the anticipated improvement in traffic flows (Loans 2302 and 8227).

182. **In the longer term, when more reform related benefits are likely to become apparent, it is likely that access to quality and affordable services will improve.** For example, the benefits from increased autonomy that enable a public utility in Viet Nam to charge full cost recovery tariffs and to adopt measures to reduce public health risks were not realized during the project implementation period, but

will become evident when consumers begin to see the benefit to public health of installing septic tanks and improved drainage. It is anticipated that this will increase consumers' willingness-to-pay and enable the utility to implement full cost recovery tariffs (Loan 2272). Similarly, the benefits from capacity development for improving airport safety and security in PNG are anticipated to become evident after project closing when non-compliance with standards set by the International Civil Aviation Organization reduces, and certification is obtained (Loans 2588, 2589, and 2590).

### 3. Results from ADB NSO and Sovereign Projects that Propagate the PPP Modality

183. **NSO projects and sovereign projects that propagated the PPP modality for developing new infrastructure recorded high success rates.** These projects have shown high success rates of 86% by number and 90% by approved amount. Nearly two-thirds of NSO projects in the portfolio of operations invested in SOEs indirectly, and whether governance improvements that resulted from ADB support benefited the parent SOE was not a consideration at the project design stage.

184. **Given the stronger governance and operational efficiency of PSOD's direct and indirect SOE clients, ADB's contribution to the clients' corporate governance and operational efficiency is modest, while to improving governments' fiscal positions and access to quality services are positive and likely sustainable.** Through NSO modalities, ADB has delivered investment projects that have contributed to improved compliance to higher standards for environment and social safeguards, as well as introduced technologies not previously tried in the country, demonstrated PPP for infrastructure development, and demonstrated the viability of long tenor financing for infrastructure projects.

185. **With regard to contribution to Reform outcomes, PSOD's direct and indirect SOE clients are normally well governed and provided ADB with only limited opportunities for improving governance. Therefore, ADB support contributed modestly to improving their governance.** However, some examples show that such improvement is possible. PSOD supported governance improvements in two direct SOE clients in the PRC: (i) by incorporating a corporate governance action plan as a covenant and supporting training of the client's board (Investment 7316); and (ii) by providing TA support to enhance the client's corporate governance system (Investment 7377). PSOD also influences governance improvements when it acquires an equity stake in the client company and takes a board position (as for two direct and one indirect SOE clients). The extent PSOD helped improve governance in its indirect SOE clients, and whether or not any improvements flowed back to the parent SOE, was not well captured in the results framework design.

186. **ADB support in this area of operations contributed positively to improving the governments' fiscal positions.** Most NSO projects have contributed to improving government finances and fiscal positions. These included projects where PSOD helped raise equity and mobilize cofinance on parallel or lender-of-record basis. Where PSOD facilitated transactions, it may also have been supporting subsequent financings from the market. For example, In the case of Powergrid, a NSO project helped establish a benchmark for foreign commercial borrowing. A few years later Powergrid succeeded in raising \$500 million through its first international bond issue—although the extent ADB contributed to the success of the bond issue is not documented. Additionally, some NSO projects that have demonstrated their value may also be replicated by SOEs that seek to raise financing without government guarantees or budgetary assistance, and thus further contribute to improving governments' fiscal positions.

187. **With regard to contribution to Sustained and Improved Performance of SOEs, ADB supported NSO projects contributed modestly to improving SOEs' operational efficiency or enhancing their commercial viability.** For NSO, where the clients are normally well governed, efficiently operated and commercially viable, the outcome of ADB support in terms of improving operational efficiency and commercial viability of the client is modest from a portfolio perspective. However, there are few examples where ADB made a significant contribution, one being PSOD assistance for reducing energy consumption in pilot wastewater treatment and reuse plants (PRC, Investment 7392). Another was the implementation

of pilot projects that provided energy efficiency solutions to industrial and other energy users, and helped the direct SOE client expand its business (Indonesia, Investment 7327).

188. **NSO projects contributed significantly to increasing access to quality and affordable services. These improvements were directly related to investment support and not to Reform efforts.** Given the stronger governance systems of these clients, the performance is likely sustainable. NSO projects that demonstrated new technologies (not previously tried in the country) and helped to improve air and water quality, reduce wastage and increased recycling, and introduce climate friendly clean technologies contributed to improved access of quality services. NSO projects that demonstrated the viability of long tenor financing for infrastructure development, and the benefits of compliance to higher standards for environment and social safeguards also had a positive impact. These included several ADB investments in PRC, such as municipal gas infrastructure (Investments 7244 and 7316) and waste-to-energy (Investments 7368, 7369, 7377, and 7512) projects that helped to improve urban air quality through expanded use of clean fuels and expanded clean energy generation respectively. ADB also supported improved and expanded water supply and wastewater management in the PRC's less-developed towns and rural communities (Investment 7455), integrated wastewater management concessions that incorporated sludge treatment, sewage conveyance and interceptor pipelines as well as civil works such as dredging of rivers and lakes, construction of riverbank reinforcements, provision of odor treatment, and landscaping (Investment 7491), and river clean up and increased reuse of wastewater (Investment 7310 and Loan 7375). In India, ADB supported city gas distribution investments in selected urban areas to improve urban air quality and support the government's reform objective of making the natural gas industry competitive and market oriented (India, Investment 7227).<sup>117</sup>

189. **Results of sovereign loans that supported a wide variety of infrastructure projects using the PPP modality can be inferred from project documents only for the Reform outcome of improving the governments' fiscal positions.** The fact that financial intermediaries and executing agencies have leveraged significant amounts of private capital in developing PPP projects indicates prima facie their positive contribution to improving the governments' fiscal positions. However, project documents provide no insights into contingent liabilities that might arise for the governments. For example, in India, \$500 million from ADB catalyzed private sector investments of about \$5.5 billion to finance 30 subprojects (Loans 2404 and 2509), and another \$700 million leveraged about \$9.1 billion of private capital for 20 projects (Loans 2586, 2717, and 2822). Documents for these projects provided no information on subproject structures and risk-sharing arrangements, or an assessment of the governments' contingent liabilities. For positive results from these loans to be sustained and multiplied, it will be important to address the underlying risks of weak regulation, insufficient autonomy, poor project supervision capability and market risks, as well as develop the long-term domestic debt market. Project documents also did not provide information on governance improvements and the extent to which PPP projects or subprojects improved access to quality and affordable services.

## D. Organization for Strategic Articulation and Delivery

190. ADB is in the process of improving internal coordination within and between departments, but there is no efficient coordination mechanism for strategizing and guiding ADB's engagement with and reform of SOEs.

191. **As part of the One-ADB approach, the interface between ADB headquarters and various resident missions and other offices is improving.** Governments of countries selected for case assessments consider that ADB is responsive, which implies there is a good (or improving) interface with ADB, and which is facilitated by resident missions. However, there is room for improvement in certain cases, for example,

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<sup>117</sup>This ADB project prompted investments in city gas distribution systems in several other cities in India, by other private sector (or joint ventures between private and public sector) players. The sector regulator has also proceeded to set up a competitive regulatory environment for city gas distribution.

the PSDI will benefit if ADB can designate staff at headquarters who can directly engage with and be responsible for providing strategic guidance and leadership to PSDI.

192. **The One-ADB approach has also improved coordination between PSOD and various regional departments. Some projects are being jointly developed, but many challenges remain.** There is an opportunity to design structured arrangements that gradually transition SOEs from being sovereign-dependent to becoming more financially viable and to begin raising long term capital on commercial terms. This can be done through a package of reform-based sovereign loans eventually leading to NSO support. ADB is also now working to create a pipeline of projects which PSOD and the relevant regional department will jointly process. The coordination and cooperation that is required is essentially about using different but complementary skills sets and aligning incentives in order to offer the best solutions to the clients. ADB also needs to avoid sending mixed signals in the market, when ADB delivers a combination of sovereign and NSO financing commitments, for it is perceived within ADB that borrowers try to maximize ADB's commitment for support and then prioritize use of lower-priced sovereign support.

193. **There is no efficient coordination mechanism that can strategize and guide ADB's macro-level operations, sovereign investments that leverage SOE reforms, and NSO investments.** Many divisions within the operations departments support projects that are not primarily intended to reform SOEs, although they support specific reform measures at the macro and sector levels as well as for specific SOEs. While the One-ADB approach has helped improve coordination within and between departments, the present system does not facilitate the articulation of a strategic approach to reforms in a given country context. An efficient coordination mechanism with a dedicated group of experts on SOE reforms does not exist for guiding ADB operations departments toward a more strategic approach, have the mandate for doing so, take ownership of articulating such a strategic approach, be headed by an expert of sufficient seniority, be backed by a knowledge base and partnerships with other centers of excellence on SOE reforms, participate in the CPS process, and provide advice on specific operations.

## E. Summary

194. More than 50% of the identified portfolio had been self-evaluated by June 2018, and about 20% had been independently evaluated or validated. The portfolio of evaluation consisted of more than 80 sovereign loans and grants and 10 NSO projects, that have been independently assessed.

195. Overall, 59% of loans and grants and 92% of NSO projects were rated successful or highly successful in independent assessments. The success rate for sovereign loans and grants was significantly below the overall success rate of loans and grants closed in recent years and independently assessed (76% in 2014–2016; 74% in 2015–2017). The success rate of the NSO portfolio of evaluation exceeded the overall success rates during recent years (58% in 2015–2017).

196. The poorest performance was registered at the macro-level, while the strongest in NSO operations supporting SOEs. Operations intended to influence macro-level approaches to improving governance recorded a 54% success rate. Interventions for strengthening sovereign investment and improving governance at the sector level and in specific SOEs showed a success rate of 61%. Finally, the highest performance levels were recorded in investments in SOE through NSO instruments (success rates of 92%) and sovereign projects propagating the PPP modality for infrastructure development (success rates of 78%).

197. Governments appreciate ADB's broad-based approach in furthering SOE reform through the three areas of operations. Government interest in pursuing SOE reforms is enhanced when expected benefits from SOE reforms reinforce the government's other higher objectives. While governments are likely to retain controlling or influencing ownerships over some SOEs for various reasons, they have also encouraged one or more of their SOEs to raise investment capital without sovereign guarantees.



198. Given the long-term nature of SOE reform, it would have been desirable for ADB to have taken special measures to track the ADB supported SOE reform measures that extended beyond the typical project timeline.

199. Stakeholders in the countries selected for case assessments have indicated that ADB has responded well to their strategies and priorities; and some have also suggested ways for further improvement. There is significant opportunity for improving ADB efficiency in delivering SOE reform. The cancellation ratio of NSO projects supporting SOEs directly or indirectly is significantly higher than for sovereign loans and grants.

200. The outputs and outcomes of about 50% loans and grants that supported macro-level approaches to improving governance, were effective and sustained in various country contexts. Likewise, outputs and outcomes of about 50% loans and grants that supported governance improvements at the sector level and in specific SOEs, were effective and sustained. The outputs and outcomes of about half the number of loans and grants that supported infrastructure development using the PPP modality were effective and sustained. Support to NSO clients which are well governed have shown good development outcomes.

201. ADB interventions that aimed to influence macro-level approaches to improving governance affected the governance of SOEs indirectly. These interventions made modest contributions to Reform outcomes and to Sustained and Improved Performance of SOEs.

202. ADB interventions through sovereign investments that were leveraged to advance the reform effort and that aimed to influence changes at the sector level and in specific SOEs provided a relatively mixed picture on contributions to Reform outcomes and toward Sustained and Improved Performance of SOEs. Regarding Reform outcomes, the contribution towards improved governance at the corporate and sector level was modest, while the contribution to improving government's fiscal position was positive. Regarding Sustained and Improved Performance of SOEs, the contribution to improved operational efficiency and commercial viability was modest, while to increased access to quality and affordable services was significant.

203. ADB supported NSO projects contributed modestly to improving the governance of their clients, although they contributed positively to improving the governments' fiscal positions. ADB supported NSO projects also contributed modestly to improving operational efficiency and significantly to increasing access to services.

204. Sovereign loans that propagated the PPP modality for infrastructure development have, *prima facie*, contributed positively to improving the governments' fiscal position. Project documents do not provide information on contingent liabilities that might arise for governments, or governance improvements and improved access through these investments.

205. ADB is in the process of improving internal coordination within and between departments, but there is no efficient coordination mechanism that can help to strategize and guide ADB's engagement with SOEs and support for SOE reforms.

# 4

## CONCLUSIONS, ISSUES, LESSONS, AND RECOMMENDATIONS



## Highlights

- SOE reform is challenging but critical.
- ADB support tends to be within the parameters defined by governments and in line with its own strategies and policies.
- ADB needs to consider both external and internal issues as it strives to improve its SOE reform interventions and to implement Strategy 2030.
- A key lesson that cuts across all areas of operations is about the need for ADB to have a well-coordinated approach to improve ADB's effectiveness in supporting SOE reforms.
- Four recommendations are made with a view to providing guidance to the ADB Board and Management on implementing SOE related aspects of Strategy 2030 as well as improving ADB performance and the results from its support for SOE Reform and Sustained and Improved Performance.

206. This chapter provides the conclusions from this evaluation, and the key issues raised. It also offers recommendations for addressing these issues.

### A. Conclusions

207. The evaluation's conclusions are based on the findings from the global literature review, the Asian and Pacific experience to date, ADB's performance in supporting SOE reforms and on-the-ground results achieved in improving SOE performance.

208. **SOE reform is challenging but critical.** The following is noteworthy:

- (i) Even where governments have shown a high level of commitment over the past 2 or 3 decades and have made significant progress in reforming SOEs, entrenched vested interests have come in the way from time to time.
- (ii) The resources and capacity required for good corporate governance can be daunting. For example: a country may need to create suitable legal and regulatory frameworks and the institutions to implement them for which it may not have the necessary capacity. It may also not have enough expertise to draw on for board and senior management positions, nor the expertise to restructure or privatize SOEs.
- (iii) Reform is necessary because business-as-usual approaches where inefficient and loss-making SOEs continue to be subsidized is simply not sustainable. In many developing and emerging market countries, SOEs have contributed to governments' fiscal crises or to national debt crises. Many transition countries have found it difficult to sustain their SOEs without massive subsidies. In Asia in particular, although poor SOE performance may not have precipitated the Asian financial crisis in 1997, SOE reform was an essential component of the recovery program. Increasingly, it appears that governments realize that reforming SOEs is also a path to achieving their other overarching national objectives.

209. **SOE reforms are influenced by many factors and have progressed at an uneven pace even when governments have remained committed over prolonged periods.** Positive outcomes are often discernable only in the medium-to-long term, i.e. significantly after the life cycle of a typical ADB project. Many governments have set some criteria for identifying SOEs that must remain within government ownership and control. The willingness of governments to undertake SOE reforms is heightened during crisis periods. ADB needs to engage continuously and intensively in a policy dialogue, providing analytical support and scenario analysis to show the need for pursuing reforms even during non-crisis periods. A possible exception is when governments consider that reformed SOEs can better help achieve their other overarching objectives. A good understanding of the government's overarching objectives as they evolve

is needed. This reinforces the need for continuous policy dialogue, to shed light on the type of reform measures that might gain traction more easily.

210. **While ADB support tends to be within the parameters defined by governments and in line with its own strategies and policies, ADB has underemphasized several aspects.** Governments pursue SOE reforms from multiple directions and ADB has responded by implementing initiatives in all three areas of operations: macro-level approaches to improving SOE governance, sovereign investments that leverage reform for improving governance at the sector level and in specific SOEs, and investments through NSO and sovereign projects propagating the PPP modality for infrastructure development. However, ADB has emphasized less on improving government oversight of SOEs, addressing board level issues, improving accountability mechanisms in infrastructure SOEs, making SOEs eligible for raising long-term capital on commercial terms, conducting SOE diagnostics, and reforming SOEs engaged in manufacturing.

211. **ADB's performance in supporting SOE reforms has been mixed.** ADB's interventions were relevant in most cases, and were effective, efficient and sustainable in about 60% of cases, but sustainable in about 57% of the cases. The following broad conclusions can be drawn:

- (i) Even where intended outputs and outcomes for influencing macro-level approaches to improving governance were achieved and sustained, the link to improved SOE governance and performance improvement was difficult to establish, in part due to a lack of proper results indicators.
- (ii) While ADB's investments to leverage the reform effort and to support governance improvements at the sector level and in specific SOEs have influenced SOEs' performance, it is not clear how sustainable these gains are. In most cases, SOE performance was closely linked to direct investment that did not address the reform components which are indispensable for the sustainability of the intended outcomes.
- (iii) ADB's NSO clients are normally well governed and efficient, although ADB has supported corporate governance improvements in a few cases. Therefore, NSO investments have had a positive and likely sustainable impact on fiscal positions and Sustained Performance.
- (iv) As ADB does not monitor progress of its interventions beyond project closing, it is difficult to ascertain whether ADB supported reform measures have been replicated by the beneficiary SOEs or by other SOEs in the same sector. Similarly, it is difficult to ascertain whether the reform measures have been sustained.

212. **The time slice for observing results from ADB interventions captures a subset of the continuum of SOE reforms.** The results could improve over a longer time-frame.

213. **Regarding contribution of ADB support to SOE Reforms,** ADB support has contributed modestly to improving governance in SOEs in all three areas of operations. With respect to addressing governments' SOE-related fiscal problems, the contribution of ADB support for macro-level approaches has been modest, while it has been positive for sector-level and SOE-specific interventions, as well as for NSO interventions and sovereign projects that support infrastructure development using the PPP modality. However, this positive result was due largely to the investment component, which effectively reduced the need for financial support from governments, although not necessarily in a sustainable manner.

214. **Regarding contribution of ADB support to Sustained and Improved Performance of SOEs,** ADB support contributed modestly to improving operational efficiency and commercial viability of SOEs in all three areas of operations. Toward improving access to affordable and quality services, however, the contribution of ADB support for macro-level approaches was modest, while it was significant for sector-level and SOE-specific interventions as well as for NSO projects. This is related to the investment components of these interventions and not necessarily to Reform outcomes.

215. **The results-based lending (RBL) modality, which was introduced in 2013, can be considered for furthering SOE reforms.** ADB has used the RBL modality where there are clearly defined expenditure frameworks, and the accompanying governance and capacity development frameworks are small. As RBL disbursements are linked to progress in reaching intermediate or final milestones, the RBL modality could be considered for supporting government investment programs that have a significant component for maintenance and upkeep of existing SOE assets, to improve their operational efficiency and commercial viability.

## B. Issues

216. ADB would need to consider many issues, both external and internal, as it strives to implement the corporate strategy to 2030. These issues are inter-related and indicate that reforming SOEs is challenging for governments and ADB alike.

### 1. External Issues

217. The key external issues are closely related to the political-economy of countries, which ADB needs to recognize political-economy issues as part of its risk management framework.

218. **In spite of political commitment, resistance and vested interest within governments and SOEs slows down the progress in implementing SOE reforms.** Political and myriad other considerations strongly influence government commitment and priorities for reforming SOEs. In many countries, governments have found it difficult to sustain the reform momentum over extended periods of time and have had to find politically savvy ways to steer the reform effort and manage vested interests. The vision of the top-level decision-makers may not be shared by the majority of government officials and SOE management and employees, as well as the public at large. Short term considerations and priorities have often come in the way.

219. **The vast range of measures required to reform SOEs and improve their performance poses a big challenge to governments and SOEs.** Financial and human resources required are seldom readily available, and the trick is to figure out a workable approach given the political-economy considerations.

220. **Soft budget constraints—no matter how justifiable they are for SOEs in infrastructure and other public goods sectors—reduce the incentive of these SOEs to reform.** Governments in most countries have sought these SOEs to perform certain public services that are not commercially viable, as well as imposed certain costs on them (for example, in terms of increasing employment) to help meet their social and political objectives. However, these governments have also often chosen to support SOEs through fiscal transfers (which governments find difficult to sustain indefinitely) and/or directed credit (which has contributed to the high incidence of NPLs and adversely affected the banking sector in many countries). These are among the factors that diminish the incentive for SOE managers to institute reforms and improve performance.

### 2. Internal

221. The key internal issues refer to ADB systems and practices that need to be improved. Internal issues tend to influence ADB's performance across all areas of operations.

222. **Project completion documents do not provide sufficiently granular information to enable assessment of the SOE reform component alone.** This issue cascades down to IED's validation and evaluation documents. It is noted that: (i) the ratings of projects that support macro-level approaches to improving governance reflect performance of all ADB supported reform measures and not just those pertaining to reform of SOEs; (ii) the ratings of sovereign projects that largely support investments and also incorporate measures for improving governance at the sector level and in specific SOEs are a

composite for the entire scope of the project, which is largely investment related; and (iii) similarly, the ratings of sovereign projects that support infrastructure development using the PPP modality, as well as ratings of NSO projects that support SOEs directly and indirectly, are largely related to the investment component.

223. **ADB support is not sufficiently strategic or well-articulated.** While this evaluation has developed a framework to understand the logic of ADB's interventions, the reality is that the three areas of operations explained here and their intended outcomes are not clearly spelled out or articulated to DMC governments and other stakeholders. Nor are interventions in the three areas of operations deployed in a coordinated manner.

224. **ADB's organizational mechanisms do not allow it to articulate and deliver a more strategic reform program.** There is no efficient mechanism with a mandate for strategizing and formulating a coordinated approach to delivering reforms, and with a dedicated group of experts on SOE reforms, backed by a good in-house knowledge base and partnership arrangements with other centers of excellence on SOE reforms.

225. **ADB has not paid adequate attention to important and strategic issues.** These include the strengthening of governments' oversight mechanisms and addressing concerns about SOEs' boards of directors.

226. **ADB has not paid sufficient attention to reforming SOEs engaged in manufacturing.** Manufacturing remains an engine of growth in middle-income countries. Where governments allow competition, the performance of manufacturing SOEs remains below that of private sector counterparts. Governments continue to attempt to restructure and privatize these SOEs to improve their productivity and competitiveness. These SOEs are also less encumbered by PSOs, and ADB could begin by assessing the opportunity for supporting manufacturing SOEs for reform (sovereign modalities), and investments (both sovereign and NSO modalities).

227. **ADB has not emphasized the need to improve accountability mechanisms in infrastructure SOEs.** This is despite the fact that accountability measures are a basic building block for good governance.

228. **ADB has not emphasized governance risk assessments in target SOEs.** Governance risk assessments at the country, sector and project levels focus largely on PFM, procurement and corruption. Besides, project documents provide high-level information such as government's major concerns and approach to reforming SOEs, and issues faced by SOEs. Issues related to board composition and functioning, and to accountability mechanisms are not analyzed for target SOEs.

229. **ADB does not tag projects for SOE reform in finance, infrastructure and other sectors apart from PSM.** This makes it difficult to identify operations that support and seek to advance SOE reforms. Tagging for SOE reforms will be an important part of creating an in-house knowledge base. ADB is now in the initial stages of creating a knowledge base on SOE reforms.

230. **ADB does not record the progress of implementing reforms during project implementation periods in a central database.** Although ADB has a central database covering progress in implementing project based sovereign loans and grants, it does not cover reform components. Likewise, there is no system of recording the progress of reforms that were supported through policy-based loans and TA projects in a central database.

231. **ADB does not track outputs and outcomes of reform measures beyond project closing dates.** Given that SOE reform is a process that goes far beyond typical ADB project implementation periods, tracking of reform progress beyond project closing dates—although difficult—can be useful for gauging the extent to which reforms have been achieved and sustained, and also replicated and mainstreamed.



232. **The extent to which PSOD has helped improve governance in SPVs, and whether any gains made have flowed back to the parent SOE has not been well captured in results frameworks.** The flow-back of institutional systems and practices from a well-governed SPV to the parent SOE is a development objective worthy of pursuit.

### C. Lessons

233. Lessons are drawn from the viewpoint of improving ADB's performance in supporting SOE reforms across all areas of operations.

234. **Well-coordinated operations at the macro-level, sovereign investments which leverage SOE reforms, and NSO support to SOE clients can improve ADB's effectiveness in supporting SOE reforms.** A coordinated approach, which can be facilitated by a central unit, will enable ADB to address SOE reform issues more comprehensively and provide well-articulated strategic direction to governments.

235. **Improved government oversight mechanisms tend to improve the governance and performance of SOEs.** A government's SOE oversight mechanism reflects the way it prefers to exercise its ownership rights; and governments have been trying to find workable mechanisms given their specific political and economic landscapes, and institutional and historical factors. The improvement in oversight mechanisms need not necessarily involve instituting a new oversight mechanism, but rather improving upon the existing skill-sets, performance monitoring metrics, database management systems and coordination among organizations that are engaged in the oversight responsibility.

236. **Addressing board issues improves the governance and performance of SOEs.** Improving accountability mechanisms is a necessary but not sufficient condition for improving SOE governance and performance. This reflects the centrality of the role played by the board of directors of an SOE. Board level issues can be addressed both at the macro-level as well as in specific SOEs. These board level issues are related to independence of boards, presence of requisite skills sets at the board level, functioning of board committees, and quality of information provided to and available to boards for decision-making.

237. **Appropriately designed monitoring and reporting systems contribute to the success in implementing SOE reform measures.** The success rates of projects with attention to monitoring and reporting was higher than for projects that did not emphasize monitoring and reporting. This is seen for projects that aimed to improve governance through macro-level approaches, at the sector-level and in specific SOEs.

238. **Strengthening sector regulatory framework and oversight is important for sustained and improved performance of infrastructure and financial sectors.** The design of sector regulations, the strengthening of regulatory capacity and enabling regulatory compliance are all measures that help improve governance and performance of regulators and sector institutions, including SOEs in the sector.<sup>118</sup>

239. **ADB's additionality is important for ADB's direct and indirect SOE clients that borrow without sovereign guarantees.** In line with ADB's developmental role, the desired ADB additionality can come from better corporate governance as well as demonstration of new technology, processes and financing structures/modalities.

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<sup>118</sup> Regulation of electricity, gas and water utilities basically addresses the natural monopoly situation of these utilities and substitutes for economic forces that come into play in a competitive market. However, even when some of the unbundled subsectors are amenable to competition in the sense that multiple players provide the same goods or services, the participants need to be regulated in most developing member countries. In the financial sector, an efficient and effective banking sector requires adequate regulatory and supervisory capacity, and a regime capable of dealing with firm failure and NPLs. Capital markets also need to be properly regulated to provide stability to the markets, protect customers and tax payers, and spur economic growth and development.

240. **Good risk management systems in executive and implementing agencies are necessary for developing infrastructure projects using the PPP modality.** This is in line with the basic justification and rationale for developing and investing in infrastructure through the PPP modality (i.e. reducing public sector investment needs, for which it is necessary to keep contingent liabilities on the government within manageable limits).

## D. Recommendations

241. Given below are four recommendations for ADB to consider. These recommendations are intended to provide guidance to the ADB Board and Management to improve ADB performance as well as results from its support for SOE Reforms and Sustained and Improved Performance, and to contribute toward implementing the corporate strategy to 2030.

242. **Recommendation 1: Address SOE reform issues more comprehensively, strengthen the provision of well-articulated strategic direction to governments, and use the country partnership strategies process for articulating country relevant approaches in project design.** Reforms call for interventions at the macro level, sector level and in specific SOEs, and are inherently complex and sensitive issues for governments, SOEs and other stakeholders. The discussion on SOE reform with governments at a high level will require continuous and intensive policy dialogue that is supported by analysis of issues relevant to fiscal management, competition policy, corporate governance practices as well as SOE operational and financial performance. It is anticipated that the proposed high-level engagement with the government will go beyond the traditional CPS country programming process and also cover program / project design aspects.

243. **Recommendation 2: Strengthen the capacity of the existing SOE Working Group to enable proper articulation of strategic approaches to SOE reforms and guide bank-wide SOE engagements for effective implementation.** This will require dedicated SOE reform experts that are facilitated and enabled by inhouse knowledge bases, and access to sector expertise through partnership arrangements with centers of excellence. The Working Group will provide knowledge inputs to operations departments, guide operations departments in project design, and participate in high-level policy dialogue with governments.

244. **Recommendation 3: Improve significantly the monitoring and reporting of ADB supported SOE reform measures.** At present, ADB records progress in implementing only investment components of project-based loans and grants until project closing; and reform components of project-based loans and grants are not covered adequately in their completion reports. ADB should record in a central database, progress on reform components of project-based loans, policy-based loans, results-based loans and TA projects until project closing. Significant improvements (such as by designing suitable indicators for various reform areas) are also required to enable ADB to monitor reform outcomes that normally become discernable after project closing. Where such monitoring is difficult for each and every specific project, it is suggested that a macro-level or sector-wise approach be adopted. The CPS country programming and policy dialogue processes can be used to gauge the extent ADB supported reforms have been sustained, replicated and mainstreamed. By incorporating SOE reform indicators in the corporate results framework, ADB will be able to better monitor at the corporate level, its contribution to reforming SOEs in line with Strategy 2030.

245. **Recommendation 4: Refine the project classification system to enable better tagging of SOE reforms in all sectors and enhance ADB's knowledge base.** The introduction of SOE reform as a subsector under PSM in the project classification system that came into effect in 2014, enabled tagging of projects classified under PSM sector. A further revision to enable tagging for SOE reform in finance, infrastructure and other non-PSM sectors would be a useful building block for expanding ADB's knowledge base on SOE reforms. This knowledge base should provide easy access to knowledge embedded in project design and completion documents, as well as consultant reports, and should enable collation and analysis. It

should help ADB in preparing specific knowledge products that enable high-level policy dialogue with governments, and for knowledge dissemination amongst governments and project beneficiaries. Some such knowledge products could be benchmarking studies and lessons from ADB support for SOE reforms in given macro and sector contexts.



# APPENDIX

## APPENDIX: LIST OF LINKED DOCUMENTS

1. Evaluation Components and Methods  
<https://www.adb.org/sites/default/files/linked-documents/1-Evaluation-Components-and-Methods.pdf>
2. Global Experience with State-Owned Enterprises Reforms  
<https://www.adb.org/sites/default/files/linked-documents/2-Global-Experience-with-SOE-Reforms.pdf>
3. Political and Economic Landscape of Countries Selected for Case Assessments  
<https://www.adb.org/sites/default/files/linked-documents/3-Political-and-Economic-Landscapes.pdf>
4. Loans, Grants and Technical Assistance Portfolio  
<https://www.adb.org/sites/default/files/linked-documents/4-Loans-Grants-and-TA-Portfolio.pdf>
5. Nonsovereign Operation Projects  
<https://www.adb.org/sites/default/files/linked-documents/5-Nonsovereign-Operation-Projects.pdf>
6. Case Studies: Historical Backdrop to Nonsovereign Interventions  
<https://www.adb.org/sites/default/files/linked-documents/6-Historical-Backdrop-to-Nonsovereign-Operations.pdf>
7. Evaluation Portfolio with Ratings  
<https://www.adb.org/sites/default/files/linked-documents/7-Evaluation-Portfolio-with-Ratings.pdf>
8. State-Owned Enterprises Performance Improvements  
<https://www.adb.org/sites/default/files/linked-documents/8-SOE-Performance-Improvements.pdf>