

OECD Review of the Corporate Governance of State-Owned Enterprises in Bulgaria



The OECD Review of Bulgaria describes and evaluates the corporate governance framework of the Bulgarian state-owned enterprise (SOE) sector relative to the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “SOE Guidelines”). It was prepared at the request of the Republic of Bulgaria with the purpose of being recognised as an Adherent to the SOE Guidelines.

More generally, the SOE reform in Bulgaria is motivated by Bulgaria’s ambition to join the European ERM-II exchange rate mechanism and Banking Union. In this context, Bulgaria engaged to implement a number of commitments in relevant policy areas, including improving the governance of SOEs by revising and aligning national legislation with the SOE Guidelines. The project was supported financially by the European Union Directorate General REFORM

In parallel with developing this Review, the OECD also actively supported Bulgaria’s legislative and institutional reform efforts by providing administrative and technical support in developing the new “Law on Public Enterprises” which was adopted on 26 September 2019 and promulgated by Decree No.79 on 8 October 2019. The new Law addresses the main vulnerabilities in state ownership practices in the SOE Review and establishes the legislative foundation for stronger ownership coordination and monitoring; more independent, qualified and transparently-nominated boards of directors; improved disclosure at both the level of individual enterprises and the level of the state; and a more level playing field with private companies through the foreseen phasing out of the separate legal form of “state enterprises” for SOEs that are engaged in commercial activities.

Based on the consideration that Bulgaria had adequately addressed its priority recommendations, the OECD Council officially accepted Bulgaria’s request for adherence to the SOE Guidelines in December 2019. As a next step, the Bulgarian authorities have been invited to consider the following conclusions and recommendations in view of strengthening recent legislative achievements.

The Conclusions and Recommendations of the Review are reproduced on the following pages.

CONCLUSIONS AND RECOMMENDATIONS

(Part III of the OECD Review of Bulgaria)

With the adoption of the Law on Public Enterprises on 26 September 2019 – the Bulgarian authorities took an important step towards aligning their state ownership practices with the standards of the SOE Guidelines. Over the past decade, Bulgaria had already undertaken some steps to clarify the state's expectations of SOEs and professionalise ownership practices. These include notably: the elaboration of several whole-of-government policy documents outlining the respective responsibilities of state bodies and boards *vis-à-vis* SOEs and establishing some – albeit quite limited – standards for SOEs' corporate governance; improvements in SOE monitoring through requirements for regular reporting to the Ministry of Finance; and the widespread use of business programmes introducing greater clarity, at least within the state administration, regarding SOEs' financial performance and operations.

Although the new legislation will not address all of the ownership and corporate governance vulnerabilities affecting Bulgarian SOEs, it can be expected to establish a solid legislative foundation to implement Bulgaria's most urgent related policy and institutional priorities, as identified in this review. Its outcome will, however, depend to a large extent on the effective and practical implementation of the Law. Hence, as a near-term priority, all relevant Bulgarian public authorities (including, where applicable, Municipal Councils) should ensure implementation of the Law on Public Enterprises by developing the necessary implementing rules of the law, in coordination with the Public Enterprises and Control Agency, within the deadlines established by the Law. In this regard, the OECD encourages the Bulgarian authorities to continue working with the Working Party and its Secretariat to ensure continued alignment with the SOE Guidelines.

Near-term priorities

In particular, the implementation phase should focus on:

- *Empowering the Public Enterprises and Control Agency.* Bulgarian authorities should ensure that the new coordination unit is effectively empowered to operate as an autonomous and independent body by ensuring that (1) its executive management is subject to a well-structured and competitive recruitment procedure, and (2) it is equipped with the necessary resources (in terms of finance, staff and institutional authority) to effectively carry out its functions of policy development (in coordination with other government bodies), monitoring of implementation and public reporting. While Bulgarian authorities have indicated that the agency is sufficiently resourced to effectively undertake its functions, there are concerns that the agency might lack autonomy as it will be operating as a “second budget spending unit” subject to funding allocated as part of the budget of the Ministry of Economy. Best practices would require the unit to have its budget directly approved by Parliament to avoid conflicts of interest – especially considering that the Ministry has direct ownership rights in several SOEs that would be overseen by the agency. In addition, there are doubts as to whether the existing staff of a (near-defunct) privatisation agency would provide for sufficiently qualified professionals to the new Agency, allowing it to effectively carry out its functions.
- *Development of the ownership policy and annual aggregate reporting.* Ensuring that the coordination unit is sufficiently resourced and

empowered will be a first step towards guaranteeing the successful delivery of important inputs mentioned in the Law on Public Enterprises such as the ownership policy and aggregate reporting, both of which will act as important tools for clarifying the role(s) of the state with respect to SOEs, and for setting clear performance objectives for the SOE sector in general. This, in turn, should support a meaningful SOE performance monitoring and assessment regime and ultimately drive improvements in their performance.

- *Disclosure and transparency.* The forthcoming Implementing Rules should ensure timely submission of all material financial and non-financial information of enterprises to the line ministries, the Ministry of Finance and the new coordination unit. The submission of the information shall take place according to the time schedule established by the law. Implementing rules could also foresee penalties in cases of non-compliance.
- *Establishing adequate rules and procedure for the competitive selection and appointment of Directors in SOEs.* Bulgarian authorities (including Municipalities) should ensure that the selection and appointment of Directors in SOEs strictly follows the procedure established in the forthcoming Implementation Rules of the Law. In all cases, the Implementing Rules should provide for an open and transparent procedure allowing for a merit-based selection process of SOE Directors. The coordination unit should appropriately be empowered to monitor the process as stipulated in the Law on Public Enterprises.

Long-term recommendations

As mentioned, the new Law on Public Enterprises constitutes only one element – albeit an important one – of the legal and regulatory environment for Bulgarian SOEs. While it provides for appropriate and feasible measures for the current legal and institutional framework of Bulgaria, several additional changes in ownership and corporate governance practices could be envisaged going forward, including:

- *Strengthening the state ownership function.* Within the new framework, Bulgaria will maintain its current decentralised ownership arrangements – in which 17 ministries oversee a portfolio of 221 SOEs. While the establishment of an ownership coordination unit should bring some clarity to the exercise of ownership rights by the state administration – notably through its important monitoring and policy coordination functions – the new entity will be granted only limited ownership rights over SOEs (upon delegation by the Council of Ministers). While advocacy efforts of the Competition Commission and the apparent strength of independent sectoral regulators in many key sectors (e.g. energy, water and communications) might alleviate concerns regarding the insufficient separation of ownership and regulatory functions usually associated with such decentralised ownership arrangements, the risk that line ministries make politically-motivated decisions at the expense of SOEs' commercial performance still remain relevant. To further align Bulgarian practices with the SOE Guidelines, Bulgarian authorities should consider the possibility of centralising the state ownership function under the coordinating entity in the future. In practice, the coordination unit could be granted direct ownership rights for a defined portfolio of SOEs, with a view to eventually broadening the portfolio to include all SOEs. This should contribute towards exercising state

ownership rights on a whole of government basis; as well as separating ownership and regulatory rights in a more consistent way.

- *Strengthening disclosure requirements.* While the new Law calls for all SOEs' financial statements to be subject to an independent audit, accounting standards still vary at the level of individual SOEs, depending on their size and/or other characteristics. To further strengthen accounting and disclosure requirements, the OECD would recommend at least all large SOEs, to keep accounts in accordance with IFRS and be subject to the same disclosure standards as listed companies.
- *Strengthening boards of directors.* While SOEs board should, in principle, be better equipped (in terms of size, independence and responsibilities) to fulfil their essential strategy-setting and corporate oversight roles under the new legal and institutional framework, the OECD would recommend (1) to eventually release the current restriction on the maximum number of independent members in SOE boards (which is set to one-half) to align with the requirements applicable in the private sector, and ensure that SOE boards are able to exercise independent judgement, absent political interference and in the interest of the enterprise and its shareholder; and (2) to improve the rules and procedures for nominating and appointing the CEO. In line with OECD best practices, boards of directors should have the power to appoint and remove the CEO (or at least be consulted in case of fully state-owned enterprises). In any case, rules and procedures should be transparent and respect the line of accountability between the CEO, the board and the ownership entity.
- *Maintaining a level-playing field with private companies.* While the new Law enshrines some important basic principles related to SOEs' competitive position in the marketplace (notably by explicitly prohibiting unfair competition and abuses of monopoly), several elements could still distort the level playing field between SOEs and (actual or potential) private competitors, including *inter alia*: the use of holding companies to facilitate intra-group financing among subsidiaries and shortcomings in the applicability of public-procurement rules to SOEs as procurers, amongst other aspects. Appropriate measures should implemented to remedy these concerns and further align Bulgarian ownership practices with the SOE Guidelines.

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