

# ICPS newsletter

## Corporatisation of state infrastructure enterprises is expected to attract more investments

***Performance of infrastructure enterprises that are currently state-owned would be boosted by transforming them into commercial companies. ICPS experts believe that it is not imperative to further privatise such companies, because commercial enterprises can perform at least as well under state ownership as under any other form of ownership. Research on the issue of which Ukrainian government agency has a better chance of becoming an effective owner is presented in the latest issue of the Quarterly Predictions journal***

A draft law was registered in the Verkhovna Rada envisaging to corporatise the state holdings in the Naftogaz Ukrainy National Joint-Stock Company, as well as the Energoatom National Nuclear Energy Generating Company and its subsidiaries. The first steps have already been taken to corporatise these state holdings. In particular, Naftogaz issued shares on the stock exchange, while Energoatom hosted a working group on corporatisation that includes consultants from TACIS. Besides these two companies, it is planned to corporatise coal enterprises and strategic airports in Ukraine. Nevertheless, to date the only infrastructure enterprise to have fully completed corporatisation is the Ukrtelecom OJSC.

Corporatisation is the conversion of state enterprises into open joint-stock companies, in order to attract investments and improve company management under market economic conditions. The corporatisation envisages the following steps:

- stocktaking and evaluation of assets;
- reorganisation of the enterprise structure and its management system, split-off of auxiliary or non-profile structural divisions into stand-alone legal entities, and separation of public service agencies;
- creation of company management bodies, including general shareholders' assemblies, supervisory boards, management boards, audit commissions, and boards of directors.

The results of corporatisation should be improved financial performance of the company and its increased market value. Under these conditions, the company will be able to attract investments either by

borrowing in capital markets or by selling itself to an investor. However, based on an analysis of the experience of corporatisation and corporate rights management in Ukraine, we see the following obstacles hampering the attainment of these results: (1) the assignment of social obligations to enterprises; and (2) faulty mechanisms for state corporate rights management.

### Social obligations

Goods and services to privileged categories of the population are sold in Ukraine by the state infrastructure companies Naftogaz Ukrainy (directly) and Energoatom (indirectly, through the sales of electricity in the energy market). Benefits are supposed to be compensated to these companies from the budget. However, since the budget is unable to finance all obligations, the state actually accumulates unrepayable debts towards the service providers. This situation strains the companies' investment resources and worsens their financial indicators. The success of these companies' corporatisation will therefore depend on whether it is possible to implement an effective mechanism for financing their social obligations that would not damage their financial standing.

### State corporate rights management

Since infrastructure companies remain state-owned for a certain period of time after corporatisation, their development will depend on the government's ability to be an effective owner. We believe that Ukraine's government lacks clearly defined goals for managing state companies, which leads to

conflicts between the government and the government body or company in charge of state corporate rights management.

In our opinion, the following institutions are capable of executing state corporate rights management:

- State Property Fund: The Fund's mandate is privatisation, and hence effort will be devoted to gear up companies for privatisation. However, it will only be possible to attract investments to the companies if the privatisation succeeds;
- sectoral ministries or agencies: Although such institutions can declare their goal of locating investments, they lack knowledge and experience in entering capital markets. Moreover, internal conflicts of interest are likely between the goal of earning more profits for a particular company and the goal of developing the sector as a whole, which would entail fostering competition within the sector, for example;
- Ministry of Finance: The mandate of the ministry is to increase budget revenues, particularly from dividends and privatisation proceeds. Therefore, it is interested in boosting companies' profit and market value. MinFin does possess the knowledge and understanding of how to locate investments in capital markets;
- managing companies: Success of this option will depend on a clearly set goal and system of incentives for the managing company.

We believe that from the viewpoint of attracting capital, the optimum manager of state corporate rights in Ukraine would be the Ministry of Finance. First of all, the ministry does not experience the conflicts of interest that sectoral ministries face. Second, the ministry is most interested in boosting companies' market value, since that affects budget revenues in the form of dividends or privatisation proceeds. Third, the Ministry of Finance is a more influential body in the government hierarchy than the State Property Fund. ■

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