State ownership policy review in Latvia

Final report

KPMG Baltics SIA

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Glossary and Abbreviations

AEL	Associations and Establishments Law
Annual report	Annual report that includes management report and annual financial statements and is prepared according with the requirements of the Law On the Annual Financial Statements and Consolidated Financial Statements
APE	Agence des Participations de l'Etat
Benchmarking Countries	Four EU and OECD member states (Estonia, France, Italy and Sweden) that were chosen for benchmarking SOE policies.
CDC	Caisse des Dépôts et Consignations
CDP	Cassa Depositi e Prestiti
CL	Commercial Law
CSCC	Cross-Sectoral Coordination Centre
CSR	Corporate social responsibility
EC SRSS	European Commission Structural Reform Support Service
EU	European Union
Evaluation Guidelines	Guidelines regarding evaluation of operating results of state-owned enterprises where state holds majority stake, developed by CSCC, 01.06.2016.
Evaluation Regulations	09.02.2016 Regulations of the Cabinet of Ministers No 95 "Regulations for evaluation of operating results and financial targets of state-owned enterprises where state holds a majority stake" (Latvia)
Financial targets	Targets (objectives) of company related to the status of its financial position and operating results (including profitability, capital structure, revenue and dividends)
General strategic objectives	Objectives of the company specified by the highest decision-making body of the public person, which the public person wants to achieve through participation in the company and which arise from legal acts and policy planning documents
GRI	Global Reporting Initiative, one of the leading global standards for sustainability reporting
Group A companies	Companies that are classified in Group A and include companies that operate on commercial terms and/ or are holders of strategic assets
Group B companies	Companies that are classified in Group B and include companies that perform public service obligations and are significantly funded from the state budget
IFRS	International Financial Reporting Standards
Information Guidelines	Guidelines regarding publication of information for state-owned enterprises and their shareholders, developed by CSCC, 30.03.2016.
IPO	Initial public offering

KPI	Key performance indicators – measures for assessing the performance of a company and attainment of financial and non-financial targets.
KPMG, we, us	Consortium of consultancy companies consisting of KPMG Baltics SIA and KPMG Advisory S.p.A. (Italy)
LAFSCFS	Law On Annual Financial Statements and Consolidated Financial Statements
Line ministry	Line (or sectoral) ministry defines sectoral policy targets for the SOE, and appropriates funding from the state budget for companies that fulfil a state delegated assignment. If the functions of sectoral policy and State Shareholder are performed within the same ministry, they should be clearly separated.
MEF Italy	Ministry of Economy and Finance (Italy)
MoA	Ministry of Agriculture of the Republic of Latvia
MoC	Ministry of Culture of the Republic of Latvia
MoE	Ministry of Economics of the Republic of Latvia
MoEI Sweden	Ministry of Enterprise and Innovation (Sweden)
MoEP	Minister for Environmental Protection and Regional Development of the Republic of Latvia
MoES	Ministry of Education and Science of the Republic of Latvia
MoF	Ministry of Finance of the Republic of Latvia; Ministry of Finance (Estonia)
MoH	Ministry of Health of the Republic of Latvia
MoI	Ministry of Interior of the Republic of Latvia
MoJ	Ministry of Justice of the Republic of Latvia
MoT	Ministry of Transport of the Republic of Latvia
MoW	Ministry of Welfare of the Republic of Latvia
MTS	Medium-term strategy, a document for planning the operation of the state owned company for a period of at least three years, on the basis of which the operation of the company, the profit share to be disbursed in dividends, and the budget of the company are planned. Required for SOEs in Latvia by the Law On Governance of Capital Shares of a Public Person and Capital Companies
NEMMC	National Electronic Mass Media Council
Non-financial targets	Targets (objectives) of the company, which arise from the general strategic objective determined for the company, from legal acts and policy planning documents, and can be related to carrying out of the assignments specified for the public person
OECD	Organisation for Economic Co-operation and Development
OEL	Owner's expectations letter
PA	Privatization Agency

PAL	Public Agencies Law
Public person	As defined in the State Administration Structure Law the public person is the Republic of Latvia as the initial legal person governed by public law and derived public persons. A derived public person is a local government or other public person established by law or on the basis of law
R&D	Research and development
ROA	Return on assets
ROE	Return on equity
Project	European Commission, Structural Reform Support Service financed project on the Review of State Ownership Policy in Latvia
SASL	State Administration Structure Law
SOE	State Owned Enterprise
SOEL	Law On Governance of Capital Shares of a Public Person and Capital Companies
State Shareholders	13 Latvian public entities managing the state's shareholdings in SOEs.
Strategy Guidelines	Guidelines regarding the development of medium-term operational strategy for state-owned enterprises; developed by CSCC in 2016 and updated on 28.08.2018.
Subsidies, state budget funding	Funding that SOEs receive from the state budget directly or indirectly, e.g., through subsidies, appropriations, public service contracts, compensations for performing certain services, or through guaranteed income (e.g., customers are legally required to purchase services from the company or company's revenue is generated mainly from providing services to public sector clients)
Supervisory board	Non-executive board, in some instances also referred to as board of directors or council
Tender specification	Tender specifications SRSS/C2018/020 that describe the technical requirements for the Project

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1 Executive Summary

The objective of the report is to support the development of an adequate classification of SOEs and the methodological framework for their governance. This report is prepared in the framework of the Latvian State Ownership Policy Review project financed by the European Commission, Structural Reform Support Service (EC SRSS). The project, according to the Tender specification, aims at enhancing the operational capacity of the Cross-Sectoral Coordination Centre (CSCC) of Latvia in its role as coordinator of the state's holdings in state owned enterprises (SOEs), in collaboration with other stakeholders, i.e. line ministries acting as shareholders in SOEs, companies, other state agencies etc.

The Policy Review was implemented in two sequenced stages and its primary focus was central government shareholding. Firstly, analysis of the state ownership model in Latvia and comparable European peer countries with an aim to develop a method for classifying all SOEs into relevant groups. Secondly, review and propose revisions in the way targets and key performance indicators are set and monitored for each group of SOEs and how dividend policy is applied.

The scope of this report is central government (national government) shareholdings and it does not consider locally-owned (municipal) enterprises or enterprises of derived public entities (other public persons established by law or on the basis of law), as the CSCC's mandate by the law does not cover sub-national entities or derived public entities. The findings of this Report, however, could be used also to shape the shareholders' policy towards municipal enterprises and enterprises of derived public entities.

The data for the study was gathered from relevant public and non-public sources as well as supplemented by questionnaires, focus groups and interviews with representatives of public sector bodies, sector experts and SOEs' management. The comparison of Latvian SOEs' policies to those in the Benchmarking Countries was carried out to support findings and recommendations. Two workshops: one with representatives of State shareholding entities and the second with representatives of State shareholding entities and SOEs' management and supervisory boards were organized in order to consult on the proposed approach.

SOEs are important players in the Latvian economy with the largest companies operating in the field of energy, transportation, communications and forestry. SOEs in Latvia account for a significant share of the economy in terms of assets, turnover and employment. Out of 159 SOEs roughly 60% are in direct ownership of the state, largely dominated by companies operating in the energy, transportation, communications and forestry segments. This SOE set includes also minority shareholdings and subsidiaries of SOEs, and those being in liquidation or insolvency. The ownership and governance structure of Latvian SOEs is set up according to a hybrid model (also called "coordinating agency" model) – SOE strategic and operational governance is implemented through a coordinating institution (CSCC) and line ministries.

The key challenge of Latvian SOE policy and the CSCC as the central government entity tasked with coordination and standard setting is the diversity of the SOE

landscape. In the cohort of 159 enterprises there are entities of various sizes, business models and sectoral policy mandates. The status of company in accordance with the Commercial Law has been chosen as the legal form of operation for all of the reviewed entities under government control. These entities range from profit making businesses operating in a free market to regulated utility companies or providers of public services heavily subsidized by the state budget. Ownership of a commercial entity is neither the only policy tool available to the government, nor the only legal form of public entity, which could fulfil the need. There are a number of other entity options, which should be considered, when the government is reviewing its SOE portfolio.

The governmental institutions as the shareholders face challenges in terms of setting and applying unified standards of SOE governance. The CSCC is mandated by the law to set common standards and issue guidelines for Latvian SOEs in terms of strategic planning, reporting, dividend pay-outs, transparency, and corporate governance. However, once the same strategic planning and target setting standards are applied to players such as a national energy company and a regional theatre it creates a large variability in interpretation and potentially disproportionate burden both on SOEs and the CSCC. The CSCC has already diversified its approach to different segments of SOEs based on size criteria e.g. requirement in terms of size of the management board or existence of the supervisory board. The regulatory framework also allows large companies to use the International Financial Reporting Standards. The aim of the analysis and recommendations under this report would be to suggest an approach to group the SOEs with an aim to calibrate the policy regarding target setting, reporting, monitoring and dividends in SOEs and hence reach a more optimal balance between the desired policy results and resources needed to achieve and sustain them. Furthermore, the report pays particular attention to the methods the State Shareholders and the CSCC could use in terms of target setting, reporting, monitoring, and dividend policy in order to make the shareholder – management dialogue more effective and result oriented.

In order to allow learning from the best practices of European Union (EU) and Organization for Economic Co-operation and Development (OECD) countries, Latvian SOE policies are benchmarked against peers in Estonia, France, Italy and Sweden (the Benchmarking Countries). All countries demonstrate a similar pattern of having the largest SOE presence in infrastructure intensive sectors such as energy and transport. In the majority of cases the investment and divestment decision-making has been driven by the opportunities in the market or budgetary considerations of the government. Only in Sweden has there been a structured longer term forward looking mandate by the government in terms of privatization. As for the management of state ownership the French and Swedish models stand out by using a centralized state shareholding model, hence also minimizing potential conflicts of interest arising from ownership and policy / regulatory functions being in the same hands. When it comes to less traditional sectors for operations of state owned commercial entities such as health care and culture the Latvian model stands out, as other peers have identified other non-profit or non-commercial organizational and legal forms to govern public entities in these sectors.

The current classification of Latvian SOEs has been used only to a limited extent to calibrate the policy. Historically Latvian authorities have not developed a generalized allocation of SOEs to specific classes or groups. There are, however, several approaches used in practice, serving either as a parameter within guidelines for a specific purpose (e.g. remuneration considerations, establishment of supervisory councils etc.) or used mainly for illustrative purposes in the annual report on state ownership (e.g. sectoral split). Though there have been attempts to analyse and group the SOEs based on the original objectives and/or business models, it has so far resulted in no practical shareholder's policy implications or guidelines to specific groups or sub-groups of SOEs.

The SOE classification in the Benchmarking Countries can be used as an inspiration though none of the models of these countries can be directly transposed to Latvia. The methods used for SOE classification in the four EU/OECD Benchmarking Countries were reviewed. The main conclusion arising from this task is that none of the Benchmarking Countries have a formal classification that would directly translate into the state as the shareholder setting some specific goals or policies for some groups or sub-groups of SOEs. The grouping or classification in use seems to follow a business related model or distinguishes between various legal forms that state owned entities can take. Nevertheless, the examples of grouping in these countries point to factors worth considering when developing the approach to SOE classification in Latvia.

The report suggests dividing the SOEs into two major groups, A and B, based on specific parameters, in particular, whether the entity should build on its commercial potential or rather focus on delivering a specific task delegated by the government. Taking into account the current reality of the SOE ecosystem and existing legal framework, in this report, in order to develop the method for grouping the SOEs, a number of distinguishing parameters are used, for example, commercial or non-commercial nature of the operations, role in the market and sources of financing. By applying these parameters it is possible to come to two groups: A: holders of strategic economic and physical assets or companies with commercial potential, and B: entities with a delegated state assignment. Further sub-grouping within both groups is possible based on the degree of financial independence from the state budget. Grouping of companies is not a goal in itself, but rather as a means to an end. Consequently, there are opportunities to calibrate requirements of shareholders in terms of target setting and governance using the grouping.

The proposition for this classification approach is to start the implementation within the 100% owned SOEs, as the CSCC has a mandate to apply guidelines towards these companies, and then gradually seek the expansion of the approach also to other SOE categories commencing with subsidiaries of 100% owned companies and companies, where the state holds a controlling stake along with other shareholders through actively engaging in dialogue with other shareholders.

The state ownership policy should evolve further through optimisation of ownership portfolio and reassessing the use of share ownership as the most adequate response to policy challenges the country is facing. The current SOE portfolio in Latvia is challenging to manage, e.g., large number of companies and shareholding institutions, share of companies implementing state policy assignments, etc. Consolidation of the Latvian state shareholding through reducing the number of shareholders and merging some SOEs would result in a leaner portfolio and reduced management costs that, in turn, would allow the governing institutions to focus more on increasing the value of state ownership. Introducing classification as suggested in this report and calibrating requirements such as target setting and reporting would be the first step and would allow a more tailored approach towards the shareholder's management of company performance according to their business models, though the ultimate goal would be to scale down the SOE portfolio and centralize the operational ownership management. The SOE portfolio can be made leaner by merging some of the smaller companies from Group B into holdings or by finding a separate form of managing and overseeing public non-profit entities in sectors such as culture and health care, by handling some public services via specialized agencies, and by improving the robustness of the regular assessment of the need for shareholding. Furthermore, new investments in shares particularly in the so-called novel sectors should be treated with caution. Acquiring full ownership of new assets or establishing new fully-owned companies is not recommended, because as proved by the examples from the benchmarking exercise this would be better addressed via specialized development financial institutions (e.g. like Latvian SOE Altum) that would handle venture capital and equity investments in new or emerging sectors along with private investors, sharing the risks and returns.

This report suggests that the CSCC and State Shareholders should focus their attention on a limited number of key targets and a compatible set of KPIs for each SOE or group of SOEs. The selection of targets and KPIs is differentiated between Group A and B companies. The general direction recommended for companies in Group A is to focus on financial targets and for companies in Group B – on non-financial targets. At the same time, no companies should be exempt from having some financial targets (at least financial stability and balanced budget) and from striving to achieve efficiency and CSR targets. The report suggests an illustrative list of KPIs as well as includes a number of case studies of specific SOEs to illustrate the approach. The proposal extends the list of financial targets and KPIs currently suggested by the CSCC with a larger set of non-financial operation indicators that are a more natural choice for Group B entities.

Streamlining the planning and monitoring cycle would allow more ambitious target setting and effective performance review. In terms of monitoring the progress towards the set targets and key performance indicators, the suggestion is to integrate them into the annual reporting cycle through creating meaningful management reports as a part of the annual report (as prescribed by the Law On Annual Financial Statements and Consolidated Financial Statements (LAFSCFS)) to ensure both transparency of company performance to public sector bodies (for performance evaluation purposes) and to the general public. A more structured involvement of the State Shareholder is recommended to set ambitious targets through the owner's letter of expectations and dialogue with the company management in the form of bi-annual shareholder meetings for companies that do not have supervisory boards. SOEs' approach to public disclosure of standardized information can be further improved, e.g., through providing clear information in websites regarding fulfilment of non-financial targets, usage of state funding, providing historic performance data, etc.

The dividend policy should be further focussed on a limited number of companies in Group A. When considering the dividend framework it is recognized that the Group A companies are and should be the main target for potential dividend pay-outs. Medium and long-term shareholder value should serve as the primary criterion, when deciding on the annual distribution of profits from Group A companies. On the contrary, Group B companies should not be expected to distribute profits. If such profits are generated in Group B companies, these should be redirected to provision of public services by the company or result in reduced price for services conditional to the appropriate application of state aid rules.

Conclusions and Recommendations for improving the Latvian state ownership model

The report provides a number of findings and recommendations in the field of SOE management aimed primarily at the Latvian state as shareholder and the CSCC as the coordinating institution. The majority of recommendations can be implemented through updating or expanding the guidelines issued by the CSCC, while others (e.g. regarding the dividend policy) require changes in the regulatory framework. Above all, implementation of the recommendations requires the will and cooperation of various stakeholders to implement the state ownership policy in an open and transparent manner, focusing on generating returns to society in the most efficient manner possible.

No	Findings	Recommendations	More details are provided in Report
1.	Classification		
1.1.	Latvia clearly stands out against the Benchmarking Countries by operating numerous non-profit / non-commercial entities in the field of culture and health care. The Benchmarking Countries in most cases have used other unincorporated legal forms of organizations for players in these sectors. There is no ready-made SOE classification model in other countries that Latvia could try to transpose. Latvian authorities rather should build their own method of classification based on realities of the SOE landscape and the existing legal framework.	It is justifiable to operate two groups in the Latvian SOE environment: A: holders of strategic economic and physical assets or companies with commercial potential; B: entities with delegated state assignments. Further sub-grouping is possible based on the degree of financial independence from the state budget. Most importantly, based on such grouping there are opportunities to calibrate shareholders' requirements in terms of target setting and governance. The classification is not a rigid system and companies can move between groups or subgroups as they evolve or the market situation changes.	2.5. Methods for developing the classification
2.	State ownership		
2.1.	The diverse character of the SOE landscape in Latvia, including entities that are clearly not profit oriented, makes management and standard setting difficult. Creation of an SOE as a response to a certain policy challenge (e.g. market failure) has become general practice. This partially could be explained by the limitations in terms of other legal forms available for	Use the classification of SOEs proposed by this report and calibrate the requirements of target setting, monitoring, and dividend pay-outs for each group of SOEs accordingly. Start with implementing the classification and target setting approach within the 100% owned SOEs, as the CSCC has a mandate to apply guidelines to these companies. Gradually seek the expansion of the approach to other SOE categories	2.2. Comparative analysis of SOE policy in Latvia and among EU/OECD peers

	establishing public entities and by underutilization of other tools in the hands of the government such as regulation or fiscal stimulus.	commencing with subsidiaries of 100% owned companies and companies where the state holds controlling stake along with other shareholders through actively engaging in dialogue with other shareholders. While it is out of scope of the report, it is recommended to gradually expand this approach also to municipal enterprises and enterprises of derived public entities. Identify an appropriate new legal form for public establishments (public non-profit entities) and seek the possibility to convert the legal status of some of current SOEs primarily in the sectors of culture and health care. Furthermore, the conversion of some of the current SOEs implementing public policy assignments and being highly dependent on state budget funding to agencies should be assessed.	
2.2.	When comparing the Latvian SOE portfolio to peers in EU / OECD countries there are no distinctive features that would make Latvia stand out. Though there are clearly differences in the composition of the portfolio, it cannot be concluded that Latvia would, for example, hold to the state ownership in some sectors where other countries had carried out major divestments. When it comes to investing in new shareholdings e.g. in novel sectors, in all the Benchmarking Countries as well as in Latvia it is managed by specialized entities as part of new enterprises' access to finance support schemes.	Investment in novel sectors should not be part of the SOE policy. It should rather be considered in the context of policy for economic growth and managed via specialized development finance entities (like Altum). Investments should be made in equity together with private sector, sharing the risks and returns.	2.1.2 Assumptions for state ownership
2.3.	In terms of shareholding management, the majority of the Benchmarking Countries have taken a more centralized approach by concentrating the largest part of shareholding in the hands of a limited number of entities as compared with Latvia operating with 13 shareholding managers. More centralized shareholding would allow the potential conflicting interests of line ministries, that need to develop policy and regulation for their respective sectors, manage government funding, and at the same time oversee the SOEs operating in their sector, to be minimized. Furthermore, the large number of small SOEs affect the	Consolidate the shareholding management function to a limited number of public institutions preferably separated from the sectoral policy making and regulatory functions. Companies in Group A (see more details on the classification in the following section of the table) are primary targets for centralized shareholding management, as these companies should be managed as commercial companies and have a stronger focus on growing the value of the company and/or generating profits. Consolidation would allow the shareholding institutions to focus capacity, competences and efforts on increasing the value of state ownership.	2.2 Comparative analysis of SOE policy in Latvia and among EU/OECD peers

	management quality and drive up external administrative costs.	Consolidate smaller SOEs into groups under holding companies (e.g. in sport, culture, health sectors), hence reducing costs associated with administration of the business, enable them to attract professional managers, and benefit from efficiencies of scale.	
2.4.	The SOEL requires that the state reassess at least once in five years all of its shareholdings in companies and whether each fulfils the conditions for state ownership listed in the SASL. However, there are cases that indicate that this process is implemented as a formality aimed at maintaining the status-quo of state ownership in the particular sector or enterprise. The lack of a relevant legal format to run state owned non-profits, insufficient transparency in financing models of SOEs and lack of a designated independent evaluator do not allow an informed and reliable assessment of economic justification to be reached in order to choose between maintaining state shareholdings or switching to other modes of state intervention (regulation or fiscal instruments).	Impose a more structured approach to the reassessment of shareholdings e.g. designate and involve independent evaluators to ensure that the state ownership is terminated as soon as there is a feasible alternative to attain the same policy goals with different tools. Ensure that reassessment of shareholding is performed when strategy is revised or significant changes occur but not less frequently than every 5 years. The ultimate goal, however, would be to scale down the SOE portfolio by finding a separate form of managing and overseeing public non-profit entities in sectors such as culture and health care, handling some of public services via specialized agencies as well as reinforcing the regular assessment of shareholdings.	2.1.2.5 Forms of entities through which the state may act in the private sector
3.	Target setting		
3.1.	Strategy Guidelines provide guidance for developing medium-term strategy for a period of three to seven years, and set the medium-term targets, business model, and KPIs with annual expected values. The strategy should include an estimate for the share of profits that will be distributed as dividends during the strategy period. Short-term targets and KPIs are set in annual operational plans or budgets and are used for the management board's annual performance evaluation against the MTS. The strategy is expected to be regularly updated or is valid until expiry of the previous one or upon significant changes. As of July 2018 47 out of 66 SOEs had developed strategies, and only 25 of them had been developed in accordance with SOEL.	Develop medium-term strategies for periods of three to five years. A new strategy cycle starts with the periodic owner's expectation letter (OEL) to set strategic direction and key targets for the next 3-5 year period. Strategy includes financial and non-financial targets and relevant key performance indicators with a range and expected trend for the target values for the strategy period instead of fixed target values for each separate year.	3.2.1 Setting targets and relevant KPIs

3.2.	In practice, the targets are often set below the past performance level and are not challenging enough. In most of the cases there is lack of evidence that benchmarking against similar companies is used for target setting. In cases when the performance bonuses for the management of the company are based on the performance of the company and the level of target attainment (over or under achieving the targets), the target setting process may be not challenging enough. This can create a situation when the SOEs in Group B – with the objective of implementing a state delegated assignment and fulfilling non-financial targets – are either setting lower, more attainable financial targets or setting easily attainable non-financial targets and overachieving them to justify underachieving the financial targets.	Set and clearly document updated annual KPI values (that will be used in performance evaluation) in an annual OEL (for companies without supervisory boards). The purpose of the shareholder when outlining the desired KPI values is to signal the expected results for the future and invite the management (executive board) to strive for ambitious results rather than continuing with business as usual (e.g. through validation of targets that are already achieved). For companies with supervisory boards the culture of setting ambitious targets is introduced through selection of professional members of supervisory boards. The preference should be given to candidates who are capable and professionally motivated to challenge the management of the company through well-structured and informed dialogue. Public policy non-financial targets are set by the sectoral ministry. Non-financial operational targets are set by the supervisory board, taking into account the delegation contracts (in cases where budget financing is involved) and non-financial goals given by the sectoral ministry.	3.2.1 Setting targets and relevant KPIs
3.3.	Evaluation Regulations include a list of financial indicators that are used for performance evaluation. Strategy Guidelines suggest setting financial and non-financial targets and relevant KPIs without specifying how many or few targets should be included in the strategy.	To ensure efficient oversight of the companies, a limited number of KPIs should be reported to the shareholder that are the best descriptors of the business and financial performance of the company. A set of 6-8 KPIs are optimal to ensure a focused approach. These are KPIs that are reported to and monitored by the shareholder. However, there can be additional indicators (according to financing or delegation contracts) that are included in the evaluation. The management can and should have a longer list of various non-financial targets and KPIs that are cascaded to the business units. For companies with supervisory boards the role of shareholder in the target setting process should be limited to setting the strategic direction during the preparation or re-evaluation stage of the strategy (every 3-5 years) but not during annual target setting as this is the role of the supervisory board. The key task of the State Shareholder in this case is selection of professional and independent members of the supervisory board who are motivated	3.2.1 Setting targets and relevant KPIs 3.2.2 Institutional distribution of roles

		and capable of challenging the level of ambition of the company's strategy.	
3.4	The majority of Latvian SOEs are fulfilling public service obligations and receive some funding from the state budget, hence, measuring their performance based on financial targets focused on profitability is less relevant for them and does not reflect the performance regarding the public policy objectives.	It is recommended for Group A to have more financial targets and KPIs and Group B – more non-financial targets and KPIs. Table 7 on page 108 provides an illustrative list of potential financial and non-financial KPIs to guide the selection process. All SOEs should have at least some financial targets, e.g., regarding financial stability and balanced budget.	3.2.1 Setting targets and relevant KPIs
3.5.	The current target setting process and lack of comparable benchmarks can limit the potential for supervisory boards and State Shareholders to gain appropriate understanding about the real and potential performance of the company and the impact that can be attributed to external factors (e.g., changes in the market environment that cause over- or underachievement of the targets) and performance of the company management. In practice, the availability of information about peers – similar companies in other countries or in the private sector – is very limited and restricts benchmarking in many cases. In most of the cases it is due to the reasons like: (1) the state delegated assignments in other countries are performed by foundations or state agencies that have different reporting and disclosure requirements, (2) private companies do not disclose information about their performance, or (3) differing regulatory environments and markets as well as business models make the companies hard to compare.	The CSCC or line ministries are encouraged to perform benchmarking studies if companies are unable to perform this exercise, especially in sectors with multiple similar companies, for example, through establishing cooperation with state shareholders in other countries.	3.2.1 Setting targets and relevant KPIs
3.6.	In practice in many cases public policy assignment contracts with line ministries have higher importance than the strategy. Strategy includes also the commercial activities and corporate governance but public service delivery contracts cover only state delegated assignments. Subsidies are not linked to performance targets or results but rather based on an as-is basis, which does not ensure financial efficiency.	Especially for Group B companies that have public service delivery contracts with line ministries or are providing services according to a regulated price list the medium-term strategy is an important tool to maintain a broader view towards the development of the company, including the commercial activities and corporate governance issues. The shareholder and management are both accountable for establishing a medium-term vision and not only focusing on annual public service delivery contracts.	3.2.1 Setting targets and relevant KPIs

3.7.	The current working practices of Latvian SOEs indicate that CSR and sustainability activities have varying levels of importance. If CSR factors are not measured they might not be considered and will not appear on the management agenda if the management is focused on the financial or business targets even when implementing CSR activities can reduce costs and increase the company's value.	Implement more awareness building activities run by the CSCC to promote relevant CSR and sustainability targets and activities to demonstrate the benefits for increasing company value and efficiency, and promote experience and knowledge sharing among the SOEs. CSR targets in the proposed approach are not primary targets and are included in the illustrative list of potential KPIs so that the management and shareholders can select them as secondary targets if they see them as appropriate.	3.2.1 Setting targets and relevant KPIs
3.8.	Data compatibility and comparability issues arise from differing approaches in demonstrating total revenue and received payments from state budget in the financial statements.	Where revenue is used to calculate a KPI, using "Revenue including government subsidies" in the calculation will ensure data comparability. Use consolidated data where appropriate.	3.2.1 Setting targets and relevant KPIs
4.	Reporting and monitoring		
4.1.	The target setting practices and public transparency varies significantly among the companies. The opportunities for the general public to track Latvian SOE performance and the results achieved, especially regarding the results achieved with state funding, are very limited. The shareholder and line ministry assessments or reports about company performance are not publicly available and the Information Guidelines do not explicitly require them to be made public. It can be argued that especially for Group B it is in the interests of the general public (tax payers are, after all, the ultimate shareholder in the state owned assets) to have this information available in order for society to be able to monitor the state budget spending and the results achieved and to see that the state acts as a responsible owner that strives to achieve the best outcome with the limited funding available. It is crucial that the state is taking measures to achieve satisfactory performance of its companies. Some but very limited information is included in the aggregated annual report prepared by the CSCC. There are some SOEs that disclose only very limited information besides	Implement reporting on financial and non-financial targets, as well as public policy objectives and the funding for these objectives in the management report (as part of annual report). Include adequate requirements in the Information Guidelines to suggest a uniform reporting standard for the management report that addresses the needs of the various stakeholders and reports on financial and non-financial targets and KPIs. Consequently, to increase transparency, the quarterly unaudited reports should include a section on the performance indicators for non-financial targets that the shareholder has selected for performance management. For companies implementing public policy objectives and receiving state funding the management report must include a section on results achieved with the allocated state funding or client fees, e.g., how many cents from the payment received per each driving licence issued are used to support the motor museum. Shareholders should publish a summary of company performance evaluation results to ensure transparency to the general public. Publish infographics to demonstrate the value created and results achieved in a clear and easy to understand way.	3.2.3 Reporting requirements and monitoring

	the financial statements while other SOEs provide information on a large number of indicators without prioritizing the ones that the management or line ministry may perceive as the most important.	Provide annual reports and other relevant data for a 10-year period on the company website. If an SOE becomes listed, the principal shareholder must follow the legal requirements and only receive the same amount of reporting and monitoring information as other shareholders.	
4.2.	During the performance evaluation process the CSCC is required to evaluate performance of 66 SOEs in a period of two months, and it can be challenging to develop deep insights in the sectoral specifics and market situation for each of the companies, in this limited amount of time.	While in the longer term the focus should be moved towards strategically important companies, in the medium-term, while the companies are still adjusting to the current SOE governance standards developed by the CSCC and implemented through guidelines, and while some companies have not yet developed and approved their strategies, the CSCC should focus on providing guidance to the small and medium Group B companies as they do not have supervisory boards and they may require additional oversight to ensure efficient target setting and implementation of strategies.	3.2.2 Institutional distribution of roles
4.3.	The current practice reveals a varying level of interaction and involvement of shareholder in the supervision of the company and monitoring its performance. In some cases, the involvement of shareholder is larger and often informal, and in other cases the management of SOEs may lack clear direction and knowledge of the vision of the shareholder.	Companies without supervisory boards should implement a more active shareholder – management dialogue through bi-annual shareholder meetings and annual owner's expectation letters. This will provide a stronger basis to monitor the performance of the company, challenge the management for more efficient performance and identify problematic issues in a timely manner. Such a structured approach would ensure transparency of the shareholder's involvement in the company. Participation of the CSCC in the shareholder meeting may be a useful tool to ensure that all representatives of state interests have a similar understanding of the situation of the company and main developments.	3.2.3 Reporting requirements and monitoring
4.4.	International organizations that focus their work on improvement of corporate governance standards suggest that SOEs should be a leading example for good corporate governance. SOEs should increase the transparency of their reporting and provide more meaningful information in their annual reports than simply fulfilling the minimum legal requirements. Annual reports can cover such issues as key performance indicators and performance against KPIs, cost and	Differentiate reporting requirements between large companies and small and medium companies, as follows: Large companies from both Groups A and B should move towards highest transparency standards and disclosing information in annual reports in a similar manner as listed companies to encourage their ultimate shareholders (the public) to monitor the company performance and hold it accountable.	3.2.3 Reporting requirements and monitoring

	funding of public policy obligations, risk management, environmental and social reporting, code of ethics, compliance with the corporate governance code, management and board remuneration, board attendance, training, and evaluations.	Large companies should consider increasing the availability of information on their websites in English language. Consider implementing sustainability reporting principles for companies that would be willing to attract financing from the financial markets in the future. Small and medium companies should report on their performance regarding financial and non-financial targets and usage of state budget funding in meaningful management reports as part of the annual report.	
5.	Dividends		
5.1.	The review of the dividend policy of Latvian SOEs indicates that only a handful of SOEs have been contributing the majority of all dividend payments received by the Latvian State. According to the proposed classification, all of the largest dividend payers belong to Group A, i.e. they hold either strategic or economic assets. There is a trade-off between a company's ability to pay out dividends in the short term on one hand and its ability to grow or sustain its current position on the market on the other. Shareholder value creation is the primary objective of Group A SOEs, which should be with a long-term view. Historically, the target dividend pay-out ratio has changed according to the State's immediate fiscal priorities which brought the target dividend pay-out ratio to unsustainable levels. The current target pay-out ratio of 80% or even up to 90% appears to be high and may not take into account the companies' investment needs.	Dividend pay-out decisions for Group A companies should be taken on a case by case basis. A 50% dividend pay-out ratio is deemed to be an acceptable policy level objective based on market practices. Individual SOEs should justify proposed deviations from that target, including benchmarking with industry-level data. The current process of involving SOEs themselves, the CSCC, Ministry of Finance and Cabinet of Ministers is appropriate, as well as involving the European Commission as far as state aid issues are concerned. Supervisory boards, the shareholders' representatives and the CSCC should continuously evaluate whether or not companies have become overcapitalised in order to optimize the capital structure and achieve a higher return rate on capital invested. If this is the case, they should pay out the excess equity. Capital structure should be benchmarked against comparable companies in other countries in order to more easily identify opportunities for reduction of capital.	4.3 Proposed framework for a balanced dividend policy – the principal guidelines
5.2.	Group B companies are SOEs with the primary objective of ensuring fulfilment of delegated state assignments. The profits of Group B companies are not expected to be a steady source of income for the state budget. A significant number of these SOEs depend on the state budget in terms of their revenue or income. In 2016 the whole list of Group B SOEs accounted for only	As Group B companies do not have a profit-generation target, they should not be required to pay dividends. The profits should be redirected as contribution to the non-economic activities of the company or fulfilment of the state delegated assignment, or provision and operation of services of general economic interest in compliance with the state aid rules.	4.3 Proposed framework for a balanced dividend policy – the principal guidelines

	3% of the total dividend receipts from the 100% state owned SOEs.	For Group B companies the dividend policy should be handled by their shareholders' representatives. It should be done without the expectation of stable dividend flows each year; however, supervisory boards', the CSCC and shareholders' representatives should continuously evaluate whether or not these companies have become overcapitalised. If they have, then they should pay out the excess equity as dividends to the State. Capital structure should be benchmarked against comparable companies in other countries in order to more easily identify opportunities for reduction of capital.	

2 Comparative analysis of state ownership models

2.1 SOEs landscape in Latvia

SOEs in Latvia account for a significant share of the economy in terms of assets, turnover and employment. Out of 159 SOEs roughly 60% are in direct ownership by the state and largely dominated by companies operating in energy, transportation and infrastructure market segments. This set of companies also includes minority shareholdings and daughter companies, and those being in liquidation or insolvency. The ownership and governance structure of Latvian SOEs is set up according to a hybrid model (also called "coordinating agency" model) – SOE operational and strategic governance is implemented through a coordinating institution (CSCC) and line ministries or in specific cases also shareholding institution (like Nacionālā elektronisko plašsaziņas līdzekļu padome) or company (Privatizācijas aģentūra). Though the SOE as a type of government intervention is relatively widely used in Latvia it is neither the only policy tool in hands of the government nor the only legal form of public entities. There are number of other options to consider, when the government is reviewing its SOE portfolio.

2.1.1 General overview

State-owned enterprises play an important role in the Latvian economy. The general purpose of SOE existence according to the Latvian legislation is to eliminate market deficiencies and fulfil public policy assignments by providing services or managing assets that are strategically important for the development of the State. In Latvia SOEs account for a significant share of the economy (in 2016 the turnover of SOEs formed 5.8% of the total turnover of commercial companies in Latvia, 13.4% of all assets and 9.7% of profits[1]) and are some of the largest employers. According to OECD (2015) with 6.25% of the total employment Latvia's SOE economy is exceeded only by Norway[2]. Some of the largest state-owned companies operate important economic assets of the country (e.g. energy and forestry) and provide essential services to the population and businesses.

In accordance with the CSCC data the total number of companies where the state directly or indirectly owns stake sums up to 159 enterprises as of 1st July, 2018. 66 of them are 100% directly owned by the Latvian state. When separating between direct and indirect ownership – 94 companies have a direct Latvian government stake holdings, while 65 of the SOE pool are owned indirectly (via another SOE).

According to the OECD Review of the Corporate Governance of State-owned enterprises in Latvia issued in 2015 and OECD Report on Latvia's Corporate Governance Landscape issued in 2017[3], in overall terms the Latvian SOE landscape is broadly in line and comparable to other post-transition economies in the Eastern part of Europe. The

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1 CSCC, Annual Report 2017, Retrieved from: http://www.valstskapitals.gov.lv/images/userfiles/parskats_final-2.pdf
2 OECD, Review of the Corporate Governance of State-Owned Enterprises, Latvia, Retrieved from: http://www.oecd.org/daf/ca/OECD-Review-Corporate-Governance-SOE-Latvia.pdf
3 OECD (2017), Corporate Governance in Latvia, Corporate Governance, OECD Publishing, Paris, Retreived from: https://doi.org/10.1787/9789264268180-en.

sectoral composition of the SOE landscape, similarly as in neighbouring countries, is largely dominated by companies operating in energy, transportation and infrastructure market segments. Additionally, all of these segments are significantly influenced by a small number of large companies dominating the sectors, which arguably can be similarly witnessed in other Eastern European countries.

When measured relative to the size of the economy, the SOE sector in Latvia is somewhat larger when compared to OECD peers, however, when accounting not only for majority investments, but including all state shareholdings, the difference becomes less significant[4].

Other noted differences to similar economies and OECD peers include the lack of manufacturing companies in the state company portfolio arising from historical privatizations of companies in this sector as well as the relatively large amount of companies providing other public sector activities that in other countries would more typically be formed as agencies rather than corporatized[5].

According to the CSCC data, the attribution of SOEs to specific sectors suggest dominance in terms of the number of companies in healthcare and transportation sectors following by a relatively large amount of state assets in the culture segment.

Latvian SOE landscape split by sectors

Sector	Company count
Healthcare	15
Culture	14
Transportation	11
Sports and education	5
Communication	4
Real estate management	4
Forestry and agriculture	3
Energy	2
Media	2
Other	99*
Total	**159**

* Including minority shares and indirect shareholdings
Figure 1 Latvian SOE landscape split by sectors. CSCC data, KPMG analysis

In general, Latvian SOEs take one of two legal forms – either limited liability companies or state-owned joint stock companies – and both forms of entities operate under the Commercial Law of Republic of Latvia (CL). According to the aforementioned law the main purpose of commercial activity is to generate profit for the company owners or its shareholders[6]. Nevertheless, the status of the company in line with CL has been chosen as the legal form of operation for a variety of entities under government control also in cases when the objectives of the entities are not profit-oriented. As a result the SOEs in

4 OECD, Latvia's Corporate Governance Landscape, Retrieved from https://read.oecd-ilibrary.org/governance/corporate-governance-in-latvia_9789264268180-en#page46
5 OECD, Review of the Corporate Governance of State-Owned Enterprises, Latvia, Retrieved from: http://www.oecd.org/daf/ca/OECD-Review-Corporate-Governance-SOE-Latvia.pdf
6 Commercial Law, Retrieved from: https://likumi.lv/doc.php?id=5490

Latvia range from profit making businesses operating in a free market to regulated utility companies or providers of public goods heavily subsidized by the state budget.

The ownership and governance structure of Latvian SOEs is set up according to a hybrid model – SOE operational and strategic governance is implemented through a coordinating institution (CSCC) and line ministries. The ownership holdings are largely in line with the sectoral breakdown of responsibilities among the ministries. There are, however, some exceptions (Elektroniskie Sakari (held by Ministry of Environmental Protection and Regional Development) and Augstsprieguma tīkls (held by Ministry of Finance)), where the line ministry is not the shareholder. Ultimately, the shareholding in all SOEs are managed either by one of 11 ministries (or in case of financial institution Altum – 3 ministries) or by one of two following entities:

— The Latvian Privatisation Agency, which itself is a incorporated SOE (state owned asset management company);
— The National Electronic Mass Media Council (an institution dealing with electronic media policy and managing state's shareholdings of public media companies).

In this report we will be referring to these 13 entities as the State Shareholders.

The Law On Governance of Capital Shares of a Public Person and Capital Companies (SOEL) dated 2015 is the key legal act setting stage for the SOE policy. With this law the CSCC was selected as a central coordinating institution for design and rollout of the SOE policy. The CSCC's mandate covers such aspects of the governance of SOEs as the strategy and strategic goal setting, reporting, transparency, recruitment and remuneration policies as well as ownership evaluation. To fulfil its mandate the CSCC has issued a number of guidelines (see the list in Annex B) and informative reports. In accordance with the law the CSCC has to consult on all the draft guidelines with the Council of the Coordination Institution consisting of State Shareholders and some public institutions and bodies like Chamber of Commerce, Baltic Institute of Corporate Governance, Labour Unions Association, Employers Association, Association of Local and Regional Governments.

2.1.2 Assumptions for state ownership

2.1.2.1 Market failure as a purpose for SOEs

The need to correct the market failure is often referred (also by Latvian legislation) as one of the key justifications for governments to create state owned companies and most of them to some extent compete with private sector players. According to the OECD – "the rationales for establishing or maintaining state enterprise ownership typically include one or more of the following: (1) the delivery of public goods or services where state ownership is deemed more efficient or reliable than contracting out to private operators; (2) the operation of natural monopolies where market regulation is deemed infeasible or inefficient; and (3) support for broader economic and strategic goals in the national interest, such as maintaining certain sectors under national ownership, or shoring up failing companies of systemic importance"[7]. In order to understand if the decision of creating (and sustaining) of an SOE is well grounded it is worth looking at the definition of the market failure and what tools are in hands of the government to address it.

According to economic theory establishing and owning a commercial entity is only the last resort solution by the government after other regulatory and fiscal tools have been exhausted. The reason for that is the fact that establishing government owned company often comes with unwanted side-effects and risks that might outweigh the positive gains from tackling the problem caused by the market failure. For example, this explains why there has been a trend in the Western economies to gradually liberalize utility sector by rather safeguarding the public interests through instruments such as consumer protection, universal service or reliability standards.

Market failure

Market failure is a situation in which relevant market sector is unable to ensure the efficient deployment of scarce resources by systematically creating overcapacity or deficiency of a product or service that might arise in a non-regulated market with problems such as public goods, external (side) effects or incomplete competition[8]. The most significant market failures[9],[10] are:

— Market can ensure the production of private goods, but does not provide for the production of public goods;

— External influences or unforeseen side effects of production or consumption, including controlling for negative externalities;

— Monopolies or lack of competition;

— Unemployment;

— Inefficient income distribution;

— Lack of information.

Market failure negatively affects the overall economy. Therefore, government plays a major role in avoiding such situations and enhancing the economic growth. To overcome market failure, the government can use various measures that are discussed in following section.

2.1.2.2 The role of government in a situation of the market failure

Overall government has four main functions in a market economy — to increase efficiency, to provide infrastructure, to promote equity, and to foster macroeconomic stability and growth. In order to increase efficiency government has to correct problems

7 OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 EDITION
8 Cabinet of Ministers of the Republic of Latvia, Annotation of Initial Impact Assessment of the Draft Law "Amendments of State Administration Structure Law", Retrieved from: tap.mk.gov.lv/doc/2005/EMAnot_120313_VPIL.365.doc
9 State Administration Structure Law, Retrieved from: https://likumi.lv/ta/en/en/id/63545
10 Economics Online, Types of market failure, Retrieved from: http://www.economicsonline.co.uk/Market_failures/Types_of_market_failure.html

of market failure. Government intervention to correct market failure always has the potential to move markets closer to efficient solutions. Furthermore, it is expected that only government can eliminate the market failures and enhance the market competitiveness and public welfare[11].

As it is discussed previously, one of the methods of government's interventions in market failure is creation of SOEs and public undertakings. In some cases market failure is not a sufficient justification for the use of this method and there could be other ways that are more efficient to prevent the market failure. According to the CSCC[12] there are several alternative tools in hands of government to address the market failure:

1 Market regulation and controls (including certificates and licenses);
2 Fiscal policy;
3 Government procurement;
4 Campaigns.

Market regulation and controls

To prevent the market failure, the government can issue laws and regulations that prohibit certain behaviour and actions. Regulations can limit or prevent various cases such as 1) Demerit goods (alcohol, drugs, and smoking); 2) Goods with negative externalities (burning of coal); 3) Abuse of monopoly power; 4) Exploitation of labour, and others. Compared to implementing changes in the fiscal policy, this method can provide a quick market response and give immediate results. In some cases, market failures can be corrected with new regulations at significantly lower cost.

Another market failure measure that is similar to the regulatory solution in that the amount of the good used is reduced through licensing. Licenses are legal agreements that grant legal permission to do something or to produce a product. Examples of cases of licensing that are relevant to market failure prevention are, for example, when government grants licenses to entrants in specific industries such as communication industries (radio and TV broadcasting), professions (doctors) and services (banking, liquor outlets)[13]. Government licensing represents an important barrier to entry in these industries.

Fiscal policy (taxation and/or subsidies)

Government can protect public interest by intervening in the market for goods that are characterized by significant external influences. The tax / subsidy alternative is government control over production in order to achieve maximum social welfare level by determining the price or volume of the goods. This is a relatively simple form of intervention and the overall principle is to tax the goods with negative externalities and grant the subsidies to goods with positive externalities. Economic inefficiencies caused

11 Libraries of University of Minnesota, Government's Role in Managing the Economy, Retrieved from: http://open.lib.umn.edu/exploringbusiness/chapter/1-7-governments-role-in-managing-the-economy-2/
12 CSCC, Guidelines for setting the overall strategic objectives for Public participation, Retrieved from: https://www.pkc.gov.lv/sites/default/files/inline-files/SMNV_30032016_.pdf
13 OECD, Glossary of Industrial Organization economics and Competition law, Retrieved from: http://www.oecd.org/regreform/sectors/2376087.pdf

by external influences can be partially addressed through regulations that prohibit or restrict actions with negative external influences.

The main difficulties, when applying taxation/subsidies policy to prevent a market failure, arise due to the determination of the required amount of tax / subsidy to correct the external impact. In spite of these difficulties, many economists consider taxes and subsidies as the most effective way to address this market failure in most cases.

Government procurement

This form of market failure prevention measure is in case when private sector is contracted by the state to make a procurement – if the state can specify the volume and quality standard of the goods, then the tax revenues can be used to pay a private sector company for the supply of the goods. If the volume and quality of the goods is difficult to determine and if the supervision and execution of the contract of attraction of the private sector is expensive, then priority is given to state enterprises.

Although government procurement can also be used as a solution to monopolies and external influences, regulation and taxes / subsidies are appropriately preferred alternatives if the costs and inefficiencies associated with government procurement are significant.

Information campaigns

According to the available information from OECD, campaigns could be used as an alternative to traditional regulation in order to prevent a market failure. This market incentive could be applicable if market failure is caused by the lack of information, e.g., using an information campaign as a tool to raise public awareness about certain issues or increase compliance with regulations[14].

2.1.2.3 Risks of Using the SOEs as an Instrument

In the case that none of the instruments of dealing with the market failure is effective, the establishment of an SOE can be a solution. It should be considered, however, that this is not a risk free option.

In several Western economies such as Germany, Ireland, the United Kingdom and the United States governments have acquired substantial stakes and in some cases full ownership of a number of private firms in efforts to revive economies that were teetering on the edge of collapse. Yet historically, government ownership of private companies has been notorious for lowering productivity, wasting resources, and distorting competition—often as a result of unclear objectives, political interference, lack of discipline, and poor transparency.[15]

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14 OECD, Alternatives to Traditional Regulation, Retrieved from: https://www.oecd.org/gov/regulatory-policy/44941844.pdf

15 Simon C. Y. Wong "Improving corporate governance at SOEs: An integrated approach,"Corporate governance Internationa, 2004, Volume 7, Number 2, June 2004. Retrieved from:

In addition, the theoreticians recognize that once the path of creating SOEs is chosen the government tends to expand the mandate of these entities. Heath and Norman[16] identify five key categories of responsibilities that the state, a major and highly influential stakeholder, assigns to the SOE task environment.

1. Macroeconomic. SOEs are pushed into counter-cyclical spending during recessions, for example, to level out the business cycle; create over-capacity and "make work" projects to stem unemployment and safeguard employment levels; and check inflation through wage and price controls. The government can also leverage the SOEs to meet specific fiscal objectives.

2. National interest. Often the "house stewards" of the national industry, SOEs provide domestic firms with subsidized goods and services (especially energy) and markets guaranteed to favour domestic suppliers over foreign suppliers. The SOEs can be a card of national strategic interest, used by the government to invest in sectors of national priority or to support the development of emerging industries to raise international competitiveness. The SOEs are also a mechanism to ensure state ownership and control of the industries, information, and productive technology considered of vital importance to national security.

3. Redistribution. The state relies heavily on the SOEs to help achieve redistributive goals. This normally translates into refraining from the kind of price discrimination practices adopted by profit-maximizing private firms to ensure that the same services are delivered at the same price nationwide (e.g. postal service).

4. Model employer. SOEs are held up as model corporate citizens obliged to 'lead by example' and to act as a 'pressure gauge' for the private firms. As a result, the SOE tends to offer higher wages, superior benefits (e.g. on-site daycare) and better job security, and to hire more women or members of disadvantaged minorities.

5. Reduction of externalities. The main social responsibilities of an SOE are to produce positive externalities while the need to control negative externalities means the state keeps certain SOEs firmly in the public sector domain. This is particularly the case of the liquor and gambling industries, where the state monopolies act to prevent the private enterprises from producing "too much" of the relevant good. Likewise, the public ownership of industries with the potential to create catastrophic environmental externalities (such as uranium mining and refinement, nuclear energy generation, etc.) serves the same purpose.

With such a broader agenda in mind the government as shareholder can easily be distracted from the original goal of dealing with the problem of specific market failure and start justifying the existence of the SOE. It might overshadow the judgment on whether the creation of the SOE is the most optimal solution for the original problem.

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https://www.mckinsey.com/industries/public-sector/our-insights/government-ownership-why-this-time-it-should-work

16 Heath, J., Norman, W. (2004). Stakeholder Theory, Corporate Governance and Public Management: What can the History of State-Run Enterprises Teach us in the Post-Enron era? *Journal of Business Ethics, 53*(3), 247-265. https://doi.org/10.1023/B:BUSI.0000039418.75103.ed

2.1.2.4 Forms of entities through which the state may act

The State Administration Structure Law (SASL) provides that the Republic of Latvia is an initial public legal person (*sākotnējā publisko tiesību juridiskā persona*), and it acts through its institutions. As a public person the state may establish other public or private law legal persons or entities, which have their own legal capacity.

The Latvian legislation provides several types of entities, which the state may establish and through which it may act. Institutions and public agencies are a part of the public governance system and ensure public governance functions. Activity in private sector can be performed through companies.

Institutions

The SASL provides an option for the state to establish and act through its institutions. The institutions are a part of public governance system and according to the definition provided by the law an institution performs only public governance functions. An institution represents state and acts on behalf of the state, it is not a separate legal entity and does not have a separate legal capacity. Institutions are financed from the state budget.

State agencies

Public Agencies Law (PAL) provides regulations for a special type of state institution – public agency (*publiskā aģentūra*).

State agency is a state institution, which provides services within the public governance tasks determined by a separate law or by regulations of the Cabinet of Ministers, including implementation of state and international projects and programs. Article 4 of the PAL provides that a state agency is financed from service fees as well as from other income, donations, gifts and foreign financial aid, unless provided otherwise by law.

As the state agency is a type of public institution, it is not a separate legal entity and it represents the state and acts on behalf of the state.

Institutions and state agencies can only operate to ensure public governance functions. Further in this report legal forms for operation in the private sector are described.

Partnerships

According to the Commercial Law (CL) partnership (*personālsabiedrība*) is a joint venture of two or more persons, which is established by a partnership agreement with the purpose to perform commercial activity. Partnership is not a separate legal entity. CL provides two types of partnerships – general partnership (*pilnsabiedrība*) and limited partnership (*komandītsabiedrība*). In the general partnership the liability of partners towards the creditors of the partnership is unlimited. The partners are liable for the loss resulting of partnership's commercial activity with all their property. In the limited partnership the liability of at least one partner is limited to its contribution in the partnership while liability of other partners remains unlimited.

In general, SASL does not permit the state to participate in partnerships but only to be the shareholder in the companies. Under Article 88 part (1) of the SASL participation in the partnerships could be allowed only under certain circumstances when the state would perform transactions necessary to ensure its operations.

Companies

According to CL a company has a commercial purpose and it has a share capital consisting of the total of par value of shares. The company can exist if there is at least one shareholder. A significant difference between companies and partnerships is that a company is a separate legal entity with its own legal capacity, and the shareholder's liability towards the creditors of the company is limited only to its contribution into the company's share capital.

CL provides for two types of the companies – a limited liability company (*sabiedrība ar ierobežotu atbildību* or *SIA*) and a joint stock company (*akciju sabiedrība* or *AS*):

	Limited liability company (SIA)	Joint stock company (AS)
Minimum share capital	EUR 2 800	EUR 35 000
Administrative bodies	Shareholder meeting, management board, supervisory board (rare)	Shareholder meeting, management board, supervisory board
Competence of shareholder meeting	In any matter	Limited by law
Extraordinary shares	No	Yes, incl. personnel shares
Shares can be listed	No	Yes

Figure 2 Types of companies. The Commercial Law (https://likumi.lv/ta/en/id/5490-the-commercial-law), KPMG analysis

For a limited liability company the supervisory board is optional and is established very rarely. For the joint stock company the supervisory board is obligatory.

However, the SOEL states that for companies fully owned by the state:

— the supervisory board is permitted only if (1) net turnover is above EUR 21 million and (2) balance sheet total exceeds EUR 4 million;

— for both types of companies (SIA and AS) the competence of the shareholder meeting is limited to the matters listed in the SOEL, that is:
  - 1) to approve the annual account of the company;
  - 2) to distribute the profit;
  - 3) to elect and revoke members of the executive board and the chairperson of the executive board (if a supervisory board has not been established in the company);
  - 4) to elect and revoke members of the council (if such has been established);
  - 5) to elect and revoke an auditor;

- 6) to bring a claim against a member of the executive board or supervisory board (if such has been established) and the auditor or to withdraw a claim against them, as well as to appoint a representative of the company for representation of the company in court;
- 7) to approve and amend the articles of association of the company;
- 8) on the amount of remuneration for the auditor, members of the supervisory board (if such has been established) and members of the executive board (except cases when a supervisory board has been established);
- 9) to increase or decrease the equity capital;
- 10) to reorganise the company;
- 11) to elect and revoke of a liquidator;
- 12) to approve the medium-term operational strategy, except the case if a council has been established;
- 13) other issues referred to in SOEL.

Article 161 of the SOEL requires to transform the state owned company, which issues administrative acts or administers state duty and income of which is formed from the state subsidies or provision of services as a result of implementation of delegated public governance tasks, into institution or public agency, unless the Cabinet of Ministers decides otherwise.

Public foundations (establishments)

Although there is no specific legal framework for the public foundations (*fonds*) in Latvia, there exist several public foundations, also called establishments (*nodibinājums*), which are established by the state according to a special law on each particular foundation.

For example, State Culture Capital Foundation is established as a separate public legal person (*publisko tiesību juridiskā persona*). The goal of the foundation is to promote a balanced development of innovations in all culture and art sectors and preservation of the cultural heritage. It is financed from state budget and various other sources, including private donations. Its highest administrative body is council, the executive role is performed by a director.

Another example is the Public Integration Foundation, which is established as a derived public person (*atvasināta publisko tiesību juridiskā persona*). The goal of the foundation is to support and promote integration of society, to support implementation of the public and private sector development programs. It is financed from the state and municipalities budgets, and various other sources, including private donations. It is administered by its council and is supervised by the Cabinet of Ministers.

Notwithstanding the existence of several public foundations, the government policy during the last couple of years regarding establishment of public funds has been that the state should not participate in them, therefore new foundations have not been established or they have been established in a status of the state institutions (see above).

Associations

Associations and Establishments Law (AEL) provides that an association (*biedrība*) is a voluntary association of persons with no character of gaining profits. An association is a legal entity with its own capacity. Members of the association are not liable for liabilities of the association towards its creditors.

There shall be no less than two members in an association. Members can be individuals and legal persons.

The association has a right to perform economic activity only as an ancillary activity, which is related to management and use of its property, and to perform other economic activity purported to implement the goals of association. AEL states that the income of an association can be used only for purpose of implementation of non-profit goals provided in its articles of association. Profits gained from the commercial activity cannot be distributed to its members.

The administrative bodies of an association are a meeting of the members and a management board. Other administrative bodies can be established according to the decision of members meeting. The competence of the meeting of members is not limited by law, it can decide on any matters. The management board is managing and representing an association.

However, Article 88 of the SASL does not provide an option for the state to participate in the associations or establish the associations (see next sections).

2.1.2.5 Forms of entities through which the state may act in the private sector

According to the SASL state has a status of public person. Article 88 part (1) of SASL provides that a state may act in the area of private law only by (1) performing transactions necessary to ensure its operations, (2) by provision of services, (3) by establishing companies or acquiring ownership in the existing company.

According to the Article 88 part 2 of the SASL a state can establish or acquire shareholding in a company only in order to ensure more efficient performance of its functions and if one of the following conditions is fulfilled:

— the market failure – the situation when the market is unable to ensure implementation of public interests in the particular area – is eliminated,
— as a result of operation of public company or company controlled by another public company the goods or services are created, which are strategically important for development of the territory of the state or municipality, or for state security,
— such properties are managed, which are strategically important for development of the administrative territory of the state or municipality, or for state security.

Before establishment of the company or acquisition of the shareholding, the state institution intending to initiate state shareholding in a company shall perform prior assessment of the planned action, including the economic assessment, in order to ensure that the goals of the planned action cannot be reached by other means.

The SOEL provides that the decision on acquisition or termination of the state ownership in a company, or acquisition or termination of the decisive influence in a company shall be initiated by the sector ministry or institution holding shares on behalf of the state. The decision proposal submitted to the Cabinet of Ministers shall be supported by the above assessment and explanation on goals of state's shareholding. If the holder of existing state's shares is other institution than a sectoral ministry, the ministry and coordination body is involved to provide its opinion. According to the SOEL, the coordination body's (CSCC) opinion is mandatory in any case. The decision regarding the acquisition or termination of the state ownership in a company, or acquisition or termination of the decisive influence in a company is made by the Cabinet of Ministers.

Accordingly, a ministry responsible for implementation of certain public function, intending to establish state's ownership in a company on behalf of the state in order to support this function, has to assess whether there exist preconditions and grounds for the state's shareholding. The Cabinet of Ministers has competence to make decision on state's shareholding. If the decision is affirmative, then the Cabinet of Ministers must appoint the institution which will be holding the shares on behalf of the state. According to the SASL it can be ministry or other state institution.

If the shareholding is established, the necessity of it shall be continuously monitored. Article 7 of the SOEL provides that state shall reassess at least once in five years its every shareholding in the companies and whether it fulfils the above conditions of SASL. After the assessment the decision shall be made whether to maintain the shareholding. There are, however, various exceptions to this rule, namely, the companies that according to specific laws (e.g. Energy Law or the Law on the Completion of Privatization of State and Municipal Property and Privatization Certificates) cannot be privatized. For those enterprises which by the Law are not subject to privatization such a regular evaluation is not required by SOEL.

In the companies, which are directly controlled by the state, this monitoring is implemented by medium term strategy document. The reassessment of shareholding (together with setting SOE's strategic goal) is obligatory and is a precondition to submit its strategy documents that are otherwise not accepted. The SOEL provides that this strategy is approved by the shareholder meeting and should include analysis of market, strengths and weaknesses, financial and non-financial goals of the company etc. The term of the strategy is at least three years, however the financial and non-financial goals are not set for more than seven years.

This requires the sectoral ministries or other institutions holding shares on behalf of the state to make regular assessment whether or not the SOE is fulfilling its set goals and if the SOE in question is the only alternative to reach the pre-set strategic goal. If as a result of the assessment a conclusion is made that conditions are not met, the state must terminate its shareholding.

Regarding the indirect shareholding Article 4 of the SOEL states that a company, which is fully state owned, may have shareholding in another company, if: 1) operation of another company complies with the one of the three conditions laid down in Article 88 of SASL, or 2) the shareholding in another company ensures implementation of the strategic goals and goals provided in the medium term strategy of the shareholder. The company which intends to establish or acquire shares in another company shall make prior assessment whether the shareholding will ensure rational and economically justified use of resources, taken into consideration the principles of good corporate governance. The assessment shall be submitted to the Cabinet of Ministers, which shall make decision on acquisition of the shareholding. If the company fully owned by the state acquires control in another company, then the subsidiary shall draft and approve its medium term strategy.

2.1.3 Typology

2.1.3.1 Typology of all Latvian SOEs

The majority of the stake holdings – 93 companies are held directly via one of the ministries or public entities. There are some exceptions, e.g. Altum, which is held by three ministries. Additionally, it is to be noted that unlike other OECD / EU countries[17], many (66) of the Latvian SOEs are fully (100%) directly owned by the state, meaning that the state can have a high level of influence on these companies.

As realized in an interview with the CSCC, it is currently still to be determined how the subsidiaries of 100% directly owned companies shall be governed and what is the right degree and channels of influence the state should use.

Latvian SOE landscape split by ownership type			
Direct ownership		**Indirect ownership**	
Full (100%) ownership	66	Full (100%) ownership	18
Majority ownership	4	Majority ownership	27
Ownership of 20-50%	4	Ownership of 20-50%	9
Ownership below 20%	16	Ownership below 20%	6
Ownership below 20%, in insolvency proceedings	3	Majority ownership, in liquidation	5
Ownership below 20%, in liquidation proceedings	1		
Sub-total	94		65
Total			**159**

Figure 3 Latvian SOE split by ownership type. CSCC data, KPMG analysis

Please refer to Annex C for a complete CSCC list of all SOEs in Latvia.

State has varying influence on the SOEs depending on the type of the ownership in the companies. So, for example, the SOEL suggests that for companies, which are controlled by the state, the strategy considerations shall be made via mandatory medium term strategy document. Similarly, as suggested by the CSCC guidelines for determining SOE overall strategic objectives, the guidelines are mandatory only for the 100% owned SOEs. Consequently, the direct influence on SOEs, their strategies and target setting is more visible and realistic for the 100% owned SOEs.

17 OECD, Review of the Corporate Governance of State-owned enterprises, Retrieved from: http://www.oecd.org/daf/ca/OECD-Review-Corporate-Governance-SOE-Latvia.pdf

Also as discussed during an interview with the CSCC, in many aspects the endeavours towards the improvements of corporate governance, strategy setting and dividend considerations are currently aimed only at the companies where state directly holds a 100% stake.

When reviewing the Latvian SOE governance structure in terms of the stake holding bodies, Figure 4 displays an insight into SOEs that are fully directly owned by the State Shareholders. Noting that the Ministry of Culture, Ministry of Health and Ministry of Transport each oversee more than ten SOEs, it is important to consider that even though varying in company sizes, these sectors are particularly dominant by the company count in the Latvian SOE landscape.

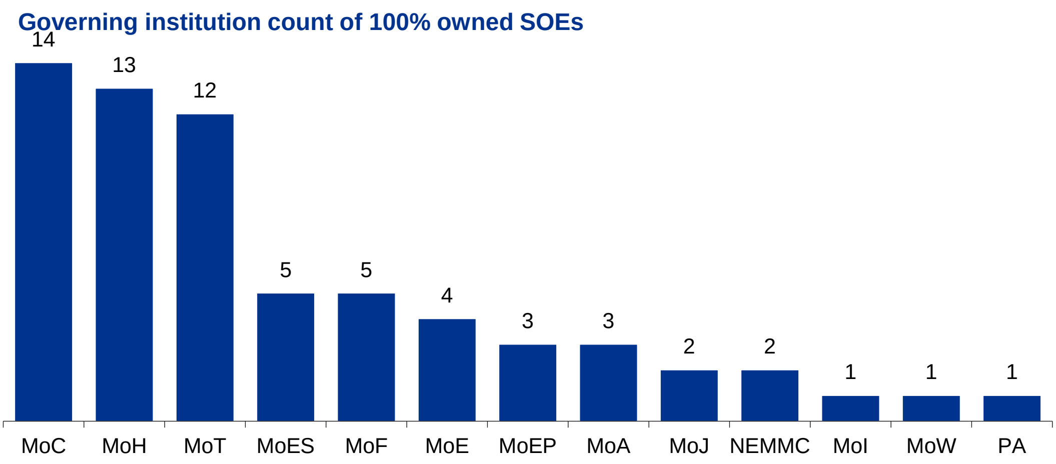
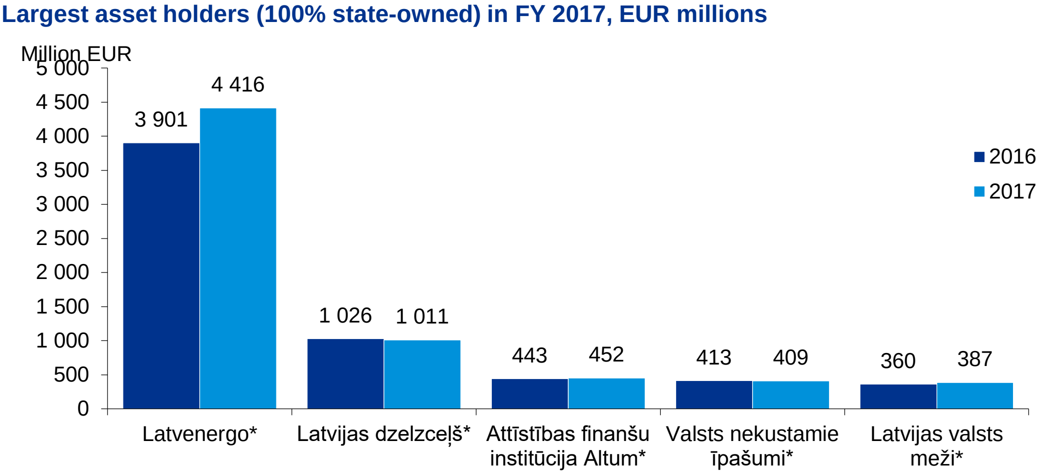


Figure 4 Governing institution split of fully owned Latvian SOEs. Altum is included at the Ministry of Finance. CSCC data, KPMG analysis

The consolidated results of the 66 SOEs which are 100% owned by the state in 2017 comprised 85% of the total asset base and 69% of the total revenue generated amongst all SOEs. A few of the majority owned companies (Air Baltic Corporation and Lattelecom) constitute half of the remaining assets and revenues, and other companies and minority shareholdings account for a small part of the total value.

Although the total number of SOEs in Latvia is 159 (as shown in Figure 3 and Annex C), further analysis includes only 66 SOEs that are fully owned by the state. Including all SOEs into the analysis would not be representative of the portfolio of SOEs that can be directly influenced through different mechanisms available to the CSCC, and insignificant state ownership might not have any influence on the company and SOEs in liquidation or insolvency procedures are better described as outliers rather than part of the group. Therefore, further analysis is provided for the 66 SOEs, which are fully owned by the state.

As in case of revenue, the two largest SOEs by assets are Latvenergo and Latvijas dzelzceļš. However, if by revenues Latvenergo was 2-3 times larger than its next follower, by assets the company exceeds Latvijas dzelzceļš almost 4 times. The five largest SOEs by assets (wholly state owned) are provided below.



*consolidated
Figure 5. Largest SOEs (100% state-owned) by assets. CSCC data, KPMG analysis

The current Latvian SOE landscape presents a wide variety regarding the size (assets, employment, and market share/share of GDP), profitability, objectives and role in the market.

From the revenue and asset perspective Latvian SOE landscape is largely dominated by energy sector companies (Latvenergo and Sadales tīkls among the largest SOEs) followed by transportation segment – railway companies (Latvijas dzelzceļš, LDZ Cargo). The representation analysis below includes the entities that are fully consolidated within the group entities in full state ownership.

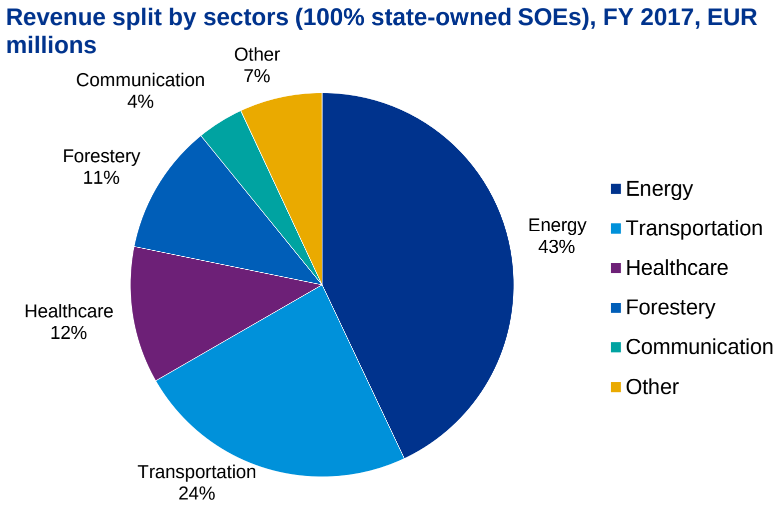


Figure 6 Revenue split by sectors (100% state-owned SOEs), CSCC data, KPMG analysis

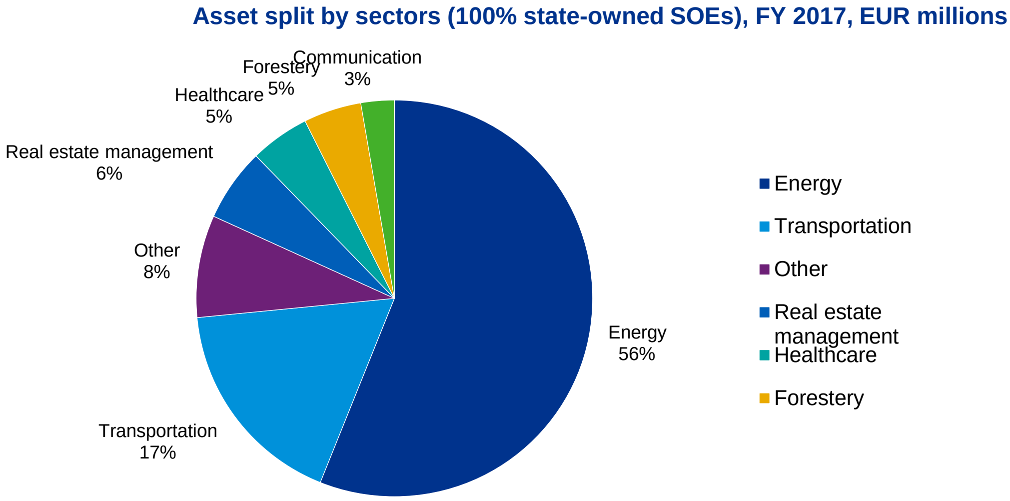


Figure 7 Asset split by sector (100% state-owned SOEs), CSCC data, KPMG analysis

When comparing the sectoral revenue data for 2016 and 2017, the energy sector has maintained its dominance by accounting for 43% of the total revenue spectrum, while transportation sector's contribution has slightly decreased from 25% to 24%.

The shares of sector contribution are largely dependent on individual state assets arising from large companies significantly driving up the importance of single sectors. When singling out the largest Latvian SOEs according to the revenues, it becomes clear why particular segments account for the largest share of the total revenues. The two largest SOEs by revenue are representatives of the two leading sectors – Latvenergo and Latvijas dzelzceļš. In fact, these two SOEs together contribute more than 49% of all fully owned SOE revenues in 2017.

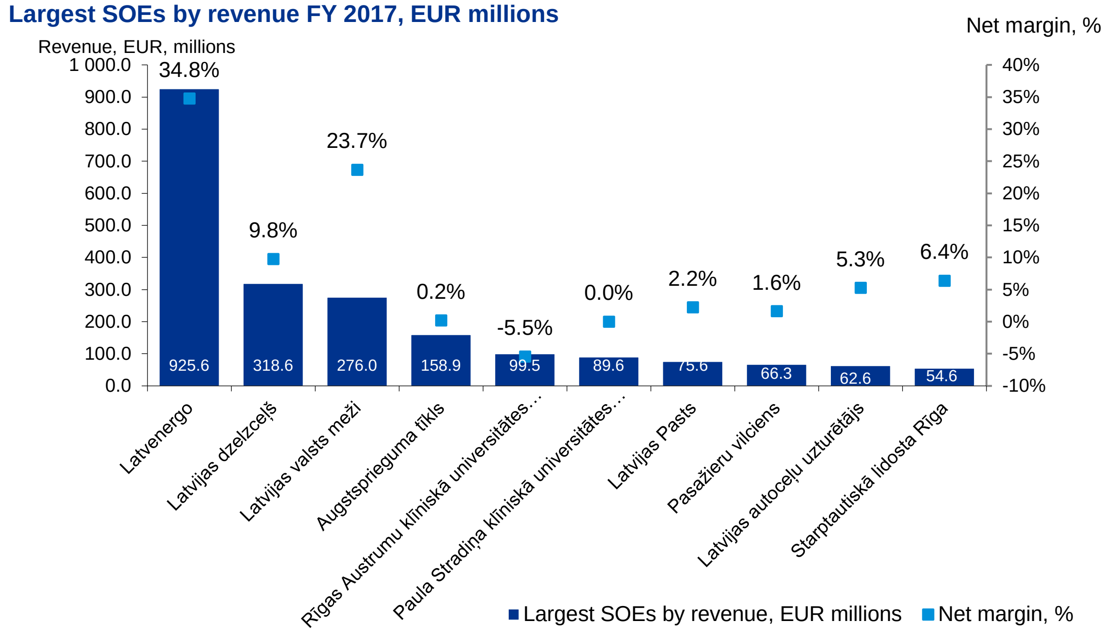
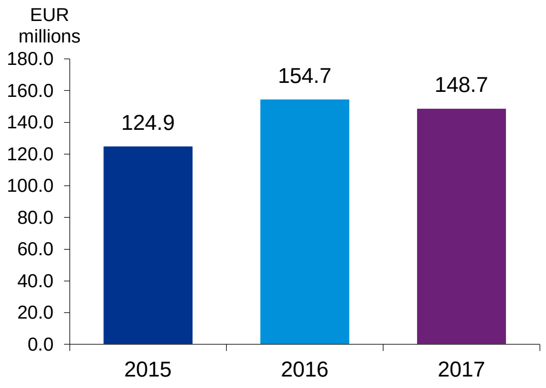


Figure 8 Largest SOEs by revenue, CSCC data, KPMG analysis

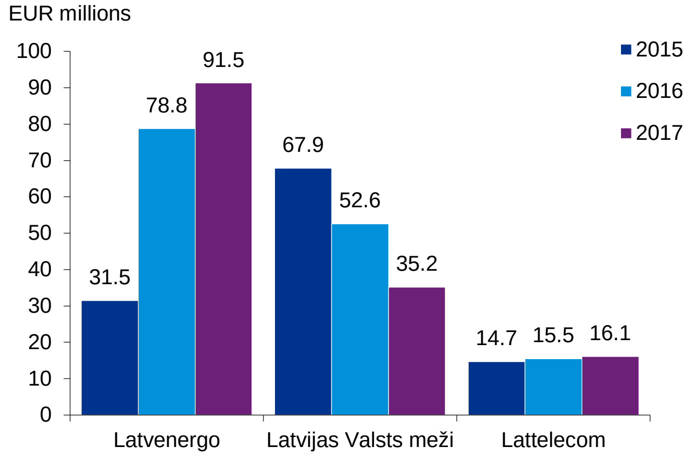
Three other SOEs – Air Baltic Corporation, Lattelecom, Latvijas Mobilais Telefons – that are not fully owned by state – are among the largest contributors to the economy of Latvia and together made 700 million EUR in revenue in 2017. Large SOEs appear to be more profitable as well, although some large enterprises – Augstsprieguma tīkls, hospitals and Air Baltic Corporation – are just breaking even, the profitability of other large players (Latvenergo, Latvijas Valsts meži, Latvijas Mobilais Telefons and Lattelecom) is quite high, averaging their net margin at almost 24%. Besides, the ability to earn profit among these companies does not appear to stagger a lot.

In 2017, EUR 148.7 million were received from SOEs in dividends. The three largest contributors – energy company Latvenergo, forestry enterprise Latvijas Valsts meži, and telecommunication enterprise Lattelecom – accounted for 95% of total dividends. Additionally, in 2017 SOEs contributed EUR 800.5 million in taxes and dividends to the state and municipality budgets.

Total dividends paid on a yearly basis, EUR millions



Largest dividend payers FY 2017, EUR millions



Total dividends paid by industry, EUR millions

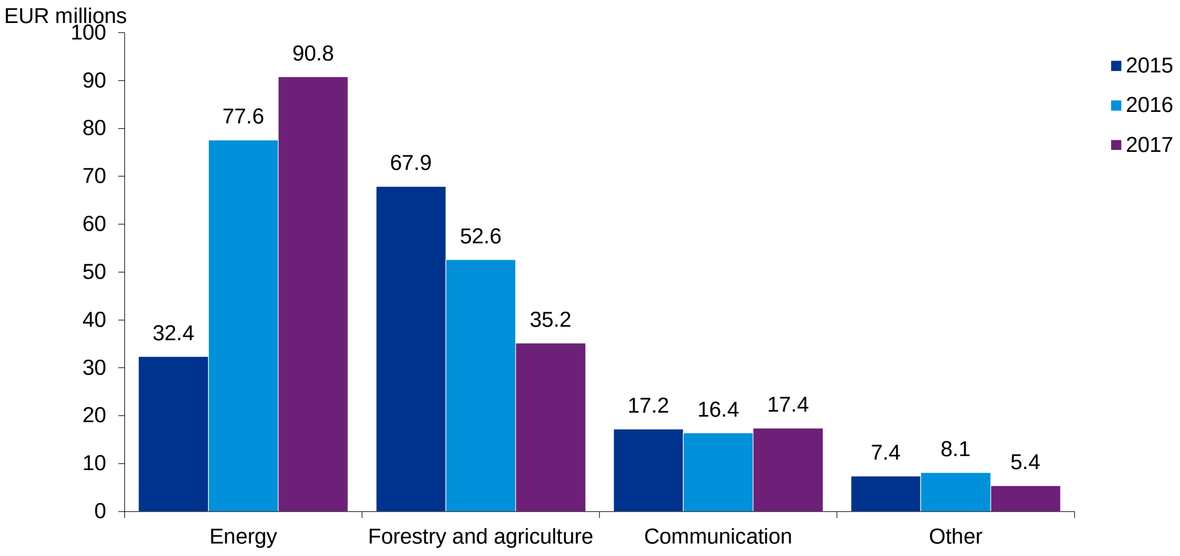
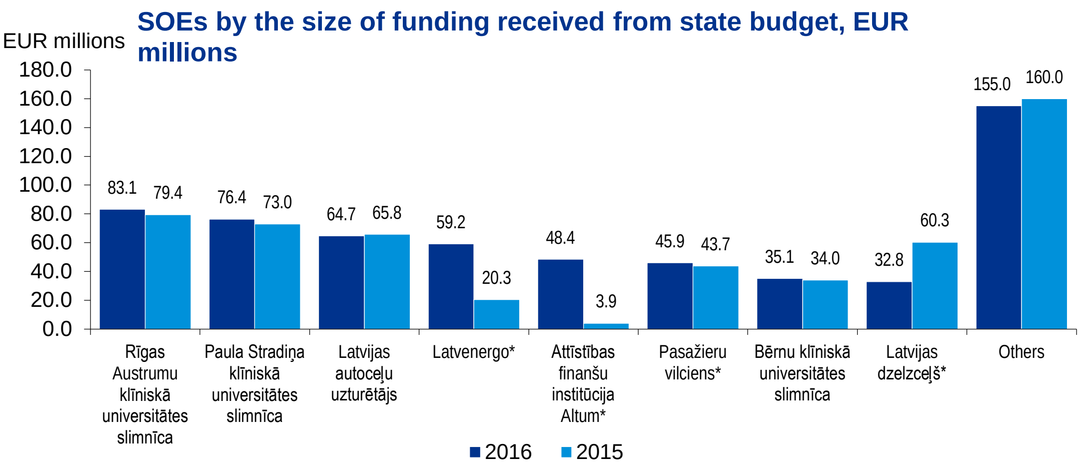


Figure 9 Dividends of Latvian SOEs, CSCC report data (http://www.valstskapitals.gov.lv/images/userfiles/parskats_final-2.pdf), KPMG analysis

Nevertheless, a large share of SOEs are receiving substantial funding directly or indirectly from the national budget (subsidies, payment for services and other financial recourses). In 2016 SOEs received more than EUR 600 million in such form of funding. Even though it is 11% higher than the 2015 total of EUR 540 million and the received funding considerably exceed the dividends paid out, this number is smaller than the direct tax contribution of SOEs. In 2017 1.12 billion EUR were paid to SOEs from the national budget but the bulk share of this payment – 454 million EUR was paid to Latvenergo as an one-time compensation for combined heat and power plant support payments. The data for state budget payments in 2015 and 2016 provide a better and undistorted overview of the largest recipients.

Unsurprisingly, the two largest receivers of the funding directly or indirectly from the national budget (subsidies, payment for services and other financial recourses) are the largest healthcare enterprises (hospitals) – Rīgas Austrumu klīniskā universitātes slimnīca and Paula Stradiņa klīniskā universitātes slimnīca, followed by the state road maintenance enterprise Latvijas autoceļu uzturētājs. These three SOEs together received 37% of all national budget funding to SOEs.



*consolidated
Figure 10. State support to Latvian SOEs. CSCC data, KPMG analysis

Given that the CSCC and the State Shareholders have direct influence only on the governance of 66 100% owned SOEs, and this group of 66 companies contribute 85% of the total Latvian SOE asset base, we suggest that the recommendation and findings of this report primarily consider this segment of SOEs in Latvia. The government as shareholder would benefit from applying the same accountability standards also to the remaining SOEs (majority / minority shareholdings, indirect ownerships), however there is limited possibility to enforce those requirements directly. Gradual approach in the implementation shall be undertaken starting with the shareholdings that are in a more direct control of the state (majority shareholdings, daughter companies of 100% owned SOEs). Similar considerations could be further made for the entities that are municipality owned.

2.2 Comparative analysis of SOE policy in Latvia and among EU/OECD peers

In order to allow learning from the best practice EU and OECD countries Latvian SOE policies are benchmarked against peers in Estonia, France, Italy and Sweden.

All countries demonstrate a similar pattern of having the largest SOE presence in infrastructure intensive sectors such as energy and transport. In the majority cases the investment and divestment decision-making has been driven by the opportunities in market or budgetary pressure on the government. Only in Sweden there has been a structured longer term future looking mandate by the government in terms of privatization. As for the management of state ownership the French and Swedish models stand out by using a centralized state shareholding model, hence also minimizing the potential conflict of interest arising from ownership management and policy / regulatory functions being in the same hands.

With respect to the new investments including the novel sectors majority of peers associate it with support to innovative business run by development financial institutions via equity instruments. When it comes to less traditional sectors for operations of the state owned commercial entities such as health care and culture the Latvian model stands out, as other peers have identified other non-profit or non-commercial organizational forms to govern public entities in these sectors.

2.2.1 Typical sectors with high state ownership

As of 2017, the **Estonia's** largest SOEs according to revenue were Eesti Energia (electricity production), Elering (electricity transmission system operator), Riigi Kinnisvara (real estate management company) and Tallinna Sadam (Port of Tallinn)[18]. SOEs have assets worth about 6 billion euros and they employ about 15,000 people[19]. In addition to the 29 state owned companies in the state's portfolio as at July 2018, Estonia also has a large cohort of foundations (65) that are governed under the same legal framework (State Assets Act) as SOEs, but separated in terms of the legal form of the entities in the state portfolio[20]. Similarly, a large share of state's investments are realized through non-profit entities (115). Additionally there is one profit-making state agency "State Forest Management Centre", which is regarded as an SOE and is regulated by a special Forest Act[21]. The typical sectors for the state ownership in Estonia are historically formed and similarly as in Latvia mainly follow sectoral policy and state security reasons. The activities of central state government companies include energy (Eesti Energia and Elering), transportation and logistics (Estonian Railways, EVR Cargo,

18 Ministry of Finance of Estonia, Brief summary of state-owned companies in 2017, Retrieved from: https://www.rahandusministeerium.ee/sites/default/files/2017_luhikokkuvote_au-d.pdf
19 Ministry of Finance of Estonia, Governance of State ownership, Retrieved from: https://www.rahandusministeerium.ee/et/riigivara/riigi-osaluste-valitsemine
20 Ministry of Finance of Estonia, State Assets, Retrieved from: https://www.rahandusministeerium.ee/en/state-assets
21 Estonian State Forest Act, Retrieved from https://www.riigiteataja.ee/en/eli/ee/Riigikogu/act/528062018009/consolide

Rail Baltica, Nordic Aviation Group, Eesti Post) as well as harbours and an airport (i.e. Port of Tallinn, Tallinn Airport)[22].

In **France** the Government Shareholding Agency (Agence des Participations de L'État – APE) holds stakes in 81 companies (mainly large corporations) with an approximate total revenue of EUR 144 billion and a market value of shareholdings close to EUR 100 billion for 2017[23]. The majority of the shareholdings are not 100% owned. Current SOE portfolio is diverse including a wide range of historical investments in the typical French industries such as energy, manufacturing, services and finance as well as transport. Some of most significant holdings of French SOE portfolio, similarly as evidenced in other OECD countries as well as Latvia, are in the energy sector (companies as Engie and EDF that are both also listed on stock exchange). One of the dominant sectors – manufacturing – includes such worldwide known producers as Renault (car manufacturing) and Airbus (aerospace).

In addition to APE, there are two other state participation governing bodies: BPIfrance – an investment company, which aims to foster the economy and increase competitiveness of French companies and Caisse des Dépôts et Consignations (CDC), which acts as a major long-term institutional investor with holdings in social real estate, sustainable energy companies and others. The three mentioned governing bodies are discussed in more detail in the Section 2.4 of this Report.

From the portfolio of the state's listed shares, the energy sector constitutes 49.5% of the EUR 66 billion market capitalization, while aerospace accounts for 24.1%, telecoms for 7.5% and the automotive sector for 7% respectively[23].

According to OECD the **Italian** SOE landscape is relatively complex and therefore more difficult to monitor. According to the estimates of the Ministry of Economy and Finance done in 2015, there were 9,465 state owned enterprises (SOEs), of which 557 central government-owned enterprises, 8,222 local government-owned enterprises, and 252 owned by other public sector entities[24].

There are no particular sectors where the state historically has held a high ownership. The historical development has greatly shaped the portfolio of the state holding. So, for example, IRI (Istituto per la Ricostruzione Industriale) was a holding company created in 1933 at first with the main aim at saving banks following the crisis, but then ended up being a conglomerate (subject to public law) of companies subject to civil law, and operating in almost all branches of the economy – from the financial sector to airports, from companies operating in the iron and steel industry to those producing the traditional, Italian Christmas pudding, Panettone.

Also the current SOE landscape, after a major privatization process started back in 1992, provides examples of a major sectoral diversification – the list of state holdings includes Poste Italiane (postal service), Ferrovie dello Stato (railroads and train services), Fincantieri (shipbuilding) and RAI (National broadcasting company). Among the central

22 Estonian State Portal, State-owned Companies, Retrieved from: https://www.eesti.ee/eng/contacts/riigi_osalusega_ariuhingud_1/riigi_osalusega_ariuhingud_2
23 Agence des Participations de L'État, Annual Report 2016 / 2017
24 The Italian Ministry of Economy and Finance, Report on Public Participations (2015)

government owned SOEs, 37% from total revenues are attributable to the energy sector (including the largest Italian SOEs ENEL and ENI) and 26% to transportation sector (Italian Post, railway companies, the freeway management company as well as the motorway concession company ANAS).

Culture, arts, entertainment and recreation segment's importance is largely impacted by ALES – Arte Lavoro e Servizi S.P.A. – company primarily engaged in operating and managing museums, monuments, galleries and archaeological areas in Italy[25].

Similarly as in Latvia also in **Sweden** the state is an important company owner managing variously sized ownership stakes in 47 SOEs. The typical sectors with high state ownership have evolved historically[26] – 41 % of the total portfolio value comprise companies operating in the basic industries – energy (Vattenfall), forestry (Sveaskog) and minerals (LKAB). Another major contributor of 12% of the portfolio value is the Swedish telecommunications company Telia. Together these four companies constitute more than half of the portfolio value. Other sectors where state has high ownership shares include services, real estate, finance and infrastructure. From revenue perspective Vatenfall contributes to around 40% of the turnover figure realized by Swedish SOEs, followed by PostNord (11%) and Telia (9%)[27].

Conclusion

In terms of the typical shareholding sectors there is a similar pattern in all reviewed countries i.e. energy related enterprises are the largest by revenues and in most cases also by the asset value. More general, sectors with large physical infrastructure base (railways, airports, harbours, telecoms etc.) tend to play a more important role in the SOE landscape mainly arising from historical and national security reasons.

In addition to the aforementioned traditional SOE sectors, there are also more country specific industries present in the reviewed countries, such as, for instance, car and aerospace manufacturing in France, culture and arts related companies in Italy and minerals in Sweden representing the uniqueness of the individual countries in terms of natural resources or areas of specialization (manufacturing, production etc.).

2.2.2 Organization of state ownership

In certain countries, where the ownership of SOEs is not centralized, one state institution can be simultaneously the direct owner of the SOE, the underlying policy planner and the shareholding entity in the SOE (with direct influence on governance decisions). In Latvia, this approach has historically been a common practice as in many cases the only

25 Interview with SOE Experts from KPMG Advisory SpA (Italy)
26 Interview with Lars Erik Fredriksson; Investment Director of the Division for State-Owned Enterprises, Ministry of Enterprise and Innovation, Sweden
27 Government Offices of Sweden, Annual report state-owned enterprises 2016, Retrieved from: https://www.government.se/4a6e13/contentassets/e66654348c76492c8504413f3413e9a5/eng-vb-2016-final-2.pdf

shareholder of the SOE is the respective line (sectoral) ministry while being also the dominant client of the company[28].

In Latvia the State Administration Structure Law lays out the ownership rationale and rules, administering the governance of SOEs. In light of this, the discussion of separation between ownership and planning functions regarding SOEs shall be raised in order to ensure efficient control while maintaining objective sectoral policy implications.

Foreign practices display a wide mix of ownership possibilities. The typical OECD[29] defined ownership models, however, usually are:

— Centralized ownership model: a sole governmental institution has accumulated the stake holding in the entire set of enterprises controlled by the state. Usually this institution takes the form of a specially created entity or a separate government ministry, which allows for a better coordination of practices. Financial targets, operational tasks and the monitoring of SOE performance are conducted by the central coordinating entity.
— Dual model: Two government institutions – typically the respective line-ministry owns and coordinates the SOE together with the Ministry of Finance. Financial targets are usually set by MoF, while strategy is developed together with the line ministry.
— Twin track: ownership model in countries that have two individual portfolios of SOEs centrally overseen by two different government institutions.
— Mixed (or hybrid) ownership model / Coordinating agency: there is a central entity doing the coordination of the policies and goal setting (usually a separate entity or Ministry of Finance), but the shareholding is administered by the line ministries and / or other entities. This ownership model has been adopted also in Latvia.
— Decentralized ownership model: shareholding is administered by individual sectoral/line ministries in their respective fields of policy competence. In this ownership model, the overlaps and conflict of interest between ownership and policy goals are most likely to occur.

In the case of **Estonia** the **dual model** of SOE ownership is in place. According to the State Asset Law *“the shares owned by the state are administered and the founder’s rights in a company are exercised by the ministry or profit-making state agency”*[30]. According to the Estonian SOE annual report, the ownership functions and governance of Estonian SOEs are divided between 6 ministries, the majority of the SOE pool being governed by Ministry of Economic Affairs and Communication (18 companies). There are 4 companies under the ownership of the Ministry of Finance: Eesti Energia, Eesti Loto, Levira and Riigi Kinnisvara[31].) In addition, all of the minority shareholdings according to the State Asset Law are also administered by the MoF. Objectives for SOEs

28 OECD, Review of Corporate Governance of State-Owned enterprises Latvia, Retrieved from: http://www.oecd.org/daf/ca/OECD-Review-Corporate-Governance-SOE-Latvia.pdf
29 OECD, Ownership and Governance of State-Owned Enterprises, Retrieved from: http://www.oecd.org/corporate/ca/Ownership-and-Governance-of-State-Owned-Enterprises-A-Compendium-of-National-Practices.pdf
30 State Asset Act of Estonia, Retrieved from: https://www.riigiteataja.ee/en/eli/ee/Riigikogu/act/506042018001/consolide
31 Ministry of Finance of Estonia, Governance of State ownership, Retrieved from: https://www.rahandusministeerium.ee/et/riigivara/riigi-osaluste-valitsemine

are drafted by line ministries and then have to be submitted and approved by MoF implying the use of the dual ownership model as defined by the OECD.

France has consolidated the vast majority of its SOEs' ownership under one of the three governing bodies – APE, BPIfrance and CDC. As the major investments of the large corporations are managed and held by the Government Shareholding Agency APE – it can be seen as the main **centralized** body having the owner and coordinator role. This is a model that is, in many cases, recommended by the OECD as highly functional in implementing unified strategic approach and better attainment of unified government goals, provided the country has a strong and transparent governance itself[28].

A conceptually similar **dual model** to that of Estonia (however with some characteristics of a centralised model in some cases) can be seen in **Italy** where ownership and governance of the SOE pool is split between the Ministry of Economy and Finance and the separate line ministries. The ownership in some of the cases is also dual – there are two state shareholders holding a stake in the company e.g. Italian post is held 35% by the state investment agency CDP and 30% by the Ministry of Economics and Finance[25]. Line ministries are responsible for sectoral guideline development that the companies having state policy assignments should follow[29].

The ownership and governance of the **Swedish** SOEs is **centralized** via the Ministry of Enterprise and Innovation, which includes the Division for State-Owned Enterprises, responsible for administration of the majority of state-owned enterprises. There are some exceptions in terms of seven companies, which are in the responsibility of other ministries (Culture, Foreign Affairs, Finance, Health and Social Affairs)[32].

The Ministry of Enterprise and Innovation is specialized in corporate governance and company management to ensure long-term value generation in the state company portfolio[32]. It, therefore, sets the guidelines and describes the path how SOEs are encouraged to be managed in terms of corporate governance and general company management[29]. Jointly with the company, the owner develops the goals aimed at specific public policy obligations and financial targets that are tracked through regular progress meetings between the owner and the company (owner dialogue)[33].

2.2.3 Investment and disinvestment

The SOE policies can change over time, therefore the states usually reevaluate their investments and shareholdings on a regular basis in order to understand the potential need for a full or partial divestment of a specific SOE or an entire industry. Similarly, as the markets change, new situations might arise, where the state intervention in terms of new SOE establishment or investments can become necessary. Below we summarize the recent trends with respect to investments and divestments in the benchmarked countries.

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32 Annual Report 2016, https://www.government.se/4a6e13/contentassets/e66654348c76492c8504413f3413e9a5/eng-vb-2016-final-2.pdf

33 Interview with Lars Erik Fredriksson; Investment Director of the Division for State-Owned Enterprises, Ministry of Enterprise and Innovation, Sweden

In **Estonia** the number of SOEs has remained relatively stable in the recent years. From 2007 to 2018 the total number of SOEs has decreased from 37 to 29 mainly due to liquidations, mergers and sale of some of the companies.
Some of the current mandates for divestments of partial stakes in Estonian SOEs originated in 2016 when the government approved the plans for initial public offering (IPO) for two Estonian SOEs – Port of Tallinn and the daughter company of Eesti Energia – Enefit Green. This decision was of high importance especially considering the rather low liquidity of the Baltic stock exchange Nasdaq as well as the relatively inactive Baltic IPO experience in the latest years. The IPO of Enefit Green, originally planned for 2017, has now been delayed to 2019[34]. The IPO of the minority holding of AS Tallinna Sadam (Port of Tallinn), however, took place on 7 June 2018 and was oversubscribed three times amounting to the total gross proceeds of the offering at EUR 147.7 million. According to the Minister of Economic Affairs and Infrastructure Kadri Simson, the results of the IPO prove that the government's decision to list the minority holding of the state-owned port company was correct and, as planned, provided *"new opportunities for investing in Estonia as well as to activate local financial markets"*[35].
In addition, two SOEs are currently approved to be sold via public auction – EVR Cargo (new name – Operail) railway cargo operator and a road maintenance company[36].
According to the interview with the Deputy Head of State Assets Department in Estonia, there are no specific plans approved for new state investments other than direct equity investment via risk capital instruments. New sectoral activities in the near future are most likely to be performed via foundations.[36]

In **France** the major SOE governing body APE in the period from 2016 to July 2017 has concluded six share divestments with the total closing value at EUR 5.3 billion. These include entire or partial divestments in: Aéroport de Nice, Aéroport de Lyon, Safran, ENGIE, PSA and the disposal of EDF preferential voting rights. Moreover, a total of four acquisitions for the period between June 2016 and June 2017 were concluded for the total amount of EUR 530 million. The companies acquired are: FSI-Equation, holding Bpifrance's stake in Eramet, 51% of Société Technique pour l'Énergie Atomique and, finally, acquisition of one share in New AREVA holding[37]. In addition, APE also participated in the capital increase activities including the energy company EDF and Radio France.

One of APE's publicly stated objectives is to bail out companies that are facing difficulties and are considered by the government as pivotal for the economy. For example, the most recent intervention in AREVA is related to the crisis in nuclear energy sector kicked off by Fukushima nuclear incident[38].

Currently, there are ongoing discussions about potential divestments from two large state SOEs – the Airports of Paris and the state lottery company[38] (Française des Jeux) resulting from the plans of the President Emmanuel Macron to use the proceeds from

34 Estonian Public Broadcasting, State renewable energy firm Enefit may go public says Finance Minister, Retrieved from: https://news.err.ee/836929/state-renewable-energy-firm-enefit-may-go-public-says-finance-minister
35 Estonian Public Broadcasting, €1.70 share price approved in Port of Tallinn IPO, Retrieved from: https://news.err.ee/837736/1-70-share-price-approved-in-port-of-tallinn-ipo
36 Interview with Tarmo Porgand, Deputy Head of State Assets Department at Ministry of Finance, Estonia
37 APE, Annual Report, Retrieved from: https://www.economie.gouv.fr/files/files/directions_services/agence-participations-etat/Annual_Report_APE_2016-2017.pdf
38 Interview with French SOE expert, KPMG France

privatizations to finance more than EUR 10 billion innovation and research fund, which was first mentioned by the President at the World Economic Forum in Davos in 2017[39]. The fund shall support research in the battery technology, transportation and artificial intelligence. As the future of the fund is still debated, the privatization plans continue. *"The first asset to be sold off will be the Aeroports de Paris, the group which runs the French capital's three airports – Orly, Charles De Gaulle (CDG) and Le Bourget."* Interestingly, in order to complete this, a new law will have to be introduced, as according to the current law the state has to maintain a 50% stake in this company[40]. The second target for the privatization – the national lottery company Francaise des Jeux – is expected to be 50% sold via an IPO on the stock market. The state is expected to retain a stake of close to 25% in the company[41].

Apart from sectors in difficulties, there are also significant efforts and policies to invest in smaller businesses with growth potential. Those investments are handled via Bpifrance and might take the form of equity investment or loan facilities. Bpifrance has invested a total of EUR 1.92 billion in 2017. Some of their largest investments include IDEMIA (smart card and security solutions) totalling EUR 110 million with a rationale of supporting Oberthur Tech in its acquisition of Morpho (leader in identification and digital security technologies). Moreover, an investment of EUR 363 million was made in Ingenico Group (payment services), assisting the company with a stable long-term investor. Some of the larger divestments were seen in Eiffage (concession and public works) totalling to EUR 932 million over 2016 and 2017. The reasoning behind was related to the companies backing of a stable shareholder base – capital could be invested in other strategic sectors. EUR 200 million was divested from Valeo in 2014 due to stabilizing shareholder structure and a strengthened market position[42].

According to KPMG analysis there is no one distinct strategy agreed by the French Government regarding the reduction of the state involvement in the commercial sector (through divestment and privatization). Decisions on divestment of some of shares are made mostly reacting to opportunities deriving from favourable market conditions or following purely political decisions that usually trigger wide discussions in the society.

The **Italian** approach to investments and disinvestments can be seen as very heterogeneous with regard to the sectors affected by privatizations. Additionally, it has developed over time through ever-changing strategies. As a matter of example, the most "symbolic" history to be recalled, which is symptomatic of the "patchy" approach to management of SOEs in Italy, is perhaps the case of the Italian Airlines company, "Alitalia", which, after a series of privatisation attempts and other operations occurred in the past, might be re-acquired by the State in the near future[43].

39 Independent.ie, France to set up £8.7bn fund for research and innovation, Retrieved from: https://www.independent.ie/world-news/france-to-set-up-87bn-fund-for-research-and-innovation-36526958.html
40 The Local Europe AB, French government all set to fully privatise Paris airports, Retrieved from: https://www.thelocal.fr/20180307/french-government-ready-to-privatise-paris-airports
41 Reuters, France planning to sell 50 percent of lottery group though IPO: paper, Retrieved from: https://www.reuters.com/article/us-france-privatisations-lottery/france-planning-to-sell-50-percent-of-lottery-group-though-ipo-paper-idUSKBN1HF095
42 BPI France, Bpifrance Investissement Mid & Large Cap, Retrieved from: https://www.bpifrance.fr/content/download/69133/746913/file/Pr%C3%A9sentation%20MLC%20-%20Jan%202018%20%20-%20english%20version.pdf

More formally, the “nota di aggiornamento” (an update) to the “Documento di economia e finanza 2013” prepared in September 2013 discusses the possibilities of reducing Italy’s public debt up until 2017 by disposing real estate assets and performing privatizations of certain assets. The Ministry of Economics and Finance had selected certain assets for divestment:

- Eni (holdings exceeding 30%);
- STM and ENAV (direct holdings);
- SACE, Fincantieri, CDP Reti, TAG and Grandi Stazioni/Cento Stazioni (for indirect holdings) [43].

The rationale behind these divestments was to obtain financial resources for reducing public debt, while increasing the privatizable company development through new local and foreign capital, and, finally, broadening the share ownership through stock market listings increasing overall capitalization of the Italian Stock Exchange[44].

The new investments similarly as in France are also done via equity and financial instrument investments through Cassa Depositi e Prestiti (CDP). The investments in various cases are undertaken for state value maximizing reasons or in order to foster the development of Italian companies[43].

The **Swedish** state owns 100% in most of the SOEs, thus potentially leaving the room for reduction of the stakes in some of the sectors. Among the existing portfolio the State has recognized 6 to 7 possible targets for divestment. For each such target the Parliament has granted a mandate to the Government to consider the potential disposal that can be exercised based on specific cases.. The stake for ownership decrease can also be flexibly adopted[45]. The recent changes in the company portfolio in Sweden include reduction of the state’s stake in national airline SAS as well addition of Saminvest – state’s new venture capital management company, which was set up to make indirect investments in venture capital funds and seed funds. Moreover, co-investing with private capital with an aim to strengthen the financing system for innovative companies with high growth potential[46].

2.2.3.1 Novel sectors

The general notion behind investigating investment in new or novel sectors is to understand if governments consider expanding ownership, in the light of evolving economic trends and disruptions into highly perspective businesses both for the sake of supporting and potentially extracting high future yields resulting in economically beneficial outcomes.

43 Interview with SOE Experts from KPMG Advisory SpA (Italy)
44 Destinazione Italia, Retrieved from: http://www.sviluppoeconomico.gov.it/images/stories/documenti/DESTINAZIONE_ITALIA_version_EN.PDF
45 Interview with Lars Erik Fredriksson; Investment Director of the Division for State-Owned Enterprises, Ministry of Enterprise and Innovation, Sweden
46 Government Offices of Sweden, Annual report state-owned enterprises 2016, Retrieved from: https://www.government.se/4a6e13/contentassets/e66654348c76492c8504413f3413e9a5/eng-vb-2016-final-2.pdf

Estonian Fund KredEx was *"founded in year 2001 by the Ministry of Economic Affairs and Communications with a purpose to improve the financing possibilities of enterprises, manage credit risks connected with export, enable people to build or renovate their home and develop energy-efficient way of thinking"*[47]. The mission of the financing institution is therefore twofold – firstly, providing the investment opportunities for the high growth companies via the venture capital arm, and secondly, fulfilling the market inefficiency by providing financing to the market participants that will most probably not be credited by commercial banks. This can be seen as a close proxy to the Latvian SOE – Altum.

Similar to Estonia's venture and investment arm of KredEx, Bpifrance is a **French** investment bank created in 2012 with the purpose of assisting indebted, growing, early stage venture, seed and similar companies for raising capital in their riskiest business development stages and supporting innovation. Bpifrance is compliant with banking regulations as a credit institution. It works together and has partnership agreements with local authorities and Regional councils[48]. The operations and principles of Bpifrance are further elaborated on in the Section 2.4 of this Report.

As briefly described in Section 2.2.3, Cassa depositi e prestiti (CDP) is an **Italian** joint-stock company under public control acting as a lender, anchor investor and financier for public entities etc. The majority shareholder is the Italian Ministry of Economy and Finance. CDP's mission is to invest and promote Italy's future by economic development. It holds shares in ten listed Italian enterprises and fourteen unlisted ones and approximately thirty private equity funds[49].

There are several financial fund related investments in the **Swedish** SOE portfolio. Already since the 1970s when the state realized a need for support programs for SME and newly established company financing, growth capital has been distributed through various methods – both directly and through financial funds that are held as assets in the state SOE portfolio. A major example is the aforementioned Saminvest.

Another example of the novel sector development approach in Sweden is the RISE, Research Institutes of Sweden, an SOE 100% owned by the state. RISE is a group of technology and research organizations. There are four corporate groups leading sixteen technology and research organizations in approximately 100 test-beds[50.] Up until recently, RISE was consolidated into six new divisions – ICT, safety and transport, bio-economy, bioscience and materials, certification and built environment institutes. RISE aims to ensure that Swedish business remains competitive on an international scale and helps to increase the sustainability of the society by supporting innovation in technologies, products and services. Moreover, it is helping to develop Swedish companies, which sometimes have limited access to research and development[51].

47 KredEx, Fund KredEx, Retrieved from: http://kredex.ee/en/kredex/sihtasutus-kredex/
48 BPIfrance, Annual Report 2017, Retrieved from: https://www.bpifrance.fr/content/download/71643/777033/version/1/file/Annual%20Report%202017%20Bpifrance%20Financement.pdf
49 CDP, Annual Report 2016, Retrieved from: https://en.cdp.it/ImagePub.aspx?id=1226416
50 European Commission, ISE Research Institutes of Sweden, Retrieved from: https://rio.jrc.ec.europa.eu/en/organisations/rise-research-institutes-sweden
51 The Swedish Research Institute, Welcome to RISE – The Swedish Research Institute, Retrieved from: https://www.ri.se/en

Conclusion

To conclude, the reasons for investing in new industries in the reviewed countries are mainly linked to support development of new/high growth industries in terms of supporting local businesses, providing stability to certain businesses through additional funds, supporting general growth strategies for long-term company plans etc. In certain cases, additionally, as in France or Italy, for example the state is actively managing their company portfolio and therefore taking the opportunities that arise in the market.

On the other hand – divestments are mainly based on strategic decisions and therefore are more politically debated and evaluated. In certain cases (as seen from the Italian example) the reasons, however, in favour of privatization can also be budgetary. In addition – the recent French example from the planned privatizations of large state companies in order to use the proceeds to finance innovations might arguably be seen as a new example for the state company policies.

2.2.4 Social services, health, culture

Health institutions in **Estonia** are mainly public foundations overseen by the Ministry of Social Affairs. There can, however, be some historically formed exceptions, like a specialized nursing home being formed as a company rather than foundation, but they are rather rare. There are specialized medical centres, formed as foundations, such as the North Estonia Medical Centre with seven clinics, Foundation of Haapsalu Neurological Rehabilitation Centre and Tartu University Hospital with seventeen different clinics. Ministry of Culture oversees Museums of Virumaa, Estonian National Museum and 37 other culture related foundations. Ministry of Education and Research oversees 37 foundations and state offices, consisting mainly of education centres, schools, academies and colleges[52].

As mentioned before the foundations are generally recognized and governed under the State Asset Act, however, due to the nature of the operations that mainly aim at fulfilling policy goals, the requirements and target setting for these companies are rather policy based.

The **French** approach to entities operating in the sectors of social services, healthcare and culture in most cases is realized via the legal form of public establishment. The governance of these entities is performed via the line ministry with the direct support of the Ministry of Finance as well as regional governing bodies. As these establishments are mostly directly dependent on the state budget, also the governance and budgeting of these entities are done in close collaboration with the state[53].

Italy has implemented a varying approach for the sectors of culture and healthcare[54]. The importance of culture for the state history can largely be seen also in terms of the companies in this segment that are owned and governed by the state. The cultural sector of museums, monuments, galleries and archaeological areas in Italy are all managed by

52 Estonian State Portal, Foundations, Retrieved from: https://www.eesti.ee/eng/contacts/sihtasutused_1
53 Interview with SOE expert, KPMG France
54 Interview with SOE experts from KPMG Advisory SpA (Italy)

the SOE – Ales-Arte Lavoro e Servizi. In addition, there are several other SOEs operating in the cultural segment – Coni Servizi – organizing, authorizing and promoting sports events, Istituto della encyclopedia Italiana fondant da Giovanni Treccani societa per azioni – one of the largest knowledge publications companies in Italy, and Istituto Luce Cinecitta – engaged in the motion picture and video production and distribution business.

The healthcare sector, on the other hand, is far less corporatized. With respect to the public health care providers, they are either under control of local ASLs (Italian health authority) or other independent organizations (University hospitals, public research institutes)[55].

Swedish SOEs operating in the non-traditional sectors of social services, health and culture diverge from the centralized governance structure and are managed by the respective ministries – Ministry of Culture and Ministry of Health and Social affairs. There are three culture related enterprises – the Royal theatre, Royal opera and a dedicated conference center (Voksenåsen) that are held by the state. Other major state theatres and cultural institutions are not corporatized and operate as state agencies funded by state for up to 85%. State's social and health sector goals are realized through ownership of a pharmacy and laboratory chain and the state's alcohol monopoly – Systembolaget[56].

Conclusion

To conclude, in the benchmarked countries, the social service, culture and healthcare entities are out of scope of the primary SOE policy. The differing legal form from the companies (i.e. public establishment in the French case, foundation in the Estonian) are used as the primary measure to differentiate the public policy goal fulfilling nature of these companies from the commercial peers. The exception of this case is the Italian approach to the culture related companies that however can be explained by the strong historical dependence.

Consequently, the governance, target setting and expectations from these usually state-budget subsidized entities are more policy goal related and aim at increasing efficiency and similar non-financial goals rather than purely financial measures.

2.3 Existing SOE classification in Latvia

Historically the state has not developed a generalized allocation of SOEs to specific classes or groups within the entire SOE landscape. There are, however, several approaches used in the practice serving either as parameter within guidelines for a specific purpose (e.g. remuneration considerations, establishment of supervisory councils etc.) or used mainly for illustrative purposes (e.g. sectoral split).

Latvian government as the shareholder currently categorizes SOEs by grouping the companies based on the indicators of operational and financial performance. The

55 WHO, The Health Systems and Monitor, Italy, Retrieved from: http://www.who.int/health-laws/countries/ita-en.pdf
56 Government Offices of Sweden, Annual Report of State owned enterprises, Retrieved from: https://www.government.se/4a6e13/contentassets/e66654348c76492c8504413f3413e9a5/eng-vb-2016-final-2.pdf

grouping has implications on the governance and reporting requirements. Though there have been attempts to group the SOEs based on the original objectives and/or business model, it has so far resulted in no practical shareholder's policy implications to specific groups or sub-groups of SOE's.

2.3.1 Reason for SOE existence

As described before, the SASL Act Clause 88.1 foresees three main cases where the state is permitted to establish an SOE. In a broader view these causes can be perceived as the parameters for different categories of SOEs:

- Companies aimed at fixing a market failure;
- Companies that offer service or product of a strategic importance for the development of the administrative territory of the state, local government or for national security;
- Companies that manage physical assets that are of strategic importance for the development of the administrative territory of the state, local government or for national security

The law, however, does not specify if there should be a difference in terms of requirements for target setting, reporting or dividend policy regarding the companies included in any of these groups[57].

2.3.2 Size of the company

Requirements for Annual Financial Statements

The size of the company serves as a parameter for company governance not only among the government owned companies, but also applies to the privately held ones. According to the Annual Financial Statements and Consolidated Financial Statements Law of the Republic of Latvia, the companies are divided into micro companies, small, medium and large ones. The grouping, which results in different reporting requirements, is done based on:

- Average number of employees during the financial year;
- Total assets as per balance sheet;
- Net turnover[58].

57 State Administration Structure Law, Retrieved from: https://likumi.lv/doc.php?id=63545
58 Law On the Annual Financial Statements and Consolidated Financial Statements, Retrieved from: http://www.vvc.gov.lv/export/sites/default/docs/LRTA/Citi/Law_On_the_Annual_Financial_Statements_and_Consolidated_Financial_Statements.pdf

Group	No of employees	Assets (EUR, million)	Revenue (EUR, million)	Criteria
Micro	<10	<0.35	<0.7	Matches at least two criteria
Small	< 50	<4	< 8	
Medium	50 - 249	4 - 20	8 - 40	
Large	> 250	>20	> 40	

Figure 11 Latvian enterprise grouping by size as suggested by the Law on the Annual Financial Statements and Consolidated Financial Statements of the Republic of Latvia

Remuneration guidelines

In 2017 the CSCC issued guidelines for determining the remuneration of members of the management board and council members of SOEs. The goal of the guidelines was to provide suggestions for remuneration principles in Latvian SOEs based on the regulation by the Cabinet of Ministers No.791. Even though the guidelines do not directly imply any classification of the SOE landscape, the factors used for determining remuneration for the boards of various entities indirectly point to company specific parameters.

The guidelines imply to set the remuneration targets based on two main factors:

— Size of the enterprise (as suggested in the Annual Financial Statements and Consolidated Financial Statements Law of the Republic of Latvia);

— Commercial entities operating in free market conditions versus non-commercial entities receiving state subsidies and / or operating in limited competition environment[59].

59 CSCC, Guidelines for determining the remuneration of members of the board of directors and councilors of public corporations and public private equity, Retrieved from: http://www.pkc.gov.lv/sites/default/files/inline-files/PKCvadl_Atlidziba_240817_0.pdf

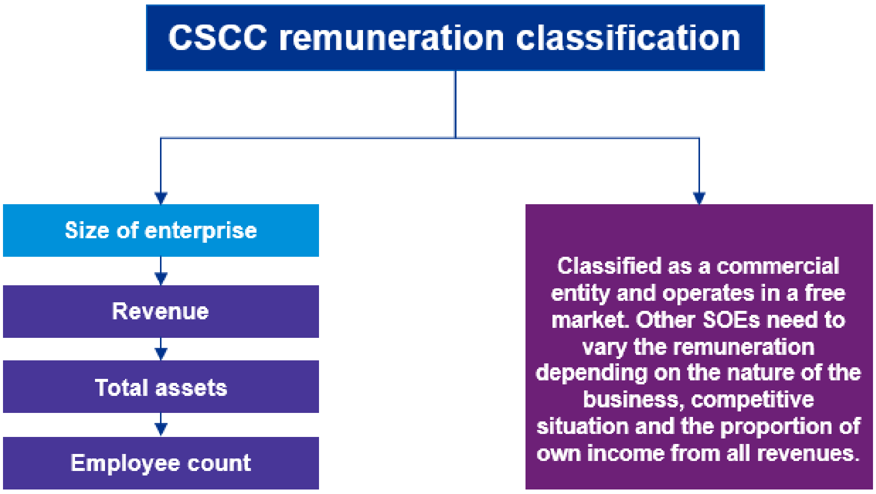

Figure 12 Guidelines for determining the remuneration of members of the management board and council members of SOEs, CSCC data, KPMG analysis

SOEs with a supervisory board

SOEL states that for companies fully owned by the state the supervisory board is permitted only for companies whose net turnover is above EUR 21 million and balance sheet total exceeds EUR 4 million.

Additionally, the OECD assessment of Latvian SOE management recommended to establish a council in the largest commercial state owned companies. As a result the Latvian state in general undertook to establish councils in twelve largest state-owned corporations. In seven of them the shareholder is the Ministry of Transport, in three – Ministry of Finance, but in one – each the Ministry of Economics and the Ministry of Agriculture. In addition, there is a council established in Altum that has three shareholding ministries.

The councils were established and started their work after a selection process was completed in 2016.

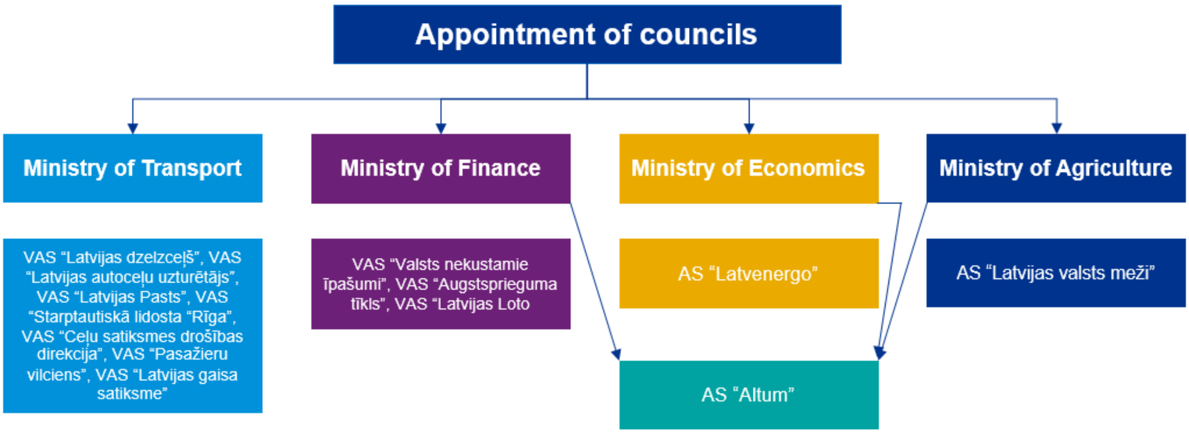

Figure 13 Appointment of councils in Latvian SOEs, CSCC data, KPMG analysis

2.3.3 Profitability measures

In June 2017 the CSCC published an informative concept note on the Determination of Effective Capital Output Goals in State-Owned Companies[60]. As growth of the return on equity (ROE) is set as a target measure of the government action plan for state-owned capital companies, the CSCC performed a comparative study about ROE determination practices in several Benchmarking Countries and based on OECD studies and best practice examples suggested a unified approach for this task in Latvian SOEs.

When analysing the net results and ROE based on the sectoral split, some of the sectors like telecommunications, forestry and agriculture showed above average returns, while other less commercial sectors such as culture and healthcare scored negative. The CSCC, however, accurately realized that not all of the companies operating in the less performing segments e.g. healthcare and culture show negative returns as the averages in most cases are driven down by several single entities.

Sector	Profit / loss, EUR million (2017)	ROE, %
Energy	330	11.1
Telecommunications	81	15.2
Forestry and agriculture	65	18.2
Transportation and logistics	52	8.4
Culture	0,05	1.5
Healthcare	-5	-6.4
Real estate	-15	n/a
Other	0.4	0.1

Figure 14 Profitability and ROE of SOE sectors, CSCC data

60 CSCC, Informative report "Determination of effective capital return targets in State-owned capital companies" (2017), Retrieved from: http://tap.mk.gov.lv/doc/2017_06/1_2_10_14_130617_PKCZin_Efekt.622.docx

Based on this analysis and the financial results for 2015, the CSCC suggested to split the SOE landscape according to the following classification:

Figure 15 SOE split according to CSCC Report on ROE determination, CSCC data, KPMG analysis

Based on these segments, the implications for ROE target setting were made suggesting that:

— Commercially independent SOEs that do not have non-financial goals or their influence is insignificant shall apply market practice methods for setting their ROE targets;

— SOEs that combine financial and non-financial goals in their strategies shall use the market practice method for setting the ROE goal and then correcting it for the implied costs for the non-financial goal realization. For this purpose the SOE shall determine the profitable and loss creating activities as well as account for the state subsidies.

— For the problematic assets and loss making SOEs, the long run goal shall be to determine the ROE goals based on the market practice, while in the short term focusing on positive earnings and equity ratios[61].

2.3.4 Commercial vs non-commercial SOEs

Arising from the SOEL, the guidelines for determining overall strategic objectives for public participation were issued by the the CSCC. The aim of the guidelines was to advise to the public persons on how to determine overall strategic objectives for corporations and to re-evaluate the existing general strategic objectives. The guidelines

61 CSCC, Informative report "Determination of effective capital return targets in State-owned capital companies" (2017), Retrieved from: http://tap.mk.gov.lv/doc/2017_06/1_2_10_14_130617_PKCZin_Efekt.622.docx

are dated 30 March 2016. Under the section "The division of capital companies according to their general strategic objectives" the following segmentation of SOEs can be found:

- Commercial entities that do not receive budget funding, operate in free market conditions, sell goods and provide services in a sector where also private sector companies operate. Such entities should include the following as strategic goals: international competitiveness and growth, the development of the respective industry, the impact on the environment and the economy, the public benefit provided, good management principles and future trends for the industry the entity is operating in;
- Partially commercial entities that receive budget funding, provide statutory services as defined in the law, operate in a limited or free market environment and can be distinguished from private sector entities and their operations. Such entities should include the following as strategic goals: the set out goals and priorities by the state in the respective industry, the impact on the environment and the economy, good management principles, SOE international competitiveness and revenue generating options and define why the private sector cannot fulfil the set out strategic goals and fill in the market gaps;
- Entities with special tasks, which are not part of the abovementioned groups and provide necessary services to the society and which are not available in the market. As these services in many cases are not otherwise provided by the market, the balance between SOEs impact on the environment, society and economics of the country shall be used for the strategic goal setting. [62]

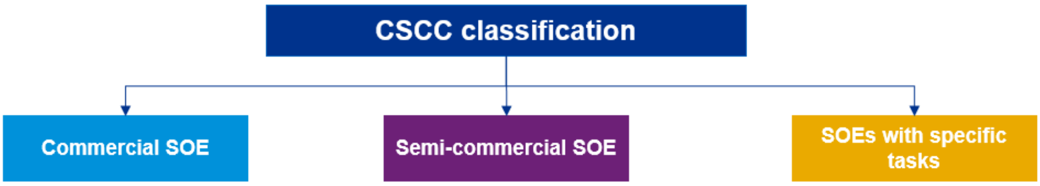

Figure 16 SOE split according to CSCC guidelines for determining SOE overall strategic objectives, CSCC data

This document also tackles the issue of seemingly controversial strategic goals, for example, for state monopolies, where the suggestion is to ensure that the companies operate in a fair manner and therefore do not abuse the privileged status in comparison to other private companies in the market.

2.3.5 Sectoral split

A sectoral classification can be observed from the CSCC annual report. This segmentation does not, however, provide any insights into target setting or dividend distribution policy as all companies are bundled based only on the field of operations. The sectoral split arguably mostly serves for illustrative purposes.

62 CSCC, Guidelines for setting the overall strategic objectives for Public participation, Retrieved from: http://www.pkc.gov.lv/sites/default/files/images-legacy/Kapitalsabiedribas/SMNV_30032016_.pdf

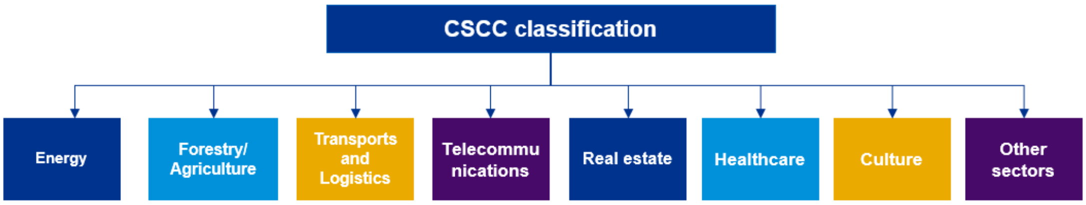

Figure 17 Sectoral split of SOEs as used in CSCC Annual Report, CSCC data

2.3.6 Market role of the company

The State Chancellery of Republic of Latvia has published a Report and Recommendations "Evaluation of Criteria for Deciding on Purpose, Necessity and Status of Ownership in Shareholding by Public Entity" ("*Publiskās personas dalības kapitālsabiedrībā mērķa, nepieciešamības un statusa kritēriju izvērtējums*") [63]. In addition to the review of the legal framework governing Latvian SOEs, the report also propose a segmentation framework of the SOE landscape, which according to the authors can be applied not only to companies, where state owns majority stake holding, but also extended to minority stake holdings and companies owned by municipalities.

The classification is primarily based on SOE's impact in situations, where the outcome of the free market is not optimal for the welfare of the society. In such cases market inefficiencies arise – monopolies and public goods. The report presents three main SOE classification groups that are each supplemented by several sub-groups formed primarily around the size of stake holding by the state, the amount of state funding and sector. The proposed classification therefore distinguishes companies up to three levels of varying characteristics.

Market inefficiency	Index		SOE description
Group A Natural monopolies and private goods	A1		Nationally important infrastructure
	A2	A2.1	Significant capital investment (states share 100%)
		A2.2	Significant capital investment (states share <100%)
	A3		Not nationally important infrastructure and capital investments
	A4		Real estate management
Group B Public goods	B1		Self-financed
	B2	B2.1	Significant state budget funding (>60%)
		B2.2	Significant state budget funding (15% - 60%)

63 State Chancelary, Recommendation Report (2012)

		B2.3	Insignificant state budget funding (<15%)
Group C Externalities	C1		State aid support
	C2		Culture
	C3		Healthcare
	C4		Education
	C5		Sports

Figure 18 Classification attempt of Latvian SOEs by the State Chancellery, 2012

Group A: Natural monopolies and private goods

Group A consists of natural monopolies operating for commercial purpose and managing real estate. To a certain extent, these companies might also observe the characteristics of public goods and similar market segments.

— The first sub-group (A1) contains companies that are considered strategically important for the state safety and provide infrastructure that is important on the country level (e.g. rails, forests, airport runway, electricity grid, etc.). The majority of the companies included in this segment are commercially oriented and receive little to no state support. Additionally, as most of these companies operate in monopolistic markets with limited competition, the prices shall be regulated centrally. The 6 companies in A1 subgroup include Latvenergo, Latvijas Valsts meži, Latvijas dzelzceļš, Latvijas gaisa satiksme, Starptautiskā lidosta Rīga, Latvijas Valsts radio un televīzijas centrs.

— The second sub-group (A2) comprises companies that own significant infrastructure, which has been established as a result of large capital investments and therefore mostly operate in limited competition markets. Based on the stake held by the state in these companies, sub-group A.2.1 comprise companies where state holds 100% stake (Latvijas Pasts, Latvijas autoceļu uzturētājs, Pasažieru vilciens) and sub-group A.2.2 including companies, where the state holds less than 100% (Lattelecom, LMT, Air Baltic Corporation).

— The third sub-group (A3) segment the monopolies and commercially oriented SOEs that do not hold strategically important infrastructure assets. All four of the included SOEs (Latvijas Loto, Meliorprojekts, Latvijas Nacionālais metroloģijas centrs, Vides projekti) are 100% owned by the state.

— The final sub-group (A4) singles out five real estate management companies that in addition to ensuring and maintaining state's real estate objects additionally gain their own revenue in the commercial markets.

Group B: Public goods

Companies included in the segmentation Group B basically provide public goods, but the services provided also show signs of a side-effect segment. In this group the further breakdown is based on the share of state subsidy that the company is receiving.

— Companies in sub-group B1 provide public goods and perform state delegated services and receive no direct state subsidy (Ceļu satiksmes drošības direkcija, Privatizācijas aģentūra, Latvijas vēstnesis, Latvijas jūras administrācija).
— Sub-group B2 based on the share of state subsidy (up to 60%, between 15% and 60% and below 15%) is further split into three sub-groups.

Group C: Externalities

Group C comprises a wide range of Latvian SOEs that usually do not operate based on commercial terms. According to sectors, this group is split into five sub-groups:

— C1 – SOEs ensuring state aid support (in terms of EU funds, guarantees, etc.);
— C2 – Companies operating in the culture segment (theatres, opera, orchestras, etc);
— C3 – Healthcare providers;
— C4 – Educational institutions;
— C5 – Sport infrastructure providers.

Even though the classification outline set out in this State Chancellery of Republic of Latvia report is very comprehensive and comprises various characteristics and company related factors, the recommendations regarding differentiated treatment of groups A, B and C, including turning Group B entities into public agencies, has not been followed in practice, and entities have remained subjects to the SOEL and Commercial Law.

2.4 Classification amongst EU/OECD peers

The methods used for SOE classification in the four Benchmarking Countries were reviewed. The main conclusion arising from this task is that none of the four countries has a formal classification that would directly translate into state as the shareholder setting some specific goals or policies for some groups or sub-groups of SOEs. Rather the grouping or classification in use seems to follow performance monitoring related issues or be based on separation between various legal forms that state owned entities can take. Nevertheless, the indirect implications point out areas that potentially could be used as guidelines for developing the Latvian SOE grouping.

Estonia

According to the Estonian legislation state assets are defined as all the assets that belong to the state and are managed by state agencies. The majority of state assets in Estonia usually take either of two legal forms – public companies (SOEs) or foundations. Both types of state assets are governed by the State Assets Act[64]. The decision on the legal form of a state activity is usually decided on case by case basis, however generally an important criteria is whether the service or product can be sold in a free market environment[65].

64 Ministry of Finance of Estonia, Governance of State ownership, Retrieved from: https://www.rahandusministeerium.ee/et/riigivara/riigi-osaluste-valitsemine
65 Interview with Tarmo Porgand, Deputy Head of State Assets Department at Ministry of Finance, Estonia

Different than in Latvia, in Estonia foundations and non-profit entities constitute a significant share of state assets. As at July 2018, in the state portfolio there were 29 companies, 65 foundations and 115 non-profits[66]. For example, companies operating in the healthcare and culture sectors with some exceptions are usually formed as foundations rather than corporatized.

Even though there is no formal SOE classification framework, the legal form constitutes an implied categorization in terms of target setting and reporting requirements.

For companies, the basic principle for the target setting is directly derived from the State Assets Act meaning that for any SOE with a public assignment also the revenue generating purpose shall be followed implying the necessity to set and follow financial targets. In case of corporatized SOEs also the ROE and capital structure are monitored.

The coordination and monitoring of the foundations are covered by sectoral ministries. In terms of target setting they tend to mainly have activity based targets. In addition to the activity targets, the MoF monitors the foundations also from the financial efficiency perspective thus implying indirect goals on financial sustainability.

The reporting by the companies is done directly to the shareholding ministries and the MoF. Similarly as in Latvia, the extent of detail of how much companies report to the governing bodies depends on the shareholding – whether state owns the majority of company. Specific requirements apply to the listed companies in order to ensure that all shareholders of the public companies have the same access to company information and does not put the state in a privileged position.

Additionally, reporting requirements differ in accordance with the size of companies – as for larger companies there are additional requirements in terms of audit committee, internal controls and disclosure requirements[65]. The grouping by size is also, similarly as in Latvia, dependent on company's revenue, assets, number of employees as well as number of supervisory board members[65].

France

The implied SOE classification in France directly arises from the governing body of the SOE. As mentioned before there are three governing bodies that are set up to manage and overview the French SOE pool. Depending on the governing body also the requirements in terms of target settings, reporting practices, dividend policies and state policy implications arise[68].

Separate approach to the below mentioned SOE management companies is applied to the health care providers and hospitals, museums, culture related and similar entities that are not corporatized, but rather have a different legal form – public establishment. As the criteria for the choice of the legal form serves the argument about financial independence – when most of companies' revenues come from subsidies or highly regulated revenue systems, most likely these companies will be formed as public

66 Ministry of Finance of Estonia, State Assets, Retrieved from: https://www.rahandusministeerium.ee/en/state-assets

establishments. Following the legal form separation, significant differences in the overall governance practices are implied from incorporated entities[68].

APE (Agence des Participations de l'Etat)

APE is the governing body for the large state owned industrial companies[67]. APE is one of the largest managers of public shareholdings worldwide, with its extremely diverse portfolio of majority or minority holdings in 81 companies. 13 of the companies are listed on the stock exchange. The ultimate goal of the agency is to maximize the long-term value of the shareholdings. The companies managed by APE include regional and international airports, railway operators, aerospace and defence companies, energy sector players, post, telecommunication companies, manufacturers, airline and ports. Additionally, APE is the governing body for SOEs that are problematic or are experiencing specific situations that require additional state attention (e.g. currently the nuclear energy sector companies). Also the divestments of parts or entire state assets are managed by APE.

The APE itself being a sub-department of the Ministry of Economy and Finance[68] is structurally divided into 4 sectoral divisions – transport, energy, financial services and manufacturing thus implying the sectoral split for the responsibilities and specializations.

The legal form of the companies also vary – the APE managed portfolio includes 55 public limited companies, 23 government funded institutions and 3 semi-public companies. The legal form in this sense indirectly represents the varying degrees of commercialization of companies – meaning that the government funded institutions might be seen as forming a SOE subgroup, which is largely dependent on the state support. The direct implication of this results in a higher sectoral ministry's and state budget authority's (a unit in the Ministry of Economy and Finance) involvement in the board of the institutions in order to better maintain the oversight and ensure the fulfilment of state tasks.

All of the companies are expected to follow financial value maximization guidelines by setting ambitious and value creating targets. In addition, the companies governed by the APE are supposed to maintain the highest corporate governance standards in terms of gender equality and executive pay etc. Additionally APE has set the goal of rounding out its Government as Shareholder policy by outlining a corporate social responsibility (CSR) roadmap, with the aim of assessing the CSR performance in the companies[67].

BPIfrance (Banque Publique d'Investissement)

Bpifrance[69] has two shareholders, the French State and the Deposits and Consignments Fund (Caisse des Dépôts). The investment company aims at fostering the economy, increasing competitiveness and providing direct investments. The Government as shareholder and Bpifrance focuses mainly on minority interests in partnership with other

67 Agence des Participations de l'Etat, Annual Report 2016/ 2017
68 Interview with French SOE expert, KPMG France
69 Bpifrance, Bpifrance est dans toutes les regions, Retrieved from: http://www.bpifrance.com/Who-we-are, Doctorine

investors to support companies through a specific development, international growth or consolidation phases.

Other financial instruments besides equity for SMEs and mid-large cap companies include guarantees, grants and subsidies aimed at innovation financing, short-term loans, investment credits, export financing and funds of funds investments[70]

Bpifrance may invest in the companies through its own equity or through the management of a third-party account. Similarly as the Latvian company Altum, it may manage state budget financed programs as well as international (e.g. EU) funds[68]. The investment company is also particularly important for the regional development.

The principles and goals of the BPIfrance are:

- Minority investments;
- Prudent investment principles on the market terms;
- Patience;
- Clear ethical guidelines (transparency, no financial crime, prevention of conflict of interest, financial and operational risk management)[69].

CDC (Caisse des Dépôts et Consignations)

Caisse des Dépôts is a major public bank in France and the third governing body of some of the SOEs in the country. Different to the previous two shareholders, CDC is under the direct oversight of the Parliament (the Government as the executive branch of power has no control over CDC)[68]. According to the French Monetary and Financial Code – *"Caisse des Dépôts et Consignations carries out missions of public interest and is a long-term investor and contributes to the development of enterprises in line with its own proprietorial interests"*[71].

The reason for CDC existence is the public interest, which is ensured through local and national policies in sectors like financing of social housing, development of enterprises, and energy and ecological transition. CDC acts as a major long-term institutional investor and enjoys highly protected legal status – immunity to liquidation and bankruptcy as well as protected solvency[72].

The sectors and companies held by the CDC include investment company BPIfrance, insurance company CNP Assurances, stake holding in the Post, real estate companies, transportation company Transdev, transmission system operator RTE and others.

70 Bpifrance, Bpifrance's Activity Report 2017, Retrieved from: http://www.bpifrance.com/Bpifrance-Fresh-News/Bpifrance-s-Activity-Report-2017

71 Caisse des Dépôts, Article L. 518-2 of the French Monetary and Financial Code (amended by the 2008 law on modernisation of the economy), Retrieved from: https://www.caissedesdepots.fr/en/our-model

72 Caisse des Dépôts, Investor_presentation, Retrieved from: https://www.caissedesdepots.fr/sites/default/files/medias/relations_investisseurs/cdc_investor_presentation_english_-_april_2018.pdf

The funding policy is based on long-term investments from the accumulated reserves and deposits from the legal entities. In addition to company management, CDC also performs the saving fund division tasks and administration of retirement schemes[73].

Italy

Historically[74], Italy has seen a quite complex mix of criteria adopted to manage SOEs. For some assets (e.g. state roads), in certain periods, the “strategic assets” criterion prevailed. For some other assets and in other historic periods, however, a purely opportunistic criterion (e.g. Alfa Romeo, construction companies, engineering companies) dominated. In either way, the rationales behind SOEs ownership and management have not been continuously consistent over time, making it very difficult to associate strategic patterns to events linked to SOEs management.

The state company management approaches can be considered very heterogeneous with regard to the sectors affected by privatisations and developed over time through ever-changing strategies by legislators. In light of this, the only prevailing criterion that could be used nowadays to classify SOEs is the “formal (or substantial) criteria” meaning that a company can be considered a SOE if a company is either owned or in which the state holds the majority of shares, including those cases in which control is realized through “relevant” minority stakes.

Companies controlled by the state, either directly through the Ministry of Economy and Finance (MoF) or indirectly from Cassa Depositi e Prestiti (CDP), act in the same ways as private joint-stock companies – and they are subject to CL etc. with no particular impact on financial or any other aspects of their management.

Indirect state participation through CDP is mainly justified by opportunistic reasons, and aims at one or more of the following:

- stressing the fact that these companies might be privatised and that the state participation in these companies is temporary in nature;
- addressing issues related to public finances – allocating the entity within the CDP (or other) instead of within the MoF;
- assigning semi-public control setting, also in view of special investment plans.

Furthermore, CDP is fulfilling the role that could be at least partially compared to BPIfrance in the French context by managing investment companies aimed at fostering the investments directly in Italian companies in line with the state aid regulations. The equity and debt financing SOEs that are in direct shareholding of MoF or CDP include, for example, FSI Investimenti S.P.A (company investing in companies of "major national interest" that has a stable financial position and performance), CDP Investimenti SGR S.P.A. (company operating in the real-estate investment sector) and CDP Equity S.P.A (holding entity for equity investments)[74].

73 Caisse des Dépôts, Group, Retrieved from: https://www.caissedesdepots.fr/en/group
74 Interview with SOE experts from KPMG Advisory SpA (Italy)

Another indirect classification singles out a subgroup of companies that are strategically important for the state. Implied by the Law 474 from 1994, which later was modified by Law 56/2012 the introduction of the so-called "golden share" entitled the Treasury special powers with regard to the management of SOEs operating in certain sectors of the economy – acquisition of shareholdings bigger than 5% by a single investor were not allowed. The definition of the certain sectors of the economy to be considered as "strategic" can vary depending on the context, but can typically be defence and national security, communication, energy and transportation. Some examples of the Italian SOEs with "special powers" are Eni, Enel, Telecom (now TIM), Terna and Finmeccanica (now, Leonardo)[74].

Additional consideration for sub-grouping arises for companies where the state holds 100% e.g.:

- ALES (company primarily engaged in operating and managing museums, monuments, galleries and archaeological areas in Italy, 100% held by Ministry for Culture);
- ANAS (company engaged in the management of motorways, freeways, and national roads in Italy, indirectly 100% held by Ferrovie dello Stato Italiane);
- Ferrovie dello Stato Italiane SPA (company operating the nation's rail transportation system, 100% held by Ministry of Economy and Finance);
- Difesa Servizi S.P.A (company engaged in the management trademarks of the armed forces, 100% Ministry for Defense and national security).

Due to the nature of the business and provision of certain public goods these companies are unlikely to get privatized in future[74].

Sweden

Sweden has no formally established classification. Typically, SOEs operate on market terms in relatively competitive markets. Accordingly, they are subject to the same conditions as other market actors and generating value is the overall objective of their operations. In terms of the legal form almost all (except for 2 minor foundations) are formed as JSC.

Sweden has clearly defined the companies that are in the state's ownership to fulfil specifically adopted public policy goals. According to the definition – *"When the Riksdag commissions a company to conduct operations that are aimed partially or entirely at generating effects other than a financial return for the owner, this constitutes a specifically adopted public policy assignment"*[75].

23 SOEs in Sweden are defined to have public policy assignments including investment funds, specialized culture and health goals fulfilling companies (including the state alcohol monopoly) and the largest forest owner in Sweden[75.] It has to be noted that the public policy assignments can be reevaluated and amended, so, for example, the public

75 Government Offices of Sweden, Annual Report SOE 2016, Retrieved from: https://www.government.se/4a6e13/contentassets/e66654348c76492c8504413f3413e9a5/eng-vb-2016-final-2.pdf

policy assignment for the forestry has become limited and shall be finalized soon. Based on whether company is serving public policy goals the SOEs can be seen as divided into one of the three groups:

Figure 19 SOE classification in Sweden based on the policy goals

The implications of this approach on the target setting and reporting requirements, however, are not direct. Sweden sees that there is no conflict between specifically adopted public policy targets and financial efficiency[76]. Financial targets are set for state-owned enterprises in order to keep financial risk at a reasonable level and to ensure that the businesses are run as efficiently as possible. Companies with specifically adopted public policy assignments have additional public policy targets to enable assessment of their performance.

The targets are set individually for each company following benchmarking practice both locally and on the EU and international level where appropriate. Jointly with the company in an active dialogue with the responsible management members, the respective owner develops the financial targets that shall be long-term, ambitious and realistic. For the public policy serving entities, the state usually calculates the cost for having the public policy assignment and is taking it into account when deciding on financial targets. Financial targets are normally set simultaneously with public policy targets allowing public policy assignments to be balanced with the creation of financial value. The differences for target setting can vary for financial and non-financial companies[77]. Targets are tracked through regular progress meetings between the owner and the company.

Conclusions

This overview shows that in terms of the SOE classification approaches similar patterns can be observed at least for some of the countries. The parameters for differentiation include:

— Legal form of the entity. As evidenced in Estonia, France and Sweden the entities with strong public policy tasks (e.g. healthcare, culture, etc.) are mostly not corporatized and rather use a different legal form therefore clearly differentiating the

76 Government Offices of Sweden, Objectives for state-owned companies, Retrieved from: https://www.government.se/government-policy/state-owned-enterprises/goals-for-state-owned-companies/
77 Interview with Lars Erik Fredriksson; Investment Director of the Division for State-Owned Enterprises, Ministry of Enterprise and Innovation, Sweden

commercial companies that shall be compared to the market practices from the non-commercial ones strongly relying on state funding.

- State delegated tasks. Swedish practice clearly identifies companies whose primary goal is the state delegated task fulfilment and therefore shall incorporate these tasks in their strategies and target considerations.
- Size of the state's shareholding. As seen in the Estonian an Italian example, the size of the state's shareholding might have direct implications on SOEs governance – both in terms of realizing the strategic importance for asset (i.e. no privatization considerations) as well as for the extent of the reporting that SOEs are expected to provide.
- Size of SOE. Similarly as in Latvia, also in Estonia there are more extensive reporting requirements for larger companies.
- Companies providing investments. France and Sweden have set up separate bodies, whose main task is the provision of financing in terms of loans and equity with an aim to foster the innovation and support the growth of the national companies. In Italian case this mandate is partially implemented by CDP, which is a shareholder in various equity and real estate investment companies and funds. The target setting and goals for these companies are differentiated from the rest of SOE pool. These practices can be seen as similar to the Latvian SOE Altum.
- Assets important for state security. In Italy the assets that are seen as crucial for the sectoral or national security do not allow significant investments by other than state investors. Similarly in other countries certain sectors of the economy that can vary depending on the context, but typically being defence and security, communication, energy and transportation are seen as strategic and therefore are mainly controlled by the state.

2.5 Methods for developing the classification

There is no standard SOE classification model in the reviewed countries that could be transposed to Latvian situation. Latvian authorities rather should build their own method of classification based on the current reality of SOE ecosystem and by considering the existing legal framework. In order to develop the method for grouping the SOEs a number of distinguishing parameters should be set, for example, commercial or non-commercial nature of the operations, role in the market and financing. Therefore, it is possible to come to two main groups: A: holders of strategic economic and physical assets that are mostly operating on commercial principles; B: entities with a delegated state assignment. Further sub-grouping of the groups A and B is possible based on the degree of financial independence from the state budget in form of state support, payments received from state and similar. Consequently, there are opportunities to calibrate requirements of shareholders in terms of target setting and governance using the grouping.

Grouping companies is a tool and not a goal in itself, therefore, it is important to take the step one – grouping – and follow with the step two – clarifying the objectives of the companies, applying tailored target setting to different groups and appropriate dividend requirements.

According to the applicable Latvian laws and guidelines, state has varying influence on the SOEs depending on the type of the ownership in the companies. For example, the SOEL suggests that companies, which are controlled by the state shall run their business based on medium term strategy agreed by the shareholder. Similarly, as suggested by the CSCC guidelines for determining SOE overall strategic objectives, the guidelines are applicable only to 100% owned SOEs while remaining as a recommendation for the rest of the shareholdings. Consequently, the direct influence on SOEs, their strategies and target setting is more visible and realistically achieved for the 100% owned SOEs, which are therefore used as the base case for the classification. With respect to the other SOEs, the implications of the classification shall be seen on case by case basis. Otherwise, similar approach to the Swedish one could be used in respect of partially owned companies, where the state engages in a dialogue with the other owners in order to ensure that the ownership policy is applied.

The method proposed below consists of identifying key parameters that would allow distinguishing between the SOEs and then application of the described parameters by classifying the SOEs in groups and sub-groups.

2.5.1 Parameters for classification

Based on the review of the Latvian SOE landscape, the existing classification patterns as well as the analysis of the practice in the benchmarked countries, we propose a classification method for grouping of SOEs in Latvia as well as indicate the target focus areas for the differing groups. An in-depth description of choice of targets and relevant performance monitoring indicators are provided in section 3.2.1.

Table 1 provides a summary of characteristics that is proposed for classifying Latvian SOEs. It must be noted that many SOEs in Latvia possess a combination of characteristics that make them fit to certain parameters from one group and certain parameters from the other group, therefore some judgement has to be applied when classifying them in one group or the other. The principles and characteristics described below serve as guidelines. The companies do not necessarily have to fit all parameters that characterize a specific group, but are likely to meet the majority of parameters. It also has to be noted that the classification is not intended to be rigid and companies can migrate from one group or subgroup to another as they evolve or their strategic direction changes.

Group A	Group B
– Management of infrastructure or natural resources of national significance, for example, the non-privatisable SOEs specified in the laws of the Republic of Latvia – Ownership or management of infrastructure of a size that another	– Goal – to correct/prevent market deficiencies – Goal – to provide a specific public service in line with the legislation

economic operator is unlikely to create/recreate – An exclusive government-granted right to conduct business in a particular market niche – Commercially mostly independent companies (conduct at least part of their business activities on a commercial basis, including competing for customers in open markets) – Opportunity and interest to borrow in financial markets (incl., issue of obligations and/or securities) – Compete in the market with private companies	– Operating activity is conducted in a limited (or non-existent) market conditions; – Exclusive rights to supply the service as prescribed by the law – Might have a regulated price list – Companies that enjoy a statutory guarantee of customers/consumers, and / or their expenses related to service provision are covered by government grant, subsidy, contract or another regulated special public funding source

Table 1 Characteristics for Latvian SOE classification

National and sectorial security

Similarly as in other reviewed EU / OECD peers, the state concerns for national and sectorial security in various cases result in direct control of SOEs that hold strategic physical or economic infrastructure or assets.

In addition, the Law on the Completion of the Use of State and Municipal Property Privatization and Privatization Certificates stipulates that the six large state-owned joint stock companies – Latvenergo, Latvijas pasts, Starptautiskā lidosta “Rīga”, Latvijas dzelzceļš, Latvijas Gaisa satiksme and Latvijas Valsts meži cannot be privatized. According to the Energy Law, this condition also applies to the joint-stock company "Augstsprieguma tīkls". The Law directly implies that these companies are strategically important for the Latvian state security and the economy in terms of the assets they are managing.

To apply this parameter it should be evaluated whether the company holds a strategically important physical or economic infrastructure or asset. The strategic importance can be defined as being crucial for the state or sectoral security or requiring large capital investments to replicate the existing infrastructure, which is unlikely to be implemented by another market player. However, it should be noted that the current Latvian legislation has a wide and vague interpretation of strategic assets that can allow creation of state or municipality owned companies in sectors that are not fully justified, for example, tourism.

Commercial vs non-commercial operators

Based on the SOEL and Strategy Guidelines this is a parameter, which is already formally in use in the Latvian SOE market set-up. The original purpose of the SOE and shareholder’s strategic objectives associated with the SOE in most cases reflects to what extent the entity is considered as a commercial operator. If the company has originated through a delegation of state assignment, it is usually less financially independent from its founder (the State) and aims at implementing policy rather than creating financial value. The companies that have originated with a more commercial focus, on the other hand, have higher ability to generate revenue streams directly from their core business in market conditions, therefore, the shareholder also expects creation of financial value in form of prioritizing financial goals and serving as value adding for the state budget in terms of dividends. The parameter can be measured by the share of payments in various forms received from the state budget in proportion of the total income of the SOE.

Role in the market

In order to correctly imply the differences in target setting approaches, it is essential to consider the varying role that SOEs take in the market. As previously suggested by the Report published by State Chancellery, the market failure (e.g., unprofitable passenger railway routes, post-delivery in the furthest regions of Latvia, and others), which the SOE is trying to tackle, comprises another important parameter for the classification. This is especially important for companies that operate as natural monopolies or have received unique rights to provide their goods and services in the market.

Dependence on funding received from state budget

In most of the cases the financial objectives closely correlate with the dependence of SOE on the state support in terms of subsidies, payments for services, compensations, or guaranteed fee income (from a strictly regulated or exclusive market and regulated price list). For commercial entities the objectives are maximizing the value of the company (profitability, level of capitalization etc.), while for non-commercial entities the financing model is clearly related to the needs of covering solely the operational costs associated with the delivery of the delegated assignment.

2.5.2 Proposed grouping

Based on the above mentioned parameters, the classification approach follows the proposed scheme of grouping:

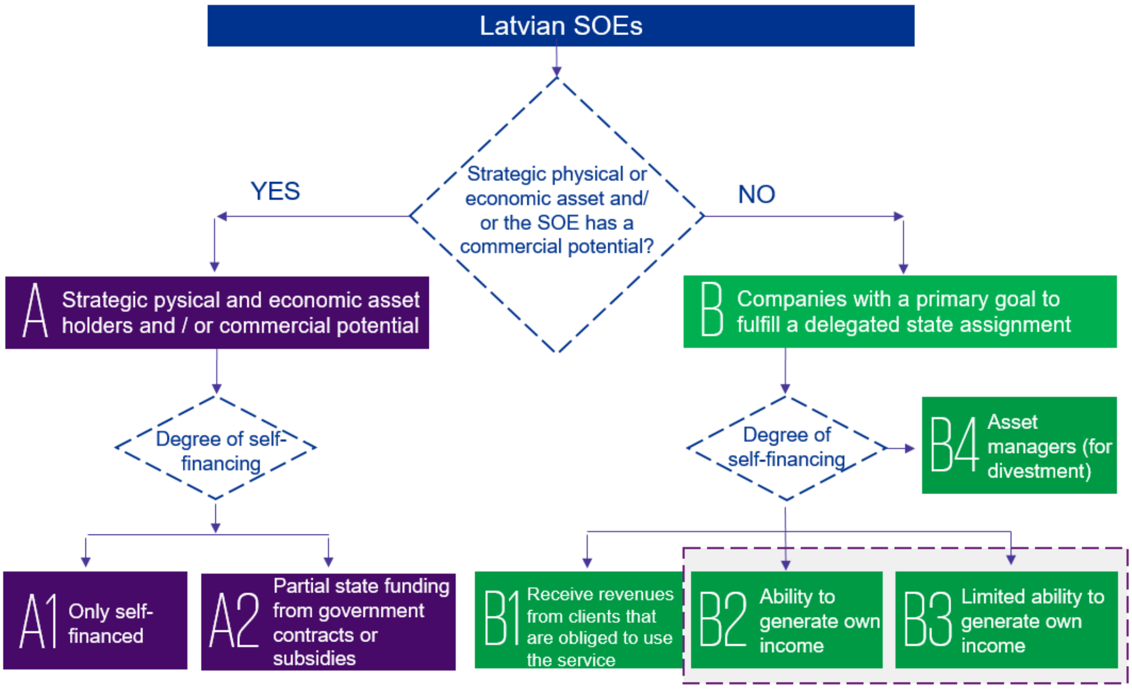

Figure 20 Proposed approach for Latvian SOE classification

Group A: SOEs holding or managing strategic physical and economic assets and/or having commercial potential. The assets may include both – infrastructure related asset pool (i.e. rail system, airport infrastructure) as well as important economic assets (i.e. exclusive rights for state lottery). Consequently, this group includes companies that according to the law cannot be privatized and ensure the national and sectorial security, except for Latvijas gaisa satiksme, the case of which will be described in Group B1.

Figure 21 Proposed approach for Latvian SOE classification – Group A

The companies in Group A are mostly commercially oriented and from the company governance perspective shall be compared to private sector peers as well as benchmarked to the respective international peers.

Companies in Group A shall have the highest corporate governance standards and serve as the example for the rest of Latvian SOEs. Additionally, as many of the companies in Group A have strong market positions and high brand familiarity in the Latvian society, the companies shall be seen as the best SOE examples also by the population.

Additionally, the companies shall foster the overall growth of their respective industries in a sustainable manner while striving for internationally competitive positions in the market (i.e. airport and railway infrastructure providers). With respect to financing the companies should aim at attracting financing from financial markets (bond issuance, borrowing from institutional lenders etc.) where it is feasible and does not undermine fiscal stance of Latvian Government. It has to be noted, however, that inclusion of a company in Group A does not necessarily imply that it shall become listed company or divested. Such decisions are made based only on analysis of specific company cases and interests of Government as shareholder.

Companies in Group A are split in two subgroups depending on the their degree of self-financing. Group A1 includes companies whose core business is commercially self-sufficient, i.e. revenues collected from competitive market, allow running a sustainable business. Group A2 includes companies that receive a part of their revenues from the state budget in various forms, e.g., as subsidies, payment for services, compensations or others.

Companies where the state has majority but not full ownership may be included in Group A (specifically, Group A1) as the state has demonstrated their commercial potential through acquiring only partial ownership or partly divesting its shares and involving private shareholder.

The main goal of Group A companies is to maximize the financial value creation for the country while implementing their mandate in terms of fixing specific market failure and maintaining the value of the asset that state has provided them for use. For physical asset holders this goal might also imply balanced capital investments in order to prevent deterioration of the asset value. This marks the main difference between companies in Groups A1 and A2:

Group A1 should aim to maximize the company value and generate profit from their commercial activities;

Group A2 should aim to maximize the amount of self-financing and ensure financial stability, or, in other words, aim to decrease dependence on payments from state budget and aim for a balanced budget and stable credit rating.

Companies and holdings that belong to Group A include (see description of the companies in Annex C):

Group A1:

— Energy sector infrastructure: Augstsprieguma tīkls; Latvenergo;
— Forests: Latvijas Valsts meži;
— Transportation and logistics: Starptautiskā lidosta “Rīga”;
— State lottery: Latvijas Loto.

Group A2:

— Rail transport infrastructure: Latvijas dzelzceļš;
— Transportation and logistics: Latvijas Pasts;
— Electronic communications: Latvijas Valsts radio un televīzijas centrs;
— Conformity assessment services: Sertifikācijas un testēšanas centrs;
— Investment management: Altum.

Group B: SOEs with the primary goal to ensure fulfilment of delegated state assignments, provide essential services that in most cases are not available elsewhere in the market. These SOEs receive state budget funding or collect their own service fees with the main goal of covering their operational costs but not generating profit. According to the type and amount of state support they are receiving, a general distinction exists between several subgroups.

Figure 22 Proposed approach for Latvian SOE classification – Group B

Group B1: Companies in group B1 mostly do not receive direct state subsidy, however, the revenues received are from fees that client is obliged to pay for the service (monopolistic SOEs that fulfil a state delegated assignment that cannot be obtained anywhere else in the market), or some other out of government's balance sheet financing arrangements. Many companies in this group provide services according to a price list approved by the government or regulators. While some of the companies can generate and distribute profit, others are restricted from distributing profit that is generated from providing the regulated services, e.g., both Latvijas gaisa satiksme and Elektroniskie sakari are bind by specific regulatory framework to lower their service fees if surpluses (profits) are reported.

The case of Latvijas gaisa satiksme serves as an example when judgement should be used to classify the company in one group or the other when it meets criteria from both groups A and B. Latvijas gaisa satiksme is a strategically important asset that cannot be privatized, however, when looking forward to setting targets relevant for each of the proposed groups, Group A has a strong focus on profit generation, but that would not be applicable to Latvijas gaisa satiksme. Therefore, to maintain that the classification of the company is meaningful it is assigned to a group that has a better fit from the target setting perspective.

The target setting implications for the B1 companies include the fulfilment of the state delegated assignment in a way that is transparent and economically sustainable. Financial targets shall be set for these companies with an aim of providing highest quality service per euro collected in fees in order to ensure economically sustainable management of the companies while ensuring reasonable financial risk control.

Transparent reporting practices should tackle traceable costing and pricing structure justifying fees collected and used, including, see-through budgeting that would disclose among others also any cross-subsidy practices. The client satisfaction and service quality has to be ensured on the highest level while maintaining efficiency in the delivery. Corporate governance best practices shall be followed for the daily business and reporting.

Group B1 company list according to sectors includes:

- Electronic communications: Elektroniskie sakari;
- Public media: Latvijas Vēstnesis;
- Standardization: Latvijas Nacionālais metroloģijas centrs; Latvijas Proves birojs; Latvijas standarts;
- Transportation organization: Autotransporta direkcija; Ceļu satiksmes drošības direkcija; Latvijas Jūras administrācija; Latvijas gaisa satiksme.

Group B2: Companies having a mixture of own revenue and state budget funding (SOE receives state budget subsidies as well as gain their own income for paid services from customers), and the companies have ability to generate own income in substantial amount.

Group B2 companies shall ensure the fulfilment of the state delegated tasks in a financially sustainable and economic value creating manner and focus on indicators that describe their position in the market. The costs of the achievement of public policy goals shall therefore be transparent, controllable and considered for the financial target setting. Financial targets shall be set for these companies with an aim of providing highest quality service per euro collected in fees, to ensure economically viable (sustainable) management of the companies and ensuring financial risk control.

Transparent reporting practices should tackle traceable costing and pricing structure justifying fees collected and used, including, see-through budgeting that would disclose among others which part of costs are covered by fees, and which – by state budget subsidies, as well as any cross-subsidy practices.

The share of the own revenue shall be maximized in order to reduce the need to subsidize the business from the state budget (i.e. indirectly making every taxpayer participate in covering costs of services that are used only by a share of the society). Depending on the industry the companies work in, the efficiency and client satisfaction can be used as a target to be measured.

Companies in this subgroup include:

- Culture: Dailes teātris; Daugavpils teātris; Jaunais Rīgas teātris; Kremerata Baltica; Latvijas Leļļu teātris; Latvijas koncerti; Latvijas Nacionālais simfoniskais orķestris; Latvijas Nacionālais teātris; Latvijas Nacionālā opera un balets; Liepājas simfoniskais orķestris; Mihaila Čehova Rīgas Krievu teātris; Rīgas cirks; Valmieras drāmas teātris; Valsts Akadēmiskais koris Latvija;

- Environment related: Latvijas Vides, ģeoloģijas un meteoroloģijas centrs, Meliorprojekts;
- Transport: Pasažieru vilciens;
- Sports related infrastructure: Bobsleja un kamaniņu trase Sigulda; Kultūras un sporta centrs Daugavas stadions; Sporta centrs Mežaparks; Tenisa centrs Lielupe;
- Real estate management companies: Šampētera nams; Tiesu namu aģentūra; Valsts nekustamie īpašumi; Zemkopības ministrijas nekustamie īpašumi.

Group B3: Companies receiving the major share of the income in terms of direct state subsidy or payments for services through government contracts.

The policy goals shall be seen as primary for the B3 companies. The delegated task fulfilment and employee and client satisfaction, while maintaining efficient resource allocation (return per each euro of taxpayers' money) should serve as the minimum requirements for these companies. In addition, realistic financial targets should be set in order to control any financial risks and ensure financial stability and economically sound allocation of the financial resources. The costs of the achievement of public policy goals shall be transparent and clear serving as an input for financial target setting.

Companies in this subgroup include:

- Healthcare providers: Aknīstes psihoneiroloģiskā slimnīca; Bērnu klīniskā universitātes slimnīca; Bērnu psihoneiroloģiskā slimnīca Ainaži; Daugavpils psihoneiroloģiskā slimnīca; Nacionālais rehabilitācijas centrs Vaivari; Paula Stradiņa klīniskā universitātes slimnīca; Piejūras slimnīca; Rīgas Austrumu klīniskā universitātes slimnīca; Rīgas Psihiatrijas un narkoloģijas centrs; Slimnīca Ģintermuiža; Straupes narkoloģiskā slimnīca; Strenču psihoneiroloģiskā slimnīca; Iekšlietu ministrijas poliklīnika, Traumatoloģijas un ortopēdijas slimnīca;
- Road and railway infrastructure and maintenance: Eiropas dzelceļa līnijas; Latvijas autoceļu uzturētājs; Latvijas Valsts ceļi;
- Media: Latvijas radio; Latvijas televīzija;
- Education: Rīgas Tūrisma un radošās industrijas tehnikums;
- Environment related: Vides investīciju fonds.

Group B4: This group includes only one company – Privatizācijas aģentūra, which is a specific case of a state asset manager as the company is mandated to manage the state's problematic asset portfolio and assets that are to be divested or privatized. In addition, the resources provided by the state shall be governed in the most value adding and efficient manner. Objectives of Privatizācijas aģentūra are strategically different from real estate managers but targets can be set similar as those for B2 group companies.

In terms of target setting, the core focus here shall be the generation of the best possible value (in terms of financial outcome and policy outcome) from the portfolio of the assets at stake while securing financial viability.

2.5.3 Other considerations

Size

The target setting, reporting, and governance requirements should take into consideration the varying size of the companies of the Latvian SOE portfolio. From the 66 SOEs that are 100% directly owned by the state, 15 can be classified as large, 24 as medium, while the majority of 27 companies are small according to the criteria set out in the Annual Financial Statements and Consolidated Financial Statements Law.

For Group B companies, which with some exceptions are mostly small or medium, the minimum reporting and monitoring requirements that arise from the SOEL and regulations regarding state budget spending can create a potentially disproportionate burden, however, these requirements are there to ensure efficient management and transparency of use of public funding. To balance the state interests, this consideration can be taken one step further by evaluating the possibility for the state to increase the efficiency of the small shareholding management and monitoring by grouping the smaller companies operating in the same sectors (healthcare, sports, culture) into holdings as it is practiced in Estonia. Another similar example of joining smaller entities in holdings is the Italian approach to the culture related entities (museums, archaeological sites, etc.). Such approach could decrease the administrative burden both - for the single, small impact entities as well as for the CSCC when dealing with strategies and monitoring of the companies. Several of the companies in groups B2 and B3 initially seem to be potential targets for such evaluation.

Corporate governance goals

Corporate governance implications from the OECD recommendations suggest the countries to act as responsible and prudent shareholders while serving the public interest[67]. The practices to achieve this translate into various suggestions and requirements that shall serve as the implied goals and targets for all the SOEs, no matter which classification group they are attributed to. Some of the goals applicable to all SOEs as witnessed from Sweden, France and Italy include:

- Transparent director and executive appointment procedures;
- Gender equality in terms of balanced management boards;
- Assessment of corporate social responsibility (CSR) performance for state companies.

As the degree of consideration by Latvian SOEs with respect to these metrics currently vary greatly, they shall be seen as implementable in the longer term in order to strive to the compliance with the best practice.

Legal form

As noted from the practices in most of the Benchmarking Countries, the Group B entities in other countries would rather use a different legal form and would not operate as companies in a sense of commercial law. Particularly in case of Group B1 the option of reverting to the legal form an agency could be considered. Fiscal implications would need to be considered as these entities would become part of state budget, however, in this case comprehensive comparative analysis of costs and possible financial gains should be undertaken.

Alternatively, adjustments in the legislation could be considered allowing for a specific form of public establishment to accommodate the non-profit / non-commercial segment of entities that are currently operating as SOEs. Similarly, the evaluation of other state intervention techniques could be considered, i.e. strategic procurements of the service.

Even though currently Latvian SOEs are required by law to re-evaluate their SOE status at least once every five years, the reality shows that in vast majority of the cases the SOEs wish to keep the current form due to the fact that the change in the legal form could impact the flexibility of the company, remuneration allowances, budget implications etc. The proposed solutions for this issue could include an introduction of a more flexible legal form of a public establishment, which could be seen as more appropriate by the current SOEs. Additionally, the re-evaluation of the legal form could be supplemented by an independent review (by a third party or the CSCC) for the (1) adequacy of the state intervention type (i.e. whether a strategic procurement of the service could be used instead of a SOE); (2) the necessity of the SOE to remain corporatized instead of changing the legal form of operations.

While creating an appropriate new legal form to address these issues is a solution that requires political support and negotiations with many involved stakeholders, the issue can also be addressed in the medium-term through setting appropriate targets and expectations to these companies, mainly through focusing on their financial stability and efficiency instead of profitability.

3 Target setting, reporting, monitoring

3.1 Analysis of the system of target setting and monitoring

The regulatory framework and supporting guidelines by the CSCC provides a stable reference framework for target setting and subsequent monitoring. There is a clear guidance on how to set financial targets while developing medium-term strategy (MTS), and a system in place for monitoring and evaluation of companies' performance by the shareholder and the CSCC. The key challenge though lies with quality of application of these rules. The analysis shows shortcomings in the quality (level of ambition) of targets set, difficulties with the benchmarking, as well as lack of unified standard in terms of transparency and accountability regarding the performance of SOEs. Strategy setting and reporting requirements (or interpretations of those) sometimes create administrative burden not necessarily resulting into higher quality performance management of SOEs. The experience of the Benchmarking Countries suggest that there are gains both from a structured and regular shareholder and management dialogue, as well as from increased requirements in terms of transparency.

3.1.1 Current procedures for monitoring and reporting to the CSCC, Line ministries and State Shareholders:

The general requirements for reporting on financial and non-financial targets are set out in the Law On Governance of Capital Shares of a Public Person and Capital Companies (SOEL). While implementing the SOE governance reform, the CSCC has developed numerous regulations and guidelines that cover various aspects of SOEs' management. With respect to setting targets, reporting and monitoring the legal framework consists of:

— 09.02.2016 Regulations of the Cabinet of Ministers No 95 "Regulations for evaluation of operating results and financial targets of state-owned enterprises where state holds a majority stake"[78] ("Evaluation Regulations");

— Guidelines for setting strategic targets regarding state's involvement in a corporation ("Target Guidelines")[79];

— Guidelines regarding the development of medium-term operation strategy for state-owned enterprises ("'Strategy Guidelines")[80] – the Strategy Guidelines were developed in 2016 and updated in August 2018, providing an elaborated methodology for calculating the return on equity, as well as inclusion of R&D targets and elaborated description of non-financial targets;

78 Regulations of the Cabinet of Ministers No 95 "Regulations for evaluation of operating results and financial targets of state-owned enterprises where state's stake is majority", Retrieved from: https://likumi.lv/ta/id/280193-kartiba-kada-tiek-verteti-darbibas-rezultati-un-finansu-raditaji-kapitalsabiedribai-kura-valstij-ir-izskirosa

79 CSCC, Guidelines for setting the overall strategic objectives for Public participation, Retrieved from: http://www.pkc.gov.lv/sites/default/files/images-legacy/Kapitalsabiedribas/SMNV_30032016_.pdf

80 CSCC, Guidelines regarding the development of medium-term operation strategy for state-owned enterprises, Retrieved from: http://www.valstskapitals.gov.lv/images/userfiles/vid_term_darb_strat_vadlinijas_28082018.pdf

— Guidelines regarding publication of information for state-owned enterprises and their shareholders ("Information Guidelines")[81];
— Guidelines regarding evaluation of operating results of state-owned enterprises where state holds majority stake ("Evaluation Guidelines")[82].

3.1.1.1 Setting targets

Strategy Guidelines provide guidance for developing MTS. MTS should be developed for a period of three to seven years, and it sets the medium-term targets, business model, and KPIs with annual expected values. The strategy should include an estimate for the share of profits that will be distributed as dividends in line with the strategy period.

Short-term targets and KPIs are set in annual operational plans or budget and are used for the annual performance evaluation against the MTS.

Strategy should include both financial and non-financial targets.

Non-financial targets can include any or all of the following:

— Public policy objectives – objectives that stem from the main strategic objective of the SOE and are assigned to the SOE to fulfil a state delegated assignment. This objective should have a clear financial cost and funding source assigned to it. In cases where the government's subsidy for fulfilment of public policy objectives is lower than funding required to operate with a profit, the strategy should clearly indicate whether these objectives are financed from another (profitable) business branch or how it translates into setting lower financial targets (lower return or dividends);
— Other non-financial targets that stem from the main strategic objective and the business model, including business (operational) targets (e.g. number of customers, efficiency targets), CSR targets, and others (e.g. investments in R&D).

If an SOE does not have an assigned public policy objective, it has to be clearly stated in the MTS, as the public policy objectives are the cornerstone for performance evaluation if the company receives funding from the state budget. With respect to other non-financial targets, the Strategy Guidelines foresee that if a company has investments in R&D as one of its KPIs, it should have a respective non-financial target and risk assessment depending on the technology readiness level of the planned R&D investment project and industry benchmarks for R&D investments in similar companies.

Financial targets are grouped into targets that describe the return on assets and equity, capital structure, revenue and dividends. The SOEs should select and include in the strategy the financial targets and set KPIs that are most relevant to their business. In

81 CSCC, Guidelines regarding publication of information for state-owned enterprises and their shareholders, Retrieved from: http://www.pkc.gov.lv/sites/default/files/images-legacy/Kapitalsabiedribas/IPV_30032016.pdf
82 CSCC, Guidelines regarding evaluation of operating results of state-owned enterprises where state's stake is majority, Retrieved from: http://www.pkc.gov.lv/sites/default/files/images-legacy/Kapitalsabiedribas/Vadlin_rez_v%C4%93rt_010616.pdf

addition, the indicators are to be reported to the CSCC are set in the Evaluation Regulations and provided in the Table 2.

Absolute targets, EUR	Relative targets, %
Revenue	ROE (return on equity)
Net profit	ROA (return on assets)
EBIT	Liabilities to equity ratio
EBITDA	Total liquidity
Balance sheet (total assets)	Real-to-planned investments in fixed and intangible assets ratio
Equity capital	
Net cash flow from operating activities	Average pre-tax salary per employee
Distributed dividends	Revenue per one employee
Received funding from the state budget (subsidies, payments for services and others) by funding targets	
Other financial targets included in the MTS	

Table 2 Absolute and relative indicators for monitoring of financial results recommended by CSCC
Source: Regulations of the Cabinet of Ministers No 95 "Regulations for evaluation of operating results and financial targets of state-owned enterprises where state's stake is majority", Retrieved from: https://likumi.lv/ta/id/280193-kartiba-kada-tiek-verteti-darbibas-rezultati-un-finansu-raditaji-kapitalsabiedribai-kura-valstij-ir-izskirosa

According to the Evaluation Guidelines non-financial targets can be defined in a form of numerical values or as tasks that are accomplished (yes/no answer). All financial targets should have numerical values assigned to them. As many of the financial indicators suggested by the CSCC are expressed in absolute terms, it is more difficult to make the comparison of performance among various companies having different business models, operating in non-comparable markets and being variously sized.

The Evaluation Guidelines also stipulate that if the financial targets of the SOE are not met the SOE should provide additional information if and how the fulfilment of non-financial targets has affected meeting the financial targets. The progress in target attainment is assessed during the annual evaluation of the company's performance. Based on these results the management and supervisory board of the company can receive performance bonuses that depend on the overall performance assessment of the company and the individual board members[83].

Challenges identified in the target setting process:

- The majority of Latvian SOEs are fulfilling public service obligations and receive some funding from the state budget, hence, measuring their performance based on financial targets focused on profitability is less relevant for them and does not reflect the performance regarding the public policy objectives;
- The target setting practices and public transparency varies significantly among the companies. The opportunities for the general public to track Latvian SOE

83 CSCC, Guidelines for the determination of the compensation of the Public person capital association and publicly private capital association board and members of the council, Retrieved from: http://www.valstskapitals.gov.lv/images/userfiles/PKCvadl_Atlidziba_240817.pdf

performance and the results achieved, especially regarding the results achieved with the state funding, are very limited;

- There are some SOEs that disclose only very limited information besides the financial statements while other SOEs provide information on a large number of indicators without prioritizing the ones that the management or line ministry perceive as the most important;
- In practice, the targets are often set below the past performance level and are not challenging enough. In most of the cases there is lack of evidence that benchmarking against similar companies is used for target setting;
- In practice, the availability of information about similar peers – similar companies in other countries or in private sector – is very limited and restricts benchmarking in many cases. In most of the cases it is due to the reasons like: (1) the state delegated assignment in other countries are performed by foundations or state agencies that have different reporting and disclosure requirements, (2) private companies do not disclose information about their performance, or (3) differing regulatory environments and markets as well as business models make the companies hard to compare;
- In cases when the performance bonuses for the management of the company are based on the performance of the company and the level of target attainment (over or under achieving the targets), the targets set might lack ambition. This can create a situation when the SOEs in Group B – with the objective of implementing a state delegated assignment and fulfilling non-financial targets – are either setting lower, more attainable financial targets or setting easily attainable non-financial targets and overachieving them to justify underachieving the financial targets.

3.1.1.2 Reporting and monitoring requirements

SOEs are subject to the Commercial Law and the Law on the Annual Financial Statements and Consolidated Financial Statements, as well as specific requirements set out in SOEL. Companies are required to prepare annual reports that have to be approved by the management and supervisory board. Medium and large companies (companies that meet at least two of these criteria: balance sheet total exceeds EUR 4 million, net revenue exceeds EUR 8 million and average number of employees during the financial year exceeds 50; or if transferable securities of the company are included in the regulated market) are required to have their annual report audited by a sworn auditor[84]. The annual reports (along with the report from the sworn auditor) have to be prepared and submitted to the State Revenue Service within four months after the end of the financial year, or for medium-sized and large companies and parent company of the group of companies, which prepares a consolidated annual statement, not later than five months after the end of the financial year if international agreements do not foresee a different deadline. SOEL also requires that companies prepare quarterly financial statements and publish on their websites within two months after the reporting period.

In addition, for SOEs the Evaluation Regulations and Evaluation Guidelines require that every year the management of the SOE prepares and submits to the State Shareholder

84 Law On the Annual Financial Statements and Consolidated Financial Statements, Retrieved from: https://likumi.lv/ta/id/277779-gada-parskatu-un-konsolideto-gada-parskatu-likums

or supervisory board (if applicable) a report on the operating results of the previous financial year. This report after a review by the supervisory board and State Shareholder is submitted to the line ministry and the CSCC for further evaluation of the company performance (more details are provided in Table 3).

The report should include the following information:

— A report on status of financial and non-financial targets that are set in medium-term strategy and other internal documents;
— Statement containing explanation from the management board regarding the fulfilment of financial and non-financial targets;
— Information on a set of financial targets that are used by the CSCC to prepare the annual Public Report on the State-Owned Enterprises and Shares. These financial indicators are provided in the Table 2.

The CSCC uses the information provided by SOEs and the annual reports submitted to the State Revenue Service to prepare the annual public report on the SOEs.

If the targets are significantly over- or underachieved, the SOE should provide justification for the deviations and include this justification in the aforementioned report. The monitoring system requires the involvement of the supervisory board and the State Shareholder in the process of analysing the deviations and the underlying causes for significant deviations from the planned operational results. Each of these stakeholders can provide additional inputs to justify the deviations or challenge the reasoning provided by the management board, and add their statements to the report that is then submitted for review to line ministry and the CSCC.

If an SOE prepares a consolidated financial statement, the report should include information on financial and non-financial targets also for subsidiaries included in the consolidated report.

An overview of the roles and responsibilities of the various stakeholders for target setting, reporting the results of performance and target fulfilment are described in the Table 3.

Body:	SOE management board (1)	SOE supervisory board (if applicable) (2)	Shareholder (3)	CSCC (4)	Line ministry (5)
Target setting					
Action item for medium-term strategy (MTS)	Set financial targets, non-financial (business (operational), CSR, innovation targets and other non-financial targets	Approve the whole strategy	Strategic objectives are defined in laws or by government Approve the whole strategy	CSCC issues a statement to State Shareholders on the financial objectives set in the MTS, on the financial performance indicators (profit share to be disbursed in dividends, profit indicators, return on capital, etc.), as well as on the conformity of financial targets with the non-financial targets set in the MTS.	Set industry/sector specific non-financial targets
Annual monitoring and reporting processes as required by CSCC					
Timeframe	Not set		1 month after the approval of annual report of SOE	2 months after receiving information from (3) (in exceptional cases – 3 months)	2 months after receiving information from (3)
Action item	Prepare report on financial and non-financial targets Self-assessment on fulfilment of targets Submit to (2) or (3)	Review report from (1) Add self-assessment on fulfilment of targets. Rate the fulfilment of financial targets according to CSCC methodology (rating on a scale unsatisfactory; satisfactory; good; very good) Submit to (3)	Review report from (1) and (2) Add assessment on fulfilment of targets (financial and non-financial) and rate the fulfilment of financial targets according to CSCC methodology (rating on a scale unsatisfactory; satisfactory; good; very good) Submit to (4) and (5) After receiving information from (4) and (5) take decision on further steps and inform (4) and (5) within 5 days.	Review information received from (3) Evaluate the results against the financial targets set in MTS and indicators listed in Table 2, considering also the impact of non-financial targets on fulfilment of financial targets. Rate the fulfilment of financial targets according to CSCC methodology (rating on a scale unsatisfactory; satisfactory; good; very good) Submit the results of evaluation and opinion to (3)	Review information received from (3) Evaluate the results against the non-financial targets set for the respective year Rate the fulfilment of non-financial targets according to CSCC methodology (rating on a scale unsatisfactory; satisfactory; good; very good) Submit the results of evaluation and assessment to (3)
Reporting processes as required by SOEL					
Action item	Quarterly unaudited financial reports. Annual reports				
Monitoring and reporting processes as required by line ministries (general overview)					
Action item	Monthly or quarterly budget spending reports on all expenditure – for SOEs that receive state subsidies Additional ad hoc reports as requested by the ministries				

Table 3 Target setting, monitoring and reporting system of financial and non-financial targets of SOEs in Latvia

If the line ministry and shareholder is the same entity then the evaluation and assessment of attainment of both financial and non-financial targets are combined in one process.

The Evaluation Guidelines allow the line ministry to provide suggestions to the shareholder to improve the performance of the company, such as revise the MTS, include additional or remove some of the planned activities from the annual operational plans to better attain the non-financial targets or review the relevance of the planned activities and their contribution to attainment of the financial and non-financial targets.

The role of the CSCC as an independent coordinating institution in the reporting and monitoring process is to provide an unbiased view on the performance of SOEs. The CSCC collects information and reports from all SOEs and therefore has an overview of the development and performance trends for companies in different industries or market segments. This allows the CSCC to compare the financial results of various SOEs and assess the reasoning and objectivity of the justification for deviations from the targets provided by the management boards and shareholders.

In cases where the deviations are significant and unjustified, leading to performance of the SOE being evaluated as unsatisfactory the CSCC can suggest to the shareholder that an audit should be performed in the SOE.

Strategy Guidelines suggest that the performance of the SOE and attainment of financial and non-financial targets should be evaluated annually and assessment should be made whether the performance results, market situation or other significant changes in the operating environment require amendments in the MTS.

The guidelines or regulations do not provide additional mechanisms or processes for monitoring the performance of SOEs in the period between these annual evaluations to identify challenges early and taking corrective measures. More regular reporting and monitoring is especially useful for larger companies that operate in fast-changing market environment (this monitoring is performed by the supervisory board, if company has one) or companies that struggle to balance their budget. Nevertheless, the financial performance can be monitored through the quarterly financial reports that are published on company websites. In practice, the company performance is monitored on a case by case basis and the involvement of shareholder varies greatly across the SOE landscape. For example, for VAS “Latvijas Valsts meži” the State Shareholder representative often participates in the supervisory board meetings and is kept up to date about the company performance, but for SIA “Rīgas Austrumu klīniskā universitātes slimnīca” the approach to involving shareholder and line ministry has recently been changed to encourage bi-annual monitoring meetings and dialogue with other hospitals.

There are gaps in implementation of the Information Guidelines both on the SOE level and line ministry and shareholder level that limits the opportunities for the general public to follow the performance of SOEs. Information about the financial and non-financial targets and their attainment varies on a case by case basis, e.g., there are companies that follow the good practice in non-financial reporting and information disclosure, and there are companies that do not disclose the information at all or the information is outdated. In some cases, the information is available only for the previous period but lacks historical data. Some companies choose not to publish their targets and progress reports for reasons of protecting their trade secrets, however, experience from the Benchmarking Countries indicate that transparent companies publish information on their performance, especially in the areas of public service obligations and this disclosure is not harming the business activities.

Challenges identified in the reporting process:

— Performance of SOEs and the attainment of financial and non-financial targets is evaluated once a year. In addition to reporting requirements described in Table 3, the SOEL and Information Guidelines require that SOEs prepare and publish on their website non-audited quarterly financial reports. Additionally, line ministries require various reports throughout the year (budget spending, operational results, statistics about the served clients, etc.), and occasionally similar information is requested by various stakeholders (line ministry, the CSCC, shareholder) that creates a burden of delivering multiple reports. In addition, there is lack of evidence whether the ministries take action on issues reported;

— For SOEs that do not generate profit and are largely dependent on subsidies from government the operational target setting can be challenging, as the targets have to be set for a period of multiple years but state budget funding, though planned in three-year cycles, is allocated annually, according to SOEs. Depending on the contract that delegates a state assignment to the company additional monthly or quarterly reports on budget spending have to be submitted to the line ministry. These reports can include valuable information to assess the non-financial targets but they are not a part of the performance monitoring system and can lead to the same information being requested from the company by multiple stakeholders on multiple occasions;

— The shareholder and line ministry assessments or reports about the company performance are not publicly available and the Information Guidelines do not explicitly require it to be made public. It can be argued that especially for Group B it is in the interests of the general public (tax payers are, after all, the ultimate shareholder in the state owned assets) to have this information available in order for the society to be able to monitor the state budget spending and the results achieved and to see that the state acts as a responsible owner that strives to achieve the best outcome with the limited funding available, or that the state is taking measures to achieve satisfactory performance of its companies. Some but very limited information is included in the aggregated annual report prepared by the CSCC;

— At the moment the transparency and accountability of the company performance is limited as the Information Guidelines are not thoroughly followed by the SOEs and State Shareholders, especially regarding the information about non-financial targets and CSR and sustainability issues. Information regarding most of the non-financial targets should not be treated as trade secret, especially in areas where companies perform public service obligations. The Information Guidelines also do not require that information about the past performance should be kept on the website. If the taxpayers and general public are seen as the ultimate shareholders, then the SOEs should be held accountable to the highest transparency standards: disclose information in a similar manner as listed companies and encourage its ultimate shareholders to monitor the company performance and hold it accountable. Group A companies could consider increasing the information availability in English language on their websites;

- The current target setting process and lack of comparable benchmarks can limit the potential for supervisory boards and State Shareholders to gain appropriate understanding about the real and potential performance of the company and the impact that can be attributed to external factors (e.g., changes in the market environment that cause over- or underachievement of the targets) and performance of the company management;
- During the performance evaluation process the CSCC is required to evaluate performance of 66 SOEs in a period of two months, and it can be challenging to develop deep insights in the sectoral specifics and market situation for each of the companies, in this limited amount of time;
- When preparing annual reports some SOEs include subsidies in their “Revenue”, whilst others include it in “Other revenue” or a similar position. The law does not specify how government subsidies have to be classified, and each company has a choice to include it either in revenue or other income, whichever best represents the nature of the financial support received. According to Section 41(2) of the Law On the Annual Financial Statements and Consolidated Financial Statements “Other revenue” shall include various other income, for example, any financial support received that has not already been included in revenue. Paragraph 12 of the 22.12.2015. Regulations of the Cabinet of Ministers No 775 on application of the aforementioned law notes that income for each year should be included in the profit or loss statement under caption “Other income” or another caption if it better reflects the nature of the financial support received. This results in an issue with comparability of financial performance of various SOEs. When calculating KPIs that include revenue, the results are distorted and cannot be used, for example, VSIA Daugavpils teātris in 2017 had revenue of EUR 175 982 and Other income of EUR 1 036 647. EUR 905 499 of the Other income was government subsidy, and the rest was a local council subsidy and other funding received. Adding government subsidy to revenue increases it by 515% to EUR 1 081 481. The financial results are similarly distorted for any performance indicator that includes revenue in its calculation. Therefore, the CSCC should include an additional indicator in the annual report on SOEs performance – “Revenue including government subsidies”. The information can be obtained from the annual report or, if not disclosed in the annual report, it should be provided by the companies at the time of reporting their results to the CSCC. For some companies this indicator will be the same as revenue, whilst for others it will be significantly higher due to the proportion of the subsidy.

Lessons learnt from the SOEs analysed in the case studies

During the interviews conducted with representatives of the SOEs selected for the case study analyses, the following good practices were identified in the Latvian SOEs:

- Maintaining a flexible strategy that is updated every year to adapt the targets to market changes and to ensure that the strategy is a living document and constantly shows the strategic direction for the next 3-5 years. Investment planning is more efficient in this manner as the company continually has an updated investment plan for the next 3-5 years that is aligned with the strategic objectives, and can timely plan the necessary funding;

- Active involvement of the supervisory board in setting the strategic direction and targets;
- Management of SOEs highly appreciate the strategic direction from the shareholders and line ministries, and that the ministries do not interfere with everyday operations and decision making;
- Shareholders and line ministries have industry expertise and understanding of the market situation;
- Management performs benchmarking against companies in other countries;
- Good collaboration with industry associations and other stakeholders – helps to attain both financial and non-financial targets;
- Companies perform a wide variety of CSR activities;
- Activities to reduce impact on environment are implemented because they have an economic rationale and have a positive impact on the bottom line;
- Companies are implementing innovative activities, developing new products, also for export markets;
- Operational plans are used to set out detailed activities for the year;
- SOEs can serve as a good example for performing analysis and understanding of their customer needs, and for new product development.

The interviews also highlighted several processes that have a room for improvement:

- Lengthy strategy approval process, back-and-forth communication between the stakeholders;
- Shareholders and supervisory boards could be more active in setting challenging targets;
- Companies do not perform benchmarking against other companies;
- Short-term financial planning – for Group B companies where amount of the subsidy is determined at the end of the current year, the ability to perform timely planning and operational target setting for the next year is limited. The current practice of assigning budget for 1 year but requiring strategy for 3-7 years, including profit-loss estimates, is contradicting and guarantees that the profit-loss estimates will be inaccurate;
- Public policy assignment contracts with line ministries have higher importance than the strategy but strategy includes also the commercial activities and corporate governance; public service delivery contracts cover only state delegated assignments;
- Subsidies are not linked to performance targets or results but rather based on as-is basis, which does not ensure financial efficiency;
- Companies are performing various CSR activities but they are not tracked or measured;

— CSR and sustainability issues are not on the management's agenda;

— An emerging problem is succession planning for expert-level staff and very specific roles that require extensive training or maintenance of relationship networks.

3.1.2 Review of international practices on target setting and monitoring

3.1.2.1 Setting targets

Estonia

As described in the section 2 of this report the Estonian state policy objectives are implemented through commercially oriented companies and through non-profit foundations operating mainly in such areas as healthcare and culture. Operating under the dual model of SOE ownership, the governance of Estonian SOEs is divided between the shareholding ministries and the Ministry of Finance. This means that the objectives for establishment of new SOEs are drafted by the shareholding ministries and then have to be submitted and approved by the Ministry of Finance, but the annual objectives and targets do not require an official approval of MoF.

For target setting in commercial SOEs the main tool at disposal of the shareholder is the owner's expectations letter ("OEL") even though this document is not included in the Commercial Code as a formal tool for management of shareholder interests. OEL is informally accepted by the government and line ministries and seen as a mandatory tool for SOE management.

OEL is usually prepared by the shareholding ministry. Later on the OEL is agreed upon with the management board and supervisory board of the company. There is no standardized template for this document but it typically includes:

— Strategic reasoning for involvement of the state in the SOE;

— Strategic objectives that the state as the owner expects from the company;

— Financial targets regarding profitability, efficiency, dividend policy and capital structure.

The letter includes specific objectives and targets for each individual company, so the targets are not unified for all SOEs. Shareholder evaluates the performance of SOE against this letter and takes appropriate measures if the company is not performing according to its expectations. The OEL is generally forward looking and is renewed or adjusted in cases when there are significant changes in the market or the company realises a need for a new strategy. Therefore, the OEL is rather a longer term document and is not renewed every year with specific targets. The annual targets that are not explicitly stated in the OEL are rather discussed between the shareholding ministry, MoF and the company's board and later set and approved by the supervisory board of the company.

Three universal financial KPIs are generally set for Estonian SOEs:

— Cost of capital;
— Expected ROE (calculated by MoF and included in OEL by the line ministries. It is possible that the target is set for a longer period, especially in cases when large investment projects are made[85]);;
— Capital structure.

In addition, the line ministries set sector specific, overarching targets. It is the responsibility of the supervisory board to narrow these targets down to make them actionable. The board can set additional business or activity targets, for example, client satisfaction.

In contrary to commercial companies, for foundations in Estonia there is no target setting mechanism such as OEL. As their main purpose is the implementation of social policy objectives, there are no universal financial targets or KPIs set for these entities. Section 89 of the State Assets Act sets forth that at latest by the beginning of the financial year, the supervisory board approves the foundation's activity targets and budget for the year[86]. To improve the efficiency and analyse the past performance of operations of foundations, MoF benchmarks the foundations against similar foundations within the industries (museums are compared with other museums, hospitals with hospitals). Financial targets are generally not set by the MoF for the foundations. However, the State Budget Act includes requirements that all foundations and SOEs that belong to the central government have to meet, that is, balanced budget and net debt limits. Exceptions to these requirements are allowed only by the Government and in this process MoF has the coordinating role.

Foundations generally have funding agreements with the shareholding ministries, thus the relevant performance targets are set by the ministries. The targets generally aim at increased efficiency of the foundations as well as ensuring that the specific policy objectives are implemented. Thus, for example, non-financial targets for foundations can be set as the number of new plays for theatres, number of visitors for museums, and similar. There is no general list of targets that is applied to all the foundation pool, rather the targets are set specific to each individual foundation.

The legal acts do not require specific targets for gender balance in the supervisory boards for SOEs, but in practice the nomination committee considers this factor when compiling boards. However, this can be oftentimes difficult as there is a lack of experienced women managers, especially in sector-specific and technical fields[85].

Sweden

The ownership and governance of Swedish SOEs is centralized via the Ministry of Enterprise and Innovation, which includes the Division for State-Owned Enterprises, responsible for administration of the majority of state-owned enterprises (40 out of 47). The Swedish approach of SOE governance is often used as an example for an efficient

85 Interview with Tarmo Porgand, Deputy Head of State Assets Department at Ministry of Finance, Estonia
86 Riigi Teataja, State Assets Act, Retrieved from: https://www.riigiteataja.ee/en/eli/ee/Riigikogu/act/506042018001/consolide

and effective method of implementation of state interests, which is set up in a way to ensure a high level of transparency in the overall SOEs management.

The main requirements for target setting and reporting are laid out in the "The state's ownership policy and guidelines for state-owned enterprises 2017"[87]. The guidelines are regularly updated. The general Swedish approach to SOE governance is to ensure optimal long-term value performance and, where applicable, fulfilment of specifically adopted public policy assignments. The long-term value creation is the main objective that steers the management through short-term challenges. The government requires that SOEs are managed according to the highest corporate governance standards and sustainable business is at core of the management of SOEs (both sustainability towards the business and environmental targets).

The guidelines apply to SOEs where the state has a majority ownership share. For companies where the state has a minority share the state engages in an active dialogue with the other shareholders to ensure that the guidelines are generally applied.

MoEI (or other government office overseeing the SOE) manages the company by setting targets (through the general meeting) and monitoring and evaluating the performance of the company (through owner dialogue).

The supervisory board of each company is responsible for company's organisation and for managing its affairs. This includes regularly assessing the company's financial situation and ensuring satisfactory internal control. Company's management board is responsible for day-to-day operations and target fulfilment.

Financial targets are set in the annual general meeting. The shareholders and management of the company together discuss and propose the targets while the supervisory board is responsible for proposing specific target values to be achieved. The target setting process can take several months, including negotiations and work meetings between the company representatives and shareholder. Targets are set for the perspective of a business cycle, which typically is seen as three to five years, and the targets are not revised annually.

With respect to financial performance, there are typically three targets and the most appropriate KPIs are decided on a case by case basis for each company:

— Capital structure targets (debt/equity ratio, net debt/EBITDA ratio, interest coverage ratio, equity/assets ratio). The relevant KPI value is determined based on industry benchmarks, mainly using private, listed companies as benchmarks;
— Profitability targets (ROA, ROCE, ROC, ROIC, ROE or operating margin; with ROCE, ROE or margin targets being the most common but they wary depending on types of businesses);

87 Government Offices of Sweden, The state's ownership policy and guidelines for state-owned enterprises 2017, Retrieved from: https://www.government.se/49f639/contentassets/c6382135343d45fe8685ab7fa53a2fa3/the-states-ownership-policy-and-guidelines-for-state-owned-enterprises-2017.pdf

— Dividend targets (dividend targets are used as a tool to ensure appropriate capital structure over a longer term).

Benchmarking against private, listed companies allows the companies to set more challenging targets. During the target setting process the supervisory board and management board may have to revise the business plan of the company if there are significant gaps between the shareholder expectations and the business plan of the company. This might be the case for situations when the target values set by the companies are not seen as challenging enough by the shareholder.

For companies that receive government subsidies or are assigned specific public policy assignments (approximately half of the Swedish SOEs have public policy assignments, with some companies having very specific and narrow assignments, and others can be less specific and broader) the public service obligation targets are communicated through "owner instruction" and resolved in the general meeting. The public service and financial targets are prepared in an integrated manner to ensure that the targets, risks and financial return are balanced. Depending on the type and purpose of the company, specific targets are defined to assess the public benefit. The specific targets usually include[88]:

— For infrastructure companies (airport, road infrastructure, TV and radio broadcast infrastructure, and others) – capacity utilisation rate, customer satisfaction index, reliability;
— For growth capital companies (research and innovation, venture capital, export credits, loans for small and medium enterprises) – value added, survival/success rate, control group reviews and customer surveys;
— Community service (pharmacies, emergency response service, housing) – customer satisfaction index, service level;
— Restraint (lotteries and retail of alcohol) – volume (the public policy objective is to maintain the consumption of such products at reasonable level to improve public health).

There can be some exceptions when financial targets for companies are not set, for example, in cases when the company is structured in a way to not generate profit (e.g., Arlandabanan Infrastructure AB that owns the railway line between Arlanda Airport and Stockholm). Nevertheless, most of the companies in the Swedish SOE portfolio have financial targets.

In addition to financial and non-financial targets the supervisory boards set sustainability targets that are in line with strategy and long-term business plan of the company. The initiative is seen in line with global 2030 Agenda, which unites countries in implementing sustainable business practices across 17 sustainability goals.

These targets in broad terms relate to social aspects (work environment, human rights), climate and environmental issues (CO2 emissions, accident rates) as well as business ethics (including anti-corruption goals). The guidelines similarly provide targets for

88 Report on portfolio overview 2016 from Ministry of Enterprise and Innovation of Sweden

gender distribution in the board of directors, which contributes a share to the initiative of gender-equal Sweden[89]

Italy

According to OECD the Italian SOE landscape is relatively complex and therefore more difficult to oversee and manage. According to the estimates of the Ministry of Economy and Finance done in 2015, there were 9 465 SOEs, of which around 600 are central government-owned enterprises[90]. In addition to the large amount of SOEs and the diversity of industry sectors with some degree of state ownership, the reforms in SOEs' management are still underway.

SOEs are managed according to the conditions set out in the Civil Code[91] and the rules that apply to SOEs are the same as for private, commercial companies. Shareholder rights are exercised through shareholding ministries. In addition, line ministries act as supervising ministries either through providing general guidance or through service contracts (for provision of services) or programme contracts (for investments).

Targets for SOEs are set depending on the characteristics of SOE, including the ultimate purpose (public benefit) of the company and the industry and market where it operates. Currently there is no unified target setting for SOEs or a list of mandatory or optional KPIs.

There is limited power for the Italian government to influence the financial target setting. One of the means to do so is through the supervisory board, which is nominated by the shareholders. As the financial targets are approved by the supervisory board, this is seen as a potential mechanism how the state can influence the target setting of the company, that is, is through its nominated board members. On this matter, a full list of nominated board members within SOEs' boards directly participated by the Ministry of Economy and Finance ("MEF"), which is the main government's shareholder, is published by the MEF, and the proportion of MEF designated board members ranges from 0 in some cases to 100% in others. Nonetheless, it remains unclear, especially in those SOEs in which the majority of the members of the supervisory board is not designated directly by the government, the extent to which these nominated members actually have a real power to influence decisions of the companies.

The MEF also tracks the financial performance of the SOEs and can provide comments on any deviations from the financial targets approved by the supervisory board. The MEF, as required by law, every year publishes performance data on SOEs, both for SOEs owned by the central government and by local administrations, in the report *"Patrimonio della PA. Rapporto sulle partecipazioni pubbliche"*[92]. This data covers

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89 Government Offices of Sweden, Annual Report for State-owned enterprises 2017, Retrieved from: https://www.government.se/4a78ec/contentassets/9c99e9a92e8e44fd9434e75dfd568961/annual-report-for-state-owned-enterprises-2017.pdf

90 The Italian Ministry of Economy and Finance, Report on Public Participations 2015

91 Civil Code of Italy, Retrieved from: http://def.finanze.it/DocTribFrontend/getAttoNormativoDetail.do?ACTION=getSommario&id={9E93F1BE-06AE-4F24-8E9D-B838F7E0C2E6}

92 Patrimonio della PA. Rapporto sulle partecipazioni pubbliche", several years, retrieved from: http://www.dt.tesoro.it/it/attivita_istituzionali/partecipazioni_pubbliche/censimento_partecipazioni_pubbliche/rapporti_annuali_partecipazioni/

information regarding services offered, performance and governance. However, the data is published on an aggregated basis and consists of the results of self-declarations presented by central and local authorities owning SOEs. Law 191/2009 requires that all public administrations should report data on their participation in enterprises; nonetheless, not all of them have already started to do so and not all SOEs have actually reported data. As described in the previous sections, an ultimate report with data about performance of all SOEs is not available in Italy.

In addition, every year the MEF publishes a summary report on financial results of its own SOEs[93], listed by company together with information on financial transfers in relation to the public service assignments attributed by the government. However, this information is limited and the only financial performance KPI reported is the annual budgetary outturn. The document also specifies programme or service contracts or special agreements that regulate the relationship between the SOE and the MEF, and requires that specific financial and non-financial targets have to be set in these documents in detail. For instance, the service contract between the Ministry of Economic Development and RAI (the public TV broadcaster) for the period 2018-2022[94] sets out that RAI has the duty to ensure financial and economic stability in the same way as purely private counterparts, and to adopt and follow technical and economic criteria to achieve efficiency. The rest of the service contract is concerned with specific non-financial targets and special obligations but does not include measurable KPIs.

For the non-financial targets the line ministries usually contribute to setting the non-financial targets through service contracts. The service contracts are available to the public and published on the websites of the respective ministries or regions. Even though SOEs are not required to publish their non-financial targets (and therefore they cannot be analysed in-depth), they are usually very industry specific. In practice the availability of the information about non-financial targets depends on each company, its role in the market and the potential effect from such disclosures on the commercial or policy objectives.

Companies that provide public services or implement public policy objectives (mainly in such sectors as transport, energy, communications and postal services) are required by the Law on Transparency[95] to publish their non-financial targets (the amendments to the law entered into force in 2016). For example, the national postal service provider includes the quality targets (timeliness and quality of deliveries) in its reports that are publicly available, and therefore can use it for promotion of the business. In addition, to add a layer of complexity, some Italian SOEs have service contracts not only with ministry but also with different regions that include specific non-financial targets (e.g., quality of service), and the region may publish information about the specific non-financial targets set for the region[96].

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93 Report on Ministry of Economy and Finance participation in SOEs, Retrieved from: http://www.mef.gov.it/documenti-allegati/2017/mission_delle_societx_partecipate_2016.pdf

94 *"Contratto di servizio Rai 2018-2022"*, retrieved from: https://www.sviluppoeconomico.gov.it/images/stories/documenti/Contratto-di-servizio-Rai-2018-2022.pdf

95 Legislative Decree of March 25, 2016, Review and Simplification of Provisions on the Prevention of Corruption and Promotion of Transparency, Retrieved from: http://www.normattiva.it/uri-res/N2Ls?urn:nir:stato:decreto.legislativo:2016-05-25;97

96 Interview with SOE experts at KPMG Advisory SpA (Italy)

There are no mandatory targets regarding CSR or sustainability for the Italian SOEs, however, some companies are required to prepare sustainability reports and therefore set relevant targets (please see below the section on reporting requirements).

Italian SOEs and listed private companies are required to ensure gender equality among members of the board of directors and the board of statutory auditors by ensuring that the least represented gender must obtain at least one third of the elected directors[97].

Italian state-owned multinational enterprises (e.g. ENI S.p.A) are subject to the legally non-binding OECD Guidelines for Multinational Enterprises, which provide principles for responsible business conduct, including protection of human rights, employment relations and consumer interests.

France

France implements a centralised governance model of SOEs. The agency overseeing the companies with public participation – APE – plays the most important role in the overall SOE portfolio management. In 2017 APE had 52 employees, and 27 of them were executives and portfolio managers that are involved in the management and monitoring of SOEs in four sectors: transport, energy, services and finance, and industry. For the 81 companies in French SOEs' portfolio the government has appointed 824 directors (in management and supervisory boards) and 240 of them are government representatives.

The rules that define the government's relations with the companies are applied on a case by case basis by taking into account the status of the company and if necessary its capital structure as well as legal and specific regulatory dispositions[98].

The supervisory board validates the strategy of the company and monitors its implementation. The government (through APE) can provide a strategic roadmap through shareholder's letters or mission statements to executives. The strategic plan is updated annually and includes a detailed business plan and sales forecast. Qualitative targets are set for each company individually. For financial indicators APE monitors and discloses in its public report five main financial KPIs: revenue, EBITDA, EBITDA margin, change in net equity and change in net debt.

France has recently taken steps to enhance the social and environmental responsibility of the companies to ensure that the government owned companies act as good examples for balancing corporate interests and sustainability. In 2017 APE launched a pilot project that involves 20 companies to develop CSR roadmaps and tailored targets,

97 Articles 1-ter and 3 of Legge 12 luglio 2011, No. 120 "Modifiche al testo unico delle disposizioni in materia di intermediazione finanziaria, di cui al decreto legislativo 24 febbraio 1998, no. 58, concernenti la parità di accesso agli organi di amministrazione e controllo delle società quotate in mercati regolamentati"

98 French Ministry for the Economy and Finance, Rules governing the relations between the APE and companies, Retrieved from: https://www.economie.gouv.fr/files/files/directions_services/agence-participations-etat/Documents/Etat-et-gouvernance/Charter_APE_2004.pdf

as well as reporting framework[99]. Similarly, gender balance targets are set to increase the participation of women in the management and supervisory boards.

Summary of findings from the Benchmarking Countries

No	Target setting	Applicability or recommendation for Latvia
1	In Estonia for target setting in commercial SOEs the main tool at disposal of the shareholder is the owner's expectations letter ("OEL") even though this document is not included in the Commercial Code as a formal tool for management of shareholder interests. OEL is informally accepted by the government and line ministries and seen as a mandatory tool for SOE management. The OEL includes specific objectives and targets for each individual company, so the targets are not unified for all SOEs. Shareholder evaluates the performance of SOE against this letter and takes appropriate measures if the company is not performing according to its expectations. Companies generally have three financial KPIs – cost of capital, ROE, capital structure.	Implement a similar tool to set owner's expectations towards medium term targets and annual KPI values
2	For foundations in Estonia there is no target setting mechanism such as OEL. Ministry of Finance benchmarks the foundations against similar foundations within the industries. Balanced budget and net debt limits are requirements set out in the law for all foundations and SOEs.	Require some financial targets for all SOEs but tailor them based on the nature of the company (commercial activities or implementing of state delegated assignments)
3	In Sweden, the state ownership guidelines apply to SOEs where the state has a majority ownership share. For companies where the state has a minority share the state engages in an active dialogue with the other shareholders to ensure that the guidelines are generally applied.	Follow similar approach by engaging in an active dialogue with other shareholders in companies that are not fully owned by the state.
4	In Sweden targets are set for the perspective of a business cycle, which typically is seen as three to five years, and the targets are not revised annually. Swedish companies have three financial targets – capital structure, profitability, dividend targets. The relevant KPI for each target is determined based on industry benchmarks, mainly using private, listed companies as benchmarks	Use benchmarking more actively for target setting. If companies are not able to access data for comparable peers, the CSCC or ministry should take the lead in cooperating with policy makers in other countries to reach agreement on information exchange.
5	For companies that receive government subsidies or are assigned specific public policy assignments (approximately half of the Swedish SOEs have public	Ensure a better linkage between public policy assignments and appropriate funding. Line ministry

99 APE, French Ministry for the Economy and Finance, Annual Report of State Participation 2017, Retrieved from: https://www.economie.gouv.fr/files/files/directions_services/agence-participations-etat/Annual_Report_APE_2016-2017.pdf

	policy assignments) the public service obligation targets are communicated through "owner instruction" and resolved in the general meeting. The public service and financial targets are prepared in an integrated manner to ensure that the targets, risks and financial return are balanced.	and shareholder should be clear about sources of funding for implementing the objectives (during strategy development process and annual KPI setting).
6	In Italy SOEs are managed according to the conditions set out in the Civil Code and the rules that apply to SOEs are the same as for private, commercial companies. Shareholder rights are exercised through shareholding ministries. There is currently no unified target setting for SOEs or a list of mandatory or optional KPIs. Targets are set depending on the characteristics of SOE, including the ultimate purpose (public benefit) of the company and the industry and market where it operates. For companies implementing public services the non-financial targets are set through service contracts that are available to the public online. The targets are industry specific but rather broad.	Contracts for public policy assignments and relevant targets should be public and easily accessible.
7	Italian SOEs and listed private companies are required to ensure gender equality among members of the board of directors and the board of statutory auditors by ensuring that the least represented gender must obtain at least one third of the elected directors.	Gender equality targets among top management are worth exploring also in Latvian SOEs.
8	Majority of SOEs in the portfolio of France are large companies. The supervisory board validates the strategy of the company and monitors its implementation, but the government (through APE) can provide a strategic roadmap through shareholder's letters or mission statements to executives. The strategic plan is updated annually and includes a detailed business plan and sales forecast. Qualitative targets are set for each company individually. For financial indicators APE monitors and discloses in its public report five main financial KPIs: revenue, EBITDA, EBITDA margin, change in net equity and change in net debt.	For large companies with supervisory councils follow this approach with shareholder providing the general strategic guidance through OEL (every 3-5 years) but leave the monitoring process in the hands of supervisory council.
9	In France in 2017 APE launched a pilot project that involves 20 companies to develop CSR roadmaps and tailored targets, as well as reporting framework to ensure that SOEs act as good examples for balancing corporate interests and sustainability. Similarly, gender balance targets are set to increase the participation of women in the management and supervisory boards. In Sweden, the government requires that SOEs are managed according to the highest corporate governance standards and sustainable business is at core of the management of SOEs (both sustainability	Put stronger focus on CSR and sustainability targets; perform a pilot study for sample of companies.

	towards the business and environmental targets). In addition to financial and non-financial targets, the supervisory boards set sustainability targets that are in line with strategy and long-term business plan of the company.	

Table 4 Summary of findings from the Benchmarking Countries

3.1.2.2 Reporting

Estonia

The requirements for reporting and dissemination of the information are set in the State Assets Act[100]. Section 98 of the State Assets Act requires that SOEs and foundations established by the state have to submit a copy of an audited and approved annual report to MoF and to the National Audit Office within four months following the end of the financial year. The report should include an overview of the work of the supervisory board in arranging, presiding over and supervising the activities of the company or foundation, as well as information of the total of remuneration payments made to members of the supervisory and management board during the financial year.

SOEs have to follow a shorter deadline for preparing the annual report than private companies – the Commercial Code[101] (Section 61) provides a 6 months period after the end of the financial year for preparation and approval of the report while the term for SOEs is set to 4 months.

Each year, the shareholding ministry submits to MoF a report concerning the purpose of the state's holdings and information on administration of those holdings. For foundations the person exercising the founder's rights has to submit to MoF a report concerning fulfilment of the objectives set to the foundation. These reports have to be submitted within 5 months following the end of the financial year.

Section 97 of the State Assets Act requires that all companies where the state has a majority ownership share and foundation established by the state publish the following information on their websites:

— Within one month after the end of 1st and 3rd quarter of the financial year – the corresponding quarter's income statement, balance sheet and cash flow statement;
— Within two months after the end of 2nd and 4th quarter of the financial year – the corresponding quarter's income statement, balance sheet and cash flow statement;
— The audited annual report at the same time as the report is submitted to the MoF.

The larger companies in addition are required to publish information regarding significant facts or events having an impact on the company's activities. The quarterly reports have to be complemented with explanations and commentary about the achieved result as well as present a comparison to the previous period. The larger companies are defined

100 Riigi Teataja, State Assets Act, Retrieved from: https://www.riigiteataja.ee/en/eli/ee/Riigikogu/act/506042018001/consolide
101 Riigi Teataja, Commercial Code, Retrieved from: https://www.riigiteataja.ee/en/eli/504042014002/consolide

as companies that are required to form an audit committee under section 99 of the Auditors' Activities Act[102], and the criteria are as follows (at least three of the indicators have to be met or exceeded):

- Sales revenue or income 14 million euros;
- Assets as of the balance sheet date 7 million euros;
- Average number of employees 200 persons;
- Number of members of the supervisory board 8 persons.

SOEs in Estonia are required to follow the national accounting standard. If an SOE opts to prepare financial statements according to IFRS or is required to do so (if it is listed in stock exchange or has an international shareholder that requires the use of IFRS), the company nevertheless has to prepare information also according to the national standard for consolidation purpose of state's annual report.

Sweden

The state ownership guidelines[103] include requirements for external reporting applicable to SOEs. SOEs are subject to the same laws as private companies including the Swedish Companies Act, the Swedish Bookkeeping Act and the Swedish Annual Accounts Act. In addition, Swedish SOEs shall prepare their annual reports, interim and year-end reports and corporate governance statements in accordance with Nasdaq Stockholm's rulebook for issuers, that is, SOEs are required to report according to the same requirements as companies whose shares are admitted to trading on a regulated market. There are additional reporting requirements for companies that are either monopolies, have other special status (e.g. the state alcohol monopoly), receive funding from the state or the revenues of the company are above a certain threshold.

Swedish SOEs in their reporting have to be as transparent as listed companies. In general, they are required to follow these reporting and transparency requirements and prepare the following reports:

- The annual report, including information about the most significant external factors as well as business model and strategy, and information about the results and changes in the strategic priorities of the company. The annual report must include information about the financial and non-financial targets, public policy targets (if applicable), dividend policy, operational targets and attainment of these targets as well as information about sustainability issues. The report should be published on the company's website by 31 March;
- Interim reports – prepared quarterly and published within these deadlines: 1st quarter – by 30 April, 1st half and 2nd quarter – by 15 August, 3rd quarter – by 31 October, and year-end report (4th quarter) – by 15 February;

102 Riigi Teataja, Auditors Activities Act, Retrieved from: https://www.riigiteataja.ee/en/eli/ee/516112017003/consolide/current
103 Government Offices of Sweden, The state's ownership policy and guidelines for state-owned enterprises 2017, Retrieved from: https://www.government.se/49f639/contentassets/c6382135343d45fe8685ab7fa53a2fa3/the-states-ownership-policy-and-guidelines-for-state-owned-enterprises-2017.pdf

- The corporate governance statement (published on website by 31 March);
- The sustainability report in accordance with Global Reporting Initiative Standards (GRI) or another international framework for sustainability reporting (published on website by 31 March). The sustainability report must provide information on matters related to the environment, labour and social conditions, respect for human rights and prevention of corruption if these are perceived material to the company or its stakeholders.

The annual and interim reports have to be prepared according to IFRS. There is no differentiation in the reporting requirements depending on the size of the company. All reporting documents should be available on the company's website for at least 10 years.

SOEs are required to report data on their financial position quarterly through a web-based system that is administered by MoEI. MoEI then prepares an aggregate annual and bi-annual report on performance of SOEs using the information provided by SOEs in the online system.

Italy

Italian SOEs are subject to the same reporting requirements as private companies, that is, they are required to prepare an annual financial statement and report within 120 days after the end of financial year (or 180 days if consolidated financial statements are prepared)[104]. In addition, listed companies are required to prepare bi-annual financial statements.

Listed SOEs are required to report according to the IFRS. Non-listed SOEs can choose whether to follow the Italian accounting standards or to report according to IFRS.

Italian SOEs are encouraged to follow the OECD guidelines and the same standards of transparency and disclosure as listed companies, that is, to provide to the public and regularly update as much information as relevant about the operations and performance of the company. However, this requirement is not legally binding and its implementation is not monitored. In practice many companies have increased their transparency and many are still on their way to implementing these standards.

At the beginning of 2017[105], Italy implemented the European directive on non-financial reporting and preparation of a Sustainability Report became mandatory for public-interest entities as defined by the Legislative Decree No. 39/2010[106]. SOEs that fulfil the

104 Civil Code of Italy, Articles 2423-2434, Retrieved from: http://def.finanze.it/DocTribFrontend/getAttoNormativoDetail.do?ACTION=getSommario&id={9E93F1BE-06AE-4F24-8E9D-B838F7E0C2E6}

105 Legislative Decree No. 254/2016, Retrieved from: http://www.normattiva.it/atto/caricaDettaglioAtto?atto.dataPubblicazioneGazzetta=2017-01-10&atto.codiceRedazionale=17G00002&queryString=%3FmeseProvvedimento%3D%26formType%3Dricerca_semplice%26numeroArticolo%3D%26numeroProvvedimento%3D254%26testo%3D%26annoProvvedimento%3D2016%26giornoProvvedimento%3D&currentPage=1

106 Legislative Decree No. 39/2010, Retrieved from: http://www.normattiva.it/atto/caricaDettaglioAtto?atto.dataPubblicazioneGazzetta=2010-03-23&atto.codiceRedazionale=010G0057&queryString=%3FmeseProvvedimento%3D%26formType%3Dricerca_semplice%26numeroArticolo%3D%26numeroProvvedimento%3D39%26testo%3D%26annoProvvedimento%3D2010%26giornoProvvedimento%3D&currentPage=1

following criteria are required to prepare a sustainability report according to GRI or other accepted standards:

- More than 500 employees;
- Total assets exceeding 20 million EUR or net revenue exceeding 40 million EUR;
- Company issues securities admitted to trading on regulated Italian and EU markets, or is a bank or insurance company.

France

Companies are required to submit monthly reports containing the main financial indicators and, if deemed necessary by the company itself or the shareholder, also the non-financial indicators characterising company's activities. The specific indicators that have to be reported for each company are decided individually and regularly updated[107].

Nonetheless, it has to be noted that for the majority of the companies in APE portfolio, which are listed on stock exchange (mostly Euronext), the state as the shareholder has the same rights as the private or other institutional shareholders. In turn, this means that state cannot require any additional reporting from the side of the companies in order not to receive proprietary information that is not made public to other shareholders. Similarly, with respect to all disclosures, the listed companies have to comply with the stock exchange requirements in terms of frequency, extent and information type that is disclosed by the company.

3.1.2.3 Monitoring

Estonia

In addition to the reporting requirements set out in the State Assets Act, the SOEs are required to provide the MoF and line ministry with the materials and minutes from supervisory board meetings. This requirement is not applicable to SOEs that are listed on stock exchange.

In general, SOEs and foundations meet with the line ministry twice a year to inform about the current situation and progress in attainment of their targets. If there are significant events that require more thorough involvement or support in the decision making from the shareholder, the supervisory board is required to inform the shareholder and the necessary actions are decided on a case by case basis, depending on the significance of the events and level of management that should be involved.

On-going reporting requirements

107 French Ministry for the Economy and Finance, Rules governing the relations between the APE and companies, Retrieved from: https://www.economie.gouv.fr/files/files/directions_services/agence-participations-etat/Documents/Etat-et-gouvernance/Charter_APE_2004.pdf

MoF has implemented a State Accounting System[108], where information from all reports from SOEs and foundations belonging to the central government is consolidated on a monthly basis, and for other SOEs and foundations - quarterly. Most of this information is open to public, except for companies, whose information may be partly or entirely restricted due to security or confidentiality reasons. The State Accounting System is not directly linked to the accounting systems of SOEs, therefore the companies have to provide this information manually. Data from this system is used by the MoF for preparation of the aggregate annual report. In practice information from the State Accounting System is verified against the annual financial statements in order to avoid inconsistencies.

For SOEs where the state holds a minority share the requirements described above do not apply directly. There are cases, however, when the shareholders have reached an agreement, and the companies with minority state ownership share also follow the reporting and monitoring procedures as set out by the state.

Sweden

The shareholder and management of the company engage in an active owner dialogue to ensure the performance of the company is monitored on a regular basis. This process ensures that the target achievement is regularly tracked and necessary measures are taken when needed. Sustainability targets are also tracked through this process. The owner dialogue is implemented through regular meetings (2 to 4 times a year, or annually for smaller companies) between the chairman of the board, CEO of the company and representatives of the shareholder – minister and leadership of the ministry (vice-minister, state secretary and / or head of department). These meetings are documented and the minutes of the meetings are kept on a file in the ministry.

On an operational level the investment team at MoEI (or other ministry responsible for the SOE) continuously tracks the company's performance and latest developments. The investment team also organises meetings with relevant departments of the company to discuss issues as needed and to ensure on-going monitoring.

In practice the monitoring process is differentiated depending on the size or strategic importance of the company, that is, more management capacity is spent on monitoring the companies with large capital, monopolies or companies that carry more political risk.

Italy

Shareholding and line ministries perform on-going monitoring of the SOEs in relation to fulfilment of the public service obligation and non-financial targets set out in the service contract. Monitoring of SOEs' performance is also done by the regions who have the service contracts. The Constitution of Italy provides requirements for shared competence between the state and regional level authorities on a list of matters that are listed in the Article 117 of the Constitution[109], including transport, communications, energy, cultural

108 The Ministry of Finance of Republic of Estonia, State Accounting System, Retrieved from: https://saldo.fin.ee/saldo/reportManagement.action
109 Italian Parliament, Constitution of Italy, Retrieved from: https://www.senato.it/documenti/repository/istituzione/costituzione_inglese.pdf

and environmental assets, and others. SOEs that provide public service obligations and receive subsidies for fulfilling these objectives are subject to stricter controls and monitoring from the line ministries to ensure that the services are provided at an appropriate level of quality and price (for example, the Poste Italiane S.p.A. (postal services), ANAS S.p.A. (construction, maintenance of motorways) and Ferrovie dello Stato S.p.A. (railway services)).

The MEF is responsible for the analysis of the financial results and providing the public with information about companies where the state exercises ownership rights as required by article 22 of the Legislative Decree No. 33/2013[110], publishing information regarding to the financial results of the last three financial years for SOEs.

France

Each SOE is assigned an executive from APE that maintains a direct and close contact with the company throughout the year both through meetings and site visits as well as to ensure an active implementation of the strategic dialogue. The APE is therefore regularly provided with information about strategy implementation and financial performance, including justification for any gaps identified. Supervisory board can set up board committees that focus on specific areas of the company. Typical examples would include audit committee (responsible for organization of financial audit and designing the control process), salary committee (responsible for all management and director level remuneration questions including the performance based pay), strategic committee (ensuring that a multiyear strategic plan is in place and is followed to) and capital investments related committees. All such board and committee meetings are documented via meeting minutes or reports in case the APE requires information discussed therein.

At least once a year the management board meets with APE representatives to discuss the strategic orientation of the company and discuss main developments in the market and company itself. APE also pays special attention to quality of management level employees and the processes for managing succession, as well as compliance with good governance and CSR principles.

Compliance with the state ownership policy is monitored during these meetings, and the governance standards are continuously improved. If companies are planning exceptional investment projects, they undergo a set of separate presentations and meetings before the projects are validated. In addition, as a major share of the companies in the APE portfolio are stock exchange listed, special attention by APE is given to the monitoring of the listed companies and any subsequent developments in APE's portfolio.

110 Legislative Decree No. 33/2013, Retrieved from: http://www.normattiva.it/atto/caricaDettaglioAtto?atto.dataPubblicazioneGazzetta=2013-04-05&atto.codiceRedazionale=13G00076&queryString=%3FmeseProvvedimento%3D%26formType%3Dricerca_semplice%26numeroArticolo%3D%26numeroProvvedimento%3D33%26testo%3D%26annoProvvedimento%3D2013%26giornoProvvedimento%3D&currentPage=1

Summary of findings from the Benchmarking Countries

No	Monitoring and reporting	Applicability or recommendation for Latvia
1	In general, Estonian SOEs and foundations meet with the line ministry twice a year to inform about the current situation and progress in attainment of their targets. If there are significant events that require more thorough involvement or support in the decision making from the shareholder, the supervisory board is required to inform the shareholder and the necessary actions are decided on a case by case basis. In Estonia SOEs in addition to annual reports prepare quarterly financial reports. In addition to the reporting requirements set out in the State Assets Act, the SOEs are required to provide the MoF and line ministry with the materials and minutes from supervisory board meetings.	More regular and structured shareholder and management meetings would be beneficial for SOEs without supervisory boards. Structured dialogue in the form of bi-annual shareholder meetings (with meeting minutes) is preferable to irregular informal meetings that do not provide transparency in corporate management.
2	Estonian Ministry of Finance has implemented a State Accounting System, where information from all reports from SOEs and foundations is consolidated on a monthly basis. Most of this information is open to public, except for companies, whose information may be partly or entirely restricted due to security or confidentiality reasons.	Currently the CSCC for preparation on the consolidated annual report uses information received from the State Revenue Service. Implementing a monthly reporting requirement may create excess bureaucracy for the companies.
3	Swedish SOEs prepare their annual reports, interim and year-end reports and corporate governance statements in accordance with Nasdaq Stockholm's rulebook for issuers, that is, SOEs are required to report according to the same requirements as companies whose shares are admitted to trading on a regulated market. The annual and interim reports have to be prepared according to IFRS. There is no differentiation in the reporting requirements depending on the size of the company. All reporting documents should be available on the company's website for at least 10 years. Swedish companies prepare sustainability reports (either as standalone of part of their annual report) in accordance with GRI or another international framework for sustainability reporting. There are additional reporting requirements for companies that are either monopolies, have other special status (e.g. the state alcohol monopoly), receive funding from the state or the revenues of the company are above a certain threshold.	Implement requirement (for the future) that reporting documents should be available on the company's website for at least 10 years. Majority of the large companies in Latvian portfolio have implemented IFRS. For Group A it is worth considering increasing transparency towards those that apply to listed companies, and prepare sustainability reports, especially if these companies are considering issuing bonds or attracting financing from the financial markets.
4	In Sweden, the shareholder and management of the company engage in an active owner dialogue to ensure the performance of the company is	Similarly as the Estonian example, more regular and structured shareholder and management meetings would be

	monitored on a regular basis. This process ensures that the target achievement is regularly tracked and necessary measures are taken when needed. Sustainability targets are also tracked through this process. The owner dialogue is implemented through regular meetings (2 to 4 times a year, or annually for smaller companies) between the chairman of the board, CEO of the company and representatives of the shareholder – minister and leadership of the ministry (vice-minister, state secretary and / or head of department). In practice the monitoring process is differentiated depending on the size or strategic importance of the company, that is, more management capacity is spent on monitoring the companies with large capital, monopolies or companies that carry more political risk.	beneficial for SOEs without supervisory boards. While in the longer term the focus should be moved towards strategically important companies, in medium-term while the Latvian companies are still adjusting to the current SOE governance standards developed by the CSCC and implemented through guidelines and while some companies have not yet developed and approved their strategies the CSCC should focus on providing guidance to the small and medium Group B companies as they do not have supervisory boards and they may require additional oversight to ensure efficient target setting and implementation of strategies.
5	In Italy SOEs have the same reporting rules as private companies and prepare annual reports. Listed companies are required to prepare bi-annual financial statements. Listed SOEs are required to report according to the IFRS. Non-listed SOEs can choose whether to follow the Italian accounting standards or to report according to IFRS.	For Group A it is worth considering increasing transparency towards those that apply to listed companies.
6	In France, companies are required to submit monthly reports containing the main financial indicators and, if deemed necessary by the company itself or the shareholder, also the non-financial indicators characterising company's activities. The specific indicators for each company are decided individually and regularly updated. It has to be noted that for the majority of the companies in APE portfolio are listed on stock exchange and the state as the shareholder has the same rights as the private or other institutional shareholders. Therefore, the state cannot require any additional reporting from the side of the companies in order not to receive proprietary information that is not made public to other shareholders.	Implementing a monthly reporting requirement may create excess bureaucracy for the companies.
7	In France, at least once a year the management board of company meets with APE representatives to discuss the strategic orientation of the company and discuss main developments in the market and company itself.	Participation of the CSCC in the shareholder meeting may be a useful tool to ensure that all representatives of state interests have similar understanding of the situation of the company and main developments.
8	Overall, the French and Italian SOE management practices demonstrate less applicability to the Latvian situation due to the following factors:	

	1) More companies are large or listed and have supervisory boards that results in less frequent shareholder involvement; 2) SOE landscape in Italy is highly diversified and lacks common guidelines while in France the approach is highly centralized.	

Table 5 Summary of findings from the Benchmarking Countries

3.2 Proposed methodology for monitoring and reporting on corporate targets

The requirements for target setting should be calibrated for the needs of specific groups of SOEs. It is recommended to put a bigger emphasis on the financial targets in case of Group A companies. Group B companies, though, could explore the possibility to use a larger set of non-financial business targets. The indicative list of KPIs provides a wide sample of potential indicators to be used in order to add a quantified value for the set target. At the same time, no companies should be exempt from having some financial targets (at least financial stability and balanced budget) and from striving to achieve efficiency and CSR targets. Target setting and selection of supporting KPI is part of an annual reporting cycle with the management reports (as a part of the annual report required by LAFSCFS) as the key tool of ensuring both transparency of company performance to government bodies (for performance evaluation purposes) and to the general public. A more structured involvement of the State Shareholder is recommended in order to set ambitious targets through OEL and dialogue in the form of bi-annual shareholder meeting with the company management for companies that do not have supervisory boards. SOEs approach to public disclosure of standardized information can be further improved.

3.2.1 Setting targets and relevant KPIs

3.2.1.1 Choice of targets and KPIs

The focus of this report is targets and KPIs that can be used by the State Shareholder and the CSCC to ensure that the companies are operating in an efficient manner, striving to achieve the public policy objectives and justify state's ownership and involvement. To ensure efficient oversight of the companies, a limited number of KPIs should be reported to the shareholder that are the best descriptors of the business and financial performance of the company. Targets can generally be classified based on their characteristics as shown in figure and table below.

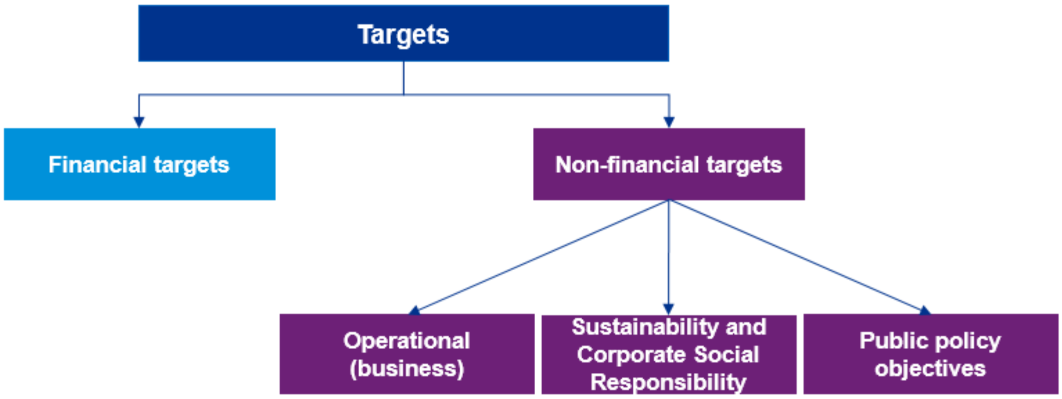

Figure 23 Target classification

Class of Targets	Areas of Targets	Reason to monitor
Financial	I. Revenue and return II. Financial stability III. Involvement of state budget IV. Financial efficiency	Set to secure profitability and sustainability of shareholder's financial investment.
Non-financial – Operational (business)	V. Customer satisfaction VI. Markets VII. Innovation VIII. Employees IX. Operational efficiency	Set to secure the best value for client, growth, and continuity of business.
Non-financial – Sustainability and Corporate Social Responsibility	X. Protection of environment XI. Social responsibility	Set to ensure sustainable business practices and contribution to overall welfare and cohesion of society.
Non-financial targets to track achievements of the **public policy objectives** set by the state.	XII. Fulfilment of the policy agenda	Set to fulfil specific policy mandate backed by public funding.

Table 6 Target classification

A successful target setting process requires a fine balance between consistency of defined targets and ability to capture the specifics of the market or sectoral environment in which the company operates. Based on the targets appropriate KPIs have to be selected that provide information on the progress of achieving of the targets. When meaningful targets are set then selecting the best matching KPIs reflects the essence of the targets. Existing measurement systems have to be used when possible to avoid establishing additional administrative burden, however, if key aspects of the business have not been measured then such systems are to be established, for example, through smaller pilot projects to assess the most effective measurement systems before contributing to full-scale programmes, for example, for measuring resource efficiency or client satisfaction.

The targets and supporting KPIs have to meet the following criteria:

- Relevant and meaningful – can be attributed to the strategic objective of the company;
- Clear (simple), specific and measurable (has base value, target value, clearly identified source of data to collect performance information);
- Detailed and precise to avoid misunderstanding as to what should be measured;
- Credible and comparable (can be benchmarked against industry standards, performance of peers);
- Cascadable to business divisions and responsibilities.

Following the SOEs' classification proposal and the different objectives of companies classified in groups A and B, as well as the subgroups, the general direction for companies in Group A is to focus on financial targets and for companies in Group B – on non-financial targets. At the same time, no companies should be exempt from having some financial targets and from striving to achieve efficiency and CSR targets. As shown by the practice in the Benchmarking Countries, there is no one-size-fits-all approach to setting non-financial targets and using the same indicators for measuring success, and the management should be capable to choose those indicators that are most appropriate for the respective business.

To explain better the suggested approach an illustrative list of targets and respective KPIs is proposed in Table 7.

Illustrative list of KPIs per Group of SOEs			
No.	**KPI**	**Primary focus (e.g. not less than 4 out of 7 KPIs)**	**Secondary focus (e.g. not more than 3 out of 7 KPIs)**
Financial targets			
Revenues and return			
1	Net revenue, EUR*	A1	A2, B1, B2, B3, B4
2	Revenue growth, YoY		
3	Profit / Loss, EUR		
4	Net profit margin (%)		
5	Gross Profit, EUR		
6	Gross profit margin (%)		
7	EBITDA, EUR		
8	EBITDA margin (%)		
9	EBIT, EUR		
10	EBIT margin (%)		
11	Forecasted dividend pay-out (% from net profit or fixed EUR)		
12	Return on Equity (ROE)		

Illustrative list of KPIs per Group of SOEs			
No.	**KPI**	**Primary focus (e.g. not less than 4 out of 7 KPIs)**	**Secondary focus (e.g. not more than 3 out of 7 KPIs)**
13	Return on Assets (ROA)		
14	Capital expenditure, EUR		
15	Capital expenditure / depreciation		
16	Economic value added		
Financial stability			
17	Equity, EUR	A1, A2, B1	B2, B3, B4
18	Debt / Equity ratio		
19	Debt / Assets ratio		
20	Liquidity, Current ratio		
21	Liquidity, Quick ratio		
22	Cash balance, EUR		
23	Balanced budget (Revenue/Costs)		
24	Contribution margin, % (Revenue-Variable costs)/Revenue		
25	Costs of debt service to EBITDA ratio		
State funding			
26	Direct or indirect subsidies / transfers / payments for services from the state budget EUR	A2, B2, B4	B3
27	Direct or indirect subsidies / transfers / payments for services from the state Budget to revenue ratio		
28	Direct or indirect subsidies / transfers / payments for services from the state budget change YoY		
Non-financial targets: (1) Operational (business)			
Customer satisfaction			
29	Net promoter score	B1, B2, B3, B4	A1, A2
30	Share of highly satisfied clients YoY		
31	Customer satisfaction index or survey results		
32	Number of complaints received YoY		
33	Returning customers (or members of loyalty programme) to total customers ratio		
Markets			
34	Number of clients served - change YoY	B1, B2, B3, B4	A1, A2
35	Number of transactions completed - change YoY		
36	Value of transactions, EUR		
37	Market share (%)		
Innovations			
38	Investments in R&D to revenue ratio		

Illustrative list of KPIs per Group of SOEs			
No.	**KPI**	**Primary focus (e.g. not less than 4 out of 7 KPIs)**	**Secondary focus (e.g. not more than 3 out of 7 KPIs)**
39	Number of scientific publications, patents or other scientific outputs	B1, B2, B3, B4	A1, A2
40	Number of new services YoY		
41	Number of innovative solutions in the existing products and services, YoY		
Employees			
42	Employee satisfaction (%)	B1, B2, B3, B4	A1, A2
43	Employee turnover (%) (employees who have left the company/average number of employees)		
44	Hours spent in trainings to total hours worked (%)		
45	Age structure: ratio of employees with less than 3 years to the retirement age (%)		
Operational efficiency			
46	Infrastructure usage rate (%)	B1, B2, B3, B4	A1, A2
47	Administrative costs to revenue ratio		
48	Revenue per employee ratio		
49	Salary costs to revenue ratio		
50	Productivity: number of clients served per employee		
51	Productivity: number of items produced/processed per employee		
Non-financial targets: (2) Sustainability, Corporate Social Responsibility			
Environment			
52	Energy consumption (electricity, heat, gas, diesel etc.) to revenue ratio		A, B
53	Energy consumption (electricity, heat, gas, diesel etc.), YoY change		
54	Water consumption m3 YoY		
55	Share of recycled waste out of total waste produced (%)		
56	Consumption of paper YoY		
57	CO2 emission levels YoY		
58	Contribution to carbon offset schemes EUR YoY		
Social Responsibility			
59	Hours spent on charity work by employees YoY		A, B
60	Gender balance, ratio of female in top management (three highest salary groups/ranks) %		

Illustrative list of KPIs per Group of SOEs			
No.	**KPI**	**Primary focus (e.g. not less than 4 out of 7 KPIs)**	**Secondary focus (e.g. not more than 3 out of 7 KPIs)**
61	Number of clients served or items produced that are donated for charity purposes or for client groups with special needs YoY		
62	Number of employees undergoing regular training on integrity and risks of corruption, fraud to total number of employees ratio		
63	Share of part-time employees (%)		
Other targets set by the State to track achievement of the public policy objectives			
64	*Sector specific*	B	A
65	*Sector specific*		
	Currently recommended as indicators for monitoring of financial results by the CSCC for performance evaluation according to Evaluation Regulations and Evaluation Guidelines. According to the Strategy Guidelines, there is not a defined list of suggested or preferred financial KPIs.		
	* Revenue calculation should include direct or indirect subsidies / transfers / payments for services from the state budget		
	* Consolidated data should be used for calculation of indicators		

Table 7 Illustrative list of KPIs per Group of SOEs

The illustrative list of targets and KPIs in the Table 7 suggests a long list of possible indicators, however using all of those in case of every SOE would not be rational.

Target setting for specific groups of SOEs

Though there is not a single right response on how many indicators the shareholder should monitor, it is believed that there should be at least five KPIs to capture sufficient spectrum of the business and finance. At the same time if the number of KPIs goes above 10 it becomes challenging for the shareholder to ensure efficient monitoring and for management to deliver on the implementation without cascading responsibility to numerous structures of the entity. Therefore, this study suggests that around six to eight KPIs per company would strike a good balance. If, for example, the number of KPIs is selected as seven, then the approach would involve the following:

— The focus would be on the KPIs that could be primarily used by the CSCC and State Shareholder to assess the performance of the company on annual basis. It does not rule out the necessity for the management board of the company to use a larger set of specific indicators or sub-indicators allowing to monitor quarterly or annually the operational performance of the company;

— For each group of SOEs there are set of targets of primary or secondary importance. If the total number of KPIs to be monitored by the shareholder in case of each SOE would be seven, then, at least four of these KPIs should be attributed to primary targets, and the remaining three to the secondary targets.

The SOEs belonging to **Group A1** would have primary focus on targets of:

— Revenue and returns, and
— Financial stability.

In this case at least four indicators would be chosen from items one to 25 in the Table 7. The shareholder would mainly pay attention to such factors as growth of profitability, receiving the highest return on equity, reaching optimal capital structure, and thereby increasing long-term value of the business to the state as the shareholder. Group A1 includes companies that potentially could become listed and for these companies focus on long-term value generation is most appropriate, and indicators such as EBITDA over a period of several years or return on capital invested (ROIC) can be used as proxies for long-term value creation.

The shareholder might also look at other relevant non-financial targets. Preserving environment or promoting positive changes in society would usually be the most natural choice, as largest SOEs in Latvia already now are striving to develop and implement their own CSR strategies.

The shareholders of **Group A2** companies whose business model is more reliant on income streams from state budget would put the emphasis primarily on targets of:

— Financial stability, and
— Reduction of state budget funding.

The four KPIs to be used in this case would aim at securing the solvency of the company and reducing its revenue dependence from the state budget funding (17 to 28 in Table 7). From the set of the secondary targets the operational efficiency (46-51 in Table 7) could be considered in order to demonstrate the most effective use of state funding.

In case of **Group B1** the shareholders main interest could be targets of:

— Financial stability;
— Financial and operational efficiency, and
— Customer satisfaction.

Hence, the four KPIs should be selected recognizing that these companies are not commercial by nature and their main mission is striking the best equilibrium between quality of services provided to citizens and businesses and costs. It is equally important to ensure transparency in establishing the service rates and client price list. From the set of the secondary targets the focus might be on employee issues, as their business continuity and quality of their service might largely depend on availability of a sufficient number of qualified staff. The target of innovations might be equally important, as it would allow improving quality and cost relationship for their clients.

As concerns the **Group B2** the shareholders core interest would lay with targets of:

- Reduction of state budget funding;
- Financial and operational efficiency, and
- Markets.

A well-adjusted set of four KPIs matching each of these targets would contribute to the improvement of the balance between the company's own revenues and the state budget funded part of the business by exploring the possibilities of addressing a larger group of clients and offering a more diverse set of services and products. The additional three KPIs could match the target of financial stability and customer satisfaction to counter balance the risks associated with expansion of the business. Moreover, the traceability of the use (distribution) of own revenue and government funding might also be an important consideration when the shareholder chooses the KPIs.

The shareholders of the **Group B3** might be primarily preoccupied with targets of:

- Financial stability;
- Financial and operational efficiency, and
- Employees.

The first four KPIs would address the need to balance the limited resources of state budget funding, costs of operating the company and securing the highest possible return per each taxpayers EUR. Furthermore, the personnel costs being a major expenditure item of the budget makes staffing policy crucial. The second-tier KPIs could look into measuring the customer satisfaction recognizing that every taxpayer contributes a substantial share of company's revenues.

For Group B3 in particular a major set of KPIs would normally be linked to the targets regarding the public policy objectives set by the state.

Group B4 currently consists only of one specialized company acting as the state asset manager. The targets of financial stability and operating efficiency might be by far the most important for this company when choosing its KPIs as its portfolio consists of both performing and non-performing assets.

Target setting considerations for all SOEs

SOEs in general should serve as an example of the highest corporate governance, transparency, sustainability standards. Analysis of the current target setting process in Latvian SOEs indicate that there are several categories of non-financial targets that should be paid more attention both from the shareholder perspective (recognizing the importance and/or applicability of these targets to specific companies) and from management (implementing activities towards these targets and measuring progress):

- Client orientation and openness to receiving client feedback;

- Innovation, development of new products, digitalisation, forming partnerships with innovative start-ups and researchers;
- CSR and sustainability activities (environmental issues, gender equality, worker protection, human rights issues).

Currently none of the players involved in the SOE oversight system (e.g. shareholders, line ministries, the CSCC) has a clear ownership over targets of sustainability and corporate social responsibility. Strategy Guidelines include suggestions for SOEs to include such targets in MTS but these targets are not mandatory. While this Study recommends having CSR targets as optional, it is suggested that the CSCC as the coordinating body is well placed to advocate for targets in such overarching corporate governance and CSR areas as employee satisfaction, reduction of CO2 emissions, charity contributions, and others; and direct the SOEs towards more sustainable and socially responsible business models in line with the long-term strategic planning documents of Latvia and the best practices globally. Due to the fact that only about a half of all SOEs have CSR targets (hospitals, culture SOEs and large SOEs, according to information provided by the CSCC), in many companies sustainability and CSR targets have not been given enough attention currently, therefore comparison or benchmarking among the Latvian companies may not lead to targets that are challenging enough.

The current working practices of Latvian SOEs indicate that CSR and sustainability activities have varying levels of importance. If CSR factors are not measured they might not be considered and do not appear on the management agenda if the management is focused on the financial or business targets even when implementing CSR activities can reduce costs and increase the company value. There is a variety of activities and measures that can be implemented without additional expenditure but can easily demonstrate the values of the company, increase loyalty of staff and decrease impact on the environment (such as flexible working hours, part-time employment, automating or digitalizing processes, bike parking, recycling, reducing consumption of resources (paper, water, electricity); changing lightbulbs, etc.). Integrating sustainability measures in the management of all SOEs would align the Latvian SOEs with the strategic objectives of Latvia (e.g., the Latvia 2030 strategy) and the general direction towards smart and green growth strategies spearheaded by the European Commission and the 2030 climate and energy framework and 2050 low carbon economy framework[111].

As evidenced from the Benchmarking Countries, gender balance is additional area of focus for SOEs. Especially strong in terms of execution and reporting on this metric are Swedish SOEs that are largely contributing towards gender equal country initiative. Even though in Western Europe this objective has been considered already for a longer period, it is suggested that this practice in medium term is considered and pursued in Latvia. Recent reports indicate that while Latvia has a good gender balance in management overall[112], this is mainly achieved through having women managers in mid-level managerial positions and in smaller enterprises. There is a wider gap in the top

111 European Commission 2050 low-carbon economy strategy, retrieved from: https://ec.europa.eu/clima/policies/strategies/2050_en
112 Eurostat publication regarding women managers, 2017. Retrieved from: https://ec.europa.eu/eurostat/documents/2995521/7896990/3-06032017-AP-EN.pdf/ba0b2ea3-f9ee-4561-8bb8-e6c803c24081

management positions and in large companies where only 20% of top management are women[113]. Gender equality can therefore be set as one of the CSR targets for Latvian SOEs.

The approach described above is further illustrated by the case studies of eight Latvian SOE's representing different groups of companies (section 3.3 of this report). For each company covered by the case study there is a sample of KPIs developed.

3.2.1.2 Benchmarking

Benchmarking financial and operational performance against peers is of utmost importance and should be performed continuously by the management. A good example for this is the Swedish practice of benchmarking the performance of SOEs against listed companies. On the one hand, listed companies are required to disclose more information to the public and hence the information is readily available. On the other hand, the private companies demonstrate the performance that should be expected when companies operate on commercial terms, and for companies with public service obligations the financial performance requirements should be adjusted to reflect these obligations and company size, differences in regulatory environment and infrastructure ownership models, among other factors.

However, the business and efficiency performance indicators, such as client and employee satisfaction, sustainability, efficiency, quality, overheads, can serve as a valuable guiding force for performance improvement. SOEs should serve as examples for efficient and sustainable management. Management and supervisory boards should use their industry expertise and professional network to identify the most appropriate peers for benchmarking, and this should not be thought of as a formal exercise for preparation of the strategy. These industry benchmarks ought to be used in the owner dialogue process to help the shareholders and management identify areas that could be improved and to appreciate the areas where the performance is outstanding.

Benchmarking should be performed during the target setting and on an on-going basis during the monitoring process to ensure the performance improves as the competitors and market environment improve. The CSCC or line ministries are encouraged to perform benchmarking studies if companies are unable to perform this exercise, especially in sectors with multiple similar companies, for example, through establishing cooperation with state shareholders in other countries (for line ministries) or regarding CSR and sustainability practices (the CSCC).

Possibilities offered by the benchmarking are further demonstrated in the eight case studies of Latvian SOEs covered in the Section 3.3 of this report.

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113 Report on gender situation in large enterprises in Latvia, 2014. Retrieved from: http://www.sif.gov.lv/images/files/SIF/progress-lidzt/petijums/precizets_zinojums_final.pdf

3.2.2 Institutional distribution of roles

Based on the challenges identified in section 3.1.1 and the practices from the Benchmarking Countries (section 3.1.2), this section tackles the question of the role distribution in the monitoring and reporting process. While the current strategy approval and performance monitoring process of Latvian SOEs is well designed, the actions of different bodies occasionally are not well coordinated, resulting in lengthy strategy approval process, double reporting requirements or varying levels of participation and inconsistent approach in the overseeing process.

To streamline this process, the roles should be distributed as follows:

The Parliament, Cabinet of Ministers should set overarching strategic objectives (through appropriate laws or regulations); ensure that the necessity of state's involvement in certain industries is regularly evaluated and reassessed based on objective criteria.

Line ministry defines industry or sector specific non-financial targets that stem from the overarching strategic objectives and *raison d'etre* of the SOE.

— For Group A the line ministry defines a few targets that relate to non-financial performance and are in line with the strategic objectives of the company e.g., targets regarding the reliability, availability, quality of the services, however these targets should not compromise the financial performance;

— For Group B the line ministry plays a more important role and defines clear non-financial targets that the SOE is expected to attain and provide an appropriate subsidy. Line ministry should clearly define the outcomes and results that are expected from the company in return for the subsidy provided, so that the line ministry can assess the effect of the company's performance on the public policy objectives.

State Shareholder challenges the level of ambition of the financial and non-financial targets proposed by the management board (if the company does not have supervisory board), suggest additional or alternative targets if deemed necessary, and evaluate the performance of the SOE against these objectives. In ministries that hold both the shareholder and sectoral policy roles these roles should be clearly separated within the organization. For companies with supervisory boards the role of shareholder in the target setting process should be limited to setting the strategic direction during the preparation or re-evaluation stage of the strategy (every 3-5 years) but not during annual target setting as this is the role of the supervisory board. Furthermore the key task of the State Shareholder in this case is selection of professional and independent members of the supervisory board who are motivated and capable of challenging the level of ambition of the company's strategy.

The CSCC should use its role as a coordinating institution and focus its evaluation on the performance of the SOE against the financial and efficiency targets, as well as promote, facilitate and perform comparative analysis and benchmarking on these and CSR targets among the SOEs or against best practices in the corporate world.

It is not feasible for the CSCC to perform an in-depth analysis of company performance for all SOEs in the limited number of months dedicated for annual evaluation. In the longer run, the focus should be moved towards strategically important companies (Group A companies and the large companies from Group B due to their considerable impact on the state ownership portfolio). However, in medium-term while the companies are still adjusting to the current SOE governance standards developed by the CSCC and implemented through guidelines (e.g. some companies still developing their first generation of strategies) the CSCC should focus on providing guidance to the small and medium companies in Group B. As these companies do not have supervisory boards, an additional guidance and oversight to ensure efficient target setting and implementation of strategies might be beneficial.

Supervisory board defines broader operational (business) targets and challenge the financial, operational and CSR targets proposed by the management. The supervisory board should receive regular, clear and transparent reports on company performance and act in line with the OECD Guidelines on Corporate Governance of State-Owned Enterprises[114] and not get involved in the operational and every day management of the company.

Management board sets financial targets and defines detailed operational (business) and other non-financial targets that can be cascaded to business divisions and employees. Management board should put in place and secure smooth operation of effective and transparent performance monitoring and reporting system.

3.2.3 Reporting requirements and monitoring

Overall, the current reporting process does not pose major issues for shareholders to implement an oversight over the companies. The SOEs are generally subject to more extensive reporting requirements than private sector companies, mainly through requirements to report on non-financial target performance and provide quarterly financial statements to shareholder and public, as is also recommended by the Information Guidelines. It is recommended that all reports prepared by the SOEs are taken action on; that is, the supervisory board, shareholder, line ministry should not require reports that are not used for monitoring of the performance and are not in accordance with the new structured approach to shareholders involvement in the oversight of the companies.

Examples of the Benchmarking Countries indicate several trends in the reporting and monitoring process: increased transparency and providing more information to the public; allocating time for SOEs' management on a case by case basis, that is, strategically more important companies receive more attention and staff resources from the shareholders and coordinating institutions. Individual and flexible approach is provided towards companies when significant changes occur in their market environment. Subsidized companies tend to be subject to more thorough controls in terms of their public policy objective achievement and efficiency and less focus on financial profitability.

114 OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015

Annual report

The Article 8 of LAFSCFS provides that the Annual Report consists of Financial Statement and Management Report. The Article 55 of the law prescribes that Management Report shall include not only financial results and performance of the company but insofar as it is important also the main non-financial indicators characterising the company and the relevant sector. In practice, the approach of SOEs varies – some SOEs provided detailed information in their management reports about their non-financial targets, while others fulfil only the minimum requirements for the content of the management report.

In addition, in practice the implementation of Information Guidelines varies significantly. The Information Guidelines suggest a certain amount of information that is published by SOEs and State Shareholders. In practice, for a number of SOEs and shareholders the amount of information available on their websites is incomplete or the information itself is outdated and does not provide a clear, comparable information about the performance of the company and its contribution to generating value for the public. Especially this tends to be the case with the non-financial targets.

As a result, multiple reports and information are generated to provide information to the shareholder, line ministry, the CSCC, State Revenue Service and other institutions, as well as information to the general public. To address this issue, it is recommended to revamp the management report section of the annual report (as prescribed by LAFSCFS) and include the relevant information regarding results and brief evaluation of financial and non-financial targets and KPIs. The financial and non-financial targets and their KPIs are set in MTS and in this way the management report would provide an annual status update on the limited set of the relevant targets and KPIs that the shareholder has requested. Therefore, the annual report would serve 1) the shareholder with the relevant information for performance evaluation of the SOE; 2) the CSCC with the necessary information for performance evaluation of the SOE and for preparation of the annual report on state ownership; 3) general public with information about the overall performance and results of company performance.

To implement the recommendation, the CSCC may include adequate requirements in the Information Guidelines to suggest a uniform reporting standard for the management report that addresses the needs of the various stakeholders mentioned above, e.g., a table format.

Target	Target KPI value (as set in MTS)	KPI value in reporting year	KPI value in previous year	Deviation from target value, comments	Information about benchmarking against other companies
For example					
Financial stability	*Balanced budget (Revenue/ Costs) >1*	*1.03*	*0.99*	*+0,03* *Financial performance has increased compared to the previous year due to better balancing of costs and revenues. More information can be provided in footnotes.*	*Company performance is benchmarked against similar peers X in Lithuania (KPI value) and Y in Estonia (KPI value). Company has performed similarly to its Baltic peers.*
…					

When evaluating the performance of the company it is important to analyse the trends in SOEs' performance and compare results over a period of time, not just to the previous year. When the recommendations to focus the attention of the shareholder on a small set of meaningful KPIs is followed, then the necessary information about the performance of the company can be included in the management report in a concise way.

Consequently, to increase transparency the quarterly unaudited reports should include a section on the performance indicators for non-financial targets that shareholder has selected for performance management. Given the different types of non-financial KPIs and the regularity with which this information is collected (that is, some non-financial KPIs can be updated quarterly while others annually (e.g., satisfaction survey results), the quarterly reports should include the latest available values for these indicators or management remarks regarding progress towards the targets.

Structured shareholder dialogue

The current practice reveals a varying level of interaction and involvement of shareholder in the supervision of the company and monitoring its performance. In some cases, the involvement of shareholder is larger and often informal, and in other cases the management of SOEs may lack a clear direction and knowledge of the vision of the shareholder.

One instrument to address this issue and clarify the owner's expectations is to use a similar approach as in Estonia – an owner's expectation letter (OEL). OEL is a brief document (1-2 pages) where the shareholder expresses its expectations regarding the company and its performance. There are two instances when the OEL becomes especially useful:

1) Periodic OEL – once every 3-5 years when a new strategy planning cycle begins (or when a clear need is identified to revise the strategy due to significant market, regulatory or other changes) in order for the shareholder to provide indications to the management and supervisory boards regarding the strategic objectives of the company and its expected performance (for all SOEs), and expected dividend target (for Group A);

2) Annual OEL – every year when the shareholder has to express the expected KPI values for the financial and non-financial targets in order to set measureable indicators against which the annual performance of the company and its management board are evaluated (for SOEs that do not have a supervisory board).

For OEL to remain a concise document it should include:

— The overarching strategic objective of the company (the reason for the state to be a shareholder in the company as defined in the legal acts establishing the company) to ensure that the medium term objectives and targets are in line with it;
— Strategic objectives for the medium term (for strategy development for all SOEs);
— Financial and non-financial targets that stem from the medium term objectives defined in the strategy, e.g., profitability, capital structure, operational efficiency, customer targets, and others (from strategy) (for SOEs without supervisory boards);
— Expected 6-8 KPIs and their values (or ranges for values) for the financial and non-financial targets (for SOEs without supervisory boards).

To ensure a proper reporting and monitoring process, the OEL has to be made available to the CSCC so that all involved parties in performance evaluation of the SOE have access to relevant and timely information.

Strategy updates

This report recommends that medium-term strategy should set out the strategic direction for the company for a 3-5 year period, instead of the current practice of 3-7 years, considering that the strategic planning process is becoming more dynamic and agile. While in practice some SOEs update and extend their strategies annually, thus extending their duration by one year and always having a strategy for the next 3-5 year period, it is important to regularly (once every 3-5 years) for the shareholder, supervisory board and management to sit down together and reassess the strategic direction of the company and change its course as necessary. In this instance the periodic OEL becomes an effective document to kick-start the strategy revision process.

Setting specific financial and non-financial target KPI values for a period of 5 years in practice means that the target values and budgetary forecasts are outdated by year 3 or 4, and the performance of company may not be best evaluated against these values. Instead of performing a lengthy updating process of the strategy, the strategy should include an expected range for the KPI values for the strategy period but the updated target KPIs values should be included in the annual OEL (for companies without supervisory boards), or set by the supervisory board, and the company performance evaluated against these values.

For Group A companies, the majority of which operate on commercial terms in markets and in many cases compete not only in domestic, but also in international markets, the ability to flexibly and efficiently adapt to the changes in market dynamics, standards and prices is especially important and hence a regular dialogue with supervisory board instead of a rigid strategy updating process is crucial.

For Group B companies the current budget planning process limits their ability to plan the future development past the medium-term state budget period. For subsidized companies where line ministries delegate the state assignments through regulations, public service delivery contracts (*"deleģēšanas līgumi"*) or specific funding contracts, the contracts should be aligned with the approved strategies. In practice, the contracts and strategies are often set for varying time periods, and the contracts are perceived as having higher importance than strategies. Compared to the contracts the strategy has a wider scope, includes the governance issues and sets the direction for achieving the objectives that include development of the company (e.g. becoming more efficient, responsive to client needs, socially responsible) while the contracts focus solely on the services provided by the company. For SOEs in Group B2 the strategy must have a meaningful emphasis on the commercially-oriented activities to ensure that the proportion of company's own revenue is maximized as far as it is possible and does not harm the fulfilment of the state delegated assignment; this balanced approach should be monitored by the CSCC.

Minority shareholding

The review of the Benchmarking Countries does not present a formal, optimized model for monitoring of SOEs where the state is a minority shareholder. In practice, the oversight is implemented through shareholder dialogue and agreeing on at least partial application of the reporting and monitoring requirements that are applied to the fully state owned SOEs. This applies also to companies where the government is a majority but not the only shareholder. Implementing formal (legal) requirements for additional reporting or monitoring processes for companies where state is a minority shareholder would not be feasible and could lead to potential conflicts with the other shareholders.

Suggested reporting and monitoring requirements

Based on the current Latvian situation analysis and the benchmarking country experience, a proposal for a general approach to reporting requirements is summarized in the tables below.

Current system:

Timeframe	Reporting document	Document prepared by	Reviews and/ or approval	Action	Required by
April / May (4 to 5 months after the end of financial year)	Annual report	Management board	Supervisory board, shareholder	Regular shareholder meeting – Approve annual report	The Commercial Law (Art. 174) SOEL (Art. 54)
1 month after the approval of annual report of SOE	Report on financial and non-financial targets and self-assessment on fulfilment of targets	Management board	Supervisory board	CSCC, shareholder and line ministry evaluate the performance of the company (according to the Evaluation Guidelines)	SOEL (Art. 27) Evaluation Regulations Evaluation Guidelines
Every quarter	Quarterly financial statements	Management board	Supervisory board, shareholder	Monitor financial performance; Publish on company website for public transparency.	SOEL (Art. 58)
Not set	Reports or meetings as required by the shareholder or line ministry	Management board	Shareholder, line ministry	Monitor performance	n/a
Not set	Strategy	Management board	Supervisory board, shareholder, CSCC, line ministry	Strategy updates as necessary	Strategy Guidelines
Every 3-7 years	New strategy	Management board	Supervisory board, shareholder, CSCC, line ministry	New strategy document for 3-7 years	SOEL (Art. 26) Strategy Guidelines
Every year	Information for CSCC annual report			CSCC prepares annual report	Information guidelines

Table 8 Current general approach to reporting and monitoring requirements

Proposal for SOEs with supervisory boards:

Timeframe	Reporting document	Document prepared by	Reviews and/ or approval	Action
April / May (4 to 5 months after the end of financial year)	Annual report (including financial and non-financial KPI results in the management report);	Management board	Supervisory board, shareholder, line ministry CSCC	Regular shareholder meeting – Approve annual report; CSCC, shareholder and line ministry evaluate the performance of the company (according to the Evaluation Guidelines)
	Current year Q1 results – financial and non-financial targets	Management board	Supervisory board, shareholder	Monitor financial and non-financial performance
Every quarter	Quarterly financial statements (incl. financial and non-financial KPIs)	Management board	Supervisory board, shareholder	Monitor financial and non-financial performance; Publish on company website for public transparency. The main body performing the monitoring function is the supervisory board; shareholder can review the reports for information
November-December	KPI target values for next year	Supervisory board, Management board		Discuss targets for the next year, identify necessary changes in strategy (if any). Supervisory board informs CSCC and shareholder about the set targets.
Every 3-5 years	Periodic OEL – strategic directions for the medium term strategy	Shareholder		Shareholder provides strategic direction and expectations for development of next medium-term strategy

Table 9 Proposal for a general approach to reporting requirements – for SOEs with supervisory boards

Proposal for SOEs without supervisory boards – stronger and more structured shareholder involvement in the monitoring of the company performance

Timeframe	Reporting document	Document prepared by	Reviews and/ or approval	Action
April / May (4 to 5 months after the end of financial year)	Annual report (including financial and non-financial KPI results in the management report);	Management board	Shareholder, line ministry CSCC	Regular shareholder meeting – Approve annual report; CSCC, shareholder and line ministry evaluate the performance of the company (according to the Evaluation Guidelines)
	Current year Q1 results – financial and non-financial targets	Management board	Shareholder	Monitor financial and non-financial performance
Every quarter	Quarterly financial statements (incl. financial and non-financial KPIs)	Management board	Shareholder	Monitor financial and non-financial performance; Publish on company website for public transparency
November-December	Current year Q3 (9 months) results and financial and non-financial targets	Management board	Shareholder	Extraordinary shareholder meeting – monitor financial and non-financial performance; Discuss targets for the next year, identify necessary changes in strategy (if any)
	Annual OEL – KPI target values for next year	Shareholder		At the same extraordinary shareholder meeting – shareholder presents the expected target KPI values for the next year that the board performance will be evaluated against. OEL is included in the decision of the shareholder meeting
Every 3-5 years	Periodic OEL – strategic directions for the medium term strategy	Shareholder		Shareholder provides strategic direction and expectations for development of next medium-term strategy

Table 10 Proposal for a general approach to reporting requirements – for SOEs with supervisory boards

Special considerations for Group A:

— Supervisory board should perform check upon financial and non-financial targets quarterly for financial targets and bi-annually for non-financial targets.

— The idea behind an active owner dialogue (through supervisory board and shareholder meetings) is that the system should be kept flexible and adaptable to the market situation and events and transparent at the same time. Shareholder has access to quarterly reports on company performance, and should not be spending additional state resources on requesting additional monthly reports but instead engage in an active dialogue with the supervisory board. For example, if there are issues that require immediate action from the shareholder, these steps should be taken through an extraordinary shareholder meeting and not postponed until the annual shareholder meeting.

- For Group A companies that have potential or future needs to attract financing from the financial markets it is worth considering to implement GRI standards (or similar) in addition to IFRS that majority of Group A has already implemented, as these are prerequisites for listed companies.
- For companies that are listed on stock exchanges (including bond listings) the reporting requirements that apply to listed companies are applied. The state as shareholder may not receive more information about the company performance than is available to other shareholders.

Special considerations for Group B:

- The majority of companies in Group B do not have a supervisory board, therefore the interaction between the management, shareholder and line ministry is closer. The shareholder must be a more active and reliable contributor towards setting the strategic direction and business targets for the company and the management.
- Shareholder must perform checks upon financial and non-financial targets bi-annually through structured shareholder meetings (if the company does not have a supervisory board).
- The shareholder must engage in active owner dialogue in the form of bi-annual shareholder meeting with the SOEs (that do not have supervisory board) and check upon financial and non-financial targets bi-annually to assess the results and be able to react timely to potential problems. Monitoring the results of the third quarter should provide good indications about the overall performance of the company and allow setting KPIs for the next year in the annual OEL.

Transparency and accountability

As discussed in section 3.1.1.2 and according to the identified challenges, the general public should be treated as the ultimate shareholder in the SOEs and be enabled to monitor the performance of state owned companies. Therefore, the transparency requirements should move towards the information disclosure practices applied to listed companies.

The World Bank has developed a progression matrix that allows assessing the transparency of SOEs from a level of basic corporate governance practices to leadership and significant contribution to improving the national transparency and accountability practices[115]. Preparation of annual and bi-annual financial statements according to domestic financial reporting standards and making these reports publicly available are the first steps in ensuring transparency. According to the World Bank, for SOEs to be a leading example for good corporate governance the companies should move towards

115 World Bank. 2014. Corporate Governance of State-Owned Enterprises: A Toolkit. DOI: 10.1596/978-1-4648-0222-5. Washington, DC: World Bank.

real leadership and create annual reports that contain not only financial statements but also cover such issues as key performance indicators and performance against KPIs, cost and funding of public policy obligations, risk management, environmental and social reporting, code of ethics, compliance with the corporate governance code, management and board remuneration, board attendance, training, and evaluations.

Such extensive reporting standards through more detailed annual reports can be applied to the large companies in Groups A and B as these companies represent the largest state ownership and contribution to the economy or receive the largest share of state budget funding. Small and medium SOEs have a more limited administrative capacity and it is not feasible for them to produce additional in-depth information in annual reports and, as recommended above, they should report on their performance regarding financial and non-financial targets and usage of state budget funding in meaningful management reports as part of the annual report.

In addition, concise infographics are a user-friendly way for informing the general public about the company performance and results achieved with the state budget funding. This applies to both groups A and B as the information should be presented to the public in an easy-to-understand manner.

To increase accessibility of the information companies should consider providing information in machine readable and open data formats.

3.3 Case Studies – illustrative KPIs for each group

To illustrate the application of KPIs to the various classification groups, a representative set of companies was selected by KPMG and the CSCC for an in-depth analysis. The list of companies covers five out of the six proposed classification groups; Group B4 has only one company in it – the state asset manager "Privatization Agency" – that has an entirely different business model and therefore is not analysed as a specific case study. From groups B2 and B3 that contain the largest number of SOEs, the sample companies were selected in a way to represent the sectors, where the state is a shareholder in multiple companies (e.g. sports infrastructure, healthcare, culture).

Classification group	Company
A1	AS "Latvijas Valsts meži"
A2	VAS "Latvijas pasts"
B1	VAS "Elektroniskie sakari"
B2	VSIA "Latvijas Koncerti"
B2	SIA "Bobsleja un kamaniņu trase "Sigulda""
B2	VAS "Valsts nekustamie īpašumi"

B3	SIA “Rīgas Austrumu klīniskā universitātes slimnīca”
B3	VISA “Latvijas televīzija”

Table 11 Selected SOEs for case studies

To prepare a list of suggested KPIs for the specific companies, the management representatives of the companies were interviewed in order to better understand the current practices of target setting and monitoring of company performance, e.g. which performance indicators are the most important for the management and what kind of information is collected and analyzed by company’s management reporting systems. Similar companies in the Benchmarking Countries were analysed to assess which targets and KPIs are used by comparable peers. The list of proposed KPIs for each company was developed based on the indicators presented in Table 7 and adapted to the specifics of the company.

The case studies serve as an example of the approach how companies can implement the suggested target setting model, while choosing targets that are company specific and relevant. The proposed targets in the case studies are set for a period of approximately three years. In some cases the current strategies of the companies contained KPIs that were in line with the indicators presented in Table 7 and the target values from the strategies were used, or target values were benchmarked against peers. The KPIs presented in the case studies are used for illustrative purposes and do not present a mandatory set of KPIs for the studied companies or other companies in the same classification groups.

"Latvia's State Forests" (AS "Latvijas Valsts meži")

Classification group	A1	Company	AS Latvijas Valsts meži	Size (Annual report 2017)	EUR
Description	The purpose of "Latvia's State Forests" is administration of state-owned forest property and management of public forest, ensuring preservation and increase of its value and generation of revenue for its owner – the State. (Source: company website)			**Revenue**	275 829 752
Strategic objectives	LVM's strategy states that by means of the rational management of state-owned forests, the company will be a stable and predictable partner on the market and will implement state interests as stated in the Latvian Forest policy – generating a profit from the management of this sustainable national asset (the forests) without depleting its value, preserving the values which are important as an environmental and cultural-historical heritage and ensuring the accessibility of the forests to the public. (Source: company website)			**Assets**	387 087 209
				Employees	1 298
Current targets, KPIs	Summary of company's medium-term strategy lists 10 targets with numerous sub indicators, such as EBITDA, dividends, value of the forest assets, value of the forest infrastructure, and many non-financial targets relating to CSR, involvement of society, climate change and public image or reputation.				
Comments, experience from Benchmarking Countries	Companies in Estonia and Sweden operate on different business models and under different regulatory environment, hence, benchmarking against their performance is possible to a limited extent. In Estonia the benchmarking company measures the percentage of protected forests, number of newly planted trees and the size of the area that has not been replanted. Company has a large focus on environment protection measures and fulfils some assignments that in Latvia are assigned to an environment protection agency. Swedish state forestry company Sveaskog has set a target to increase the total productivity by 2% p.a. until 2021. In 2017 productivity increased by 6.4%. In Sweden employee and management engagement is measured by separate indexes, the target for 2021 for the Motived Employee Index and the Manager Index is 75. 99% of the equity of Sveaskog is retained earnings. Debt to equity ratio is around 1.				
KPI	**Results (2017) (base value)[116]**	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**	
				Estonia Riigimetsa Majandamise Keskus[117]	**Sweden Sveaskog[118]**
Revenues and return					
EBITDA margin, %	36.22%	31.60%	Strategy target (market situation is expected to change due to gas and timber price movements)	33.05%	29%
Revenue gowth YoY, %	7.38%	>3%	At least the same as forecast GDP growth[119], however, it could be challenged and set more challenging	-0.66%	5%
Dividends (EUR or % of net income)	58.6% (38.2m)	>50% or >60%	Strategy target or similar to Benchmarking Countries	46%	75% (900m SEK)
Financial stability					
Contribution margin, % ((Revenue - variable cost) / Revenue)	29%	>40%	Target set similar to Benchmarking Countries	50%	n/a
Innovations					
Investments in R&D, % of revenue	0.37% (1.02m EUR)	>0.6%	Strategy target Need to improve; increased investment in R&D is in line with the Latvian national target (to reach 1.5% of GDP)	average 0.11% (2008-2017) (0.2 million EUR)	n/a
Customer satisfaction					
Customer satisfaction index (survey) (business clients), change YoY	45% (baseline)	Annual improvement +2% (e.g., reach 48% by 2020)	Benchmarking companies may have different methods for calculation. Target should be a yearly improvement in the satisfaction level.	n/a	72%
Employees					
Employee turnover rate (%) (employees who left the company to average number of employees ratio)	5.2%	<10%	Attraction of new talents to ensure planning for retirement of the experienced staff members	n/a	n/a
Environment					
CO_2 emissions, tonnes	121 736	Decrease by at least 10% until 2020		n/a	Target for CO_2 emissions is to decrease by at least 30 % between 2010 and 2020 (measured as CO_2 emissions per tonne/ delivered km3)

116 Annual report 2017 and Strategy summary, retrieved from: https://www.lvm.lv/par-mums/skaitli-un-finanses/finanses/2017-g
117 Annual report 2017, retrieved from: https://www.rmk.ee/organisation/publications-by-rmk/annual-reports-of-rmk
118 Annual report 2017, retrieved from: https://www.sveaskog.se/en/about-sveaskog/financial-information/financial-reports/
119 GDP forecast (Bank of Latvia): https://www.bank.lv/monetara-politika-iev/tautsaimniecibas-un-monetara-attistiba/prognozes

"Latvian Post" (VAS "Latvijas pasts")

Classification group	A2	Company	VAS Latvijas pasts		Size (Annual report 2017)	
Description	Latvijas Pasts provides the traditional postal services (services of general economic utility), parcel delivery and other additional services, such as financial services, advertising mail, mailboxes and others.				**Revenue**	75 589 029
Strategic objectives	The overall strategic objectives of the company are: 1) develop and deliver client oriented postal services based on newest technologies; 2) increase the efficiency of postal services while ensuring that services are available and reachable to the population; 3) be the market leader among postal services providers in Latvia and provide high quality domestic and international services. (Source: company website)				**Assets** **Employees**	96 219 015 4 100
Current targets, KPIs	Strategy is in the approval process. The main targets used in everyday management relate to EBITDA, revenue, customer satisfaction and employee satisfaction (Source: interview with the management board).					
Comments, experience from Benchmarking Countries	The customer value index (CVI) has since 2011 been used as PostNord's (Sweden) monitoring tool for regular follow up of customer satisfaction and how customers perceive the business. In Italy a key measure is the number of customers registered in the digital channels (web and app) of Poste Italiane and operations carried out by consumer digital channels (through web and application channels). In Estonia one of the focus areas is to improve the efficiency of free market services to offset the decline in profitability resulting from the decline in demand for universal postal services (Source: Annual report 2017)					
KPI	**Results (2017) (base value)**[120]	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**		
				Estonia Omniva Group[121]	**Sweden Post Nord**[122]	**Italy Poste Italiane**[123]
Revenues and return						
EBITDA margin, %	6.88%	>5%	Target set similar to Benchmarking Countries	6.88%	3.22%	15.69%
Financial stability						
D/E ratio	5.21	<2	Target set similar to Benchmarking Countries (Damoradan ratio for utilities = 0.67)	1.37	1.97	25.84
Liquidity (current ratio)	1.05	>1		0.88	1.07	0.39
State budget						
Share of revenue from business activities, excluding subsidies or compensation from state budgets	0.93	>0.95	Target set to increase revenue from other than state budget	0.99	0.999	0.98
Operational efficiency						
Number of deliveries per employee (international parcels) [124]	1951 (international parcel deliveries per employee)	>4 500	Target set similar to Benchmarking Countries	n/a	4912	3604
Customer satisfaction						
Service quality - on time deliveries [125]	94.50%	>94.5%	According to or better than national or international standards	88.60%	91.2% (in 2017: Delivery of priority letters 90.4% (target 85%) next day and 99.7% (target 97%) after three days.	83.90%
Customer satisfaction (survey) (business clients)	Data not made public but monitored by the company	>80%	Target set similar to Italy (high level of satisfaction)	n/a	n/a	n/a
Environment						
Energy (gas) consumption or CO2 emissions (reduction through usage of more efficient vehicles, optimization of delivery routes)	need to establish baseline	Decrease by at least 10% until 2020		n/a	Target: To reduce carbon dioxide emissions by 40% by 2020 from the 2009 level. Outcome 2009–2017: –32%	CO2 emissions per km travelled decreased in 2017 from 215 grams per km to 210 grams per km

120 Annual report 2017, retrieved from: https://www.pasts.lv/lv/par_mums/parskati_un_statistika/#finansu-raditaji
121 Annual report 2017, retrieved from: https://www.omniva.ee/meie/ettevottest/majandustulemused
122 Annual report, retrieved from: https://www.postnord.com/en/investor-relations/financial-reporting/annual-and-sustainability-reports/
123 Annual report 2017, retrieved from: https://www.posteitaliane.it/en/financial-performance.html
124 https://www.pasts.lv/lv/zinas/4468-latvijas-pasts-pusgada-klientiem-izsuta-15-miljonus-mobilo-iszinu-par-neregistreto-sutijumu-sanemsanu
125 EC statistics for 2016: http://ec.europa.eu/eurostat/tgm_grow/table.do?tab=table&init=1&language=en&pcode=post_qos_1&plugin=1

"Electronic Communications Office of Latvia" (VAS "Elektroniskie sakari")

Classification group	B1	Company	VAS Elektroniskie sakari	Size (Annual report 2017)	
Description	Company is performing the assignment of radiofrequencies by providing electromagnetic compatibility (EMC) services to the users of the frequency spectrum.			**Revenue**	6 646 465
Strategic objectives	According to company's medium-term strategy the strategic objectives are: 1) To provide electromagnetic spectrum services and effective planning; 2) Continue developing a monitoring system for radio frequency spectrum through increasing the area that is monitored continuously; 3) Maintain a balanced budget; 4) Develop additional commercial services.			**Assets**	12 851 694
				Employees	92
Current targets, KPIs	According to the medium-term strategy the current targets are: Financial targets according to the CSCC requirements; non-financial targets: implementation of planned investment projects; development of digital permits and wider use of e-signature; client satisfaction level; implementation of work safety plan.				
Comments, experience from Benchmarking Countries	In Latvia the company is required to balance the income received from its main line of business with expenses and is forbidden to generate profit. In 2017 the share of commercial revenue from total revenue was 3%, and profit may be generated from these activities. In Estonia similar assignments are managed by the Technical Regulation Authority (government agency). In Sweden it is managed by the Swedish Post and Telecom Authority (PTS) (government agency). Italy: Rai Way is a leading operator in the Italian radio and television transmission infrastructure market (Annual report 2017). One of the strategic targets is maintenance Capex/revenues ratio (target for 2018 8.5%)				
KPI	**Results (2017) (base value)**[126]	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**	
				Italy **Rai Way S.p.A. (listed on Italian stock market)**[127]	**Estonia** **Tehnilise Järelevalve Amet (Technical Regulation Authority)**[128]
Revenues and return					
Capital expenditure/depreciation	4.28	[data pending]		0.49	n/a
Financial stability					
Balanced budget (Revenue/Costs)	1.07	>1	The ratio should be larger than 1, as the share of commercial (profit making) activities increases	1.35	n/a
Liquidity (current ratio)	5.808818422	>1		1.38	n/a
Efficiency					
Administration costs / revenue	5.19%	<5%	Target set similar to Benchmarking Countries	5.0% (Rai Way is part of Rai group; these costs represent "Services provided under intercompany contract". Other admin costs are not disclosed in annual report)	7.56%
Customer satisfaction					
Customer satisfaction (survey)	92.10%	>92%	Maintain at least the same level	n/a	n/a
Quality of service (number of complaints)	0	<3	Maintain at least the same level	n/a	n/a
Employees					
Hours spent in trainings to total hours worked (%)	data not available	3% (annually)	Attraction and training of new talents to ensure planning for retirement of the experienced staff members	n/a	n/a

126 Annual report 2017, retrieved from: http://www.vases.lv/lv/content/finanses-atalgojuma-politikas-pamatprincipi
127 Annual report 2017; Bilancio di Sostenibilità 2017, retrieved from: http://www.raiway.it/web/guest/bilanci-e-relazioni
128 Annual report 2016, retrieved from: https://www.tja.ee/sites/default/files/content-editors/TJA/Aastaraamat/tra_annual_report_2016_eng_web.pdf

"State Real Estate" (VAS "Valsts nekustamie īpašumi")

Classification group	B2	Company	VAS Valsts nekustamie īpašumi		Size (Annual report 2017)	
Description	Professional and high-quality management and development of state real estate properties and provision of premises to the state institutions are the main functions of the company.				**Revenue**	40 361 505
Strategic objectives	The primary strategic objective of the company is to ensure growth and development, as well as to increase return from the shareholders' input, improve service quality and increase customer satisfaction. The strategic targets of the company are: 1) Market principle-based activity; 2) Customer and service orientation; 3) Separation between commercial activity and public assignments; 4) Observance of public interests, preservation of cultural and historical values. (Source: company website)				**Assets**	408 833 142
Current targets, KPIs	Strategy is in the approval process.				**Employees**	581
Comments, experience from Benchmarking Countries	Comparable companies in the Benchmarking Countries operate on market terms and are profit-generating. In Estonia the real estate management company reached 16 million EUR net profit last year, while employing 217 employees. The annual investments reached 77.2 million EUR and repair works worth more than 12 million EUR were performed. In 2017 the company issued a debt instrument w in the amount of 48.5 million euros, which will be used to finance investment properties that are deemed crucial for the state.					
KPI	**Results (2017) (base value)**[129]	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**		
				Estonia **Riigi Kinnisvara AS (RKAS)**[130]	**Italy** **Investimenti Immobiliari Italiani Sgr S.p.A.**[131]	**Sweden** **Akademiska Hus**[132]
Revenue and returns						
Capital expenditure / depreciation	0.14	>0.5	Gradual increase to move towards more sustainable asset management	4.06	n/a	2.29
Financial stability						
Debt/Equity ratio	0.46	>0.6	Target set similar to Benchmarking Countries	0.54	0.55	1.31
State budget						
Share of revenue from commercial clients	20% (according to interview with the company's management)	25%	To be treated in line with lowering the vacancy rate for commercial properties	n/a	n/a	n/a
Operational efficiency						
Administration costs / revenue	11.87%	<10%	Strategy target	3.97%	64%	6.48%
Vacancy rate	10%	7%	Strategy target	29% across portfolio; incl. vacancy rates in management portfolio 7%	n/a	4.20%
Customer satisfaction						
Customer satisfaction (survey) (business clients)	62.4	71.2	Strategy target	47%	n/a	60%
Employees						
Employee satisfaction level (employee survey)	[data pending]	32%	Strategy target	Conducted, but results not made public	n/a	Measures accident rate at workplace (target is to be accident-free)

129 Annual report 2017, retrieved from: http://www.vni.lv/lat/par_vni/finanses/gada_parskati/?doc=736
130 Annual report 2017, retrieved from: http://media.voog.com/0000/0001/6018/files/RKAS_annual_report_2017_ENG.pdf
131 Annual report 2017, retrieved from: https://www.invimit.it/wp-content/uploads/2018/07/Bilancio-2017-assemblea.pdf
132 Annual report 2017, retrieved from: https://www.akademiskahus.se/globalassets/dokument/ekonomi/ekonomiska-rapporter/annual_report_2017.pdf

Bobsleigh and Luge Track "Sigulda" (SIA "Bobsleja un kamaniņu trase "Sigulda"")

Classification group	B2	Company	VSIA Bobsleja un kamaniņu trase "Sigulda"	Size (Annual report 2017)	
Description	Company is the manager of Bobsleigh and Luge Track "Sigulda". Company holds international and Latvian bobsleigh, skeleton and luge competitions; provides training facilities for Latvian and foreign athletes and organises leisure/tourism rides.			**Revenue**	343 304
Strategic objectives	According to company's medium-term strategy 2018-2023[133] the overall strategic goals of the company are 1) to ensure the management and development of the national sports base in line with international standards, 2) to ensure appropriate conditions for preparation of athletes for Latvian and international sports competitions, 3) to promote Latvia on the international level.			**Assets**	11 389 091
Current targets, KPIs	Main financial targets are financial stability, increased total revenues and increase of the share of revenue from organizing sports events. Non-financial targets are set as the number of visitors, rides and energy consumption (Source: Strategy 2018-2023).			**Employees**	37
Comments, experience from Benchmarking Countries	The case of Sigulda bobsleigh track is a rather unique as it is one of only a few bobsleigh tracks around the world, and the nearest competitors are in Germany, Norway, Switzerland. The tracks usually are managed as part of a larger sports infrastructure (Olympic parks, recreation facilities), not standalone companies. Specific non-financial targets should be tailored for Sigulda individually.				
KPI	**Results (2017) (base value)[134]**	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**	
				Italy Coni Servizi S.p.A. (National Olympic Committee)[135]	
Financial stability					
Balanced budget (Revenue/Costs)	0.80	1		1.00	
Liquidity (current ratio)	1.51	>1		1.31	
State budget					
Share of revenue from business activities, excluding subsidies or compensations	0.52	>0.6	Suggested to increase to improve the budget balance		
Operational efficiency					
Infrastructure utilization rate (% of days in a year when facility is used for 3 or more rides)	data not available	>85%	Increasing utilization of the track in off-season (for tourism /leisure purposes)	n/a	
Administration costs / revenue	7.97%	<8%	Maintain at least the same level	n/a	
Markets					
Number of rides provided	22 486	23 000	Strategy target	n/a	
Customer satisfaction					
Returning customers (sport) (% of total)	[data pending]	>65%	Measured as the teams (national teams, sports clubs, etc.) that are loyal customers; indicator serves as a proxy for customer satisfaction	n/a	
Environment					
Energy consumption (electricity, heating), kWh	1 722 157	1 500 000	Strategy target	n/a	

133 Strategy 2018-2023, retrieved from: http://bobtrase.lv/lv/strategy
134 Annual report 2017, retrieved from: http://bobtrase.lv/assets/page_documents/9/document/Gada_p%C4%81rskats_2017.pdf?1524641274
135 Annual report 2017, retrieved from: http://coniservizi.coni.it/it/bilancio-d%E2%80%99esercizio-2017.html

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"Latvian Concerts" (VSIA "Latvijas Koncerti")

Classification group	B2	Company	VSIA Latvijas Koncerti	Size (Annual report 2017)	
Description	The company promotes the national and international music heritage in Latvia through managing the chamber orchestra "Sinfonietta Rīga", choir "Latvijas Radio koris" and "Latvijas Radio bigbends" and organizing other concerts with guest musicians.			**Revenue**	1 442 566
Strategic objectives	According to 2017-2021 strategy, the strategic objectives are: 1) Maintenance of a variety of national culture heritage (in music); 2) Promotion and development of Latvian professional music in Latvia and abroad; 3) Ensuring world music performance availability in Latvia.			**Assets** **Employees**	1 169 012 118
Current targets, KPIs	Annual targets are set in the contract between Ministry of Culture and the company. For 2017 the ministry had delegated 15 tasks to the company and numerous targets regarding the number of concerts, number of new performances of Latvian composes, number of concerts abroad, and others. (Source: annual report)				
Comments, experience from Benchmarking Countries	Estonian Concerts is a foundation managing several large concert halls directly impacting their balance sheet. The foundation operates in a wide musical area, featuring symphonic and chamber music, jazz, choral music and electronic acoustic music. Donations can form a significant contribution to fulfilling the objectives of company. One of the strategic objectives is to increase the Estonian music exports by 25% by 2021 (base year 2017), and organize 100 to150 foreign concerts annually. In Sweden only the Royal Opera and National Theatre are operated as state owned enterprises. For the theatre one of the targets was to increase the proportion of first-time visitors by 12% by 2017. The target was already met in 2016, but the target of continuously increasing first-time visitors and tracking return visit frequency remains in place.				
KPI	**Results (2017) (base value)**[136]	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**	
				Estonia **Eesti Kontsert SA**[137]	**Sweden** **Kungliga Dramatiska teatern AB (Royal Dramatic Theatre)**[138]
Financial stability					
Balanced budget (Revenue/Costs)	1.003	1		0.916	1.02
Liquidity (current ratio)	1.07	>1		0.29	1.08
State budget					
Share of revenue from business activities, excluding subsidies or state compensations	31%	>35%		n/a	19.23%
Markets					
Number of clients (concert visitors)	data not available	+ 6% compared to 2017 (per capita growth rate of theatre visits in 2014-2017)[139]	Total number of concerts in 2017: 376	1206 concerts; 212 thousand concert attendees	1137 performances (37 productions); 277 200 visitors
Operational efficiency					
Concert attendance (% of seats filled)	data not available	>75%	Target set similar to Benchmarking Countries	n/a	76%
Administration costs / revenue	6.12%	<6%		n/a	n/a
Customer satisfaction					
Returning customers (loyalty programme members) to total customers ratio	data not available	>4%	Target set similar to Benchmarking Countries	4.7%	n/a
CSR					
% of tickets donated to charity causes	data not available	1%		n/a	n/a

136 Annual report 2017, retrieved from: http://latvijaskoncerti.lv/lv/par-uznemumu/parskati/
137 Strategy 2018-2021, retrieved from: https://concert.ee/static/A4_EKarengukava.pdf; Annual report 2017, retrieved from: https://concert.ee/static/2017_aastaraamat_vaate.pdf
138 Annual report 2017, retrieved from: http://www.dramaten.se/globalassets/dokument/2018/kdt-arsredovisning-2017-3.pdf, Sustainability report: http://www.dramaten.se/globalassets/dokument/2018/kdt-hallbarhetsredovisning-1804.pdf
139 Statistics on consumption of culture: http://data1.csb.gov.lv/pxweb/lv/sociala/sociala__kultura__kultura/KUG060.px/table/tableViewLayout1/?rxid=a39c3f49-e95e-43e7-b4f0-dce111b48ba1

"Latvian Television" (VSIA "Latvijas televīzija")

Classification group	B3	Company	VSIA Latvijas televīzija		Size (Annual report 2017)	
Description	Latvian Television is the national TV broadcasting company that produces original content and broadcasts media content according to the public service contract through two television channels and online				**Revenue**	18.3 million EUR
Strategic objectives	To become the most influential media in Latvia in TV and web; be the leading media in unique audience reach and be a quality standard for the media content and various media formats (Source: Company's Medium term strategy)				**Assets**	15.5 million EUR
					Employees	486
Current targets, KPIs	Strategy 2017-2019; example of targets for 2017:[140] 1) Unique audience weekly reach (> 39%); 2) Commercial share of viewing (CSOV) (>15%); 3) Monthly on-line audience reach (audience reached through LSM.lv channels) (>21%); 4) Audience satisfaction level with the quality of content (>65%). Company has a CSR policy and environmental policy in place.					
Comments, experience from Benchmarking Countries	In Sweden and Estonia the national TV operates as a foundation; most of the funding is received as subsidy from the state, and the share of own income generated is very limited. In Estonia TV and radio is managed under the same foundation, creating some synergies. These foundations focus on creating quality content and reaching a wide audience across different segments of the population. Benchmarking against public media companies in larger countries is limited, for example, in Italy the company has 13 channels tailored for different audiences and the metrics are incomparable					
KPI	**Results (2017) (base value)[141]**	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**		
				Estonia **Eesti Rahvusringhääling (ERR)[142]**	**Italy** **Rai SpA[143]**	**Sweden** **Sveriges Television AB (SVT)[144]**
Financial stability						
Balanced budget (Revenue/Costs)	0.99	1.00	Need to better balance costs and revenues	1.01	1.00	1.00
Liquidity (current ratio)	1.06	>1		0.45	0.65	1.01
Markets						
Number of clients (commercial share of viewing)	17.00%	15%	Strategy target	13.8	36.5	n/a
Monthly online audience reach (%)	20%	22%	Strategy target	n/a	n/a	n/a
Efficiency						
Administration costs / revenue (incl. subsidies)	8.4%	<10%	On track	10.8%	n/a	n/a
Revenue (incl. subsidies) per employee	37 701		This ratio and customer satisfaction to be used together as a marker for "generating return per each tax payer's EUR". Increase in both indicators signal a positive trend. If revenue (state subsidy) increases, but satisfaction level decreases, corrective actions should be taken	54 813	208 755	208 042
Customer satisfaction						
Audience satisfaction level (measured through an audience survey)	73%	>70%	Strategy target	n/a	n/a	80%
Employees						
Employee satisfaction level (employee engagement survey)	n/a	>70%		n/a	n/a	n/a
CSR, sustainability						
Reduction in energy consumption (MWh) (measured as change in consumption) or CO2 emissions	Base value	-10% (compared to 2017 level)	Energy costs make up a significant share of operating costs. Other resource efficiency indicators are also used by the management.	n/a	Measure total energy consumption and CO2 emissions	Measure CO2 emissions: 2016: 7 743 tons CO2, have targets for green procurement

140 Strategy 2017-2019, retrieved from: https://ltv.lsm.lv/lv/igtspejiga-attistiba/
141 Annual report 2017, retrieved from: https://ltv.lsm.lv/lv/par-ltv/gada-parskati/
142 Annual report 2017, retrieved from: http://files.err.ee/files/ERR_aastaaruanne_2017.pdf
143 Annual report 2017, retrieved from: http://www.rai.it/dl/doc/1536229057967_Bilancio%20Rai%202017%20-%20Inglese%205.09.2018.pdf
144 Annual reports 2017, retrieved from: https://www.svt.se/omoss/media/filer_public/48/d4/48d45272-5faa-4094-a603-81b396373909/psr_2018_webb.pdf, https://siffror.svt.se/det-har-vill-svt, https://www.svt.se/omoss/media/filer_public/09/1e/091e3342-9827-41e7-8fc0-b7d0d0a20670/arsredovisning_2017.pdf

"Riga East University Hospital" (SIA "Rīgas Austrumu klīniskā universitātes slimnīca")

Classification group	B3	Company	SIA Rīgas Austrumu klīniskā universitātes slimnīca	Size (Annual report 2017)	
Description	Riga East University Hospital is a multi-field medical treatment institution in Latvia that provides extensive diagnostics and treatment to patients, as well as carries out scientific research work and develops innovations, ensures training of young specialists and organizes activities for public education and health improvement.			**Revenue**	99 460 331
Strategic objectives	Main objectives of the hospital are to increase the availability of healthcare services, provide effective planning and delivering of healthcare services, and provide high quality healthcare. (company website)			**Assets**	94 603 846
				Employees	4 236
Current targets, KPIs	The company reports the financial indicators as required by CSCC. In addition, it makes a list of financial and non-financial targets available on the website. The financial targets include balanced budget, positive cash flow, positive net profit margin and current ratio. Non-financial targets include 15 indicators, including number of beds, occupancy of beds, average length of stay (in-hospital patients), ratio of doctors and nurses, customer satisfaction, and others.				
Comments, experience from Benchmarking Countries	Tartu Hospital (Estonia) has patient satisfaction as one of its targets: overall satisfaction of ambulatory patients 77%, readiness to resume treatment 92%. Tartu hospital also measures the number of e-consultations provided and the number of publications in peer-reviewed journals (target for 2018 - 150).				
KPI	**Results (2017) (base value)[145]**	**Target for a three year period**	**Comment regarding the target**	**Benchmarks (results from annual reports for 2017)**	
				Italy Policlinico di Milano[146]	**Estonia Tartu University Hospital[147]**
Financial stability					
Balanced budget (Revenue/Costs)	0.95	1	Need to better balance costs and revenues	0	1.00
Liquidity (current ratio)	0.67	>1	Need to better balance costs and revenues	1.41	2.16
Innovations					
Number of scientific publications by hospital staff in peer-reviewed journals	60	>80	There are 91 staff members with doctoral degrees and additional staff members involved in scientific and research activities. Science staff should publish their research results every few years.	n/a	217
Efficiency					
Bed occupancy rate, %	75%	77%[148]	EU average according to WHO statistics	n/a	74%
Administration costs / revenue (incl. subsidies)	2.00%	<2%		n/a	n/a
Customer satisfaction					
Customer satisfaction (survey)	76%	>77%	Maintain at least the same level	n/a	74% (target - 77%)
Number of complaints submitted to Health Authority per 1000 patients	0.22	<0.2	Maintain at least the same level	n/a	0.57 (Total number of complaints received)
Environment					
Reduction in energy consumption (MWh) YoY	base value	-5% (compared to 2017 level)	Energy costs make up a significant share of operating costs; reducing them has a positive impact on the bottom line.	n/a	n/a

145 Annual report 2017, retrieved from: https://www.aslimnica.lv/lv/saturs/publiskojama-informacija-par-kapitalsabiedribas-darbibu-saskana-ar-publiskas-personas
146 Annual report 2017, retrieved from: https://www.policlinico.mi.it/chi-siamo/annual-report
147 Annual report 2017, retrieved from: https://www.kliinikum.ee/pildid/tutvustus/tegevusaruanded/Sihtasutuse_Tartu_Ylikooli_Kliinikum_2017a_tegevusaruanne.pdf
148 https://gateway.euro.who.int/en/indicators/hfa_542-6210-bed-occupancy-rate-acute-care-hospitals-only/visualizations/#id=34412

4 Dividend framework

The dividend policy aims at balancing the state's as shareholder's benefit from an SOE with the financial stability and well-being of the company. It is therefore of utmost importance to weigh the factors influencing both – company's need for capital for investments and growth and government's interest in gaining income (dividends) from its shareholdings.

The practices to tackle this issue differ among countries as well as there is no consistent approach suggested by the OECD as the dominant one.

In Latvia the dividend policy of the SOEs are set by the Law On Governance of Capital Shares of a Public Person and Capital Companies (SOEL) and regulations of the Cabinet of Ministers, however exemptions and deviations can be observed. Furthermore, when deciding about a general framework for balanced dividend policies it shall be reminded that three largest dividend payers in 2016 – national forestry, energy and telecommunication companies – paid in 90% of the total dividend received by the state.

4.1 International practices

OECD's document – Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices sheds a light on the practices adopted by OECD countries with respect to the SOE dividend policies. The dividend question in this document is evaluated together with the capital structure considerations signalling that dividend policy shall be viewed in a broader context of company's financing approach, capital structure efficiency and state's expectation for the dividend.

With respect to the capital structure considerations, according to the document, most countries surveyed have either established broad capital structure efficiency guidelines to consult the SOE financing decisions or act according to more specific financial targets (specific rates of return or dividend ratios). Majority of the countries also benchmark the capital structure of their SOEs to the private sector companies.

In respect to specific dividend considerations, most of the 24 surveyed countries have some dividend pay-out guidelines in place. The implication serves in terms of either: (1) set percentage of net income (adopted in 7 countries including Lithuania); (2) broad guidelines stating the factors (e.g. rates of return, liquidity ratios, etc. adopted in 6 countries) that shall be considered when deciding on the dividend pay-out and (3) capital structure balancing considerations (e.g. reflected by a certain credit rating, adopted in 3 countries) – arguably resulting in a dividend policy closest to the private sector companies. Only eight countries have no dividend guidelines for their SOEs and have chosen a more short-sighted case by case approach of negotiating the target amount annually[149].

149 OECD, Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices, Retrieved from: http://www.oecd.org/corporate/ca/Ownership-and-Governance-of-State-Owned-Enterprises-A-Compendium-of-National-Practices.pdf

Apart from the annual dividend policies, it can also be the case in certain countries that SOEs have repaid capital to the state in the form of an extraordinary dividend to reduce capital proportion in the balance sheet, optimize the capital structure and achieve a higher return rate on capital invested[150].

According to the World Bank's research paper the general practice is for SOE dividends to be paid to the Ministry of Finance and the recipient body does not depend on the institution of ministry that directly holds the shares in the specific SOE. Deviations can be seen in countries with a centralized ownership model where the dividends are partly paid out to the centralized ownership bodies and partly to the MoF.

4.1.1 Estonia

In 2017, 13 Estonian SOEs paid out in dividends 137.5m EUR. For 2018 this number is estimated to grow up to 153.7m EUR. The largest dividend payers in 2017 were the Port of Tallinn (AS Tallinna Sadam) paying out 48m EUR, Eesti Energia distributing 47m EUR and national gas and electricity transmission system operator Elering contributing 20m EUR. In total, these 3 companies contributed 84% of the total dividends received by the state of Estonia in 2017.[151]

There is no formal SOE dividend policy in place in Estonia – dividends are negotiated between the SOE and the shareholder on case by case basis and the decisions are made on ad-hoc basis. Dividends are decided as an exact sum for each individual SOE. The discussions might be based on indications as described in the owner's expectation letter or pre-discussed individually set dividend targets for companies.

Individual targets for companies are always determined through discussions. It is common that the state together with the company defines a 4 year financial strategy and budget plan, which is renewed annually as a rolling forecast for the next 4 years. Within the financial strategy companies shall provide forecast on their results and expected dividends, the viability of which are commented upon by the shareholder and MoF.

The factors that are analysed by the MoF and taken into account when deciding on the dividend pay-out include the revenue dynamics, capital structure (which is also set as one of the main financial KPIs) and investment plan forecasts. In case the capital structure is deemed to be unbalanced by the MoF, the SOE can be asked to pay out more than 100% of the net profit for the year.

Once a year, typically in August when MoF prepares a detailed state's budget plan MoF verifies once again with the companies whether the dividend forecast is still valid. Through this dialogue process when extraordinary circumstances arise the expected dividends can be updated for the next year if necessary. Majority of such cases are discussed and agreed between MoF and the individual SOE; fewer have to be resolved

150 World Bank Group, Corporate Governance of State-Owned Enterprises, A Toolkit, Retrieved from: http://documents.worldbank.org/curated/en/228331468169750340/Corporate-governance-of-state-owned-enterprises-a-toolkit

151 Interview with Tarmo Porgand, Deputy Head of State Assets Department at Ministry of Finance, Estonia

via involvement of a wider government, although the final decision will be made by the government.

The dividend question is generally on agenda only for the 29 commercial SOEs of Estonia (having the legal form of public company), the 65 foundations and 115 non-profits are not required to pay any dividends – in fact, their legal form does not enable them to pay dividends.

It has to be noted that historically – approximately 15 years – ago the working practice was that 25-50% of dividends had to be paid out, as all SOEs were treated in the same way and every year government decided on the share of profits SOEs had to pay as dividends and this percentage applied to all[152].

4.1.2 Sweden

Of the 47 companies in the state company portfolio, 24 paid out dividends for financial year 2017 in total of more than 20.2bn SEK (1.96bn EUR), which was a significant increase from 13.6bn SEK in 2016. The largest dividends were received from the state owned gambling company (23% of total dividend pool) and telecommunication company Telia (18% of the total dividends received). The five largest dividend payers constituted around 75% of the entire dividend pool.

The total dividend amount paid out by Swedish SOEs have varied greatly over the last years – so in 2012 26.7bn SEK was paid out, while 2015 and 2016 only a half of that was received (15.5bn and 13.6bn SEK respectively). The average dividend yield for 2017 reached 3.6%. Sweden is strongly following the SOE portfolio performance in terms of dividends and provides a detailed benchmarking against share indices and industry standards in their Annual Report. Benchmarking against private, listed companies helps the companies to set more challenging targets[153].

There is no generally applied SOE dividend policy in place in Sweden. According to the Swedish MoEI – *“the purpose of the dividend policy is to ensure that the owner receives predictable and sustainable dividends over time”.* Therefore the dividend target constitutes one of the main areas of focus for the general SOE target setting. Along with profitability and capital structure targets, dividend yield targets are used as a tool to ensure a balanced capital structure over a longer term. The dividend target setting takes into account company’s future capital requirements and investments as well as evaluates the growth prospects and financial situation. The ultimate decision on the dividend target nevertheless is taken on case by case basis.

As the entire target setting process, dividends are proposed by the Board of Directors of the company and approved by the subsequent annual general meeting. Usually the dividend policy is set for 5-7 years, but can be revised if necessary. As explained in the Swedish SOE Annual Report – *“on the whole, this means that the dividend target does not have to be met every year, but should instead be regarded as a long-term, ambitious and realistic target”.* Concluding from the Annual Report the dividend pay-out targets

152 Interview with Tarmo Porgand, Deputy Head of State Assets Department at Ministry of Finance, Estonia

153 Annual Report for State-owned enterprises, Sweden, 2017

vary for specific companies from around 30% to 100%. In 2017, 67% of SOEs with a dividend target reached their target[154].

There are some companies having the public policy assignments that receive state budget appropriations and therefore are exempted from dividends. Those include the state theatre and opera, as well as Swedish social service company Samhall. In addition, there are couple of other exceptions when the dividend from a state company is not expected including Arlanda train service (Arlandabanan Infrastructure AB), which is structured in a way to not generate a profit, as well as scientific institute RISE, which is expected to reinvest the net proceeds back in the company[154].

4.1.3 Italy

In 2017 the dividends received by the central Italian government from SOEs reached 4.1bn EUR (3.8bn in 2016). The most important dividend payers in Italy were financial institution Cassa Depositi e Prestiti (paid out over 1.1bn EUR), the national electricity company Enel (0.7bn EUR) and railway company Ferrovie dello Stato (0.3 bn EUR). Together these three companies paid out around 51% of the total received dividend pool. Other significant dividend payers include also the Italian Post and energy company ENI[155].

The Italian government has no dividend guidelines or targets in place, and in most cases dividends are negotiated annually between the shareholders and the board of directors. In addition, there are no SOEs that are permanently exempted from the dividend pay-out.

According to the Civil Code distributions of dividends are approved by the approval of the general meeting which similarly approves the company's financial statements. Only profits which were actually achieved and are reported in financial statement can be distributed[156].In addition, it is possible to limit the right of certain shareholders to dividends by using various classes of shares.

For companies that have prepared a remuneration policy for a multiannual period (typically, listed SOEs) the annual shareholders meeting still is required to approve the financial statements and payment of dividends. When decisions on payable dividends are taken for a multiannual horizon, the remuneration policy is usually linked to the expected growth in profits and cash flows. For example, ENI's (oil and gas company) dividend policy is based entirely on a cash dividend and is progressive depending on underlying earnings and free cash flows.

154 Interview with Lars Erik Fredriksson; Investment Director of the Division for State-Owned Enterprises, Ministry of Enterprise and Innovation, Sweden

155 Italian National Institute of Statistics, "Conto annuale delle amministrazioni pubbliche", Retrieved from: http://www.rgs.mef.gov.it/VERSIONE-I/in_vetrina/dettaglio.html?resourceType=/VERSIONE-I/_documenti/in_vetrina/elem_0017.html

156 Civil Code of Italy, Article 2433, Retrieved from: http://def.finanze.it/DocTribFrontend/getAttoNormativoDetail.do?ACTION=getSommario&id={9E93F1BE-06AE-4F24-8E9D-B838F7E0C2E6}

Similarly, for all the companies that are listed on stock exchange, the state has the same rights to dividends as the private shareholders.

4.1.4 France

In 2016 the French government received dividends of 3.5bn EUR, including 1.7bn EUR in stock dividends (relating to company EDF) from its company portfolio managed by APE. As the majority of the state companies are listed on stock exchange, the dividend policies for those companies cannot be directly influenced by the state and shall be viewed in combination with the overall strategies the companies pursue. Dividends are consequently more influenced by market dynamics, industry developments and company development plans rather by government's guidelines. Therefore the state similar as the private shareholders are seeking for return either in terms of stock price appreciation or dividends[157].

In the history of the national SOE management there are no clear guidelines with respect to dividend pay-outs. France's national auditor, the Cour des Comptes in late 2016 launched criticism of the state's investment strategy, saying that in some cases — La Poste, Engie, EDF, SNCF — "the government's demand for high dividends was to the long-term detriment of the businesses"[158].

The managing agency APE performs strong benchmarking efforts with respect to comparison between portfolio's returns in terms of dividends and French Index CAC 40. So, for example according to 2017 data the dividend yield of 4.2% was gained on average for the Government's portfolio of listed shares in comparison to 3.7% for the CAC 40[157].

4.2 Current system in Latvia:

4.2.1 Legal framework

In Latvia, the legal framework foresees that the dividends in the companies fully owned by the state, companies in which the shareholders are state and other public persons, and companies which are controlled by a public person, incl. state, shall be determined based on the medium term strategy, which must include profits and dividends forecast, according to the Article 28 of the SOEL.

The minimum forecasted share of profits to be paid out in dividends and share of profits to be paid in dividends shall be 50%, according to Regulations of Cabinet of Ministers no. 806 "Provisions on forecasting and determining of the share of profits to be paid out in dividends and payments into state budget for use of the state capital by the state

157 APE, Annual Report, Retrieved from: https://www.economie.gouv.fr/files/files/directions_services/agence-participations-etat/Annual_Report_APE_2016-2017.pdf
158 Financial times, Retrieved from: https://www.ft.com/content/9be75d5c-a72e-11e6-8898-79a99e2a4de6

owned companies and companies in which the shareholders are state and other public persons" ("Regulations No. 806").

SOEL provides that the management board of the company shall prepare a proposal about the forecasted share of profits to be determined in medium term strategy which shall be paid out as dividends and later at the end of the year constitute a proposal on a particular share of profits to be paid out in dividends. In both cases the management board shall submit this proposal to the shareholding institution.

In case the management board in the medium term strategy wants to propose a different share of profits to be paid out in dividends than determined by the Regulations no. 806 or particular dividends proposal at the end of the year differs from the projection included in the medium term strategy, the shareholding institution shall submit to the MoF and the CSCC an explanation of the grounds for such proposal. If the institution holding the shares, the CSCC and the MoF do not reach an agreement, the matter is decided by the Cabinet of Ministers. The application to the Cabinet of Ministers for such permission shall be supported by the assessment of compliance with the state-aid rules, and explanation of economic basis.

After the Cabinet of Ministers has permitted to determine in the medium term strategy a different share of profits to be paid out in dividends, the company is able to determine in its medium term strategy and later pay out in dividends a different share of profits than required by the Regulations no. 806.

In case the company at the end of the year wishes to propose a deviating dividend payment from the one determined by the medium term strategy and Regulations no. 806, the holder of the shares may apply for such permission to the CSCC and MoF explaining the economic basis and other grounds for such decision. The decision proposal shall be supported by the assessment of compliance with the state-aid rules, and explanation of economic basis. However, the Regulations No. 806 determine that this is permitted only in the following cases:

1. It is necessary to increase the share of profits to be paid out in dividends when:
   - The capital investments have not been made in the planned amount and are unlikely to be made in the consecutive year, and the investment matter has been reviewed by the Cabinet of Ministers;
   - With law or regulation certain tasks or objectives of the company have been cancelled, or the scope of tasks has been reduced.
2. It is necessary to decrease the share of profits to be paid out in dividends when:
   - Due to the circumstances independent of the company (for example, force majeure) the company in order to avoid their consequences and to implement its objectives needs funds to be left at its disposal;
   - The company due to the circumstances not dependent on it has not made capital investments, the matter of investments has been reviewed by the Cabinet of Ministers, and the company is planning to make particular capital investments during the next year;

- Payment of dividends in the projected amount can create threats to the financial stability of the company;
- In the special cases when the company according to the national or EU legislation is obliged in the following years to implement measures for improvement of the quality and accessibility of its services, for which additional investments or reduction of tariffs is necessary;
- The share of profits has been gained as a result of revaluation of the long term investments.

If the shareholder, the CSCC and the MoF do not reach an agreement on payable dividends, the matter is decided by the Cabinet of Ministers.

The above are general provisions on dividends in state owned entities. In addition, specific regulation on forecasted share of profits to be paid out in dividends and particular share of profits to be paid out in dividends can be determined in other legislative acts, for example, law on medium term state budget framework or law on state budget for the particular year. In such case the law, which is adopted later than SOEL and determines specific provisions for particular companies prevails over the SOEL and Regulations no.806.

Currently, the Law on Medium Term Budget Framework for years 2018, 2019 and 2020 and Law on State Budget for Year 2018 (both adopted on 23 November 2017, entered into force on 1 January 2018) determine the share of profits to be paid out in dividends in particular financial years for several state owned companies. In addition, these laws state that for the companies where state has a decisive influence the minimum share of profits to be paid out in dividends in financial years 2017 and 2018 shall be 50%, but for companies where state is the sole shareholder – 80% from profits of financial year 2017 and 85% from profits of financial year 2018.

Notwithstanding the foregoing, both the Law on Medium Term Budget Framework for years 2018, 2019 and 2020 as well as the Law on State Budget for Year 2018 provides delegation to the Cabinet of Ministers to decide on different minimum share of profit to be paid out in dividends as prescribed by SOEL and Regulations no. 806. It means that the Cabinet of Ministers has always authorization to make decision on SOEs dividends within the framework of law.

According to the historic experience, it shall be noted that in some cases state can collect funds from SOEs also in other forms than dividend (in most cases – reduction of the share capital). With respect to the other potential options, Article 182 of the Commercial law provides that the company can make disbursements to the shareholder only if the dividends are paid, share capital reduced or the company gets liquidated and funds distributed to the shareholders. The payments to the shareholder are not allowed if the equity of the company at the end of the financial year is smaller or as a result of payment will become smaller than the share capital. Article 55 of the SOEL provides that disbursements to the state companies' shareholder shall be made in accordance with the above Article 182 of the Commercial law.

The share capital of state owned limited liability company ("SIA") company can only be reduced by means of cancellation of shares. Reduction of the nominal value of the shares is not allowed while both types of reduction are possible for state owned joint stock companies.

In case of liquidation, unless otherwise specified in the liquidation decision, the property of the state company shall not be sold, but the ownership rights shall be transferred to the institution indicated in the liquidation decision.

4.2.2 Dividend pay-out

In 2017 the total amount of dividends paid by SOEs reached 149m EUR (125m EUR in 2015 and 155m EUR in 2016).

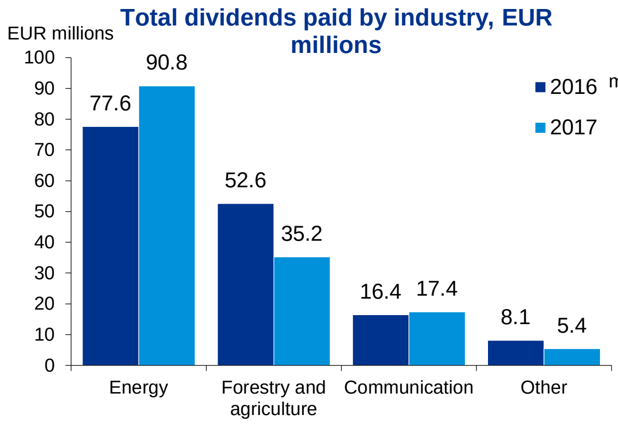

Figure 24 Total dividends, CSCC data, KPMG analysis

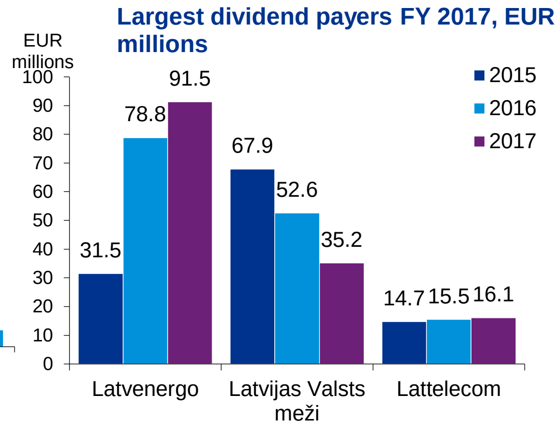

Figure 25 Dividend payers, CSCC data, KPMG analysis

When assessing the distribution of dividends to the state, the largest contributors are traditionally the forestry, energy and telecommunications sectors – in particular three companies – Latvijas Valsts Mezi, Latvenergo and Lattelecom (where the state holds 51% stake). In 2016 these 3 single companies contributed to 90% of the total volume paid out by all Latvian SOEs. Other notable regular dividend payers include the partly state-owned Latvijas Mobilais Telefons (in 2016 state received 8.8m EUR) and state lottery – Latvijas Loto (in 2016 contributed 3.6m EUR). The contribution of other companies in the form of dividends is considerably smaller. In addition, many of the companies have executed a one-off dividend in some of the previous years; however, this cannot be seen as grounds for future forecasts.

4.3 Proposed framework for a balanced dividend policy – the principal guidelines

4.3.1 Approach to Group A companies

The review of the dividend policy of Latvian SOEs indicates that only a handful of SOEs have been contributing the lion's share of all dividend payments received by the Latvian State. According to the proposed classification, all of the largest dividend payers belong to Group A, i.e. they hold either strategic or economic assets. In addition, the two partly state-owned telecommunications companies, Lattelecom and Latvijas Mobilais Telefons, are significant contributors.

At the same time, Group A also includes several other companies, whose main objective should be to maximize the shareholder value while implementing their mandates in terms of fixing specific market failures, and increasing or at least maintaining the value of the assets they hold.

There is a trade-off between a company's ability to pay out dividends in the short term on one hand and its ability to grow or sustain its current position on the market on the other. Therefore, although shareholder value creation is the primary objective of Group A SOEs, it should be with a long-term view. That means that the current year's dividends could be reduced or foregone altogether, if a company demonstrates, through its medium term-strategy, that this will result in higher profitability levels in the future, or at least will help it maintain its current profitability levels. In turn, this will help increase the dividend pay-out in the future, except for Latvijas gaisa satiksme and Altum, which are exempt from dividend payments by law. In each case, the question that the Latvian State will have to answer is whether it will be worse off over the medium to long term if it does not partly or entirely forego its current year dividend payments.

At the same time, a certain default dividend pay-out ratio should serve as a mechanism for ensuring that supervisory boards and management boards govern these companies with a view of providing compensation for the State's investments. Historically, the target dividend pay-out ratio has changed according to the State's immediate fiscal priorities, which brought the target dividend pay-out ratio to unsustainable levels. The current target pay-out ratio of 80% or even up to 90% appears to be high and may not take into account the companies' investment needs.

An important reference point in this respect is market, especially for Group A companies. According to the most recent data collected by Aswath Damodaran, the dividend pay-out ratio was 47.61% globally and 55.01% in Europe[159]. The figures do not include the financial services industry, as the only financial institution represented in the Group A is Altum, which by law is exempted from dividend payments[160]. These figures are indicative of a lower target, for example, 50% being more in line with market trends and expectations. Group A does consist of companies from different industries, which means that further subdivision and segmentations are possible. However, 50% is deemed an

159 Aswath Damodaran, Retrieved from: http://people.stern.nyu.edu/adamodar/New_Home_Page/datacurrent.html
160 Development Finance Institution Law, Retrieved from:https://likumi.lv/doc.php?id=270323

acceptable policy level objective based on market practices, and it should be up to individual SOEs belonging to Group A to justify proposed deviations from that target, including benchmarking with industry-level data.

Supervisory boards, shareholders' representatives and the CSCC should continuously evaluate whether or not the companies have become over-capitalised in order to optimize the capital structure and thus achieve a higher return rate on capital invested. If found to be over-capitalized, they should pay out the excess equity to the State. Capital structure should be benchmarked against comparable companies in other countries in order to more easily identify opportunities for reduction of capital.

However, it would be unrealistic to exclude the possibility that during an economic down-turn the dividend target could be increased to help meet the State's fiscal needs. As evidenced, such measures have been taken also during the latest financial crisis.

At the same time, industry-level data should not serve as a primary means of justifying a deviation. As described above, medium and long-term shareholder value should serve as the primary criteria for such deviations. Equally, considering the importance of the dividends paid by Group A companies to the state budget, it is considered that the current process of involving SOEs themselves, the CSCC, Ministry of Finance and Cabinet of Ministers is appropriate, as well as involving the European Commission as far as state aid issues are concerned.

4.3.2 Approach to Group B companies

Group B companies are SOEs with the primary objective of ensuring fulfilment of delegated state assignments that do not manage strategic economic or physical state assets. Companies in this group provide essential services that in most cases for varying reasons are not available elsewhere in the market. These SOEs receive state budget funding or collect their own service fees with the primary objective of covering their operational costs.

Because of the nature of their operations, the profits of Group B companies are not expected to be a steady source of income for the state budget. Rather, a significant number of these SOEs depend on the state budget in terms of their revenue or income. This is also illustrated by their actual share in the total dividends received by the Latvian state. For example, in 2016 the whole list of Group B SOEs accounted for a mere 3% of the total dividend receipts from the 100% state owned SOEs.[161]. It is therefore considered to be counterproductive for all of the aforementioned state bodies to be involved in deliberating and confirming approval of such negligible dividend payments from companies whose foremost objective is not generating financial returns for the State.

Therefore, it is proposed that for Group B companies the dividend policy is handled by their supervisory boards or shareholders' representatives. It should be done without the expectation of stable dividend flows each year; however, supervisory boards,

161 CSCC data, KPMG analysis

shareholders' representatives and the CSCC should continuously evaluate whether or not these companies have become over-capitalised. If they have, then they should pay out the excess equity to the State. Capital structure should be benchmarked against comparable companies in other countries in order to more easily identify opportunities for reduction of capital.

This approach would imply that in a default setting Group B companies do not pay out dividends. The profits, instead, should be redirected as contribution to the non-economic activities of the company or fulfilment of the state delegated assignment, or provision and operation of services of general economic interest in compliance with the Commission Decision No 2012/21/EU[162] (if applicable to the company), to ensure that the state aid rules are observed. The profits reinvested in the non-economic activities may not be used to cross-subsidize the economic activities. According to the European Commission guidance on notion on state aid[163] there are special provisions for companies operating in the culture sector. Companies that are not predominantly financed by visitor or user fees or by other commercial means (that is, companies that can cover less than 50% of their costs with income from user fees and similar, according to the explanation from the European Commission provided to the Latvian authorities) are considered as performing non-economic activities, and are allowed to use the profits for their non-economic and commercial activity.

To implement this approach in practice, preferably, there should be a specific regulation issued by the Cabinet of Ministers providing the State Shareholders and supervisory boards with a clear mandate and directions about the use of profits to avoid conflict with the EU competition law. The regulations would specify the process for redirecting the profit to the non-economic activities of the company or fulfilment of the state delegated assignment, or provision and operation of services of general economic interest, and define in more concrete terms what services are considered of non-economic nature. This will ensure that the requirement of a regular dividend payment, which was previously waived on an individual basis, does not apply to such SOEs as theatres, sports organisations and hospitals and does not require individual decisions of Cabinet of Ministers waiving the dividend payments annually or for the strategy period, thereby cutting the bureaucracy and resources used for coordinating such individual and frequent waivers. At the same time, this approach will ensure that these companies are not recipients of state aid.

162 EU Law, 2012/21/EU: Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (notified under document C(2011) 9380), Retrieved from: https://publications.europa.eu/en/publication-detail/-/publication/4158ddf0-dc57-45ba-bc8b-09969d3214c2

163 Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union C/2016/2946 (OJ C 262, 19.7.2016). Retrieved from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2016.262.01.0001.01.ENG&toc=OJ:C:2016:262:TOC

5 Annexes

A List of interviews

Interviewee	Topic of the interview	Interview date
Steering Committee Meeting including representatives of EC SRSS, CSCC and KPMG	Initial ideas and considerations with respect to the classification approach to Latvian SOEs	25 June 2018
CSCC representatives	Considerations with respect to the classification approach to Latvian SOEs	28 June 2018
SOE experts, KPMG Advisory S.p.A (Italy)	SOE overview and classification in Italy	11 July 2018
Tarmo Porgand, Deputy Head of State Assets Department at Ministry of Finance, Estonia	SOE overview and classification in Estonia	12 July 2018
Lars Erik Fredriksson, Investment Director of the Division for State-Owned Enterprises, Ministry of Enterprise and Innovation, Sweden	SOE overview and classification in Sweden	29 June 2018
SOE experts, KPMG France	SOE overview and classification in France	16 July 2018
Peteris Vilks, Dzintra Gasune, Ilze Pukite, CSCC	Current target setting and monitoring processes	16.aug.18
Tarmo Porgand, Deputy Head of State Assets Department at Ministry of Finance, Estonia	SOE target setting and dividend policy in Estonia	31.Aug.18
Lars Erik Fredriksson, Investment Director of the Division for State-Owned Enterprises, Ministry of Enterprise and Innovation, Sweden	SOE overview and classification in Sweden	31.Aug.18
Representatives of Latvijas koncerti	Target setting case study	10.Sep.18
Representatives of Latvijas Pasts	Target setting case study	14.Sep.18
Representatives of Siguldas boblseja un kamaniņu trase	Target setting case study	18.Sep.18
SOE experts, KPMG Advisory S.p.A (Italy)	SOE target setting and dividend policy in Italy	19.Sep.18
Representatives of Elektroniskie sakari	Target setting case study	19.Sep.18
Representatives of Rigas Austrumu Kliniska Universitates slimnica	Target setting case study	19.Sep.18
Representatives of Latvijas Valsts Mezi	Target setting case study	20.Sep.18
Representatives of Valsts nekustamie īpašumi	Target setting case study	20.Sep.18
Representatives of Latvijas Televizija	Target setting case study	25.Sep.18
Steering Committee Meeting including representatives of EC SRSS, CSCC and KPMG	Initial comments and considerations with respect to the target setting, reporting and monitoring as well as dividend policy for Latvian SOEs	27.Sep.18

Dace Berkolde, Edite Berzina, MoF, State Aid Control Department	State aid issues	28.Sep.18
Dzineta Innusa, MoT, Ilze Aleksandrovica, Latvijas Gaisa satiksme	Additional meeting regarding classification of transport industry companies	23.Nov.18
Agija Leitane-Skele, MoF, Legal Department, Dace Berkolde, Edite Berzina, MoF, State Aid Control Department	Additional meeting regarding classification of companies with MoF as shareholder and state aid issues	27.Nov.18

B Guidelines issued by the CSCC

No.	Name in Latvian	Name in English
1	Vadlīnijas publisku un publiski-privāto kapitālsabiedrību valdes un padomes locekļu atlīdzības noteikšanai[164]	Guidelines regarding remuneration of management board and supervisory board members of public and public-private corporations
2	Vadlīnijas kapitālsabiedrību valdes un padomes locekļu kandidātu atlasei un izvērtēšanai[165]	Guidelines regarding selection and evaluation of management board and supervisory board member candidates for state-owned enterprises
3	Vispārējo stratēģisko mērķu noteikšanas vadlīnijas valsts līdzdalībai kapitālsabiedrībā[166]	Guidelines for setting strategic goals regarding state's involvement in a corporation
4	Valsts kapitālsabiedrību vidēja termiņa darbības stratēģijas izstrādes vadlīnijas[167]	Guidelines regarding the development of medium-term operation strategy for state-owned enterprises
5	Informācijas publiskošanas vadlīnijas valsts kapitālsabiedrībām un kapitāla daļu turētājiem[168]	Guidelines regarding publication of information for state-owned enterprises and their shareholders
6	Vadlīnijas darbības rezultātu izvērtēšanai kapitālsabiedrībās, kurās valstij ir izšķirošā ietekme[169]	Guidelines regarding evaluation of operating results of state-owned enterprises where state's stake is majority

164 CSCC, Guidelines for determining the remuneration of members of the board of directors and councilors of public corporations and public private equity, Retrieved from: http://www.pkc.gov.lv/sites/default/files/inline-files/PKCvadl_Atlidziba_240817_0.pdf
165 CSCC, Guidelines for the selection of candidates for the board of directors and council members of the SOE, Retrieved from: http://www.pkc.gov.lv/sites/default/files/images-legacy/Kapitalsabiedribas/Vadlinijas_kap_sab_valde_padome.pdf
166 CSCC, Guidelines for determining overall strategic objectives for public participation, Retrieved from:http://www.pkc.gov.lv/sites/default/files/inline-files/SMNV_30032016_.pdf
167 CSCC, Guidelines for elaboration of the strategy for mid-term business strategy of SOE, Retrieved from: http://www.pkc.gov.lv/sites/default/files/inline-files/VTS_30032016_.pdf
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C Annex: List of all Latvian SOEs as of 01.07.2018.

No	Company name	Description	Company ownership status	No	Company name	Description	Company ownership status
1	Latvenergo	Production and sale of electricity and heat, sale of natural gas, provision of electricity distribution services	SOE (100% shares owned)	15	Latvijas gaisa satiksme	Aviation navigation services	SOE (100% shares owned)
2	Latvijas dzelzceļš	Rail transport and infrastructure, real estate management, electricity transmission and IT	SOE (100% shares owned)	16	Latvijas televīzija	Public media (TV)	SOE (100% shares owned)
3	Latvijas Valsts meži	Administration of state-owned forest property and management of public forest	SOE (100% shares owned)	17	Attīstības finanšu institūcija Altum	Financial services within the State aid programme	SOE (100% shares owned)
4	Augstsprieguma tīkls	Electricity transmission	SOE (100% shares owned)	18	Latvijas Valsts radio un televīzijas centrs	Provision for quality and safe telecommunications solutions	SOE (100% shares owned)
5	Rīgas Austrumu klīniskā universitātes slimnīca	Medical treatement and diagnostics. Trains medical students.	SOE (100% shares owned)	19	Latvijas Valsts ceļi	National road administration	SOE (100% shares owned)
6	Paula Stradiņa klīniskā universitātes slimnīca	Outpatient, inpatient and tertiary medical assistance	SOE (100% shares owned)	20	Rīgas Psihiatrijas un narkoloģijas centrs	Outpatient, inpatient and tertiary medical assistance to persons found to have mental illness or behavioural disorder.	SOE (100% shares owned)
7	Pasažieru vilciens	Domestic passenger transportation by rail	SOE (100% shares owned)	21	Traumatoloģijas un ortopēdijas slimnīca	Specialised hospital for bone and soft tissue trauma treatment; orthopaedic and spinal surgery	SOE (100% shares owned)
8	Latvijas autoceļu uzturētājs	State road maintenance	SOE (100% shares owned)	22	Nacionālais rehabilitācijas centrs Vaivari	Medical assistance to person in need of the second stage of medical rehabilitation	SOE (100% shares owned)
9	Latvijas Pasts	Postal services	SOE (100% shares owned)	23	Latvijas radio	Public media (radio)	SOE (100% shares owned)
10	Valsts nekustamie īpašumi	Real estate management company	SOE (100% shares owned)	24	Daugavpils psihoneiroloģiskā slimnīca	Inpatient and secondary outpatient medical aid and care to persons found to have mental illness or behavioural disorders	SOE (100% shares owned)
11	Starptautiskā lidosta Rīga	Servicing planes, passengers and freight in the airport terminal and airfield maintenance	SOE (100% shares owned)	25	Latvijas Vides, ģeoloģijas un meteoroloģijas centrs	Environment monitoring, geological research of earth	SOE (100% shares owned)
12	Ceļu satiksmes drošības direkcija	State Road safety direction	SOE (100% shares owned)	26	Elektroniskie sakari	Provision for data transfer radio frequency spectrum and numbering	SOE (100% shares owned)
13	Bērnu klīniskā universitātes slimnīca	Outpatient and inpatient medical assistance and emergency assistance to children	SOE (100% shares owned)	27	Tiesu namu aģentūra	Management of real estate of the Ministry of Justice	SOE (100% shares owned)
14	Latvijas Loto	State level lotteries	SOE (100% shares owned)	28	Slimnīca Ģintermuiža	Inpatient and outpatient psychiatric and narcotic assistance for acute and chronic illness and disturbance diagnosis, treatment and patient rehabilitation	SOE (100% shares owned)

No	Company name	Description	Company ownership status	No	Company name	Description	Company ownership status
29	Rīgas Tūrisma un radošās industrijas tehnikums	Secondary and vocational education in catering services, tourism and commerce, food manufacturing, interior and design, fashion and style	SOE (100% shares owned)	43	Mihaila Čehova Rīgas Krievu teātris	Theatre	SOE (100% shares owned)
30	Zemkopības ministrijas nekustamie īpašumi	Management of real estate of the Ministry of Agriculture; maintenance of stateowned reclamation systems and those of national importance.	SOE (100% shares owned)	44	Latvijas Koncerti	Concert organisation	SOE (100% shares owned)
31	Strenču psihoneiroloģiskā slimnīca	Psychiatric assistance in acute and chronic mental illness diagnosis, treatment, prevention and patient rehabilitation, administration of longterm social care and social rehabilitation services	SOE (100% shares owned)	45	Šampētera nams	Management and maintanance of real estate of The Ministry of Welfare	SOE (100% shares owned)
32	Latvijas Nacionālais teātris	Theatre	SOE (100% shares owned)	46	Latvijas Nacionālais metroloģijas centrs	Metrology services	SOE (100% shares owned)
33	Latvijas Jūras administrācija	Maritime transportation administration	SOE (100% shares owned)	47	Valsts Akadēmiskais koris Latvija	Choir	SOE (100% shares owned)
34	Latvijas Nacionālā opera un balets	Opera and ballet	SOE (100% shares owned)	48	Bērnu psihoneiroloģiskā slimnīca Ainaži	Medical services for children	SOE (100% shares owned)
35	Autotransporta direkcija	Road transport carrier licensing and supervision	SOE (100% shares owned)	49	Sertifikācijas un testēšanas centrs	Conformity assessment services	SOE (100% shares owned)
36	Aknīstes psihoneiroloģiskā slimnīca	Long-term mentally ill and therapeutically resistant patient treatment and rehabilitation	SOE (100% shares owned)	50	Valmieras drāmas teātris	Theatre	SOE (100% shares owned)
37	Piejūras slimnīca	Medical services, assistance and rehabilitation to people with mental problems	SOE (100% shares owned)	51	Latvijas Nacionālais simfoniskais orķestris	Music	SOE (100% shares owned)
38	Jaunais Rīgas teātris	Theatre	SOE (100% shares owned)	52	Straupes narkoloģiskā slimnīca	Medical services for treatment of alcohol addiction	SOE (100% shares owned)
39	Privatizācijas aģentūra	Conclusion of state estate privatisation process, provision of share and estate object alienation process.	SOE (100% shares owned)	53	Latvijas Leļļu teātris	Puppet theatre	SOE (100% shares owned)
40	Dailes teātris	Theatre	SOE (100% shares owned)	54	Latvijas Proves birojs	Testing of precious metals and precious stones	SOE (100% shares owned)
41	Iekšlietu ministrijas poliklīnika	Both primary and secondary level health care services	SOE (100% shares owned)	55	Meliorprojekts	Design of drainage systems and river hydrotechnical constructions; geodetic works; land management topographical works	SOE (100% shares owned)
42	Latvijas Vēstnesis	Official publication of legislation and official notices	SOE (100% shares owned)	56	Bobsleja un kamaniņu trase Sigulda	Organisation of competitions and leisure rides	SOE (100% shares owned)

No	Company name	Description	Company ownership status	No	Company name	Company ownership status
57	Eiropas dzelzceļa līnijas	European track gauge infrastructure implementation and management in Latvia	SOE (100% shares owned)	73	Starptautiskā Rakstnieku un tulkotāju māja	SOE with state ownership from 20% to 50% (including)
58	Liepājas simfoniskais orķestris	Orchestra	SOE (100% shares owned)	74	Rīgas Kinostudija	SOE with state ownership from 20% to 50% (including)
59	Sporta centrs Mežaparks	Organisation of sports events and competitions. Sports services.	SOE (100% shares owned)	75	Latvijas Gāze	SOE with state ownership below 20%
60	Tenisa centrs Lielupe	Tennis equipment and tennis court rental. Organisation of tennis events.	SOE (100% shares owned)	76	Latvijas maiznieks	SOE with state ownership below 20%
61	Kultūras un sporta centrs Daugavas stadions	Sports	SOE (100% shares owned)	77	Rīgas dzirnavnieks	SOE with state ownership below 20%
62	Daugavpils teātris	Theatre	SOE (100% shares owned)	78	Rīgas sanitārā transporta autobāze	SOE with state ownership below 20%
63	KREMERATA BALTICA	Orchestra	SOE (100% shares owned)	79	Ceļu pārvalde	SOE with state ownership below 20%
64	Rīgas cirks	Circus training for kids	SOE (100% shares owned)	80	Rēzeknes SEZ AS REBIR	SOE with state ownership below 20%
65	Vides investīciju fonds	Development of environment protection and environment friendly projects	SOE (100% shares owned)	81	Daugavpils specializētais autotransporta uzņēmums	SOE with state ownership below 20%
66	Latvijas Standarts	Other	SOE that is in the process of liquidation	82	Balt Aliance	SOE with state ownership below 20%
67	Air Baltic Corporation	Passenger and freight transportation by air	SOE under state decisive influence	83	Lopkopības izmēģinājumu stacija Latgale	SOE with state ownership below 20%
68	Lattelecom	IT and telecommunications services	SOE under state decisive influence	84	Jelgavas mašīnbūves rūpnīca	SOE with state ownership below 20%
69	Latvijas Lauku konsultāciju un izglītības centrs	Rural development consultancy services	SOE under state decisive influence	85	Stendes selekcijas un izmēģinājumu stacija	SOE with state ownership below 20%
70	Ludzas medicīnas centrs	Health care	SOE under state decisive influence	86	UNI SAN	SOE with state ownership below 20%
71	Rīgas siltums	Energy generation	SOE with state ownership from 20% to 50% (including)	87	Latgales ciltslietu un mākslīgās apsēklošanas stacija	SOE with state ownership below 20%
72	Latvijas Olimpiskā vienība	Sports	SOE with state ownership from 20% to 50% (including)	88	Pūres dārzkopības izmēģinājumu stacija	SOE with state ownership below 20%

No	Company name	Company ownership status	No	Company name	Company ownership status
89	Sanatorija Dzimtene	SOE with state ownership below 20%	117	Tilžas rapsis	Indirect ownership of more than 50%
90	Liepājas sērkociņi	SOE with state ownership below 20%	118	Vhiter	Indirect ownership of more than 50%
91	MSIA Eiropas minerāls	SOE with state ownership below 20% that is in insolvency proceedings	119	Latvijas Mobilais Telefons	Indirect ownership of more than 50%
92	MAS Latvijas zoovetapgāde	SOE with state ownership below 20% that is in insolvency proceedings	120	LMT Retail&Logistics	Indirect ownership of more than 50%
93	MAS Liepājas metalurgs	SOE with state ownership below 20% that is in insolvency proceedings	121	CITRUS Solutions	Indirect ownership of more than 50%
94	Transinform	SOE with state ownership below 20% that is in liquidation status or has ceased operations	122	Lattelecom Technology	Indirect ownership of more than 50%
95	Sadales tīkls	Subsidiary under 100% ownership of SOE	123	Liepājas enerģija	Indirect ownership of more than 50%
96	LDZ Cargo	Subsidiary under 100% ownership of SOE	124	Aviation Crew Resources	Indirect ownership of more than 50%
97	LDZ ritošā sastāva serviss	Subsidiary under 100% ownership of SOE	125	ZetCOM	Indirect ownership of more than 50%
98	Latvijas elektriskie tīkli	Subsidiary under 100% ownership of SOE	126	Lattelecom BPO	Indirect ownership of more than 50%
99	LDZ Loģistika	Subsidiary under 100% ownership of SOE	127	PINS.CO	Indirect ownership of more than 50%
100	LDZ infrastruktūra	Subsidiary under 100% ownership of SOE	128	Air Baltic Training	Indirect ownership of more than 50%
101	LDZ apsardze	Subsidiary under 100% ownership of SOE	129	Media 360	Indirect ownership of more than 50%
102	Enerģijas publiskais tirgotājs	Subsidiary under 100% ownership of SOE	130	Baltijas datoru akadēmija	Indirect ownership of more than 50%
103	LatRailNet	Subsidiary under 100% ownership of SOE	131	VRC Zasulauks	Indirect ownership of more than 50%
104	LatLoto nams	Subsidiary under 100% ownership of SOE	132	Rīgas vagonbūves uzņēmums Baltija	Indirect ownership of more than 50%
105	Jaunmoku pils	Subsidiary under 100% ownership of SOE	133	KS AIF Imprimatur Capital Technology Venture Fund	Indirect ownership of more than 50%
106	Mailmaster	Subsidiary under 100% ownership of SOE	134	KS alternatīvo ieguldījumu fonds ZGI-3	Indirect ownership of more than 50%
107	Rīgas hematoloģijas centrs	Subsidiary under 100% ownership of SOE	135	KS BaltCap Latvia Venture Capital Fund	Indirect ownership of more than 50%
108	FeLM	Subsidiary under 100% ownership of SOE	136	Blaker	Indirect ownership of more than 50%
109	REAP	Subsidiary under 100% ownership of SOE	137	KS Expansion Capital Fund AIF	Indirect ownership of more than 50%
110	OÜ Elektrum Eesti	Subsidiary under 100% ownership of SOE	138	KS Flycap Investment Fund I AIF	Indirect ownership of more than 50%
111	Elektrum Latvija	Subsidiary under 100% ownership of SOE	139	Pirmais slēgtais pensiju fonds	Indirect ownership of more than 50%
112	UAB Elektrum Lietuva	Subsidiary under 100% ownership of SOE	140	Hiponia	Indirect ownership of more than 50% that are in liquidation process or have ceased operations
113	KS Imprimatur Capital Seed Fund	Subsidiary under 100% ownership of SOE	141	Regalite Holdings Limited	Indirect ownership of more than 50% that are in liquidation process or have ceased operations
114	Auteko & TUV Latvija	Indirect ownership of more than 50%	142	Reverta	Indirect ownership of more than 50% that are in liquidation process or have ceased operations
115	Veselības centrs Biķernieki	Indirect ownership of more than 50%	143	UAB NIF Lietuva	Indirect ownership of more than 50% that are in liquidation process or have ceased operations
116	BALTIJAS KRAVU CENTRS	Indirect ownership of more than 50%	144	TravelLounge	Indirect ownership of more than 50% that are in liquidation process or have ceased operations

No	Company name	Company ownership status
145	Conexus Baltic Grid	Indirect ownership of 20-50%
146	Scantest	Indirect ownership of 20-50%
147	Autests	Indirect ownership of 20-50%
148	Meža un koksnes produktu pētniecības un attīstības institūts	Indirect ownership of 20-50%
149	KS Otrais Eko fonds	Indirect ownership of 20-50%
150	RB Rail	Indirect ownership of 20-50%
151	Venttests	Indirect ownership of 20-50%
152	Baltic Innovation Fund	Indirect ownership of 20-50%
153	Priekuļu rapsis	Indirect ownership of 20-50%
154	Latvijas Finieris	Indirect ownership of up to 20%
155	Kurzemes radio	Indirect ownership of up to 20%
156	Baltkrievijas-Latvijas kopuzņēmums MIRIGO	Indirect ownership of up to 20%
157	BRC Novatēka	Indirect ownership of up to 20%
158	Vējkalni	Indirect ownership of up to 20%
159	Strek	Indirect ownership of up to 20%

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