SOE Financial Management Issues

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Abstract— State-owned enterprise (SOE) reforms had been going on for decades and yet they still perform poorly. SOEs face challenges of low returns and significant economic costs due to poor SOE management. The paper analyses the SOE financial management system to identify the financial management issues and recommend the countermeasures to strengthen the SOE financial management and hence, improve SOE management and performance. A proposed SOE financial management framework was used for the analysis, while the follow-up meetings with the SOE management and finance teams after the Solomon Islands SOE Forum in April 2015 were used to identify the financial management issues. The results show that there is unclear and little understanding of the SOE financial management function and this, therefore, led to a high number of financial management issues. This paper thus, proposed the countermeasures to resolve these financial management issues. The conclusion can be drawn that the SOE reform programmes should re-direct their attention towards strengthening the SOE financial management systems in order to improve the SOE management and performance.

Keywords— SOE, reforms, financial management issues, Solomon Islands, countermeasures

I. INTRODUCTION

State-owned enterprise (SOE) reforms had been going on for decades and yet they still perform poorly. The case against SOEs states that many SOEs are not well run[1]. The ADB study report, “Finding Balance 2014 – Benchmarking the Performance of State-Owned Enterprises in Island Countries” states that low SOE returns are common throughout the developed and the developing world[2]. The study further demonstrates that the significant economic costs of the SOEs are generated by poor SOE management. The financial system is weak and the financial management lags behind. Because of this, financial management issues are prominent which constrains the efficient and effective management of the financial resources. Practice has proved that financial management is the core of enterprise management and it is extremely important for SOE management and performance.

The aim of the paper is to analyse and identify the financial management issues of the SOEs and recommend countermeasures to strengthen financial management and therefore, improve SOE management and performance. The remaining Sections of the paper is structured as follows: Section two covers SOE Financial Management; Section three analyses the SOE financial management issues; Section four provides the countermeasures and suggestions to resolve the financial management issues, and finally, the paper ends with the conclusion in Section five.

II. SOE FINANCIAL MANAGEMENT

Prior to discussing the SOE financial management, it is important that the word financial management must first of all be understood in its right context. Therefore, a brief definition is provided including what the financial management involves, the scope and the basic principles that it is built upon.

A. Financial Management

Financial management is the management of financial resources of an enterprise, and it involves planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. Financial management is built on three principles: the investment principle, the financing principle and the dividend principle[3]. The investment principle determines where businesses invest their resources, the financing principle governs the mix of funding used to fund these investments, and the dividend principle answers the question of how much earnings should be reinvested back into the business and how much should be returned to the owners of the business.

B. SOE Financial Management

SOE financial management should be considered at two levels: (i) the Government level, and (ii) the SOE Level. Figure 1 below illustrates how SOE financial management should be understood at these two levels.

As highlighted earlier, financial management involves planning, organising, directing and controlling the financial activities of the enterprise. The first two words, planning and organising the financial activities comes under the performance dimension in the above financial management framework; while the second two words, directing and controlling the financial activities comes under the conformance dimension. The performance dimension
At the Government level, the directing and controlling require conformance to the SOE legislations, for example the SOE Act 2007 and the SOE Regulations 2010. On the other hand, the performance dimension will require planning and organising the financial activities of the SOE. These are done through the statement of corporate objectives issued by the SOEs to the Government; based on the Government’s shareholding decisions, debt/equity financing decisions and dividend decisions.

At the SOE level, the directing and controlling require conformance to company policies on the management of financial resources, the financial management systems, policies and procedures. On the other hand, the performance dimension will require planning and organising of the investment decisions, finance decisions and dividend decisions through business plans and budgets.

There are also links between SOE level and Government level. Financing decisions under Business plans & Budget at SOE level should be linked to the Shareholding/Government decisions – Debt financing / Share or Equity decisions in the Statement of Corporate Objectives (Government perspective – Investment Decision). Dividend decisions under the Business plans & Budget at SOE level should be linked to the Dividend decisions in the Statement of Corporate Objectives (Government perspective – Investment Decision). In fact, Investment decisions under the Business plans & Budget at SOE level depend on Financing and Dividend decisions. Likewise, the conformance dimension at SOE level should also have links to the conformance dimension at the Government level.

In reality, most of the smaller SOEs in Solomon Islands do not strictly apply these three principles; investment decisions, finance decisions and dividend decisions. For example, there was no consideration done in choosing a financing mix (debt and equity) that maximises the value of the investments made and matching the financing to the nature of the assets being financed. SOEs did not strictly adhere to financial management role in the management of the SOEs, and there are many financial management issues that hinder the performance of SOEs.

III. ANALYSING SOE FINANCIAL MANAGEMENT

The author constructed the following framework (Table 1) to analyse and identify the financial management issues. This framework helps to identify the conformance and performance issues under two levels: (i) Government level (external) and (ii) SOE level (internal).

Table 1. SOE financial management framework

<table>
<thead>
<tr>
<th>Levels</th>
<th>Conformance</th>
<th>Performance</th>
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</thead>
<tbody>
<tr>
<td><strong>Government Level</strong></td>
<td>• SOE Act 2007</td>
<td>• Shareholding decisions</td>
</tr>
<tr>
<td>(External)</td>
<td>• SOE Regulations 2010</td>
<td>• Debt financing decisions to SOEs</td>
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<tr>
<td></td>
<td>• Investment decisions</td>
<td>• Dividend decisions</td>
</tr>
<tr>
<td><strong>SOE Level</strong></td>
<td>• Company policies on management of financial resources</td>
<td>• Investment decisions</td>
</tr>
<tr>
<td>(Internal)</td>
<td>• Financial management system</td>
<td>• Financing decisions</td>
</tr>
<tr>
<td></td>
<td>• Financial policy and procedures</td>
<td>• Dividend decisions</td>
</tr>
</tbody>
</table>

At the Government level, the conformance issues were identified within the scope of the SOE Act 2007 and the SOE Regulations 2010. The performance issues were identified within the scope of shareholding decisions, the debt-financing decisions to SOEs and the dividend decisions. At the SOE level, the conformance issues were identified within the scope of the company policies on management of financial resources, financial management systems, policies and procedures. The performance issues were identified within the scope of the three (3) Principles: investment decisions, financing decisions and dividend decisions.

Within this tabular construct, the author designed a set of questions to identify the financial management issues. This set of questions was used during the focus group meetings with three SOEs of Solomon Islands in April of this year, 2015. Feed-back from these meetings resulted in the following issues being identified, and categorised under external issues and internal issues

A. External Issues

First, the oversight role played by the SOE Unit remains weak. The SOE Unit lacks relevant training, experience and senior staff to appropriately discharge their responsibilities. Because of this, SOEs do not fully understand well the SOE Unit’s authority, including the SOE Act and the Regulations.

Second, there is no policy yet on SOE shareholding or ownership, divestiture, and PPPs to guide the SOE restructuring program. The government and the SOE do not have clear guidelines on policy matters to guide the SOE restructuring program. The absence of the SOE ownership policy makes it difficult for any SOE restructuring program to make any good progress.

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Third, SOEs do not understand the government’s debt financing guidelines. Smaller SOEs are finding it difficult to acquire financing for their capital projects, for example, the SOEs in the postal and media sectors.

Fourth, smaller SOEs are finding it difficult to obtain long term capital for their capital and development projects. Commercial banks offered limited financing opportunities but their financing costs are quite high. The bank credit policies depend on the cash flow or limited to working capital loans.

Fifth, there are no policy guidelines or no statement of principles to be adopted for setting annual dividends. There has not been any payment of dividends made by the SOEs since the start of the reform programs in Solomon Islands.

Sixth, there is lack of financial institutions that provide specialised services to the SOEs, especially in the areas relating to finance. SOEs are in need of specialised services such as trainings on compilation of IFRS financial statements, corporate planning, financial management systems, policy implementation and control, change management and so on. Most of the services are provided by the overseas consultants who flew in and out after their contract lapses. Thus, there is no continuity of such services.

B. Internal Management Issues

Apart from the external issues, SOEs are also faced with internal management problems due to various factors pervasive right through the financial management system.

1) Financial management level is low: SOEs perceived accounting as the solution to satisfy the external reporting requirements as stipulated in the SOE Act 2007, rather than a management tool for the management of the financial resources. Financial management is not considered as high since it is only for the management. Therefore, there is the tendency to focus more on satisfying and meeting the external reporting requirements than the internal management requirements; more focus is on financial accounting than financial management. Managers therefore, do not attach priority or importance to financial management.

2) Lack of capacity, qualified and experienced staff: Some SOEs, for example, the smaller SOEs ignore the financial management function due to limited capacity. There is lack of qualified and experienced staff to carry out the financial management function.

3) Lack of financing decisions: SOEs do not normally evaluate the mix of debt and equity financing before making decisions on raising funds. SOEs do not determine which type of financing best suits them. For example, to determine whether to seek short term or long term financing, etc., how the assets are being financed, and how the funds are being acquired.

4) Lack of investment budget decision-making function: SOEs, especially the smaller ones do not normally calculate the rate of return that indicates a good return, or plan whether to make an investment or not. SOE behaviour often shows a lack of long-term planning and decision-making. There is even no consideration to decide on the optimal size of the firm.

5) Lack of asset management and weak control: Asset management systems are weak. SOEs do not analyse what assets should be reduced or disposed and what assets to be acquired. First, lack of stringent cash flow planning, monitoring and control. This, therefore, resulted in idle or insufficient funds. Second, inventory control is weak; therefore, large inventories tie up cash and therefore, cash flow problems. Third, weak control of accounts receivables, and therefore, increase the number of bad debts. There is lesser attention given to the current asset management as compared to the fixed assets.

6) Lack of dividend policy guidelines: The SOEs do not yet have a clear policy guideline on dividend declaration and payments. Therefore, it is not clear as to how much is to be paid to the government and how much will be re-invested back into the business. On the other hand, the government do not yet have a dividend policy guideline for its SOEs.

IV. COUNTERMEASURES TO RESOLVE FINANCIAL MANAGEMENT ISSUES

After analysing and identifying the financial management issues, the following countermeasures and suggestions are recommended, and are categorised under external countermeasures and internal management countermeasures:

A. External Countermeasures

The government needs to provide support in the following areas:

First, strengthen the SOE oversight role of the SOE Unit. The government should ensure that relevant trainings are provided for the SOE Unit staff, and experienced and senior staff are recruited in order to appropriately discharge their responsibilities.

Second, the government through the SOE Unit should organise SOE Forums and Seminars or trainings to explain the SOE shareholding or ownership structure scheme, SOE roles, or even any proposed dividend policy that will be recommended in line with the SOE Act and Regulations. The SOE Unit should be facilitating other relevant trainings such as strategic or corporate planning, IFRS training, and even financial management training for the SOEs and so on.

Third, the government should explain clearly its borrowing policy and debt management framework to the SOEs.

Fourth, the government should create and strengthen the credit culture so that SOEs can source loans from commercial banks. The government should establish an SOE credit system and promote credit awareness and the concept of credit. It should also facilitate and enhance the relationship between commercial banks and the SOEs under a trustworthy environment.

Fifth, the government should established a Section with the Institute of Public Administration and Management (IPAM) to focus more on providing training services that are more specific to the SOEs.

B. Internal Management Countermeasures

1) Improve the financial system and the understanding of financial management: SOEs should improve their financial systems, implement international accounting standards, and establish and strengthen internal accounting control system.

First, SOEs should review their financial systems and draw up a Finance Policy Manual. This should clearly define the
efficiently and determine what assets should be reduced or eliminated. SOEs should attach equal emphasis on current asset management as they do with the fixed assets. This is to ensure that SOEs have operating responsibility over the assets.

Other control financing decisions include the separation of incompatible duties such as authority to authorise accounting transactions, custody of property, inspection, etc; the authorisation and approval control system; the appointment of project teams for management and monitoring of projects.

V. CONCLUSION

SOEs perform poorly and face challenges of low returns and significant economic costs due to poor SOE management. But, SOE management can be improved if SOEs re-focus on strengthening and improving their financial management systems.

The implementation of the countermeasures put forward in this paper will strengthen SOE financial management system and therefore, improving the SOE management and performance; huge costs should be reduced and thus, there should be improvements in the SOE returns.

The paper also proposes a financial management framework that SOEs can use to understand and analyse their financial management issues.

Finally, since there is unclear or little understanding of the SOE financial management function, the focus of the reforms should now be re-directed towards financial management.

REFERENCES