

# Transparency and Efficiency of SOEs: Improving Financial Performance Assessment

Workshop for the Government of Azerbaijan and State-Owned Enterprises

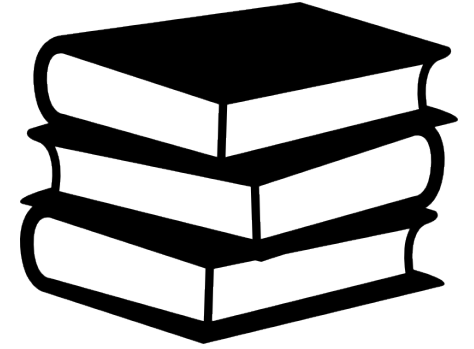
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# Introduction

- Assessment of SOEs efficiency and performance effectiveness is a key ownership function of the government
- Strong performance monitoring practices establish clear objectives and financial targets for an SOE, formalize owner's expectations and support fiscal risk management
- It is important that governments, as owner of SOEs, performs monitoring and evaluation of their performance timely and uses this information to make informed decisions
- International experience demonstrates that effective SOE performance management can lead to improved financial and non-financial performance and ultimately increased value creation for the society

# Legislative Framework: SOE Performance Monitoring



# President of the Azerbaijan Republic: Orders

- July 19, 2016, Order No 1003
  - ✓ Identifying measures to be undertaken by the government to accelerate and improve management efficiency of privatization of state property
- September 5, 2016, Order No 2300
  - ✓ Directing the government to implement additional measures in regard to increasing efficiency of activities of legal entities with controlling block of shares are owned by the state

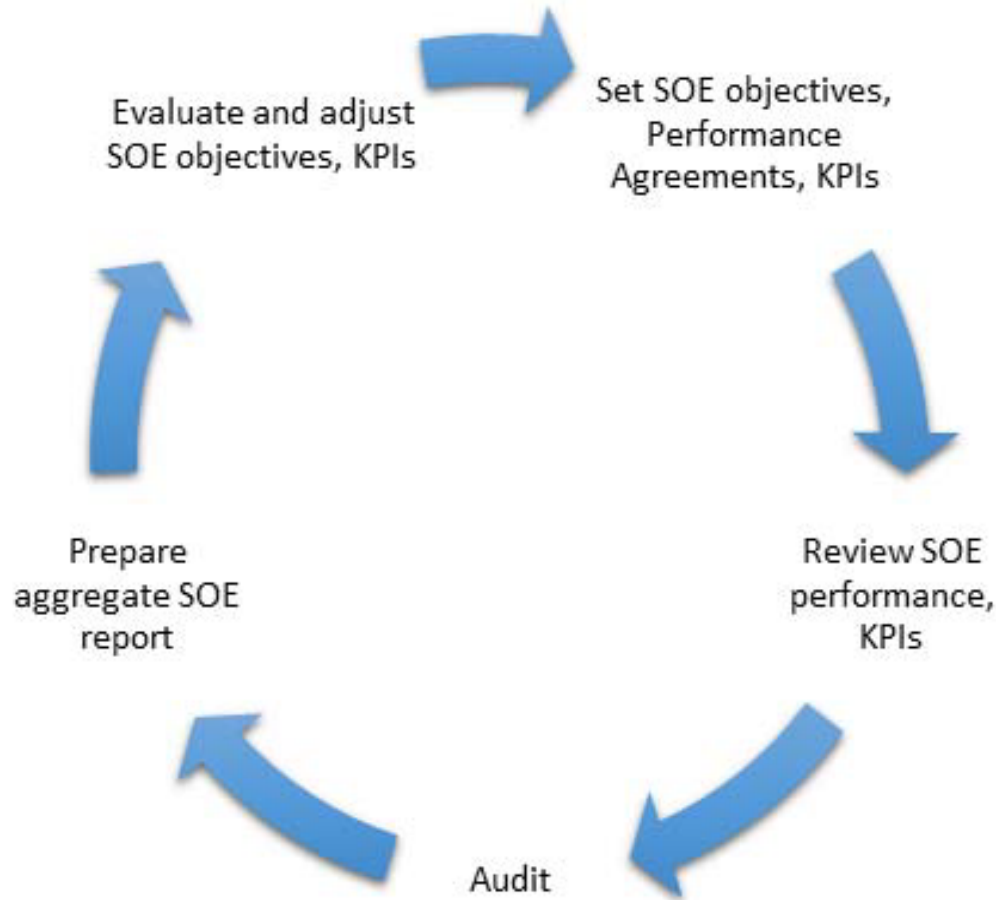
## Cabinet of Ministers: Decrees

- December 1, 2016, Decree 636s
  - ✓ Action plan to improve financial and business performance transparency and efficiency of large state owned enterprises, incl design of SOE database
  - ✓ Approved list of 20 largest SOEs
- December 30, 2016, Decree 534
  - ✓ Establishing a special high-level Commission to review and approve budget revenues and expenditures of 14 largest SOEs
  - ✓ Appointing Government officials - members of the Commission



# SOE Performance Assessment: Key Performance Indicators

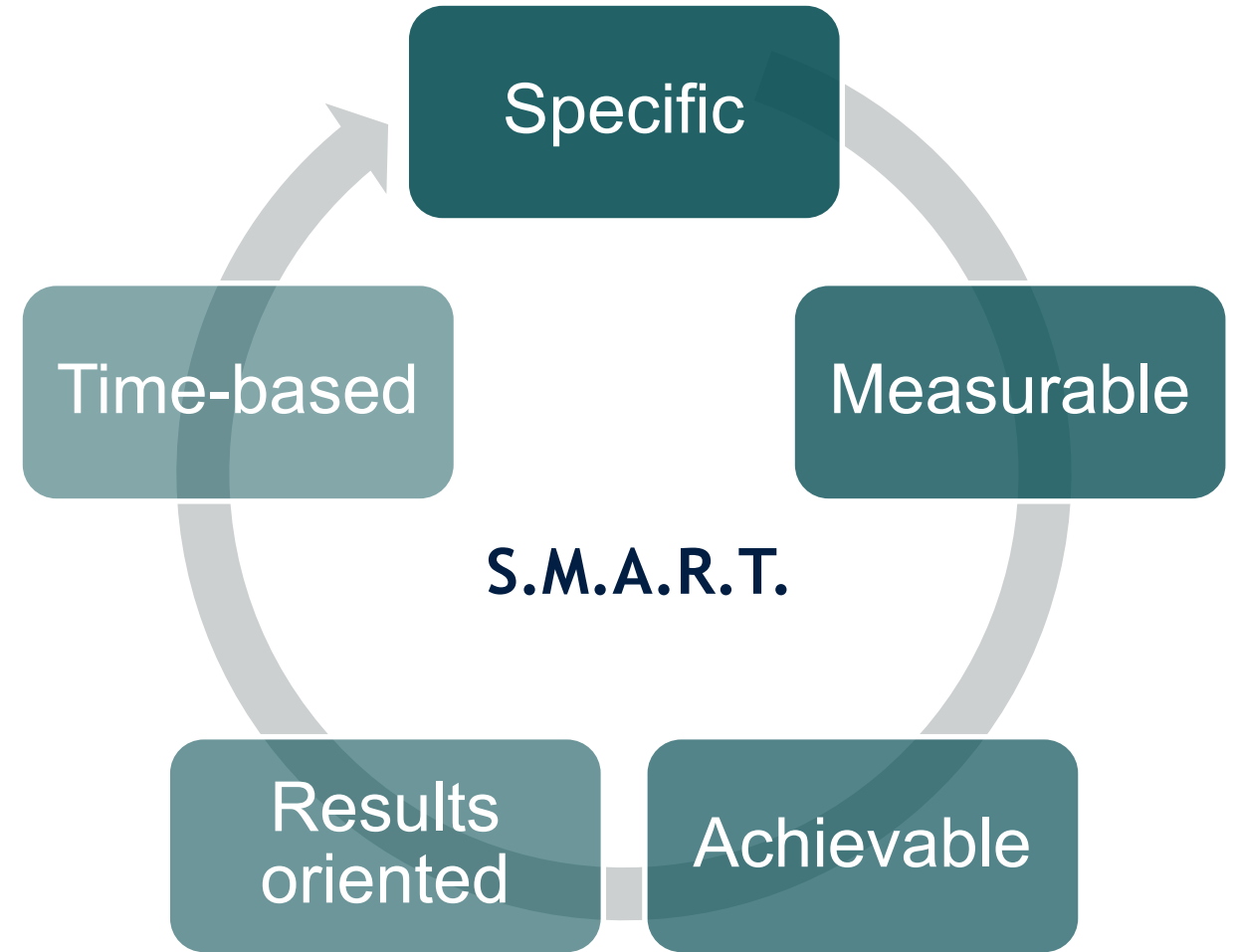
# Developing and Enforcing SOE Key Performance Indicators



- Manageable number: balance the number and importance of KPIs
- Separate commercial and non-commercial objectives/ costs
- Enforcement via performance agreements (at later stage)
- Balanced scorecard: weighted financial and non-financial indicators
- Aggregate reporting

# Developing and Enforcing SOE Key Performance Indicators

- Key Performance Indicators must be tightly linked to the strategy + address all relevant aspects of value creation for each SOE
- KPIs should measure both direct shareholder value creation and other social/ developmental objectives set by the SOE Board
- Challenging but achievable, based on historical performance
- Linked to management performance + regularly audited





## Common categories of financial KPIs

- Profitability KPIs assess SOEs' ability to generate earnings compared to its expenses and other relevant costs incurred during a specific period of time
  - ✓ EBITDA, Return on capital employed, Return on equity, Total shareholders return, Return on assets, Dividend payout ratio, Return on investments
- Solvency (leverage) KPIs measure the ability of an SOE to meet its long-term financial obligations. Solvency is essential to staying in business as it asserts a company's ability to continue operations into the foreseeable future
  - ✓ Solvency, Capitalization to equity, Debt to assets

## Common categories of financial KPIs (continued)

- Liquidity KPIs measure the ability of an SOE to meet financial obligation as they come due with liquid assets available to them without disrupting the normal ongoing operations of the business
  - ✓ Absolute liquidity
- Efficiency KPIs measure the degree of efficiency in using resources to generate revenue. labor, management and capital. Activity analysis deals with the relationship between inputs and outputs
  - ✓ Costs to income, Days creditors outstanding, Labor productivity, Days debtors outstanding, utilization of production capacity, share of accounts receivable in current assets, fixed assets turnover, energy efficiency
- Activity KPIs relate to activities of SOEs and reflect on various areas
  - ✓ Share of innovation costs in total costs, Training costs per employee, Personnel turnover, Export parameters

## Draft procedure for SOE performance assessment

- Establishes a consistent set of 23 quantitative key efficiency (performance) indicators (KPIs) to be used for assessing SOE performance against pre-set targets.
  - ✓ 15 main KPIs
  - ✓ 8 additional KPIs
- Defines a composite score for an SOE as coefficient of activity efficiency (CAE) that is calculated as the sum of the weighted variance between actual and target with individual weights assigned to each KPI
- Utilizes mainly financial KPIs reflecting common categories
- Incorporates few non-financial KPIs



# SOE Performance Monitoring Tool

## Purpose of the SOE performance monitoring tool

- Assists users with the efficiency assessment and oversight of large SOEs by automating the process of computing KPIs and CAEs
- Enables aggregate reporting on both CAEs and key financial metrics of the large non-financial SOE sub-sector
- Links together the newly established SOE database and procedure for the SOE efficiency assessment
  - ✓ The tool shall be used in conjunction with the draft "Procedure for efficiency assessment of the legal entities where controlling block of shares is owned by the state"

# Design of the SOE performance monitoring tool

- The tool can be web based or used as a stand-alone excel file
- The tool comprises 17 worksheets
  - ✓ 15 worksheets for each of the large SOEs
  - ✓ Summary KPIs and CAE worksheet
  - ✓ Aggregate SOE results worksheet
- A separate spreadsheet provides an individual SOE level version of the tool
  - ✓ It can be used by the government officials for monitoring efficiency of an individual SOE or by SOEs themselves for internally monitoring KPIs and CAE

# Individual SOE worksheet

- Four main input tables
  - ✓ Condensed Statement of Financial Position
  - ✓ Condensed Statement of Profit and Loss by nature
  - ✓ Condensed Statement of Profit and Loss by function
  - ✓ Supplementary Information
  - ✓ CAE template table
- Automatically calculates KPIs and CAEs once all the required input data has been entered

## Draft Guidelines to SOE performance monitoring tool

- Describe legal and analytical SOE performance monitoring frameworks
- Provide instructions for applying the tool
- Attachment to the Guidelines contains a detailed description of all the KPIs used, accompanied by examples of their calculation



