Governance Innovation for SOEs in Bulgaria: Based on Korean Experience

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Chapter 1

Governance Innovation for SOEs in Bulgaria: Based on the Korean Experience in 31 Questions

Governance Innovation for SOEs in Bulgaria: Based on the Korean Experience in 31 Questions*

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Summary

The recent financial performances of many Bulgarian SOEs have revealed the shortcomings in the management of its SOEs. The main direction of Bulgarian reforms should be improving transparency, better selection and appraisal of management, sustainable dividend policy, strengthening financial discipline and coherent ways to reduce the debt burden. The institutional status quo is clearly inefficient and needs to be replaced.

The direction of SOE governance reforms in Korea and Bulgaria are substantially different. Korea has maintained a very centralized grip over SOEs for an extended period of time, and it needs to reduce government intervention by guaranteeing more autonomy for SOEs. On the other hand, Bulgaria needs more centralized control over SOEs, which is expected to improve their performance. The Korean experience in reforming its SOE management system is highly relevant for Bulgaria and it complies with the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

This paper asks 31 questions regarding a system of good governance and presents options for each question regarding positive and negative aspects, followed by

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specific recommendations for the Bulgarian government. It is recommended that a centralized authority responsible for the management of SOEs be established which is composed of line vice-ministers and experts from academia and the private sector. Major tasks and responsibilities should be transferred gradually from line ministries to this new setting. Among these include increasing transparency, the introduction of an evaluation system with strict consequences and related open competitive procedures for the selection, the appointment and appraisal of CEOs, as well as an annual bonus system.

SOE governance reform in Bulgaria will touch off strong resistance from both line ministries and their SOEs. Therefore, it will require a good deal of effort and strategy to accomplish the task. It is important to win the minds of the people and the political leadership in that the current system is subject to a number of problems, and that reform of the system is critical to a more efficient economy and provision of better public services to its citizens.

1. Introduction

State-Owned Enterprises (SOEs) in any country are criticized as less efficient than the private sector. Since they are free from the risk of bankruptcy or even from competition in many cases, their slack management is not surprising. Members of an SOE labor union often enjoy higher job security, a relatively lighter workload and even higher compensation, including fringe benefits, than those in private companies, and this is why a labor union is militantly against any privatization plan. Politically motivated, the government often initiates projects using SOEs' budgets. In Korea, many under-utilized kinds of infrastructure are examples of such politically-driven projects. A low utility rate for services offered by SOEs dampens their financial imbalance even more. However, SOEs are not that keen about the need for reform. Rather, they have little motivation to change the status quo. So the question is: How can we make SOEs provide better services at a lower cost?

Although Korea's SOEs are not free from the above-mentioned problems, most demonstrate world-class performance. Incheon International Airport, for instance, has been rated number one in the ASQ global ranking by ACI for a decade.[1] KEPCO (Korea Electric Power Corporation) exhibits the lowest black-out rate in the world. KORAIL (Korea Railway Corporation) shows one of world's highest on-time arrival rates.[2] Even on the cost side, SOEs in Korea have maintained reasonably efficient

1) ASQ (Airport Service Quality), ACI (Airport Council International).

2) As a part of the evaluation system for SOEs, the Korean government introduced a so-called global comparative index system in which an evaluation is made based on the relative performance of an SOE compared to the best performing SOEs in the world. This comparative evaluation system has been abolished now since almost all Korean SOEs ranked top in the world, thereby rendering the global

and sometimes innovative management, although this may not be comparable with private companies.

What are the reasons behind the relatively good performance of SOEs in Korea? The most important explanatory variable is the Framework Act on SOE Management enacted in 1983, of which a revised version is now called the Act of the Management of Public Institutions. Among many features of the Act, there are two salient factors that have not changed since 1983: A central governance system and a strong evaluation system.

An SOE is one of the categories of the 323 public institutions in Korea.[3)] Among public institutions, SOEs have two distinct conditions: (1) It should be a corporation whose shares are owned by the government or by other public institutions controlled by the government. (2) Its revenue from the market should be more than 50 percent of its total revenue including the government budget. If a public institution does not meet any of these two conditions, it is categorized as a quasi-government organization (QGO). There are 30 SOEs in Korea as of 2016.[4)]

On the other hand, SOEs in Bulgaria have enjoyed a very high level of autonomy not only in their internal management but also in their project selection and even in their pricing. Each line ministry as the owner of the SOEs under its umbrella appoints the CEOs, but there is no formal evaluation process. There has been discussion on more centralized SOE governance in Bulgaria, but it could not overcome the resistance of line ministries and their SOEs.

This paper explains the SOE governance structure of Bulgaria, and tries to propose policy recommendations to improve the efficiency of SOEs in Bulgaria based on the Korean experience. Section 2 demonstrates the current standing of SOE governance in Bulgaria. Section 3 and 4 is the core part of the research which illustrates policy recommendations for the Bulgarian government regarding 31 key questions necessary for a good governance system for SOEs. For each of the 31 questions, different options are set side-by-side with their positive and negative aspects before a specific recommendation is proposed for Bulgaria. Section 3 focuses on governing bodies and policy tools for controlling SOEs, and Section 4 highlights an evaluation system, the most important policy tool for SOEs in Korea. Section 5 presents a

index useless.

3) These public institutions are public organizations designated as such by the government. Since the definition is rather vague, the number of public institutions varies slightly year to year. The common characteristic of public institutions is the influence of the government in the appointment of the head of the organization.

4) These are again divided into two groups: market-based SOEs with more than 85% revenue from the market, and semi-market based SOEs with more than 50%, but less than 85%, revenue from the market. There is no difference in the government policy towards those two groups. A list is available in the appendix 2.

summary and various conclusions.

2. Description of Bulgaria's SOEs and its Governance

2.1. Overview

As per the legal framework in Bulgaria there are two legal definitions. In this report, we will use the term SOEs referring to the first category of the following:

- **Commercial companies with state participation:** These are fully commercialized companies that apply Commercial Law rules and are referred to as companies with state participation. In addition to the general provisions of the Commercial Law the Regulation for Exercising the Ownership Rights in the Commercial Companies with State Participation stipulates the specific rules for governing those enterprises since they differ from the private companies. Enterprises with more than 50 percent of state participation are further governed by regulation No. 114 of the Council of Ministers for Monitoring of Financial Performance of SOEs (Attachment: List of enterprises with more than 50 percent state participation).

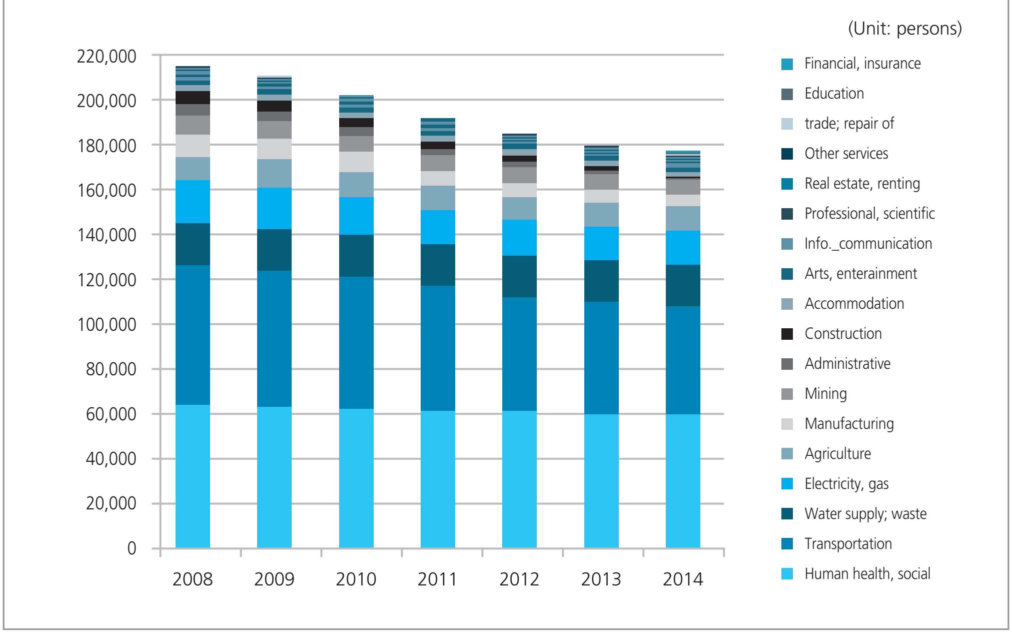
- **State enterprises:** Enterprises that are state budget based; most are regulated by the provisions of a particular Law. This corresponds to quasi-government organizations (QGOs) in Korea.

After a prolonged and hesitant privatization process, the public sector in Bulgaria was reduced to 157 companies where state participation is more than 50 percent.[5)] SOEs contribute about 5 percent of GDP and employ about 7 percent of the labor force. They are concentrated in several sectors such as medical services, transportation, water supply and sewage, energy (electricity and gas), and production of arms, by the order of its employment size.

In terms of GDP share in each sector, the largest sector is transportation, followed by medical services, energy, mining, water supply, and agriculture. The total GDP contribution by SOEs reached its peak around 2011 and is now in a declining trend.

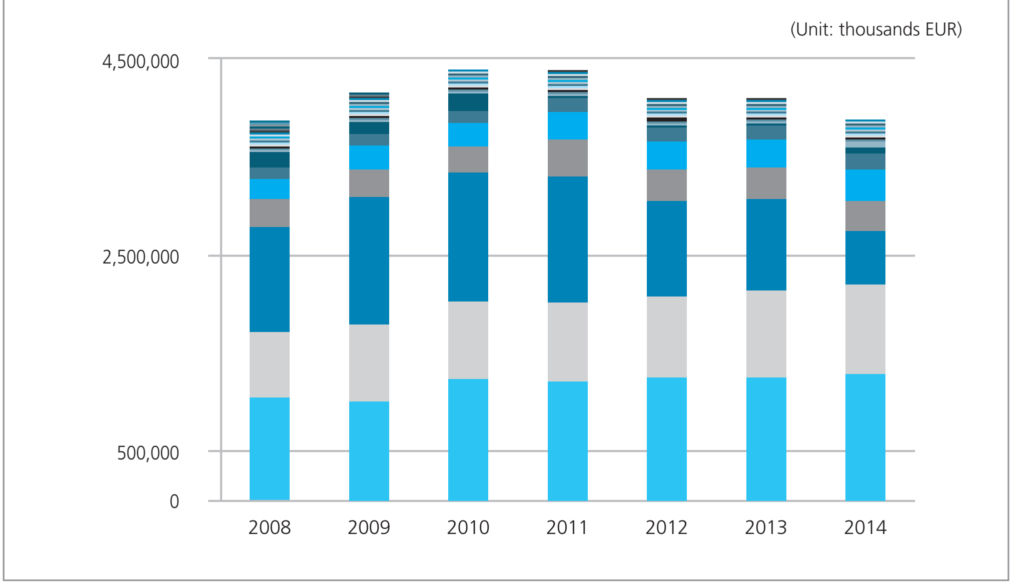
5) Without hospitals and enterprises with less than 50% state participation.

[Figure 1-1] Size of Employment in SOEs in Bulgaria



Source: National Statistical Institute (NSI). The NSI does not compile and publish data on SOEs sector. For the purposes of this project the NSI compiled data for 2014 based on the annual balance sheets and financial reports of SOEs.

[Figure 1-2] Total Value-added of all SOEs



Source: National Statistical Institute (NSI). The NSI does not compile and publish data on SOEs. For the purposes of this project, the NSI compiled data for 2014 based on the annual balance sheets and financial reports of SOEs.

2.1.1. General Problems for SOEs in Bulgaria

Performance in general is weak and the diminishing role of SOEs in the overall GDP and employment is a result of poor performance and management. A fully decentralized management system led to a rather wide range of performance. While some enterprises function efficiently, providing both public good and profit, others accrue huge deficits and burden the economy since non-serviced debts to the private sector and the state budget pose severe financial risks. The main challenges as regards the functioning of SOEs are as follows:

- Fragmented and often altered legal frameworks for SOEs. Full discretion of line ministers that lead to decentralized regulations and practices which vary between different ministries. Recently, two reports from the Bulgarian National Audit revealed that the line ministries do not efficiently exercise their responsibilities in managing state participation in the companies. In many ministries there are no internal rules for control over their performance, for the monitoring of business programs, for the evaluation of management, and the like. A recent IMF Article IV report also emphasizes that the weaknesses in SOEs governance pose a risk for economic and financial stability.
- SOEs are not sufficiently transparent
- Since 2010, the financial performance of SOEs is subject to regular monitoring and analysis according to regulation 114/2010 of the Council of Ministers. The data on each enterprise is published quarterly but not an analysis of the state-owned sector, nor is there a dynamic or comparative analysis.
- The board of directors and CEOs are directly employed without a selective procedure and clear job requirements. Management is subject to frequent change, rarely motivated by political preferences rather than the company performance.
- The dividend policy is unpredictable since the Council of Ministers makes ad hoc decisions every year. This puts the enterprises in an uncertain position and limits motivation for better performance. In past years, between 60 percent and 80 percent of SOEs' dividends went to state budget revenues, thus restricting opportunities for investment and innovation in the SOEs sector. In 2015, the government decided to request 50 percent of dividends from profits to be allocated to the state budget.
- Privatization halted in the last five years. Almost no privatization deals were concluded, though there were about 20 SOEs that are eligible for privatization.
- Severe decapitalization of enterprises with a minority stake of the state and difficulties in privatizing the minority shares. There is evidence that SOEs do not perform efficiently and that profitability is very low. According to 2014 financial reports for 152 companies with state participation over 50 percent, the net loss was 739 m BGN (496 m BGN in 2013). The main source of this loss

is the National Energy Company. Being the only sector where state enterprises prevail, this sector is the main source of financial losses. Among 152 enterprises, 60 sustained losses, and 5 had zero profit.

- Most of the SOEs are highly indebted. Three companies have debts over BGN 1 billion BGN (National Electric Company: BGN 3.5 billion, National Railway Company: approx. BGN 2 billion and Bulgarian Energy Holding: BGN 1.2 billion). Almost all energy sector companies are highly indebted.
- The SOEs spend fewer funds for R&D than the private sector. The SOEs share of total R&D dropped from 69 percent in 2000 to 36 percent in 2011.

2.1.2. Privatization Efforts

Privatization in Bulgaria was a huge and complex task. Prior to this and in the early years of transition, Bulgaria had an extensive industrial sector that represented approximately 60 percent of GDP. In addition, the private sector was practically nonexistent. The share of state property in the industry was about 95 percent. Companies were very large. Some 20 percent of companies had more than 5,000 workers and two-thirds had more than 1,000 employees. Only five percent of companies had less than 200 workers. The productivity structure corresponded to the Soviet industrialization model and the international division of the labor in the framework of the CMEA exchange system.

Privatization has been a slow process that has only accelerated since 1997. There have been several methods of privatization. The main methods were cash privatization, including MEBO sales, and mass privatization. Since 1997 with the consolidation of macroeconomic stability and external support, sales to foreign investors increased.

Privatization in the country is almost complete. The pace of privatization over the last few years has been slow. In the first half of 2014, only three deals were signed amounting to BGN 1.3 million. The total number of SOEs for privatization comes to about 20 rather small companies. The sales of minority state shares and the privatization of infrastructure branches (energy, electricity production, water supply, etc.) have yet to be finalized. The privatization of the postal service and other public services is expected in the long run. Therefore, what is a priority for Bulgaria is to improve the governance system for SOEs, which is the research question of this paper.

The Privatization Agency has almost exhausted its mandate and needs institutional changes. Among possible options, one is to merge with a new SOEs management authority. A similar pattern of institutional change was applied recently by most Central and Eastern European countries.

2.2. Governance System for SOEs

2.2.1. Governing Ministries

Practically all ministries govern SOEs in their respective sectors of competence as Appendix 1 shows. Although the Bulgarian model of SOEs management is rather decentralized, there are certain provisions that are obligatory for all enterprises with state participation. For example, all SOEs' long-term assets can be sold only through a tender based on the price determined by licensed independent appraiser and after the approval of the line minister. Loans, borrowing or lending by SOEs can be done only after approval of the line minister. Similar are the restrictions set up in the Privatization Law. A common mechanism is established, which determines the remuneration of managers, members of the board, and of CEOs. The remunerations in general should be related to results, but in practice this differs depending on the different ministries and enterprises.

An assessment of the SOEs is conducted only once a year, together with the approval of the annual financial reports and it is rather formal. There is no regular monitoring and control over the implementation of business plans.

The institutional framework for SOEs in Bulgaria changed several times, starting from a stronger Council of Ministers control on the key SOEs to a fully decentralized structure where the ministers exercise full state ownership rights. One of the main changes in the last few years was the establishment of holding companies in the sectors controlled by the state, like energy and road infrastructure. Most of the ministries have in their structure special divisions that deal with SOEs. Their primary objective is to support the minister in his capacity of representing the owner (the state) in the SOEs. These include:

- supporting the management of SOEs in performing their functions;
- preparing all the documents and positions of the state in the general meetings of the companies;
- preparing the legal acts for restructuring and closure of SOEs as well as the participation of SOEs in other companies;
- giving instructions as regards the management of long-term assets;
- preparing the management contracts and monitors their implementation;
- analyses the economic and financial performance of SOEs and preparing reports for the minster;
- monitoring the financial indicators as per the regulation of the Council of Ministers;
- monitoring the business plans of SOEs,
- in the case of bankruptcy of the SOE the department recruits and dismisses the

liquidator;
- supporting the established Audit Committees according to the Law for Independent Financial Audit;
- supporting the SOEs in their participation in the relations in tripartite committees (with trade unions),
- maintaining special register of SOEs; maintains a register of assets of SOEs;
- preparing the needed documentation in the case of privatization.

Since the management system is rather decentralized, the practice varies between the ministries and also depends on the scope of state ownership in the respective sector.

2.2.2. CEO and Board Member Appointment

The Bulgarian Council of Ministers (CM) or the minister of the specific industry branch (Branch Minister, BM) exercise ownership rights in the companies with state participation in the capital (CSPC). In these companies, where state participation composes just a fraction of the capital, the BM or its representative participates in the General Meeting of company, complying with the requirements of the Commercial Law. In the companies where all of the capital is provided by the state, the CM/BM act as a sole proprietor and appoints the Company Manager (in the case of Ltd. companies) or, the Board of Directors (BD), respectively the Supervisory and Managing Board (SB and MB) in the case of join-stock companies.

According to the powers entrusted, the sole proprietor:

- Selects and dismisses the Manager and Controller or members of the BD (SB and MB respectively);
- Determines the remuneration of the persons above.

The managers and the Board members in the Ltd companies and both physical and legal entities where permitted by the statutes of the shareholder companies. The number of members in the BD (SB and MB) is limited to five, except for the cases approved by the Council of Ministers. The number proposed by the *sole proprietor* must be in accordance to the share of the capital hold by the state.

The managers and board members are not allowed to serve on more than one managing or controlling board of the CSPC. Those individuals are subject of various restrictions in terms of their loyal and prudent behavior to the specific company if they are:

- carrying out of commercial deals*;

- being partners in limited or shareholding companies*;
- being CEO's or BM in other companies*;
- taking the managing and controlling positions if sentenced by the court;
- being ministers; MPs, mayors and such officials;
- civil servants;
- being on a work contract.

* The first three are applicable if the field of operation of the CSPC coincides with the activities of the person in question.

The managing bodies of the CSPC report on a quarterly basis to the relevant sole proprietor, about their service: corporate performance, fulfillment of the business plan, possible problems and correction measures. The sole proprietor agrees on the contracts with the persons in question; in some cases, it might be completed through a competition. The contracts are for a maximum of 3 years.

The contracts include the amount and forms of remuneration and a pledge regarding the performance of their duties. They also include a business plan on the whole mandate of the governing bodies, complying with the strategy of the company. It must be specific and hold economic targets, such as profits, market share, and employees.

Remuneration of CSPC managers and board members is supposed to be determined in accordance with the size of the long-term assets, the number of personnel, profitability, financial performance, the value added of an employee, servicing of company debt and more specific obligations, taken in the contracts. The final value is based on quantified indices and the minimum national salary for the specific month and limited to a five-month cap. It is expanded for executive members and managers representing the companies with a limiting cap up to 12 min salaries.

Remuneration is determined and revised each quarter based on the achieved targets. Additionally, in case of a profit growth, a bonus is provided from the earnings after tax and dividends, though it is limited to one average monthly payment to the board members.

2.2.3. Dividend Policy

There are two key issues as regards the dividend policies: how much of the dividend remains in the company (what is the share provided to the state budget) as well as when the dividend is to be paid. Dividend policies in both aspects were rather unstable in the past few years. These policies are not stipulated in the Law but are subject to Government decisions. Certainly, this provides the Government with flexibility and the revenues from the dividend of SOEs could well serve as a buffer in difficult budgetary times, but the uncertainty poses severe risks for the management of SOEs. A number of years ago the dividend policy was fixed in the State Budget Law, but this practice was recently abolished.

The other problem is that the state drains the dividends from enterprises. In the last few years the budget collected from 60 percent to 80 percent (after taxation) of dividends, which is an extremely unfavorable policy as compared to OECD countries. Furthermore, a more stringent policy is applied to some SOEs which perform well: for example, for Sofia Airport Ltd, the share from the profits provided to the budget is 90 percent. In the past, the state as the owner of the SOEs established overly flexible dividend policies, listing ten SOEs for which additional sums (beyond 80 percent) had to be provided to the state budget (Regulation No. 285/2013 of the Council of Ministers).

2.2.4. Managerial Autonomy

State-owned enterprises in Bulgaria are separate legal entities. They are registered in the Court as commercial companies and have their own capital provided by the state. They possess high managerial autonomy. The managers appointed by the line ministries have the right to make decisions that affect the strategic and operational problems of companies including to hire and fire staff, sign contracts with their commercial partners and to manage their finances. Managerial autonomy is limited in making these decisions is sought sanction from the state body that performs the functions of the owner of state capital:

- profit sharing and its payment and payment of bonuses to managers and their size;
- solutions to reduce and increase capital;
- determine the remuneration of managers;
- elect an auditor of the company;
- decisions to open or close branches and participating in other commercial or civil companies;
- on the acquisition and disposition of real estate and property rights;
- decisions to acquire or dispose of shares or shares-owned by the company in other companies, as well as acquisition or disposal of financial fixed assets of the company abroad;
- decisions for filing claims against the company manager or supervisor and appointing a representative to conduct trials against them;
- solutions for additional cash contributions;
- permission for lending to third parties and to grant security in favor of third parties; the conclusion of a judicial or extrajudicial agreement, which recognized obligations or forgive debt;

- where authorization to dispose of fixed assets, lease real estate with a carrying amount that exceeds 5 percent of the total book value of fixed assets as on December 31 of the previous year; conclusion of credit agreements for cooperation in meeting promissory liabilities;
- selects the insurer before the conclusion of contracts compulsory insurance of property;
- permission for a mortgage and pledge of fixed assets of the company;
- appoint the liquidators at the company.

2.2.5. Internal and External Audit

An internal audit in state-owned enterprises is carried out according to the Law on Internal Audit in the public sector (Prom. SG. No. 27 of March 31, 2006). Under the law, all state-owned companies should employ internal auditors who have special training and qualifications. An internal audit helps the company to achieve its goals by:

1. Identifying and assessing risks in the company;
2. Assessing the adequacy and effectiveness of financial management and control with regard to:
    a) Identification, assessment and risk management of the company management;
    b) Compliance with laws, regulations and contracts;
    c) Reliability and integrity of financial and operational information;
    d) The effectiveness, efficiency and economy of operations;
    e) The protection of assets and information;
    f) The implementation of tasks and achievement of objectives;
3. Recommendations for improving the activities of the company.

Large state enterprises and designated as 'enterprises operating in the public interest' from the following sectors: energy, trade and transit of natural gas, water, sewage and telecommunications services, and the "Bulgarian State Railways" EAD and its subsidiaries must have an audit committee. The Audit Committee performs the following functions:

1. Monitoring the financial reporting processes;
2. Monitoring the effectiveness of internal control;
3. Monitoring the effectiveness of risk management;
4. Monitoring the independent financial audit.

An external audit of state enterprises is done by selected by the AGM auditors and by the Bulgarian National Audit Office (BNAO). The BNAO audits are performed according to the annual program.

3. Policy Options to Improve Institutional Framework for SOE Governance

3.1. Governance Structure

3.1.1. Centralized vs. Decentralized Governing System

SOEs in Korea are under the control of two different government bodies. A relevant line ministry takes care of the business side of its SOEs, whereas the Management Committee chaired by Minister of MOSF (Ministry of Strategy and Finance) is in charge of the management side of all SOEs. Since the Committee and MOSF controls most of the managerial leverage such as evaluation, control over the number of staff, budget and remuneration, we can say that SOEs in Korea are centrally governed.

There are many benefits to the central governance system. It can minimize the collusive behavior between an SOE and the relevant ministry which has been a source of inefficiency of SOEs. In conducting its policies, a line ministry often utilizes SOEs flexible budgets, and it can even enjoy post-retirement positions at the SOEs. In order to maintain such benefits, the line ministry is in general averse to the privatization of SOEs. The ministry may also have a tendency to tolerate overly generous compensation and surplus employment in SOEs. The OECD, therefore, recommends the central governance system to member countries. However, the central governance system may turn out to be rather inflexible since universal rules and regulation should be applied to all SOEs under different ministries.

〈Table 1-1〉 Governing System for SOE

	Positive	Negative
Central system	- Tighter and more efficient management - Better for privatization	- Inflexible management - Conflicts with the line ministries
Decentralized to line ministries	- Flexible management for each SOE	- Collusion between line ministry and SOE

The recommendation for Bulgaria is the first option. Bulgaria does not have a centralized agency to manage SOEs, and instead each line ministry plays an ownership role. The current institutional framework gives unlimited powers to the line ministries in managing SOEs. That is why the practices applied by different ministries are rather different and control over their performance is weak. There was an attempt in 2010 with Regulation 114/2010 to give more power to the Ministry of Finance in monitoring the performance of SOEs with a focus on their financial situation. This did not lead to centralization or a strengthening of control, but instead the line ministries simply started to publish their SOEs' quarterly financial reports on the Ministry of Finance web page. This attempt proves resistance to reforms in the status quo. The worsening financial situation of most SOEs, though, calls for a stronger and speedier reform process. This paper suggests a centralized system for Bulgaria in institutional reform. The main benefits of this option would be the introduction of uniform management practices, avoidance or a decrease of political influence over the nomination and replacement of CEO and boards of directors, as well as the introduction of an evaluation system.

3.1.2. The Central Body: Should It be a Committee or a Single Ministry?

The central governance system will touch off some resistance from line ministries which will have to lose some of their control over SOEs. It is therefore useful to establish a Management Board, which in Korea is named the Management Committee for SOEs. Being composed of vice-ministers of major line-ministries with SOEs, the Committee in Korea is an arena where major policy decisions on SOEs are coordinated and finalized. However, the Committee in general can slow down the decision-making process, and can make accountability a little unclear. In Korea, the speed of decision-making is an issue especially in the process of CEO appointments because the Committee cannot convene as frequently as it should be. Accountability is not an issue in Korea because it is clear that the decisions by the Committee are mostly driven by the Secretariat, which is a Bureau of Public Institution under MOSF.

〈Table 1-2〉 Management Committee for SOE

	Positive	Negative
No such Committee (Instead, one central agency)	- Faster decision-making - Better incorporation of the specific sectors' concerns - Freedom and flexibility at the company's decision making level	- Difference in practices between the line ministries - Limited control
Establish a Committee	- Participatory decision-making - Useful inputs from themembers - Harmonized rules for the management - Sustainability of management and investment policy - Transferability of best practices	- Economy of scale: it is expected that the staff of departments dealing with SOEs in each ministry should be limited since some of the functions will be transferred to the steering Committee - Shared accountability

The recommendation for Bulgaria is the second option. In order to ease expected resistance from line ministries, it will be useful to have a Committee with a presence of line ministries. A tentative name for the Committee could be the 'Steering Committee for SOEs Management'. Each line ministry will maintain its control over the business side of SOEs as is the case in Korea. The most important question is which functions will be transferred to this Committee. The Committee should discuss topics, which are mainly related to the unified governance of the SOEs. The line ministers should keep their role with respect to the strategic governance of the companies in their sector. More specifically, the line ministers should be responsible for the topics and the issues, which are relevant to the general policy of the sector that they govern, in case that general policy is fulfilled by SOEs.

3.1.3. Who Should Play the Role of Secretariat of the Management Committee?

The central governing Committee needs a Secretariat whose role is to assist the decision of the Committee. There are four candidates for the Secretariat. The first option is a ministry in charge of the national budget. The second option is a ministry in charge of planning or economic policy. The first and the second option results in the same ministry in Korea since both functions are in one ministry, MOSF.[6] The third option is the Prime Minister's Office. Finally, we may create a new government body independent from ministries specializing in the management of SOEs. In option one–through three, the Secretariat of the Management Committee should be placed under the corresponding agency, whereas that of option four will be newly created and placed directly under the Committee. Each option has strengths and weaknesses as explained in the following table.

Korea followed the first option for an extended period of time. Though the ministry name has changed on a number of occasions,[7] the ministry with a budgetary function has always been the central agency in charge of SOE governance. The reasons are as follows. First, many SOE policies are boiled down to fiscal implications. Second, the budget office has accumulated knowledge on the line ministries and their SOEs. Third, it does not carry its own SOEs, which makes the budget office neutral. One problem for the budget office being the central agency is that, with a view to minimizing budgetary support for SOEs, it may allow SOEs to earn revenue from the market that should be enjoyed by the private companies rather than the government. However, this is not a problem in Bulgaria because SOEs in Bulgaria are prohibited from state aid.

6) In 2008, two ministries in charge of planning and budget (Ministry of Planning and Budget) and economic policy (Ministry of Finance and Economy) were merged in Korea.

7) Economic Planning Board (1961~1994), Board of Finance and Economy (1994~1998), Planning and Budget Commission (1998~1999), Ministry of Planning and Budget (1998~2008).

〈Table 1-3〉 Candidates for Central Agency

	Positive	Negative
Ministry with Budget Office	- Power for implementation - Some experience inmonitoring the SOEs financial performance - Stringent budgetary control - Implementing the state aid rules as per the EUrestrictions	- The mandate of MOF is focused on the state budget and dealing with SOEs may defocus from the main priority fiscal policy and financial stability - No expertise in different sectors of the SOEs, limited experience in SOEs management - More resistance from line ministries since MOF is already a strong ministry
Ministry in charge of Economic Policy	- Policy of SOEs is one of economic policies - Extensive experience in managing SOEs in a broad sector range - In the EU SOEs management falls within the competence of DG Industry	- Its mandate on economic growth may encourage SOEs' expansionary position. - Does not have expertise in some sectors where the state participation is crucial (infrastructure, health, etc.) - Limited power of the Minister of Economy, no fiscal and financial tools
Prime Minister's Office (PMO)	- Neutrality	- SOE management may not be so important for PMO - Insufficient staff, expertise and experience in SOEs management
Separate Secretariat Committee	- Specialization andNeutrality - Can be compromise among ministries	- It may not have enough of leverages for SOEs. - The new creation of government agency will take time

The recommendation for Bulgaria is option four. An independent Secretariat is the best option because it can create a neutral, specialized body. The Ministry of Economy is one good option but neutrality is an issue because there are many SOEs currently under its auspices. The MOF is another good option but its central role will touch off a strong resistance from line ministries since the MOF is already a strong ministry. A conflict over the selection between the MOE and MOF for the central agency's role could ruin the whole reform process. Although the creation of a new administrative body may be difficult, it will be easier than a choice between the MOE and MOF. The chairperson of the Management Committee will have to be at a minister level.

3.1.4. Composition of Management Committee

The Management committee for SOEs in Korea is chaired by the minister of MOSF and is composed of vice ministers and experts who are mostly professors, lawyers or public accountants. There are three options for its composition: civil servants only and civil servants plus experts, and finally the inclusion of the labor union. There are many decisions made by the Committee that have a direct and significant impact on employers in SOEs. Therefore, the involvement of labor union members in the Committee makes sense, but it may seriously slow down the decision-making process. Korea allows the third option by law, but in effect follows option two. Labor unions in Korea are rather militant, so their members have not been seriously invited to the Committee yet. By and large, the Korean system has proven successful in enforcing more transparency and openness in the process.

〈Table 1-4〉 Composition of the Management Committee for SOEs

	Positive	Negative
Civil servants only	- Faster and more realistic decision making process	- Opacity
Civil servants + experts	- More neutral and diverse view provided by the experts	- Experts have a limitation in checking the central agency only to slow down the process
Civil servants + experts + labor union	- Openness - Participation of major stakeholder	- More difficult decision making - Information leakage

The recommendation for Bulgaria is option two. Bulgaria has extensive experience in inviting external experts in governing bodies and decision making as regards state affairs. Recently, external experts were broadly invited in the public procurement procedures but the results were not encouraging since the invited external experts tend to also be dependent. In spite of this, option two seems to be appropriate for Bulgaria as well for the following reasons: i) The outside experts will closely observe current SOEs performance and will serve as a public watchdog; ii) They will act like independent directors in the listed companies; iii) They will help increase transparency of SOEs. These experts should be nominated by a special selection procedure which needs to be elaborated. It would set professional requirements for experts, determine who has the right to nominate them, and who and how the experts should be selected. The current legal framework, particularly Article 19 of the Regulation for Exercising the Ownership Rights in the Commercial Companies with State Participation sets up the requirements for the CEOs and the members of the decision making bodies of SOEs, for example, boards of directors and supervisory boards. The regulation says who cannot be, instead of who could be, members. There are restrictions for Members of the Parliament, persons who perform similar business activities, etc. Similar rules can be applied to the non-government members of the Steering Committee. It is not recommendable, however, for the central agency or Steering Committee to include members from labor unions. The labor unions in Bulgaria participate in the tripartite cooperation counsel, along with the government and the employers' organizations. There have been many cases in which decision making was delayed due to the questions and concerns raised by the labor unions. Should the labor unions participate in the Steering Committee, quick decision making will not be possible.

3.1.5. Who Should be Centrally Governed?

There are other types of public institutions in both Korea and Bulgaria. Those whose revenues mostly come from the government are called quasi-government organizations (QGO), and they are also governed by the Management Committee in Korea. However, the central agency can only supervise SOEs leaving QGOs in the hands of line ministries as in the second option.

〈Table 1-5〉 Coverage of Central Governance

	Positive	Negative
Both SOEs and QGO	- Equal treatment for both SOEs and QGOs who have many similarities	- Identical treatment for both SOEs and QGOs despite their difference
Only SOEs	- Less conflict with line ministries - Different treatment for QGOs	- Loose management for QGOs

The central agency in Korea only covered SOEs until 1998 when the Planning and Budget Commission later renamed as Ministry of Planning and Budget (MPB), first tackled the inefficient operation of QGOs. Although the intervention of the MPB was lacking in legal background, line ministries had to stay silent because it was right after the financial crisis of Korea in 1997. The MPB realized the need for a legal foundation that enabled it to cover not only SOEs but also QGOs because those two types of public institutions have a lot in common. Since 2007, both SOEs and QGOs have been governed by the Act on the Management of Public Institutions.

An SOE and QGO have both many similarities and dissimilarities. They provide a service to citizens on behalf of the government, and their CEOs are appointed by the government. Both SOEs and QGOs can collude with their relevant line ministries. However, QGOs' revenue mostly comes from the government and not from the market, which makes them much more dependent upon the line ministries than

SOEs are. In other words, SOEs need to have more managerial flexibility than QGOs do, and this is why there is an argument in Korea that MOSF should return its grip over QGOs to line ministries.

The recommendation for Bulgaria is option two, unlike Korea. Bulgaria's central agency will have to cover only SOEs, leaving QGOs in the hands of the line ministries. QGOs in Bulgaria are called state enterprises. Including QGOs in the hands of the central agency may drive the whole reform process into a cul-de-sac. In Bulgaria most QGOs are created by specific laws where their functions and the ways they operate are fixed. This supports the choice of the second option proposed above of not changing the existing system with the exception maybe for closer monitoring of their functions. Depending on the relative performance of QGOs compared to SOEs, the central agency can raise this jurisdiction issue later. It is suggested that Bulgaria's central body also cover privatization and post-privatization functions and governance of enterprises with a minority stake of the state. However, it is recommendable for Bulgaria's central agency to apply the function review to QGOs which will be explained later in this paper.

3.1.6. Open Recruitment vs. Direct Appointment for CEO

Although open public recruiting is a standard process for any appointment position, there are some problems as listed in the following. Sometimes, the most eligible person may not apply for the position for fear of losing in the open competition. Occasionally the one with the appointive power, such as the Office of the President, unofficially pre-designates the winner of the recruiting procedure, making the whole process useless. The open recruiting process also prolongs the appointment process.[8)] There is an argument in Korea that the current system has lower accountability than the direct appointment by the President since an intervention by the President or the Office of the President is camouflaged by a seemingly open and fair process. More important positions, such as cabinet ministers, are directly appointed by the President of Korea. The people accept the President's selection since the ministers' qualifications are examined in a Congressional Personnel Hearing. In this respect, direct appointment, coupled with an open public hearing, emerges as an effective way to recruit the most qualified person for the position. A public hearing for CEOs can be conducted by the central agency. There is a third option in which the one with appointive power chooses between option one and two for each case.

8) Sometimes a CEO position is vacant for more than 6 months to complete the process.

〈Table 1-6〉 Methods of Recruitment

	Positive	Negative
Openpublic recruiting	- Minimize collusive behavior - Maximize transparency	- Time consuming - The most eligible may not apply. - Pre-designation by the appointer can make the process useless.
Direct appointment with public hearing	- Clear accountability of the appointer	- May open a door for corruption due to limited competition
Mix	- Effectiveness of the system	

The recommendation for Bulgaria is the first option. The current legislative framework does not require a public recruitment process for CEOs and boards members although the rule says that an open procedure may be applied.[9] However, no minister prescribes such rules and opportunities, and therefore the practice is always a direct appointment by the responsible minister. There are no selection procedures, job requirements, public announcements, etc. Very often the appointees are simply political nominees without proper credentials and experience. Improving the procedure for the appointment of the CEO of a SOE is of crucial importance for its better governance. A more transparent and competitive procedure might be achieved if the full discretion of the minister is limited and an open selection procedure based on concrete qualification criteria is conducted. The open procedure certainly requires more time and qualified candidates may choose not to apply, but the benefits of the open procedure are enormous and will contribute to the better performance of SOEs. However, introducing a competitive recruitment process will be a radical reform that will limit political interference and that is why it will face resistance from political parties.

3.1.7. Who Should be Involved in the CEO Appointment Process?

The CEO appointment process in Korea is rather complex. The first step is the CEO Recommendation Committee in each SOE which is composed of non-standing board members and invited outsiders on an ad hoc basis, without any SOE insiders. In principle, the Board of Directors should play the role of the recommendation committee, but the Korean government wanted to separate the process from insiders. This committee accepts open applications, and selects –three to five adequate candidates. The second step is the Management Committee for SOEs chaired by the minister of MOSF, which narrows down options to –two to three

9) “The management of the SOEs could be assigned after a competitive procedure set up by the minister.” (Regulation for Exercising the Ownership Rights in the Commercial Companies with State Participation).

candidates. This decision by the Committee is supposed to be seconded by the relevant line minister, which is only a rubber stamp process. The third step is the appointment by the President of Republic of Korea.[10)]

[Figure 1-3] Process of CEO Appointment for SOEs in Korea

Sequence	1st step		2nd step		3rd step
Who	CEO Recommendation Committee (RC)	⇒	Management Committee (MC)	⇒	Appointment by the President
Where	In each SOEs		Under MOSF		
Role	Public open application Select 3–5 candidates	⇒	Review of candidates Narrow down to 2–3	⇒	

There are four different types of CEO appointment process. One extreme is Korean model that follows for all three steps. The other extreme is a direct appoint without the first step of open recruiting by Recommendation Committee (RC) and without the second step of review by the Management Committee (MC). There are two variations in-between the two extremes. Korea follows the first option of open public recruiting.

〈Table 1-7〉 Those Involved in the CEO's Appointment

	Positive	Negative
Both RC and MC	- Transparency - Finding the most suitable person	- Time consuming - The process may not be respected
Only MC	- Minimize collusive behavior	- Too much power of the central agency
Only RC	- Accountability of each SOE's Board of Directors	- Possibility of collusive behavior if the Board is not fully accountable
Neither RC nor MC (direct appointment)	- Time saving - Accountability of the appointer	- Too much discretion of the appointer

10) The CEO Appointment process for QGOs is relatively simpler than that for SOEs in that it does not go through the second step. The CEO of QGO is appointed by the relevant line minister rather than the President unless there is a separate specification.

The recommendation for Bulgaria is the third option (only RC, skipping the second step) in which each Board of Directors (or Recommendation Committee) in SOE narrows down the applicants to –two to three candidates so that the appointer appoints the best performing candidate. The second step of the Management Committee will not only slow down the appointment process but also will create a huge resistance from the line ministries who have to share their appointive power with the central agency.

3.1.8. Who Appoints the CEO and Board Members?

The CEO of the SOE is appointed by the President in Korea, whereas in Bulgaria it is by the line ministers. There are four possible appointers of CEOs of SOEs: political leaders such as the President or Prime Minister, the Chair of Steering Committee (or central governing agency), relevant line ministers, or Chairman of Board of Directors.

〈Table 1-8〉 Who Appoints the CEO?

	Positive	Negative
Political leader (President, or PM)	Strengthen the independence of SOE	Less delegation from the top
Chair of Management Committee	Strengthen the power of the central agency	Resistance from line ministries
Relevant Line Minister	Accountability of the line ministry	Possibility of collusion
Chairman of Board of Directors	Accountability of the BoardIndependence of SOE from line ministries	Weak accountability of Board members

The recommendation for Bulgaria is option one or option three. It is a highly political decision to select option one. Bulgaria may find it very difficult to deviate from the current third option when the central agency takes a controlling power away from the line ministries. However, the source of inefficiency in SOEs is the collusive behavior between the line ministries and SOEs which will be reduced if the appointive power is given to political leaders such as the President or Prime Minister. If CEOs are appointed by a political leader, the relationship between the line ministry and the SOEs will become a little more horizontal and less collusive. Support for option three will depend on the fairness and openness of the recruiting process.

3.1.9. Composition of Board Members

The general rule is that the board needs to operate as a representative of the whole entity. Regarding the composition of the board, there are three models: all insiders without non-standing members, all outsiders, or a mixed composition. Korea follows a mixed composition: more than half of the board members are composed of outside non-standing members.[11] However, some SOEs like four port authorities[12] have boards of directors composed of only non-standing outsiders, with the exception of the CEO. In this case, the board is dominated by outsiders, which makes the board much more independent from inside executive managers.

〈Table 1-9〉 Composition of Board Members

	Positive	Negative
All insiders (no non-standing members)		High possibility of collusive behavior
CEO is the only inside board member	Strong role of the board	Burden of the CEO
Mixed composition	Middle of the Road between two extremes (option 1 and 2)	

The recommendation for Bulgaria is the second option. The mixed composition of the Bulgarian public boards is a legal requirement and it is advised by the OECD to follow such a procedure for the SOEs as well in order to enhance the objectivity of SOE boards. It is important to nominate a sufficient number of competent non-executive board members who are capable of independent judgment. These board members should have the relevant competence and experience and it is advisable that they be recruited from the private sector. It will help in making boards more business-oriented, particularly for SOEs that operate in competitive markets. Their expertise could also include qualifications related to an SOE's specific obligations and policy objectives. Bulgaria may want to expand its public companies' legislation over the SOE and confirm the mixed composition if not the second option.

3.1.10. Who Appoints Non-standing Board Members?

The appointment process for non-standing board members in Korea is similar to the CEO position except that the appointment is made by the MOSF minister, not by the President of the Republic of Korea. It is notable that the non-standing board members are appointed neither by the relevant minister nor by the CEO of the SOE. This is a way to guarantee the objective role of the non-standing board members in

11) These non-standing members are appointed by the minister for MOSF, and they are supposed to play a role in the checks and balances process of board operations.

12) There are four Port Authorities in Korea: Busan, Incheon, Ulsan, Yeosu.

checking the CEO.[13] Standing executive board members are by law supposed to be appointed by the CEO, but sometimes this is influenced by the relevant ministers in Korea.

〈Table 1-10〉 Who Appoints Non-standing Board Members?

	Positive	Negative
All insiders (no non-standing members)	Checks and balances with insiders of the board	Time consuming process
CEO is the only inside board member	Harmony between SOE and the relevant line ministry	Too much influence of line ministry on SOE
Mixed composition	Autonomy of SOE	Weak checks and balances

Recommendations for Bulgaria somewhere between the first and the second option. It is important to change the current practice in which the line ministers alone appoint board members, including the CEO, without any prescribed rules and requirements. The power of appointment can be shared by the two: a half of non-standing board members appointed by the central agency, and the other half by the line ministry. Alternatively, it may stay with the line minister but the whole process can be regulated and supervised by the central agency. In Bulgaria, the nomination and selection of all board members should follow same procedure as the CEO. That is enforced by the fact that according to commercial law in Bulgaria, all members of the board have equal rights and obligations. As in Korea, though contrary to some other countries, in Bulgaria the executive director is also a member of the board, and the executive director is empowered by the other members of the board to represent the company in accordance with the board's decisions.

3.2. Policy Tools for SOEs by the Central Agency

The Management Committee (hereafter, the Committee) in Korea has diverse leverages on SOEs. This part will investigate whether those policy tools are applicable to Bulgaria.

3.2.1. Input Control

In Korea, the central agency controls the budget, employment, internal organization, and remuneration of SOEs in a very tight manner. It is safe to say that MOSF controls all those policy tools for the SOE since the MOSF minister is the chair of the Management Committee, and since the Secretariat of the Committee is an internal organization of MOSF.

13) Insiders are a CEO and standing board members of the SOE who are appointed by the CEO.

There are three different approaches for input control. First, strict approval may be required as in Korea where all the inputs variables are approved by MOSF. Second, after basic guidelines are provided, the efficient use of the inputs is assessed by a formalized monitoring and evaluation system. Third, we may grant full autonomy to the SOE for its inputs when we can enforce an evaluation on its final performance.

〈Table 1-11〉 How Much to Regulate the Inputs for SOEs?

	Positive	Negative
Approval for major input variables	Tight control of SOE efficiency	Lack of autonomy
Setting input guidelines and Ex-post monitoring and evaluation for inputs	Harmony between autonomy and efficiency	
No ex-ante intervention and Ex-post Outcome Evaluation	Autonomy of SOE	Possibility of inefficiency

The recommendation for Bulgaria is the second option. In principle, control over input variables is not necessary when the outcome is clearly measured. However, since it will take time for the outcome index and strict evaluation system to be developed in Bulgaria, controlling inputs makes good sense. However, option one appears to involve too much intervention by the central agency. Guidelines coupled with ex-post monitoring will be enough to strengthen the efficiency of SOEs. With initial guidelines, ex-post monitoring will be much easier. In Bulgaria input control is delegated to the line ministry within the framework of the control over the business plans implementation. The management of the SOEs is obliged every quarter to present written report to the line minister as regards the results of their activities in implementing the business plan of the company, the financial situation, the weaknesses and the measures undertaken for their resolution.[14)] The three-year business plans have to consist concrete economic indicators. Regulation, though, fails to prescribe clearly the compulsory indicators for the performance of SOEs. This makes the practice and the assessment very weak. The entire process rests at the discretion of the line ministry. The ministries do not set up performance targets. Recently the national audit chamber has performed an evaluation of the control performed by two ministries on the SOEs' business plans. The result in both cases was worrying. The reports state that there is no internal procedure involving reports on neither business plans nor an evaluation of results. The ministries do not prepare regular reports on the economic and financial performance of the SOEs under their control.

14) Act 23 of the Regulation for Exercising the Ownership Rights in the Commercial Companies with State Participation.

3.2.2. Input Regulator

The next question is who should set the input guidelines and conduct ex-post monitoring to check whether each SOE satisfied the guidelines. In Korea, the result of the monitoring is an important part of the management evaluation that will be explained in the next section. There are three options, as follows: the Chairman of the Committee, Relevant Line Minister, and Chairman of the Board of each SOE. If input control is necessary to enhance the efficiency of SOEs, the central agency's direct involvement is unavoidable. However, SOEs will be seriously resistant to these new regulations on their salary, new hires, etc. The decision should be made based on this pros and cons for strong input control by the central agency.

〈Table 1-12〉 Who Regulates the Inputs for SOEs?

	Positive	Negative
Central Agency	- Efficiency	- Resistance of the lineministries - Same treatment for different SOEs
Relevant Line Minister	- More information	- Possibility ofcollusive behavior
Chairman of Board of Directors	- Autonomy of SOEs - Flexible management	- If the Board has low accountability, serious collusive behavior is expected

The recommendation for Bulgaria is the first option, as practiced in Korea. As long as Bulgaria introduces a more centralized governance system, the central agency should assume such roles. The second and third options will simply open the door to collusive behavior. As was discussed earlier, however, controlling the business plan should remain with the line ministries since they do understand the sectors better than the central agency.

3.2.3. Project Control

Normally SOEs' projects are controlled by the line ministries unless the projects are financed by the government. Korea has maintained the division of labor between the line ministry (projects and business) and MOSF (management and evaluation). However, the line ministry has been inclined to be generous for the new projects of SOEs since both the ministry and SOEs have enjoyed the expansion of business even when it is not profitable. This collusive behavior resulted in huge debts in many SOEs. Therefore, the Korean government recently introduced a pre-feasibility study for SOE projects even though they are not financed by the government. The pre-feasibility study for government projects has been conducted by the KDI (Korea Development Institute) since 1999, and non-budget SOE projects became a recently added mission for the KDI. There are three options for the project intervention by the central agency. First, no intervention is called for unless the project is funded by the government. Second, even projects funded by a SOE's own revenue are controlled if the amount exceeds US$10 million. Third, one may lower the floor to US$1 million in order to control more SOE projects. In Korea, the floor is presently US$50 million.

〈Table 1-13〉 Should Projects of SOEs be Controlled by the Committee?

	Positive	Negative
(1) Only projects by government budget	Autonomy of SOEs	Possibility of over-expansion
(1) + any projects with more than US$10 million	Target only large projects	Few projects are controlled.
(1) + any projects with more than US$1 million	Tight control over SOE projects	Loss of autonomy of SOEs

The recommendation for Bulgaria is option one. The line ministers should deal with project control and planning when such projects are related to the execution of governmental programs and strategies. When the projects are related to operational activities, then the management of the company has to have autonomy and flexibility. The current practice in Bulgaria is that all investment projects are part of the business plan and the line ministry controls their implementation as much as it controls the business plan implementation. In cases where the state budget is involved, this falls within the EU state aid rules. In order to receive approval, such investments follow a strict EU procedure including permission from the European Commission. Since the government receives the bulk of the profit (60 to 80 percent) there is not much room for large investments by SOEs. There is no risk for over-expansion. The problem in Bulgaria is just the opposite. The limited investment makes SOEs non-competitive and their products and services difficult to penetrate the market except in areas where they have monopolistic positions. This is one of the reasons for their weak performance. Reforms need to give more room for investment by the SOEs. It is not just who is going to control the investment, but how to provide opportunities for investment.

3.2.4. Information Disclosure

Korea has regulated 323 public institutions, including 30 SOEs, to upload their managerial information on Alio, an integrated website (www.alio.go.kr). It includes 37 pieces of information, such the level of employment, salary, budget, fringe benefits, debt level, etc. It also provides information on job openings, tenders of

SOEs, and best practices. The benefit of an integrated system comes from the easy comparison of different SOEs. When the integrated website was first opened, however, there were many discrepancies between information on Alio, the respective internet homepages of each SOE, and the accounting report. Some were simple mistakes, but some were intentional. MOSF asks each SOE to punish personnel who are responsible for incorrect information being submitted to Alio. MOSF is working to improve Alio to the level of the DART (Data Analysis, Retrieval and Transfer System) which is an on-line information disclosure system for private companies listed on Korea's stock market.[15] Depending on the level of enforcement, there are four approaches. Korea took the first option.

〈Table 1-14〉 The Enforcement Level of Information Disclosure

	Positive	Negative
Integrated website with punishment for false info	Strong impact	Burden for SOEs and their resistance
Integrated website without punishment	Easy implementation	Possibility for many false info
Enforce info disclosure thru respective internet homepage	Easier implementation	Difficult to compare info of different SOEs
Recommend SOEs to list information on their homepage	Easiest implementation	Weak impact

The recommendation for Bulgaria is the second option for the time being. Bulgarian SOEs are not sufficiently transparent and this is one of the main reasons for their weak performance. SOEs should disclose material information on all matters prescribed by the best corporate governance practices, while additionally focusing on areas of significant concern for the ultimate owner, the general public. This means that in addition to the third proposed option, it needs to report to a centralized reporting system for public companies, something akin to the Alio system or DART in Korea. However, the punishment clause seems to be somewhat excessive since it may invite serious resistance from SOEs. As for the legal framework, they are obliged to present their annual reports and accounts. Currently, the quarterly reports of SOEs with more than 50 percent state participation may be also found in the Ministry of Finance web page, but it is neither comprehensive nor accurate. If this is the case even after the mandatory information disclosure through an integrated web site, Bulgaria can move on to the first option.

15) The DART is managed by Financial Supervisory Service in collaboration with KRX (Korea Exchange). For more information on DART, please visit englishdart.fss.or.kr/.

3.2.5. Customer Satisfaction Survey

Every year, all SOEs in Korea should conduct a customer satisfaction survey. In order to guarantee the objective survey process, MOSF, not the SOEs, designates one consulting company to conduct a survey for all SOEs. Each SOE negotiates with MOSF over the definition of customers, the method of the survey, and the questionnaire. The result of the survey is one index in a management evaluation that will be explained in the next section.

As the survey has been conducted over the years, almost all SOEs receive a score over 90 percent, making the survey lose its differentiating power as an evaluation index. Some people say that this is a result of the efforts by SOEs to enhance customer satisfaction, but some say that the equally high score for all SOEs is a result of customer manipulation. Although both arguments are not wrong, the truth seems to lie closer to the positive interpretation: It cannot be denied that the survey has contributed to the enhanced satisfaction level of customers. Defining their customers and their needs, the questionnaire turned out to be a very educational process for SOEs.

Depending on the level of enforcement, there are three options. First is the Korean model where the central agency (MOSF) conducts a mandatory customer satisfaction survey. Second, each SOE conducts a mandatory customer satisfaction survey. Compared to the first option, the second option may end up with less reliable results because the survey is conducted by the SOE itself. The third option is a simple recommendation to SOEs to initiate a customer satisfaction survey, which may end up with no implementation by any SOE.

〈Table 1-15〉 The Level of Enforcement of Customer Satisfaction Survey

	Positive	Negative
Mandatory for all SOEs conducted by central agency	Strong impact	Cost for the central agency (budget, administration)
Mandatory for all SOEs conducted by each SOE	Impact with less costs	Reliability of the survey result
Simple recommendation for SOEs	No conflict	No implementation

The recommendation for Bulgaria is option one. This will have a strong impact and opportunities for comparison between the different SOEs. In Bulgaria there has never been a consumer satisfactory survey. There has been a discussion just recently about a similar survey to be conducted for health services provided by some of the nation's hospitals. Conducting different surveys for each sector and SOEs, together with a different methodology and interpretation of the results, may be harmful. Since Bulgaria has no such experience it would be better to start with a more uniform approach. This part of the reform is of key importance for overall reforms since the public will gain a substantial amount of knowledge and clear opinions about the performance of SOEs.

3.2.6. Function Review

In Korea, MOSF regularly reviews the functions of an SOE to see if any should be stopped or integrated with another SOE. Many SOEs in Korea have expanded their businesses for different reasons. They may want to raise revenue in the market even when there are already private providers. When SOEs compete against private firms, competitive neutrality is often violated. Sometimes SOEs start a new business in the face of unfavorable financial prospect only to expand their employment and organization hoping to enjoy speedier promotion. There are also cases where line ministries ask for a certain project against the will of the relevant SOE to fulfill their policy objectives. As a result, the functions of SOEs are often very much bloated and excessive. There are even cases where similar functions are being conducted by multiple SOEs.

There are three different approaches for a function review. First, as in Korea, the central agency can review the functions of SOEs annually. Although implementation of the review is strongly enforced by the law in Korea, this may not be the case in Bulgaria. Second, the central agency can perform a function review sporadically right after the new political leadership comes in. This will provide a good political environment in dealing with the resistance of SOEs and line ministries. However, a sporadic review matching with the political cycle may not allow enough time for the examination and analysis of the different functions of SOEs. Some functions could be left out of the review due to the time constraints. Third, one may pass the responsibility to a line ministry, in which case not much will happen since no one wants to fundamentally reform its SOEs. In Korea, MOSF initially followed option two, but altered its policy to option one in 2013 to make the function review a more continuous process. Every year, MOSF sets areas of priority for the function review. During the first half of 2015, 87 public institutions in three focus areas[16] had to undergo a function review by MOSF.

16) The three areas were social overhead capital, agriculture and fisheries, and culture and arts. 52 different functions were streamlined: integrated, reduced, and stopped. There are, however, cases where an expansion of a certain function is recommended.

〈Table 1-16〉 The Level of Enforcement of a Function Review

	Positive	Negative
Continuous process conducted by central agency	- High impact	- Large burden for the central agency
May not be implemented	- Impact with less costs	- Reliability of the survey result
At the beginning of a new government conducted by central agency	- Good political support	- Not enough time for review - Some functions are let out.
Leave the function review at the hands of line ministry	- Easy implementation	- Weak impact

The recommendation for Bulgaria is the first option. Ministries have no interest in initiating the privatization of SOEs. That is why a central agency could take over this function. The central agency will have to conduct a regular function review, but may stage rather substantial reforms such as privatization of SOEs during the honeymoon period of a new government. The line ministries should be asked to propose a reform plan of their SOEs, but it is the central agency that approves and makes the decision. When the central agency does not have enough staff for the function review, it may want to form a taskforce with experts from the private sector and academia. However, these experts can provide only knowledge, not a driving force, that is essential to overcome the strong resistance from both a ministry and an SOE. Therefore, when the central agency is seriously under-staffed, the second option could prove more realistic.

The function review of SOEs in Bulgaria is defined in two legal acts, the Commercial Law and the Law on Privatization. The Privatization Agency, which reports to Parliament, prepares an annual program where it proposes which SOEs have to be offered for privatization. They make their proposal on the grounds of their assessment of the functions of the SOEs and also in coordination with the line ministries and the Council of Ministers. Once the program is adopted the Agency starts the procedure.

Mergers and acquisitions of SOEs are prescribed in government regulations, where the power is clearly divided between the Council of Ministers and the line ministries. The current practice does not create substantial problems and there may be need for radical reforms. The problem is that the Bulgarian legislation does not clearly distinguish between the commercial and the social functions of the SOEs as requested by the OECD Guidelines for SOEs management. Such distinctions would be beneficial for both remuneration from the budget of the social functions and also for the facilitation of the decision as to which SOEs should remain state-owned and which should be privatized. Such an analysis is also needed when it comes to the creation[17] of a new SOE to see whether the function it will perform has a social or any other public interest.

3.2.7. Long-term Fiscal Planning: Scope and Enforcement

Every year in Korea, SOEs have to submit their five-year fiscal planning which is delivered to National Assembly after being reviewed by MOSF. The first question is which SOEs should submit a plan. The central agency may enforce the submission of a plan for all SOEs or only for large SOEs,[18] or for SOEs with a bad financial status.[19] Every year, MOSF designates SOEs that are either large or financially bad. However, we may have an option where it is simply recommended that SOEs conduct a five-year fiscal assessment without legal obligation.

〈Table 1-17〉 Four Ways of Enforcing a 5-year Fiscal Plan for SOEs

	Positive	Negative
Mandatory for all SOEs	Simple	Too much work for the central agency if the plan should be reviewed
Mandatory for large SOEs	Effective	Where to draw the line?
Mandatory for financially bad SOEs		
Simple recommendation for SOEs	Autonomy of SOEs	Not much impact

The recommendation for Bulgaria is the first option, unlike Korea. The current practice in Bulgaria is that the management of SOEs is employed for three years (The contracts are for three years). According to Art. 28. (1) of the Regulation for the Execution of Property Rights of the State in the SOEs the Board members are obliged to prepare a business plan for the entire three-year period and also for each year. The business programs shall consist indicators such as productivity, turnover, profitability, new markets, equipment, maintaining a certain number of employees, financial obligations, investments, etc. The business program is presented to the responsible minister for approval.

17) According to the legislation, the Council of Ministers may create new SOEs.
18) The size of an SOE in Korea is measured by the amount of assets.
19) This is measured in Korea by the debt/asset ratio.

3.2.8. Long-term Fiscal Planning: Involvement of the Central Agency

Another dimension of long-term fiscal planning is whether or not the central agency intervenes in the formulation of the plan. When this new regulation was first introduced in Korea, MOSF simply accepted the plan which was formulated by the SOE and was discussed with the relevant line ministry before being submitted to MOSF. As the debt of SOEs became a serious issue, however, MOSF began to deepen its involvement since planning was a very useful process in directly changing the future financial status of SOEs. However, we can have an option where the central agency lets SOEs and their relevant ministry submits their plan directly to Congress. Korea's current practice is option three, which requires substantial human resources during a relatively short review period.[20] When the initially submitted plan proves unsatisfactory, MOSF asks for a revision by an SOE.

〈Table 1-18〉 Three Ways of Reviewing 5-Year Fiscal Planning of SOEs

	Positive	Negative
SOE → Parliament	- Accountability of SOEs	- Limitation of self-reform
SOE → line ministry → Parliament	- Accountability of line ministries	- Collusive behavior
SOE → line ministry → central agency → Parliament	- Possibility of Reform	- Too much work for the central agency - Could be ineffective process if the central agency is not powerful enough

The recommendation for Bulgaria is option two, with elements of option three. Bulgaria may start with the second option, but the central agency can review the adequacy of financial plans of selected debt-ridden SOEs. When the financial plan is not innovative enough to reduce the high debt of such SOEs, the central agency should decisively step in to correct the plan. However, such intervention will require more human resources with relevant competency.

3.2.9. More vs. Less Dividend

The Korean government has maintained a rather low propensity to dividend at around 20 percent. Since prior to 2008 the Korean government enjoyed a consolidated fiscal surplus, dividends from the SOEs were not important for the government. After 2008, however, the debt of SOEs soared, reducing the dividend capacity of SOEs. As the debt situation has stabilized, the Korean government plans

20) MOSF works with Research Center for SOEs established under Korea Institute for Public Finance.

to increase the propensity to dividend to 40 percent by 2020.

〈Table 1-19〉 Propensity to Dividend in Korea

	2009	2010	2011	2012	2013	2014
Government investment (US$1 billion)	55.6	59.0	60.5	61.1	61.5	61.7
Dividend (US$1 billion)	0.34	0.20	0.43	0.60	0.49	0.33
Rate of Return on Investment (%)	0.60	0.34	0.72	0.99	0.80	0.53
Propensity to Dividend (%) = Dividend/Net profit		19.8	20.2	20.4	24.2	21.5

Source: MOSF Press Release.

MOSF divides all SOEs into four different groups depending on the ratio of self-generated revenue. Then, to finalize the dividend ratio, MOSF applies index such as profit ratio, debt ratio, reserve ratio, and government support. What is the optimal dividend ratio is not an easy question to answer. This paper suggests a higher ratio than Korea's current level of 21.5 percent because higher dividends will enforce the motivation of the government to increase the profits of SOEs and eventually to list the SOEs in the stock market.

〈Table 1-20〉 The Level of Propensity to Dividend

	Positive	Negative
Lower than now	- SOEs can use more reserves for investment - SOEs' stronger motivation for profits	• Government's weaker motivation - to list SOEs in the stock market - to see more profits of the SOE
Higher than now	• Govt's stronger motivation - to list SOEs in the stock market - to see more profits of the SOE	- SOEs' less reserves forinvestment - SOEs' weaker motivation for profits

The recommendation for Bulgaria is the first option. The propensity to dividend in Bulgaria has been extremely high, reaching 80 percent. Only recently was it decreased to 50 percent. The dividend policy of Bulgaria has two problems: (i) the uncertainty about how much the budget will take in the next year, which makes it difficult for SOEs to plan for business and investment, and (ii) the huge propensity to dividend. By all standards, the Bulgarian practice is irrelevant for the development of SOEs. First, unlike Korea, the dividend ratio should be lowered. Bulgaria should adopt a dividend policy which takes into account the conditions of each company and its growth possibilities. The policy goal should escape from securing additional income for the central budget. Second, the dividend ratio should be predictable. Korea's way of calculating dividend ratio is one good example. All those issues have to be agreed in the Central Steering Committee and then adopted in the three-year fiscal plan.

4. Evaluation System for Better Performance of SOEs in Bulgaria

Management evaluation of SOEs is one of the most influential policy tools for the central agency in Korea. Evaluations have been conducted since 1984, and the backbone of the system has been maintained without much change. The efficiency and good performance of Korea's SOEs can be credited to this evaluation system.

4.1. Evaluation System

4.1.1. Who Should be Evaluated: Type of Organizations

Korea evaluates both SOEs and QGOs. Out of 323 public institutions, all 30 SOEs and 90 QGOs are evaluated by the central agency, leaving 203 small QGOs being evaluated by line ministries based on a much simpler method. Evaluating SOEs is easier than QGOs since performance of SOEs can be easily measured by a quantitative index such as net profits. Including QGOs requires a much larger evaluation team and involves more costs.

〈Table 1-21〉 Scope of Organizations for the Centralized Evaluation System

	Positive	Negative
Only large SOEs	- Easier to get a consensus - Less financial and time cost	- Inefficiency of QGOs
All but only SOEs	- Same rule for all SOEs	- Large burden for evaluation
All SOEs and QGOs	- QGOs will be more efficient.	- QGOs are more difficult to evaluate - Serious financial and time costs

The recommendation for Bulgaria is option two. While Korea's central agency is undergoing huge financial and time costs in dealing with 120 organizations, 157 SOEs for the Bulgarian central agency is a considerably large group for evaluation. This is why the third option is not realistic. However, all SOEs should be evaluated by one single system, if not, the central management will lose its ground, and this is why the first option should not be selected. An evaluation system will not be effective without clear consequences. A universal evaluation system for all SOEs is a foundation for the universal consequences attached to its result. There is, of course, a need for reducing the burden to the central agency, which will be discussed in the following.

4.1.2. Evaluator in Charge

Which ministry should be in charge of the evaluation? There are three options. The central agency is the first option, and the second is a line ministry. The third option is evaluation by the line ministry which is examined and corrected by the central agency. This type of two-layer evaluation system is often found in the performance management system in the Korean government. The third option is useful when the line ministries have more essential information than the central agency, and when there is not much room for discretionary evaluation by line ministries.

〈Table 1-22〉 Who Should be in Charge of Evaluation?

	Positive	Negative
Central Agency	- Objective and Time saving - More power to central agency	- Too much work - Resistance from line ministries
Line ministry	- More information - Accountability of ministries	- Collusive behavior
Evaluation by line ministries is re-evaluated by central agency	- Double check - Participation of line ministries	- Expensive - Re-evaluation creates more conflicts with line ministries

Recommendations for Bulgaria are a combination of the first and third option. We should not just leave the evaluation in the hands of the line ministry as is the current standing, which has already been proven problematic. It is therefore recommended that the first option be followed where the central agency is in charge of the evaluation. However, it will be difficult for the central agency to evaluate all SOEs in Bulgaria. Therefore, some of the evaluation can be delegated to line ministries. The next issue pertains to the division of labor between the central and line ministry.

4.1.3. Division of Roles between the Central Agency and Line Ministries

In terms of their roles in evaluating SOEs, there are two ways of drawing the line between the central agency and line ministry. In the first case, the central agency designates and evaluates around 30 out of 157 SOEs using criteria such as volume of revenue, size of assets, or the volume of liability. Though the same evaluation methods and criteria should be applied to all SOEs, relatively smaller SOEs are evaluated by line ministries and then if necessary checked and amended by the central agency. The central agency can focus on 30 SOEs with major implications for the national economy. When the central agency is equipped with more staff and resources, it can designate more SOEs under its direct evaluation. The problem with this option is whether or not we can trust the evaluation by the line ministries. If there is no such trust, the central agency will have to repeat the evaluation process for the remaining 127 SOEs, which will be a very costly process.

The second option is to draw the line depending on an evaluation index: a qualitative one which is a more subjective evaluation by the central agency, and a quantitative one, which is a more objective evaluation by the line ministries. Since there is little room for discretion in the quantitative evaluation, the central agency can better trust the evaluation by line ministries than in the first option. Since both the central agency and the line ministry evaluate all SOEs, there are times when the evaluations by two parties may be very different. Integrating the two evaluations should be done by the central agency.

〈Table 1-23〉 Division of Roles between the Central Agency and Line Ministries

	Positive	Negative
Large SOEs by the Center Others by line ministries*	- Focus on Big Fish - Easy adjustment of workload by the Center	- How to compareresults by two organizations - Collusive behavior
Qualitative index by the Center Quantitative index by line ministries	- Universal treatment for SOEs - Utilize better knowledge of line ministries - Less resistance from line ministries	- A heavy burden for the central agency

Note: * The evaluation by line ministries will be checked and subject to change by the central agency.

The recommendation for Bulgaria is the second option. By providing specific guidelines for quantitative evaluation, the central agency can minimize the collusive behavior of the line ministries. The line ministries will be relatively more receptive to the evaluation reform initiative under the second option since they can share power with the central agency. The consumer satisfaction survey may have to be conducted by the central agency although it is a quantitative index. The central agency can conserve resources in the evaluation by utilizing the expertise of the line ministries. The only problem left is the large burden of the central agency which can be handled in the following manner.

4.1.4. Implementation of the Evaluation: External Experts vs. Government Staff

Another issue pertains to who actually conducts an evaluation. In Korea, MOSF organizes the evaluation taskforce, which is composed of mostly professors and certified public accountants. The number of members in the evaluation team ranges around 150, and approximately 30 percent of members change every year in order to minimize any collusive behavior between team members and the SOEs. Since the evaluation takes place mostly from March –through May, the taskforce is appropriate in order to complete the work in a short period of time. However, some team members are occasionally criticized for their superficial understanding of SOEs. An alternative option is an evaluation by government officials in the central agency. This is an effective way to maintain the quality and consistency of the evaluation. However, this may also entail collusive behavior between the central agency and the SOEs. Another problem is the concentrated workload of those government officials during a specific period of the year.

〈Table 1-24〉 Who Actually Conducts an Evaluation?

	Positive	Negative
Expert Taskforce	- More neutrality and independence - Easy to conduct in a short period of time	- Lower expertise in some cases - Increased costs
Government Staff	- Higher expertise after a certain period - Higher accountability	- Possibility of collusion - Uneven annual workload

The recommendation for Bulgaria is the first option. As previously stated, one of the main weakness in SOEs is insufficient transparency. One of the powerful tools to make an evaluation more independent and at the same time build public confidence in the performance of SOEs is to open the evaluation to external experts. Taking into consideration that around 150 experts are actively engaged in Korea's evaluation process for three months, option two is not realistic for the current state of human resources for Bulgaria's central agency. The first option will, however, create a lot of resistance from the ministries and political powers that will see their influence on SOEs decline. One of the arguments against this approach will be the complications in selecting external evaluators[21] and garnering financial resources[22] to hire and implement external experts.

4.1.5. Which Should be Evaluated: The CEO or SOE?

Should we evaluate the SOE as an organization or the CEO as an individual? Korea evaluates both because the performance of an SOE and its CEO are not necessarily correlated. A first-rate CEO cannot perform well in a hopeless SOE such as the Korea Coal Corporation (KCC). Since the coal industry is on the decline in Korea, no amount of genius in management can improve the negative financial status of the KCC. On the other hand, a hopelessly incompetent CEO who works for a well-established SOE may have a high score in the evaluation thanks to all the managerial and technological systems in place.

What should be evaluated depends on the consequences of the evaluation. If an annual performance bonus for each staff member is a result of the evaluation, the SOE should be evaluated. However, CEO should be tested if personnel decision for CEO such as discharge, reappointment is the consequence of the evaluation. In Korea both the SOE and CEO are evaluated because this has consequences for both staff and the CEO. Another issue is correlation: If the performance of the SOE and the CEO are closely correlated in Bulgaria, and if the CEO can influence the salary level of each employee, the central agency can evaluate only the CEO since a well-motivated CEO can change his or her own SOE.

〈Table 1-25〉 Who Should be Evaluated?

	Positive	Negative
SOE as an organization	- Good for changing staff in an SOE	- Is the CEO responsible? (A bad CEO in a well-established SOE or vice versa)
CEO as an individual	- Good for personnel decisionsby CEO - Easy to implement	- Can we motivate staff in each SOE?
SOE and CEO	- Powerful	- Redundancy - More costly

21) Many professors and public accountants seek to join the evaluation taskforce in Korea. The member of the taskforce can expect the following benefits: an opportunity to learn about insider information on SOEs, networking with SOEs, and a substantial evaluation fee. The central agency (MOSF) designates the head of the taskforce along with the other members.

22) It takes US$ 2 million for an annual evaluation in Korea, which is mostly spent on fees for the 150 members of the taskforce.

The recommendation for Bulgaria is option three, as is the case in Korea. Instead of the current indirect evaluation of CEOs in Bulgaria, there is a need for a full-fledged evaluation procedure criteria and results, including dismissal for the worst performers. The legal framework for the evaluation is rather different from current practices in Bulgaria. Management is an indirect subject of evaluation when the business plan is annually evaluated. Also, management shall be evaluated for the purposes of setting salaries. According to the Council of Ministers Regulation Art. 33. (1) the remuneration of the managers depends on: long-term assets, the number of personnel, profitability, financial results, the change of the value added per employee, debt service, as well as other obligations as per the management contract. The monthly salaries should be based on an integral score of the indicators for the last quarter. In practice, though, this is not strictly followed. The regulations also stipulate the scope and the basis for the calculation of bonuses. The SOE performance in Bulgaria should also be evaluated according to Regulation 114/2010.

4.1.6. Implementation of SOE and CEO Evaluation

If both SOEs and CEOs are evaluated, should there be two separate taskforces or can just one taskforce cover both? Korea once divided the taskforce into two in order to ensure the accuracy of the CEO's evaluation, which would then be used for re-appointment. However, this bifurcation incurred more costs, and there was some redundancy in the process. Korea now utilizes only one taskforce to evaluate both SOEs and CEOs.

The next question is which evaluation is a subset of which. If the CEO evaluation is subset of the SOE evaluation, the results of the CEO evaluation will be one part of the SOE evaluation meaning that the SOE evaluation has more indexes. The rationale for this option is that CEO leadership is also a factor in SOE performance. Since the result of the SOE evaluation determines the compensation of employees in Korea, when the CEO evaluation is poor, the employees may complain as to why they should be penalized by the performance of a poor CEO whom they did not appoint. The other option is to make an SOE evaluation a subset of the CEO evaluation, which makes sense since the CEO should be responsible for the performance of his or her SOE. In this case, there still remains the issue of an unclear correlation between SOE performance and CEO competency. In addition, employees may not pay a great deal of attention to the exclusive index of their CEO since their annual bonuses are already determined by the SOE evaluation.

〈Table 1-26〉 How to Evaluate both the SOE and CEO?

	Rationale	Criticism
Two separate evaluations and teams	- More thorough evaluation of the CEO	- Redundancy in evaluation index - More costs
CEO evaluation + more index = SOE evaluation	- Leadership of CEO is one input for the SOE's performance	- Why should employees be responsible for a bad CEO?
SOE evaluation + more index = CEO evaluation	- CEO should be responsible for the SOE evaluation	- Why should a CEO be responsible for ahopeless SOE? - Staff may not be keen about a 'more index' CEO evaluation.

The recommendation for Bulgaria is option three, unlike Korea's selection of option two. The performance of the CEO's SOE is the most important evaluation criteria for the CEO. Compared to Korea, SOEs in Bulgaria are relatively more autonomous in their policies on service and pricing, and CEO competency is more closely correlated with SOE performance. Although there is the possibility that the employees are not helpful to their CEO in preparation for the 'other index' of the evaluation, this poses no significant problem when the other indexes are properly selected, and when the CEO can effectively control his or her staff.

4.1.7. Frequency

How often should we evaluate SOEs? The first option is an annual evaluation, which is practiced in Korea. However, this option is criticized not only by SOEs but also by scholars for two reasons: It encourages CEOs to have a myopic one-year horizon, as well as being a burden for SOEs. The second option is therefore once in every three years, which matches the CEO's term in office. Korea's MOSF defends the annual option on the grounds that option two makes it difficult to set annual bonuses for SOE employees based on the results of the evaluation. MOSF also wants to penalize SOE wrongdoings or incompliance through annual evaluations, as opposed to having to wait for two more years. The third option is a combination of the first two options: The central agency conducts a full scale evaluation every three years, but applies a simplified[23] evaluation annually for the first two years: Full scale - simple – simple – full scale – simple – simple – full scale – etc.

23) One example of a simplified evaluation focuses on a quantitative evaluation for an input category.

〈Table 1-27〉 Frequency of Evaluation

	Positive	Negative
Every year	- Prompt feedback - Easy for setting annual bonu	- Myopic horizon of CEOs - Burden on SEOsHigh cost
Every 3 years	- Longer term horizon - Match with CEO's term - Less burden for central agency	- Slow feedback so less discipline of SOEs
Comprehensive: every 3 years Simple scale: 1st, 2nd year	- Combination of the first and second options - Simple scale: only quantitative evaluation (by line ministry) - Comprehensive: quantitative + qualitative (by central agency)	

The recommendation for Bulgaria is the third option. The status quo in Bulgaria, which is to have a remuneration related evaluation each quarter, simply does not work. It needs to introduce the annual staff bonuses. The annual bonus in a year of a simplified evaluation can be calculated by a weighted average of a full scale evaluation and a simplified one.[24)] Option three is also useful to reduce the burden on the central agency. By dividing 157 SOEs into three groups, the central agency can focus on a full-scale evaluation of 52 SOEs annually, which is much more manageable. On the other hand, the line ministries will have to conduct an evaluation every year.

〈Table 1-28〉 Criteria of an Annual Bonus (example)

Annual Bonus of	Comprehensive Evaluation (2017)	Simplified evaluation	Evaluation is based on performance of
2017 (comprehensive evaluation)	100%	-	2016
2018 (simplified)	60% (2017)	40% (2018)	2017
2019 (simplified)	40% (2017)	60% (2019)	2018

24) One example is as follows. An annual bonus for 2017 is based 100% on a full scale evaluation of the 2016 performance conducted in 2017. An annual bonus for 2018 is based on a full scale evaluation conducted in the previous year (60%), the simplified evaluation for 2017 as conducted in 2018 (40%). An annual bonus for 2019 is based on a full scale evaluation conducted two years prior (40%), a simplified evaluation for 2018 conducted in 2019 (60%).

4.1.8. Consequences

The secret behind more than 30 years of history of the evaluation system in Korea lies in the harsh consequences of the evaluation. There are three consequences of the evaluation.

〈Table 1-29〉 Three Consequences of Management Evaluation in Korea

Grade	(1) CEO Re-appointment	(2) Annual Bonus of Each Employee	(3) Non-payroll Expense Budget for Each SOE
S	No official consequence (only unofficial recognition by President)	250%	Increase up to 1%
A		200%	
B		150%	Unchanged
C		100%	
D	Warning	0%	Decrease up to 1%
E	Recommended to be discharged		

First, MOSF recommends to the President of Korea a discontinuation of the contract with the CEO if the CEO gets the lowest grade E out of six levels of S, A, B, C, D, E. If one receives a D, he or she will be warned by the central agency. If one is warned two years in a row, he or she will be recommended to be discharged as well.

Second, each and every SOE employee will receive an annual bonus payment depending on the results of the evaluation. Prior to the Korean government giving this annual bonus based on the results of an evaluation, each SOE used to pay annual bonuses mainly based on seniority. The government, however, passed a law that the total volume of annual bonuses must depend on the results of the evaluation. Each SOE employee with an S grade will receive an annual bonus equal to 250 percent of their monthly basic salary, but one working for SOEs with a D or E grade will end up with 0 percent. For instance, if one's basic monthly salary is US$2,000; the annual bonus will range from US$0 to US$5,000 depending on the evaluation results.

The third consequence of the evaluation is the increase rate of non-payroll expenses for each SOE. Non-payroll expenses include travel, maintenance costs, office appliances, costs for gatherings, and other miscellaneous expenses. Although this is not a substantial part of the budget, it has a certain influence on the smooth operation of the SOE. This is why all employees and CEOs of SOEs in Korea are so keen about their management evaluation. Based on the three consequences that are applied in Korea, we can postulate the following five combination of consequences.

〈Table 1-30〉 Consequences of the Evaluation

	Positive	Negative
CEO Re-appointment only	CEO's accountability	Staff and labor union may not be interested in the evaluation.
Annual bonus of employees in SOEs only	Attract SOE employees' attention	Resistance from labor union
Non-payroll Expense	Incentive for the organizational level	Lower autonomy of SOEs
CEO and Annual Bonusof Employees	Good pressure for both CEO and employees	Resistance from SOEs
All three (Korea's case)	Most tight control	Too much intervention

The recommendation for Bulgaria is option four, unlike Korea. Current policies in Bulgaria do not envisage consequences from the CEO evaluation other than a change in salary and the bonus. And even for defining the salary, the rules do not fully work. From that prospective, introducing a full-fledged evaluation system with well-defined and harsh consequences will be a very radical change. The CEO re-appointment and annual bonus of each employee seem to be very useful leverage. However, the inclusion of the non-payroll expense budget as a consequence appears to be too much intervention in the Bulgarian context where SOEs' budgets are formulated based on their own revenue.

4.2. Evaluation Methods

4.2.1. Relative vs. Absolute Evaluation

In a relative evaluation, the central agency needs to provide an ordering in the evaluation results of different SOEs. Since it is very difficult to compare different SOEs, an absolute evaluation is in general a more ideal way of evaluation. However, an absolute evaluation may provide overly generous results for all SOEs. Korea's evaluation is in principle based on absolute criteria. In reality, however, quantitative indexes follow absolute criteria, whereas non-quantitative indexes tend to follow relative criteria. The final grade also tends to follow a relative evaluation with a certain curve. The distribution for the past years is as follows: S (less than 1%), A (around 15%), B (around 40%), C (around 30%), D (around 10%), E (4–% to 5%).

〈Table 1-31〉 Evaluation Criteria

	Positive	Negative
Relative	- Easy to evaluate - Maximizecompetition	- Controversy for unequal footing - Apple to apple comparison?
Absolute	- Ideal way	- Undifferentiated generous result - Difficult to evaluate
Mix	- Absolute evaluation in principle but with a distribution of the final grade	

The recommendation for Bulgaria is the third option, as in Korea. The evaluation should be completed using absolute criteria, but the final grade should be given based on a certain curve. Without such a distribution, the evaluation could be all too generous without providing much by way of differentiated consequences. This will be the case in Bulgaria which has not yet experienced such an evaluation system which enforces harsh consequences.

4.2.2. Grouping of SOEs for Relative Evaluation

The curve distribution of the final grade inevitably entails a grouping issue. Korea divides all public institutions under evaluation into three groups: SOEs (30), large QGOs (around 30), and small QGOs (around 60). Size-based grouping makes sense because a large SOE has as many as 30 full time staff to prepare for the evaluation whereas a small SOE has only three members for the same job. Since all 30 SOEs are in one pool for grade distribution, there are many complaints from smaller SOEs. In the past, however, the grouping was made based on functional similarities such as an SOE group for social overhead capital, fund management, etc.

〈Table 1-32〉 Grouping for Distribution of Final Grade

	Positive	Negative
All SOEs in one group	- Big pool for a curve	- Most difficult to compare - Many complaints from SOEs
Grouping depending on size	- Fair in terms of the capacity of an SOE preparing for evaluation	- Difficult to compare
Grouping depending on functions	- Easy to compare	- Insufficient number of SOEs in a group

The recommendation for Bulgaria is option two and option three. Bulgaria has 68 state hospitals and 29 district water supply SOEs. Each can be a group within which the SOEs are relatively compared for distribution of final grades. Another 60 SOEs have a wide variety of sizes. While some enterprises in the service sector are composed of 10 to 50 employees, others employ thousands. That is why grouping on the size could be also a good solution: The 60 SOEs can be divided into two based on their size of employment and revenue. Then, there will be four groups of SOEs: 68 hospitals, 29 district water supply SOEs, around 30 small SOEs, and around 30 large SOEs. If the hospitals have a wide range of sizes, we may divide the hospitals into two groups as well. As was discussed in Question 26 on frequency, a comprehensive evaluation will take place once every three years. The following is one example of a cycle of comprehensive evaluation: the hospital group (68 SOEs) in the first year, water supply group (29 SOEs) and the 30 small SOEs in the second year, around 30 large SOEs in the third year. This kind of allocation will evenly distribute the work load of the central agency over a 3-year period.

4.2.3. Evaluation Indexes

There are two dimensions regarding the issue of indexes: whether to evaluate (1) all input, process, performance aspects of an SOE management, and (2) by a quantitative or non-quantitative index. The following are the current indexes in Korea. As you can see, all three aspects of management are evaluated with more emphasis (70%) on quantitative methods. Input and process indexes are the same for all SOEs, whereas the performance indexes are all different for each SOE.

〈Table 1-33〉 Evaluation Indexes in Korea

	Quantitative 70%	Non-Quantitative 30%	
In-put	Labor and asset productivity Budget and financial management Remuneration and performance management	Labor relation	Same indexes for all SOEs (60%)
Process	Customer satisfaction survey result*	Leadership (vision...) Board of Directors Transparency and ethics Social responsibilities	
Performance	Core business 1 (performance index) Core business 2 (performance index) Core business 3 (performance index) Core business 4 (performance index)	-	Different index for each SOE (40%)

Note: * As was discussed in Question 22, the survey may have to be conducted by the central agency although it is a quantitative index.

The evaluation index, as based on two dimensions, can be categorized into the following four options. One may say that performance should be the only domain under evaluation. However, if the evaluation omits an input index, SOEs may become a good service provider with a bad financial statement, which is often the case with many SOEs in Bulgaria. The process index should measure customer satisfaction, anti-corruption, social responsibility, etc.

〈Table 1-34〉 Four Options of Evaluation Index

	More Quantitative	More Non-quantitative
All three domains input, process, performance	Option 1 (Korea)	Option 2
Performance + input or process	Option 3	Option 3

The recommendation for Bulgaria is option one, as in Korea. This corresponds with the proposal to introduce a customer satisfaction survey in Bulgaria. As far as the composition of the criteria is concerned, the emphasis should be on quantitative indicators. The Korean model includes the CEO's leadership in the process domain, but Bulgaria can isolate the CEO evaluation from the SOE evaluation as was recommended in Question 25. It also recommendable for Bulgaria to give more weight to quantitative indexes as Korea does since it will enhance the level of acceptance by SOEs, which will be even more the case in Bulgaria if the quantitative evaluation is conducted by each line ministry as was recommended in Question 22.

4.2.4. How to Set Targets

For an absolute quantitative evaluation, there should be a target because an evaluation is made depending on the rate of achievement to the target. Since input and process indexes are identically applied to all SOEs, the same target level is given for all SOEs. However, since the performance indexes are different across SOEs, each index of an SOE needs to have its own target. This leads to the question of how to set the target in this case.

The first method adopted by Korea is forward induction based on past performance. The evaluation taskforce measures standard deviation of the past three years of the performance index of an SOE, and assigns grade A if the SOE outperforms previous year's index by more than the standard deviation. If the SOE maintains the previous year's performance level, grade C will be given. This method is a way to provide constant pressure on SOEs for better performance, which could, on the other hand, be too demanding on them because maintaining the status quo means C (around lower 44%).

〈Table 1-35〉 Standard for Each Grade

Grade	Distribution*	Standard for Each Grade
S	1%	$P(16) > P(15) + 2\sigma$
A	15%	$P(15) + \sigma < P(16) \leq P(15) + 2\sigma$
B	40%	$P(15) < P(16) \leq P(15) + \sigma$
C	30%	$P(16) = P(15)$
D	10%	$P(15) - \sigma \leq P(16) < P(15)$
E	4%	$P(16) < P(15) - \sigma$

Note: 1) P(16): Performance of 2016, P(15): Performance of 2015.
σ : standard deviation of the performance index over the past three years.
2) * This is an average of recent years. No written regulation on the distribution of final grades.

The second method is a groperformance of foreign SOEs in the same business. For instance, the ACI[25] average score of the performance of the world's top 3 airports is set to be the upper target and the ACI average score of all the world's airports is the lower target. If Incheon International Airport exceeds the upper target, grade A is given, but if it falls below the lower target, it will get a D. This method is effective in that it uses an easy and unquestionable target, but one may argue that two SOEs in different countries cannot be compared. Another problem is that once an SOE reaches the top of the world level, there is no more pressure. After 2010 Korea applied this method for some years, but soon dropped it because almost all SOEs received full marks with this global performance index. The third method

〈Table 1-36〉 Three Ways to Set the Target

	Positive	Negative
Based on the past performance	- Continuous pressure for improvement	- Fatigue of SOEs
Global comparison	- Unquestionable standard - Easy to find the target	- No pressure once you reach the top - Can we compare SOEs in different countries - Availability of information
Based on the future goal	- Future-oriented	- Difficulties in setting the future goal - Asymmetry of information between the central agency and SOE.

25) ACI stands for Airports Council International.

is backward induction: First, set the strategic long-term goal of 5–10 years mostly benchmarking foreign companies, and then determining the next year's target as a first step towards the long-term goal. Although this method provides a future oriented perspective, it creates another difficult question of setting the future target.

The recommendation for Bulgaria is option one, as in Korea. Bulgarian SOEs are experienced in setting target based on the past performance. Introduction of this tool would be easier than the other options. In addition, information to apply this tool is accessible which is not the case of other options.

5. Conclusion

The SOE management system in Korea has given too much power to the central governance agency (MOSF), leaving little managerial autonomy for SOEs. Although their performance is very high by global standards, their efficiency has a good deal of room for improvement. It seems like Bulgarian SOEs, on the other hand, are enjoying much more autonomy and flexibility, but their performance and efficiency is still not very positive. Therefore, a number of modifications should be made in formulating Bulgaria's own governance model for SOEs based on Korea's experience since the two countries have a very different status quo and since the Korean model has many problems as well. Out of the 31 The recommendation for Bulgaria is this paper, only 11 recommendations are currently in practice in Korea.

〈Table 1-37〉 Comparison of SOE Management Systems

	Bulgaria now	Korea
Governing Body	Line ministries	Central agency, MOSF
Autonomy of SOEs	High	Low
Overall Performance	Low	High
Overall Efficiency	Low	Medium
Direction of Reform	More control over SOEs by the central agency	More autonomy of SOEs by reducing government intervention

The directions of SOE governance reforms in the two countries are in this respect very different. Korea needs to reduce government intervention by guaranteeing more autonomy of SOEs. On the other hand, Bulgaria needs to start institutional reforms. As a first step it could create a Steering Committee and a Secretariat that will coordinate, design and control SOEs' policies. To accommodate the voice of the line ministries, it is recommendable that a committee composed of line vice-ministers and experts from academia and the private sector be established. Together with institutional reforms, Bulgaria needs to strengthen the transparency and accountability of SOEs as well as setting up a comprehensive but also working system for the evaluation of both SOEs and CEOs. In line with the Korean experience, the 2015 OECD guidelines for the SOEs should be implemented.

The future of the governance model for Bulgaria can be called a "collaborative governance" between the line ministries and the newly-created central agency, whereas the current Korean model is more a 'centralized governance.' In many respects, the Bulgaria's future seems like Korea's future as well.

〈Table 1-38〉 Future of Bulgaria's SOE Governance System

	Bulgaria now: Weak Governance	Bulgaria's future: Collaborative Governance	Korea now: Centralized Governance
Governing structure	Line ministries	Partially Centralized system	Centralized system
Centralbody	-	Steering Committee with its own Secretariat	Steering Committee with MOSF
CEO appointment	Line minister	Political leader or Line minister	Political leader
Inputcontrol	None	Ex ante guideline followed by monitoring	Tight ex ante control
Project control	None	All by line ministry	Major projects by the central agency
Evaluation in charge	None	Central agency and line ministries	Central agency
Frequency of evaluation	-	Once every three years	Every year
Consequence of evaluation	None	- CEO reappointment - Annual bonus	- CEO reappointment - Annual bonus - Non-payroll expense

These reforms will take a lot of effort and strategy. The following steps will have to be pursued. The recommendations will have to be presented to the Ministry of Finance and Ministry of Economy for their consideration. As requested by the MOF, the proposal to create a united body for the governance of SOEs will be provided together with the arguments and a necessary analysis. A discussion as regards possible legal changes will have to be made. Policy tools such as customer satisfaction surveys, evaluations, and an integrated information disclosure system will be organized. Most of all, it is important to win the minds of the people and political leadership in that the current system has a number of problems, and that reform of the system is critical to a more efficient economy and better service to citizens.

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Appendix 1: List of SOEs in Bulgaria with more than 50% State Participation

NAME	LINE MINISTER	FUNCTION
Bulgarian Export Insurance Agency Pls	Minister of Economy	Export Insuarance
LB Bulgaricum Pls		Milk Processing and production
KINTEX Pls		Exporter of military equipment
National Company Industrial Zones Pls		Industrial park
VMZ Pls		Production of military equipment
Sofia Tech Park JSC		Innovation
Bulgarian Energy Holding Pls and it's subsidiary companies: KOZLODUY NPP Pls National Electric Company Pls Electricity system Operator Pls Mini Maritsa Iztok Pls TPP MaritsaEast 2 Pls Bulgargaz Pls Bulgartransgaz Pls	Minister of Energy	Energy sector
Holding BDZ Pls	Minister of Transport Information Technology and Communication	Railway Transport
BDZ Passenger Services Ltd		
BDZ Freight Servicies Ltd		
2 Sea Ports (Burgas and Varna)		Maritime Transport
3 River Ports (Ruse, Vidin and Lom)		Inland Waterway Transport
4 Airports (Sofia, Plovdiv, Ruse, G-Oryahovica)		Air Transport
Bulgarian Posts Pls		Postal Servicies
Bulgarian Stock Exchange JSC	Minister of Finance	Financial servicies
Bulgarian Development Bank JSC		
Napoitelny Sistemy (Irrigation Systems) Pls	Ministry of Agriculture and food	Agriculture
Ribni Resursi (Fishing resources) Ltd		
Terem Pls and it's subsidiary companies: TEREM TSAR SAMUIL Ltd TEREM-OVECH Ltd TEREM–Krz Flotski Arsenal Varna Ltd TEREM IVAILO Ltd EREM HAN KRUM Ltd TEREM-LETETS Ltd	Minister of Defence	Military repair and production
29 Water supply companies	Minister of Regional Development and Public Works	Water supply
Agency of Diplomatic real estate Ltd	Minister of Foreign Affairs	Property management
68 Hospitals	Minister of Health	Medical servicies

Appendix 2: List of 30 SOEs in Korea as of 2015

NAME	MINISTRY	FUNCTION
Incheon International Airport Corporation	Ministry of Land, Infrastructure and Transport	Transportation
Korea Airports Corporation		
Busan Port Authority		
Incheon Port Authority		
Ulsan Port Authority		
Yeosu-Gwangyang Port Authority		
Korea Expressway Corporation		
Korea Railway Corporation		
Korea Land and Housing Corporation		Land Development
Korea Water Resources Corporation		
Jeju Free International City Development Center		
Korea Appraisal Board		
Korea Housing Finance Corporation		
Korea Electricity Power Corporation	Ministry of Trade, Industry and Energy	Resource and Energy
Korea Gas Corporation		
Korea National Oil Corporation		
Korea Resources Corporation		
Korea Coal Corporation		
Korea District Heating Corporation		
Korea Hydro and Nuclear Power Corporation		
5 Power Generating Corporations		
Korea Horse-Racing Agency	Ministry of Culture, Sports and Tourism	Others
Korea Broadcasting Advertisement Corporation	Korea Communications Commission	
Korea Minting and Security Printing Corporation	Ministry of Strategy and Finance	
Korea Marine Environment Management Corporation	Ministry of Oceans and Fisheries	