STATE-OWNED ENTERPRISE ANALYSIS
(Republic of the Marshall Islands: Public Sector Program)

A. Introduction

1. The Republic of the Marshall Islands (RMI) operates an extensive state-owned enterprises (SOE) sector (Table 1 provides an overview of the major SOEs).[1] In fiscal year (FY) 2009, the sector accounted for 8.1% of wage and salary employment and 10.2% of total wages and salaries. Most SOEs are fully owned by the Government, the notable exception being the National Telecommunications Authority that has a minority private sector ownership. Most SOEs are in poor financial health, are likely to see a further financial deterioration without corrective action, and are offering service standards below what is achievable. Extensive subsidies are provided to compensate for prices and charges that are below cost, for the obligation of SOEs to undertake non-commercial activities and for inefficiency in operations. Subsidies are normally provided without strong accountability requirements.

2. Each of the SOEs has its own board of directors, with the large majority of directors being Government ministers and employees. This arrangement can result in SOE Boards lacking the independence and commercial expertise required to guide SOEs as commercially-oriented businesses. Furthermore, the administration of SOEs is diffuse—different ministries and statutory government agencies have operational control, often with conflicting plans of actions and priorities. And a number of SOEs operate as monopolies, without the pressures for performance provided by competition. Performance-oriented supervision is generally absent. These arrangements further weaken the commercial performance of SOEs.

3. There is recognition of the need to revisit the SOE reform agenda. Reforms are now underway or are being seriously considered for Marshall Electricity Company (MEC), Tobolar (a copra trading company) and Air Marshall Islands, three enterprises that have encountered serious challenges in recent years. The reform framework is, however, yet to be fully developed, and, in its absence, there is a risk that reform will be partial or short-lived.

B. Financial Performance in the Ten Years to FY2008

4. **Revenue.** SOEs collectively receive nearly $50 million in annual revenue. Most collect less than $5 million annually. Revenue growth averaged around 7% p.a. in the ten years to FY2008, but revenue trends vary widely. Much of the recent growth was due to higher tariffs charged by MEC (to cover higher import fuel costs) and higher revenues earned by Tobolar due to favourable world market prices for coconut.

5. **Profitability.** The majority of SOE have incurred significant losses. Expenses have tended to grow with revenues and operating results have been poor. In several cases, expenses significantly exceeded revenues, leading to growing operating losses. The SOEs incurred annual average losses of around $6.4 million in the ten years to FY2008. In FY2008, total losses rose above $9 million, the equivalent to 5.9% of gross domestic product.

[1] This document is based on B. Graham and L. Alik. 2010. *Revisiting the Marshall Islands Reform Agenda: A Review of 11 SOEs and Options for Reform*. ADB TA-7336: Responding to Economic Crisis. Majuro (February). Background on the SOE sector is also provided in ADB. 2006. *Juumemmej: Republic of the Marshall Islands Social and Economic Report 2005.* Manila and ADB. 2003. *Republic of the Marshall Islands–A Private Sector Assessment: Promoting Growth Through Reform.* Manila (May).

Table 1: Overview of the Major SOEs (FY2008)

SOE	Short name	Year established	Primary business activity	$ million							Rate of return (%, est.)	
				Operating revenue	(of which: subsidies)	Operating profit	Total assets	Total liabilities	Non-current liabilities	Equity	On assets	On equity
Air Marshall Islands	AMI	1989	Scheduled domestic passenger, charter and cargo air services	1.1	2.7	(2.6)	5.0	4.6	0.0	0.4	(51.3)	(632.4)
Kwajaleing Atoll Joint Utility Resoruces	KAJUR	1990	Electricity, water and waste water services on Ebeye and Santos Islands	4.0	0.6	(3.1)	6.7	1.8	0.8	4.8	(46.3)	(63.9)
Majuro Atoll Waste Corporation	MAWC	2006	Solid waste collection and disposal on Majuro Atoll	…	…	…	…	…	…	…	…	…
Marshalls Energy Company	MEC	1984	Electricity generation and transmission and the buying and selling of petroleum products	19.6	0.4	(2.9)	18.6	29.5	16.4	(11.0)	(15.9)	…
Marshall Islands Development Bank	MIDB	1988	Provision of viable development loans	2.9	0.2	0.8	16.7	6.1	0.7	10.6	4.6	7.2
Marshall Islands Ports Authority	MIPA	2003	Operation and maintenance of the sea port and international airport	2.2	0.4	(1.6)	40.9	2.4	0.0	38.4	(3.9)	(4.2)
Marshall Islands Shipping Corporation	MISC	2005	Management and operation of the Government's shipping vessels	2.4	1.1	0.1	…	…	…	…	…	…
Majuro Resort	MRI	1995	Operation of a 150-room hotel on Majuro Atoll	2.3	0.0	(0.5)	2.2	1.2	0.0	1.0	(21.9)	(49.5)
Majuro Water and Sewer Company	MWSC	1989	Collection and distribution of fresh water and wastewater on Majuro Atoll	1.1	1.3	(0.3)	0.4	0.2	0.0	0.2	(83.3)	(155.9)
National Telecommunication Authority	NTA	1990	Communication services throughout RMI	8.0	0.0	1.1	22.8	14.4	12.4	8.4	4.8	13.0
Tobolar Copra Processing Plant	TOBOLAR	1977	Production and processing of copra products on Majuro Atoll for export	4.8	1.1	0.0	2.8	0.2	0.0	2.6	0.7	0.8
Total				**48.3**	**7.7**	**(9.1)**	**116.1**	**60.6**	**30.4**	**55.5**	**(7.9)**	**(16.4)**

… = not available, est. = estimate, FY = fiscal year, SOE = state-owned enterprise, RMI = Republic of the Marshall Islands.

Source: B. Graham and L. Alik. 2010. *Revisiting the Marshall Islands Reform Agenda: A Review of 11 SOEs and Options for Reform*. ADB TA-7336: Responding to Economic Crisis. Majuro (February).

6. **Asset balances.** The 9 largest SOEs held a total of $116 million in public assets in FY2008, the equivalent of 76.3% of GDP. Asset values have grown in recent years, driven almost entirely by the Marshall Islands Port Authority major airport infrastructure projects funded by grants from the United States. Without the Marshall Islands Port Authority, asset balances are on a strongly negative trend. Many enterprises, such as MEC, have not followed adequate capital replacement policies and practices (mostly due to financial difficulty) and have borne strong and steady deterioration in their net operating assets. Several SOEs, including MEC, have a history of running up and subsequently writing off significant accounts receivable balances.

7. **Return on assets.** The majority of SOEs yield very low or negative rates of returns. In the ten years to FY2008, the 9 major SOEs returned an annual median of negative 10 cents for every dollar invested. Only the National Telecommunications Authority and the Marshall Islands Development Bank have generated a consistently positive return on assets.

8. **Liabilities.** As component units of the government, liabilities held by SOEs are contingent liabilities for the Government. As a group, SOEs liabilities totalled just over $60 million in FY2008, or around 40% of GDP, and total liabilities have grown over time. The National Telecommunications Authority and MEC hold the largest debt liabilities, mostly in the form of government-guaranteed loans which financed large infrastructure projects. Several SOEs have a history of delinquency on retirement and health fund taxes that saw them run up significant liabilities to the Marshall Islands Social Security Administration.

9. **Net assets (equity).** The net asset balance for all SOEs trended down from FY1999 through FY2005, but grew rapidly from FY2006 as the Marshall Islands Port Authority accumulated assets. Without the Marshall Islands Port Authority, net assets were nearly $50 million in FY1999 but by FY2008 they had declined to less than $20 million.

10. **Short-term solvency (liquidity).** Most SOEs show deteriorating short-term solvency positions, as measured by their current and cash coverage ratios. Several have defaulted on their obligations and called on emergency assistance from the Government (for example, MEC received $7.9 million in cash advances from July 2008 to July 2009 to fund fuel imports).

11. **Subsidies (transfers).** Subsidies, in the form of both operational and capital transfers, more than doubled from FY2005 to FY2008. There is wide recognition that current subsidy levels are unsustainable, given the fiscal outlook and the need to now refurbish deteriorated assets. Air Marshall Islands, Marshalls Water and Sewerage Company, Tobolar, and Marshall Islands Shipping Corporation were the four largest subsidy recipients in FY2008, collectively absorbing over $6 million in funds from the national budget.

C. The Way Forward

12. Past reform efforts had less impact than expected, and generally were not sustained. Notably, SOE reform was a key component of the late 1990s public sector reform program and a private sector unit technical assistance project. While several SOEs have reduced their reliance on subsidies, problems of inefficiency, a risk of service disruption, and crowding out of the private sector remain. On the whole, SOE financial returns and other performance measures remain below expectations. In most cases, poorly performing SOEs have been given the public funds needed to operate, at considerable impact on the budget, but without an obligation to restructure themselves or to develop a clear and sustainable reform plan.

13. There have, however, been positive, recent developments. In 2008, the MEC Board and management adopted a series of reform measures and began drafting a Comprehensive Recovery Plan. These measures will be implemented on a priority basis under the proposed program. MEC reform and improvement of its financial position along with strengthened management and enhanced efficiency are at the core of the RMI Public Sector Program. Early efforts are now underway to explore options to improve the operations of Tobolar, following recent changes in the Board and management. In early 2010, a joint recommendation was put to Cabinet by the Board of Directors of the Marshall Islands Visitors Authority and the Marshall Islands Tourism Association for the creation of a special task force whose mandate will be to analyze Air Marshall Islands' status and future. The task force is also to asses the broader issues of domestic and international air connectivity, and to recommend options to reform Air Marshall Islands (including potential full privatization) and to improve air connectivity to and within the country. Reforms to other SOEs have been discussed and considered.

14. SOE reform is, nonetheless, hindered by the absence of a comprehensive, sector-wide reform framework. Such a framework should be built on a widely accepted set of good practice principles, such as:

(i) the establishment and public release of plans approved by Cabinet and SOE Boards that set out the strategic direction of SOEs and performance targets;

(ii) the identification of essential activities and the sale or winding down of non-essential activities;

(iii) ensuring SOE boards have independence in operation and are staffed by suitably qualified and experienced members;

(iv) ensuring senior management of SOEs have suitable qualifications and experience;

(v) the alignment of prices and charges with the total cost of service delivery, except where funded by community service obligations; and

(vi) sound financial management of SOEs including the timely production of audited accounts.

15. An SOE policy is needed to implement good practice principles across the SOE sector. Ideally, this would be backed up by umbrella SOE legislation that would modernize the legislative framework for SOEs. A priority for the SOE policy and SOE Act is the strengthening of the corporate governance framework (see Box 1), the area of SOE supervision probably most under-developed in RMI. Medium-term action plans, such as MEC's Comprehensive Recovery Plan, are also needed for each SOE to articulate clear, agreed-upon and time-bound goals, objectives and actions.

16. The recent SOE sector review recommended that SOE action plans have the following elements: (i) be planned and executed by a Cabinet-appointed Task Force, with appropriate representation from various sectors and with technical assistance and expertise provided where needed, including specialist expertise in the more technical areas where local expertise is thin (such as aviation, electric utilities, water and sewerage systems); (ii) prioritize reforms to those SOEs that pose the highest fiscal risk over the short to medium term; (iii) encompass both on enterprise- and sector-specific reforms as well as broader institutional and legislative reforms that cut across all SOEs and aim to strengthen the governance, accountability, and incentive structures in which SOEs operate; (iv) ensure SOE reform is harmonized with other, ongoing reform components such as tax reform; (v) be customized to each enterprise, following the most

feasible and appropriate forms of reform (including full privatization, where feasible); (vi) support and expedite, where possible, reforms already underway; (vii) include the use of both positive and negative incentives; (viii) give serious consideration to a new policy of excluding elected officials and senior public servants from sitting on public enterprise boards; and (ix) take into full account the failures and lessons learned from past reform efforts.[2]

Box 1: Key Elements of an Improved Governance Framework

(i) A recognition that SOEs are to be operated as successful businesses and provide a commercial return on investment.

i.(ii) The strengthening of governance and monitoring frameworks through: (a) the appointment of a responsible minister(s) to look after the ownership interests of the state in the SOEs; (b) the development of a code of conduct setting out the duties, obligations, powers and accountabilities for SOE directors; and (c) mechanisms for the appointment and performance assessment of SOE directors.

(iii) The designation of an advisor or advisory agency to the responsible minister. This would monitor the performance of the SOEs and ensure the board and management of the SOE are following policies and practices that will ensure the SOE achieves its objective. That agency could be a government ministry, part of an existing ministry or the function could be contracted out to the private sector (e.g., an accounting firm). The good practice principal is that "performance of the SOEs needs to be monitored to ensure that the SOE is meeting the requirements of is objective, and if not there is a process or mechanism in place to take action to protect and enhance the interests of the State as owner".

(iv) Mechanisms for ensuring that SOE boards have independence in operation and are staffed by suitably qualified and experienced members free of a conflict of interest. A strategy should be set out for building the capacity of potential directors, or holding company type arrangements can be established to make full use of the directors are available. This will help ensure that Ministers and non-essential civil servants are not required on SOE boards, where their progressing departure is important to enhancing the independence of SOEs.

(v) An agreement between the owner and the board as to the strategic direction the company is going to follow to achieve the SOE's business objective—often termed a statement of corporate intent— and also how this will be achieved on a year by year basis—the business plan. The policy should establish: (a) how the owner and board will reach agreement on the strategic direction of the SOE and how that will be documented, and (b) that there will then be regular reporting against financial and non-financial performance targets set out in the statement of corporate intent and business plan, including provision for benchmarking against peers.

(vi) Mechanisms for ensuring public scrutiny over the performance of SOEs. The public (either directly or through their representatives (the Parliament) or both) should know: (a) why these SOEs exist, in other words what is their mandate; (b) what is their principal objective; (c) who is running them (the board and senior managers); (d) how performance is measured; and (e) how SOEs are performing against the agreed measures. Often, this is achieved through tabling the Annual Report which would include key performance targets from the statement of corporate intent and results in the Parliament.

(vii) Acknowledgement that the government will interact with SOEs not only as owner, but also often as a purchaser; particularly where the SOE is a provider of key infrastructure services. Often the government will want to contract the delivery of community service obligations from the SOE and the policy should indicate that this will be done in such a way as to ensure sound economic outcomes that do not compromise the SOEs ability to meet its objective. The SOE policy could outline the implementing guidelines required to outline how community service obligations can be identified, costed, contracted, funded and monitored.

Source: Asian Development Bank.

[2] B. Graham and L. Alik. 2010. *Revisiting the Marshall Islands Reform Agenda: A Review of 11 Public Enterprises and Options for Reform*. Majuro; and ADB. 2009. *Technical Assistance to the Republic of the Marshall Islands for Responding to the Financial Crisis*. Manila (February).