

GOVERNMENT-OWNED COMPANIES AND CORPORATE GOVERNANCE IN AUSTRALIA AND CHINA: BEYOND FRAGMENTED GOVERNANCE

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Abstract

The ownership and control of government owned companies presents a major challenge for the integrity of established corporate law ideas regarding accountability of directors and the independence of government owned companies. Drawing upon experience from China and Australia, the article discusses some of the key corporate governance tensions that have emerged from the corporatisation of state owned assets. The attempt to uncritically apply private sector ideas to the corporatisation of state owned and controlled companies is fraught with difficulties that are discussed in this article. The article also examines attempts to place state owned companies on a sounder conceptual footing through changes to their culture brought about by adopting and embedding guidelines and standards, such as the recent OECD *Guidelines on the Corporate Governance of State-owned Enterprises*.

Keywords: ownership, corporate control, government, accountability

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¹ R Grantham, "The Governance of government owned corporations", (2005) 23 *Company and Securities Law Journal* 181 at 193.

1. Introduction

"The rationale of the corporatisation movement was to try and capture the efficiency and accountability attributes of the private sector company...[T]his has clearly not been achieved [in Australia]. Internally, the board of the GOC [government owned company] has been explicitly emasculated, both in its control over senior management and in its autonomy to set strategic direction. Externally, few of the [private sector] market-based controls have application to the GOC."

*Professor Ross Grantham*¹

"In their dash to efficiency under a nascent market-oriented legal and regulatory environment with unclear or poorly defined property rights, China's SOEs face a formidable hurdle to introduce (or in some cases, strengthen) the four basic elements of the modern corporation²...*The reality is that in China the corporate form is an innovation for the State and an imposition for most enterprises, not a natural evolution. The result is that the fundamental attributes*

of the modern corporate form are not yet well-established, though early steps have been made in the right direction."

*The World Bank*³

For a variety of reasons, some of which have been largely economic⁴, the sovereign state has been under pressure to withdraw wholly or in part from many social and economic activities; this is especially so where there is a perception that entities with private sector features might be better able to deliver activities in a more cost effective way.⁵ Some observers have taken the ideological view that the role of government should be "to steer and not to row", seeing an increasingly strong movement in recent decades to minimize the involvement of government in the governance of various entities.⁶ This has seen government responses ranging from the mere "commercialisation" of the internal activities of government agencies to their disposal through "privatisation". These responses have often involved

¹ R Grantham, "The Governance of government owned corporations", (2005) 23 *Company and Securities Law Journal* 181 at 193.

² These are seen to be: (i) a company's separate legal identity from its owners; (ii) limited liability for the owners of shares in the company (iii) a centralised role for corporate managers and its board of directors; and (iv) the transferability of ownership rights in the company.

³ World Bank, *China's Management of Enterprise Assets: The State as Shareholder*, Washington DC, 1997.

⁴ JR O'Connor, *The Fiscal Crisis of the State*, New York, St Martins Press, 1973.

⁵ Some has seen evidence of a crisis in sovereignty or at least a transformation in the role of the state. See generally, N Walker (Ed), *Sovereignty in Transition*, Oxford, Hart Publishing, 2003

⁶ D Osborne and T Gaebler, *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector*, Reading, Mass. : Addison-Wesley Pub. Co., 1992.

the intermediate step of “corporatization”.⁷ As Bottomley has noted, there is “a clear trend towards use of the company structure combined with a general move towards devolution of responsibility closer to operating levels.”⁸ Corporatization of public entities may take a diverse range of forms,⁹ and the extent to which private sector models have been followed, varies greatly between them. Sometimes corporatization is seen as an end in itself for public sector entities (as is often the case in Australia), whilst in other cases it is seen as a step on the way to full privatisation (as has been the case in the UK and NZ).¹⁰ China presents a special case as corporatization of parts of large state owned enterprises has been used to try to attract outside investment in corporatized listed companies and to break out of the cage of the planned economy model, without necessarily moving away from strong state control as the dominant shareholder in corporatized entities. Corporatization reforms have often been undertaken with a view to achieving greater efficiencies and creating more effective incentives for managers.¹¹ In Australia, it has often been claimed that the government owned corporation has advantages of greater “independence, accountability and efficiency”.¹² As Donald C Clarke has noted while discussing Chinese corporate governance, “[w]hile corporatization has many purposes, the chief one is the promotion of higher efficiency through better management.”¹³

However, for political reasons, there are often limits on the degree to which efficiency is allowed to become the ultimate goal of the corporatization of state owned entities, especially where these entities are seen to hold some strategic importance for the state. Corporate governance arrangements are always a reflection of political factors.¹⁴ The current Australian debate regarding the sale of Australia’s

dominant telephone carrier, Telstra, well illustrates this on-going tension; the element of agrarian socialism evident in the debate over the use of funds realised from the sale of Telstra for the provision of “uneconomic” services in the “bush” (or in rural areas) might well be compared with similar arguments in China regarding the continuing communitarian obligations of corporatized state owned entities, often to their parent companies.¹⁵

The corporatization movement has often been driven by a perception that the public sector has failed in some way or even that the state has been deficient in its capacity to deliver certain types of activities, or at least to deliver them as efficiently as some might expect.¹⁶ Whilst the limits of the state to respond to changing circumstances are more readily criticized in countries such as Australia, this has not always been the case in China. The existence of a one party state in China has meant that reforms of state owned enterprises and economic laws have had to be undertaken very carefully so as not to criticise the Party or the State itself. For example, at one stage it was often said that it was absurd to seek to introduce insolvency or bankruptcy laws to deal with loss making state owned enterprises as this was tantamount to suggesting that their owner, the state, was itself bankrupt. In any event, through some clever championing of change by paramount leader Deng Xiao Ping, China was able to move to adopting market principles, the corporate form and stock markets without adopting capitalism itself.¹⁷

In August 2004, the Commonwealth Government released the so-called Uhrig Report, *Review of the Governance of Statutory Authorities and Office Holders*.¹⁸ Whilst pointing to some difficulties with the use of private sector models in public sector contexts, Uhrig continued to believe in the greater accountability and efficacy of these private sector models; however, this faith has not gone without some

⁷ See generally, B Collier and S Pitkin (Eds), *Corporatisation and Privatisation in Australia*, Sydney, CCH Australia Limited, 1999.

⁸ S Bottomley, “Regulating Government-Owned Corporations: A Review of the Issues”, (1994) 53 *AJPA* 521 at 52523. Bottomley has pointed out (at 524) that corporate lawyers have generally ignored the distinction between public regulation and private enterprise.

⁹ S Bottomley, *supra* at 524.

¹⁰ R Grantham, “The Governance of government owned corporations”, (2005) 23 *C&SLJ* 181 at 182.

¹¹ See generally, *Report 336, Public Business in the Public Interest: An Inquiry into Commercialisation in the Commonwealth Public Sector*, Joint Committee of Public Accounts, The Parliament of the Commonwealth of Australia, Canberra, AGPS, 1995 at p 4.

¹² S Bottomley, “Regulating Government-Owned Corporations...” *supra* at 524. For a more detailed discussion of the accountability problems of government business enterprises, see S Bottomley, “Government Business Enterprises and Public Accountability through Parliament”, Research Paper 18, 1999-2000, Parliament of Australia at <http://www.aph.gov.au/library/pubs.rp/1999-2000/2000rp18.htm>

¹³ DC Clarke, “Corporate governance in China: An overview”, (2003) 14 *China Economic Review* 494 at 497.

¹⁴ See further, MJ Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, New York, Oxford University Press, 2003.

¹⁵ The national government decided in August 2005 that it would move to sell off its remaining 51.8% of Telstra over the next two years if the demand was strong enough; see further, C Catalano, M Gratton and M Gordon, “Telstra share slump may force delay”, *The Age*, 18 August 2005; and D Crowe, L Tingle and T Boyd, “Telstra fights ‘draconian’ sale rules”, *The Australian Financial Review*, 18 August 2005, at p 1.

¹⁶ As Stephen Bottomley has pointed out, the alleged greater efficiency of government owned companies is undermined by the fact that public ownership is not voluntary and, as such, individual members of the public are not willing monitors of corporate performance; moreover, they have little incentive to be such monitors; Furthermore, the lack of an effective market for corporate control in government owned companies (ie through takeover) means that managers have little incentive to seek to achieve greater efficiencies: S Bottomley, “Regulating Government-Owned Corporations...” *supra* at p 531.

¹⁷ See further R Tomasic and J Fu, “Regulation and Corporate Governance of China’s top 100 listed companies: Whither the Rule of Law?”, paper presented to Annual Meeting of the ISA Research Committee of the Sociology of Law, Paris, 11-13 July 2005, and available at: <http://www.reds.msh-paris.fr/colloque/tomasic-fu.pdf> .

¹⁸ Uhrig Report, *Review of the Governance of Statutory Authorities and Office Holders*, Canberra, 2003.

criticism.¹⁹ At the same time private sector models and practices have also been subject to some adverse comment and criticism, as seen in the failure of private sector entities to deliver efficiencies to their stakeholders, most notably due to failures in accountability and effective corporate governance. The collapses of Enron in the United States and of HIH in Australia are perhaps good illustrations of this phenomenon.²⁰

This article will look at some legal issues regarding the corporatization of state-owned agencies in China and Australia and assess the extent to which it has been possible to transplant private sector models into the bodies which are still largely state controlled. Our conclusions are somewhat pessimistic and suggest that a dominant state shareholding significantly limits the capacity of the state owned company to fully exploit the advantages of corporatization. In our analysis, we draw upon some fieldwork into China's listed companies that we have undertaken with colleagues from Victoria University over the last three years.²¹ Whilst there are many ways of describing the subjects of our discussion, we will use the term to "Government Owned Corporations" (GOCs) to refer to corporations incorporated under a general corporations statute, such as the 1993 Company Law of China and the Australian *Corporations Act 2001* (Cth), [as well as State and Territory Incorporation Acts at local level in Australia]; such GOCs are ones in which governments have a substantial or a controlling interest or shareholding. Other types of corporations, such as those, which are the creature of a statute passed by the Parliament, are outside the scope of our discussion as their features will vary greatly depending upon particular inputs by the legislature.

The 2005 *List of Australian Government Bodies*, published by the Commonwealth Department of Finance and Administration lists over 1,100 Australian Government bodies up until the end of December 2004; government companies are a small proportion of this number. The Secretary of the Department of Finance and Administration has noted that there are "...86 entities or office holders of various types under our Financial Management and Accountability Act, and 104 entities of various types under the *Commonwealth Authorities and Companies Act*."

The latter legislation (known as the CAC Act) applies only where government bodies are legally and financially separate from the national government and where they are best governed by a board of directors

¹⁹ See for example, R Gratham, "The governance of government owned corporations", (2005) 23 *C&SLJ* 181.

²⁰ See for example, R Tomasic, "Corporate collapse, crime and governance – Enron, Anderson and beyond", (2002) 14 *Aust Jnl of Corp Law* 183.

²¹ Tomasic and Fu at <http://www.reds.msh-paris.fr/colloque/tomasic-fu.pdf> and R Tomasic, N Andrews and J Fu, "Corporate Governance in China's Listed Companies: Whither the top 100?" paper presented to the Inaugural Asia-Pacific Corporate Governance Conference, Hong Kong, 25-26 August 2005; see conference programme at <http://www.hkbu.edu.hk/~apgc/programme.php>.

and not ultimately controlled by the Minister.²³ However, the number of incorporated Australian Government business enterprises is relatively small,²⁴ although there is a larger number of incorporated government companies at the State Government or provincial level.²⁵

2. The increasing use of the corporate form for public purposes

In many respects, the use of the concept of the corporation has to some extent come full circle. In its earlier usages the company was a means of housing various public, governmental and community functions and was part of the system of governance.²⁶ It was not until the end of the nineteenth century that it began to become the almost universal vehicle for business enterprise, if we leave aside the professions (at least until recently). However, we seem to be returning to a pattern of making greater use of the corporate form to undertake public functions and activities. In part, this may reflect a movement in the legitimacy of the corporation as a social vehicle, something that James Willard Hurst alluded to in his book on the history of the business corporation. Perhaps it is the power of the corporate form in legitimating the power of corporate managers (and insulating them from shareholders) that has been its main attraction for governments in China and in Australia.²⁸ For some time we have seen efforts to introduce more market-oriented disciplines into the operation of government owned agencies. This has included moves to corporatize and sometimes even privatise public sector agencies or functions. Whilst this is by no means a new phenomenon, it has gained in pace in recent times.²⁹ Professor Ross Grantham reminds us that: "[p]ublic functions have been undertaken through chartered and statutory corporations since medieval times." He adds,

²³ *Ibid* at p 8.

²⁴ The Australian Government Department of Finance and Administration lists the following companies: ASC Pty Limited; Australian Postal Corporation; Australian Rail Track Corporation Limited; Australian Technology Group Limited; Health Services Australia Limited; Medibank Private Limited and Telstra Corporation Limited; It also refers to the following other government business entities: Australian Government Solicitor and Defence Housing Authority and Aairservices Australia; see further: <http://www.finance.gov.au/GBPFAU/index.html>.

²⁵ http://www.ogoc.qld.gov.au/corporation_details_2.html (for a list of 20 Queensland government owned companies); and <http://www.treasury.nsw.gov.au/links.htm> (for a list of 21 New South Wales government owned companies) and <http://www.treasury.tas.gov.au/domino/dtfdtfdt.nsf/4fd752e16a6a34814a256819001ca> (for a list of ten Tasmanian government owned companies).

²⁶ A Fraser, "The Corporation as a Body Politic", (1983) 57 *Telos* 5.

²⁸ Stokes, "Company Law and Legal Theory", in W Twining (Ed), *Legal Theory and Common Law*, Oxford, Basil Blackwell, 1986.

²⁹ For discussions of the use of the corporate form by government in Australia see: G Sawyer, "The Public Corporation in Australia", in W Friedmann (ed), *The Public Corporation: A Comparative Symposium*, Toronto, Carswell, 1954; and R Cranston, *Law, Government and Public Policy*, Melbourne, Oxford University Press, 1987.

however, that “[w]hat makes the modern wave of corporatisation new is the utilisation of a private sector corporate vehicle and governance structure, the registered company.”³⁰ The supposed greater efficiency of the board of a private company³¹ is also said to be enhanced by the so-called “market for corporate control” under which inefficient managers or boards are at risk of being displaced through a corporate takeover which may install a new management team; this risk is less likely in the case of government controlled companies.³² Also, it should be noted that the shares of a privately owned listed company would normally be transferable so as to allow shareholders to use their funds for more efficient purpose should they decide to sell their shares; the lack of ready transferability of state-owned shares (especially in China) has been another major constraint upon the efficiency of government owned companies. This may be contrasted to a similar, but different problem, in small closely held companies where shares are also not readily transferable, either due to the lack of a suitable market or due to restrictive rules in the company’s constitution which determine the way in which shares are to be offered for sale. However, large government owned companies are very different from small closely held private corporations. It may also be noted that because government owned companies are unlikely to be subject to insolvency proceedings they are further removed from the kinds of competitive forces that are to be found in private companies. Similarly, the fact that their capital raising activities may also often be backed up by the state, means that these companies are further protected from the full operation of the market. Another factor which also contributes to inefficiency in government owned companies arises from the dominance or monopoly position that the company is often given in a particular market (we need to think now further than Australia’s Telstra [the major national telephone company] or China’s Sinopec [China National Petrochemical Company]).

We will now briefly discuss some statutory and regulatory responses to the governance of government owned companies which are dominated by the state as shareholder.³³

3. Australia’s Corporation Law and Government Owned Companies

Whilst there has been much discussion in Australia of the administrative aspects of corporatisation of government owned entities, there has been relatively

little legal analysis of this matter by corporate lawyers. Although there are many forms of corporatization that are available in Australia, the principal forms that are of concern in this article involve incorporation under the *Corporations Act 2001* (Cth) or under a state incorporation statute.

In Australia, the board of a limited liability company would usually be assumed to be concerned to protect the interests of the company as a whole and not merely those of a particular dominant shareholder, such as the majority shareholder. This is usually expressed in terms of the fiduciary duties of directors³⁴, although it is increasingly common to introduce some safe harbour defence, such as the business judgement rule.³⁵ In theory, the company’s “owners” would only hold shares in the company, but do not own the company’s property as this is seen to belong to the company alone; this is because the company is assumed to be the owner of its assets.

Usually, it is assumed that the company’s Board of directors should be the primary arbiter of company policy and decision-making. However, government owned companies in Australia are often required by statute to comply with various public policy objectives often set out in a corporate plan or a statement of corporate intent.³⁶ Just as many large private sector companies face considerable agency problems, government owned companies also encounter some serious monitoring problems for their owner, the state and ultimately the citizen. In theory, it is usually assumed that a registered company incorporated under a general incorporation statute will have a separate legal personality and that the newly formed company will be legally separate from its shareholders, and have a separate management structure from these shareholders (in this case, the government). This separation is not always apparent in the case of government owned companies. Similarly, in the case of the wholly owned subsidiaries of large private sector company groups, it is also not uncommon to find that special rules have been introduced (as in Australia) to deal with accountability and financial reporting of subsidiaries in such groups.³⁷ However, corporate law theory in Australia and the United Kingdom assumes that this separation will be the prevailing norm. In any event, the use of the incorporated company form inevitably raises accountability challenges or “moral hazards” in ensuring that the members of the board do not place

³⁰ Supra at pp 182-182.

³¹ See further, Stout, “The unimportance of being efficient: An economic analysis of stock market pricing and securities regulation”, (1988) 87 *Michigan Law Review* 613.

³² M J Whincop, *Corporate governance in government corporations*, Aldershot, Ashgate Publishing, 2005 at p 65.

³³ For an excellent extended discussion of the legal aspects of government owned corporations, see further: S Bottomley, “Regulating Government-Owned Corporations : A Review of the Issues”, (1994) 53 *Australian Journal of Public Administration* 520.

³⁴ Determining what constitutes the best interests of shareholders in a business corporation is probably less complex than determining the best interests of the stakeholders in a government controlled company: see further, Whincop, supra at pp 72-73.

³⁵ See for example, s 180(2) of the *Corporations Act 2001* (Cth) and s 22(1) of the *Commonwealth Authorities and Companies Act 1997*.

³⁶ *Commonwealth Authorities and Companies Act 1977* (Cth), s 42.

³⁷ 187 of the *Corporations Act 2001* (Cth); This allows directors of wholly owned companies to act in the best interests of the holding company in certain narrow circumstances; Also see s 323A regarding the preparation of consolidated financial statements for controlled entities that are part of a group of companies.

their own interests above those of the company. This is sometimes referred to as the “agency” problem in large widely held private companies³⁸ arising from the fact that the owners have handed over control of the company to a board with a class of professional directors who then are seen (by economists at least) to act as agents of the owners.³⁹ Government owned corporations have had particular difficulty in dealing with agency costs unless they are prepared to adopt the kinds of measures (such as the use of incentives, monitoring and controls) that help to achieve greater efficiencies in private sector companies.⁴⁰ Whilst these agency problems are unlikely to be ever completely solved within companies, whether publicly or privately controlled, they are likely to be more severe in government owned enterprises. Grantham has noted that the ministerial responsibility system which supports the accountability of the government owned corporation in Australia is subject to some basic problems when compared with private sector accountability systems. He argues that the position of the Minister (as the sole or principal shareholder in a government owned company) is not comparable to that of a private owner as the Minister is also an agent of the government and of his political party. Grantham therefore points out that “to assess the effectiveness of the Minister as a monitoring device, one must examine the extent to which the agency costs associated with the Minister are adequately constrained.”⁴¹ He goes on to question the effectiveness of ministerial responsibility in ensuring adequate accountability by the government owned company’s board, noting that:

“First, while the Minister as shareholder may have a right to a range of information about the company’s affairs, the Minister may in fact not wish to acquire that information for political reasons... [so as to be able to avoid responsibility]... Second, even where the Minister does detect self-interested behaviour by the GOC’s management, the Minister does not bear the cost of that behaviour or of doing nothing about it..[effectively reducing the Minister’s personal stake in the outcome].. Third, the goals of the Minister in monitoring the GOC are not wholly directed toward

maximizing the value of the company, as is the case with the private sector owner.”⁴²

The multiplicity of purposes that are imposed upon the government owned company can be contrasted with the much more focused orientation of the private company on the goal of profit maximization. It is very difficult for the government owned company to replicate this single-mindedness as it will usually also have non-commercial goals and these goals are in part set by the state (such as through instructions or policy statements issued the Minister). Also, the fact that the chief executive of the government owned company is usually appointed by the government, means that the effectiveness of the board in being able to sanction poorly performing management is significantly reduced. This problem exists in Australia (as the Uhrig report has noted);⁴³ and it also exists in China’s government owned companies where the chairman or chief executive of a state-owned listed company will effectively be appointed by the government.

4. China’s Company Law: Providing an Acceptable Vehicle for State-Owned Companies

When looking at the corporate laws of China and Australia we find that ideas drawn from the private sector models often sit awkwardly within entities that are still little more than incorporated state owned enterprises. The roots of China’s Company Law are to be found in the logic of the old command planning economy. Whilst it is true that China’s Company Law is only a little more than a decade old, it is a vehicle that is still poorly suited to promoting private sector companies. Paradoxically, it also does not fit comfortably with the patterns of behaviour within government owned companies. This dissonance may not merely be a product of a transitional economy; and there may well be a case for greater differentiation in the mechanisms for the governance of privately as opposed to government controlled companies. Similarly, in Australia, corporate law ideas drawn upon in the incorporation of public enterprises also sometimes sit uncomfortably in such government owned companies. China’s 1993 *Company Law*, and its various corporate governance regulations and Codes, have primarily been enacted with a view to solving problems in the state owned sector. The emergence of a large private owned corporate sector has almost been an unanticipated consequence. In

³⁸ See further, MC Jensen and WH Meckling, “Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure,” (1976) 3 *Journal of Financial Economics* 305-360.

³⁹ In ensuring that the board operates efficiently and in the interests of the company as a whole, such agency problems are usually addressed in a number of ways; these include the threat of being removed by another board through a takeover (the so-called “market for corporate control”); corporate governance standards may also seek to closely monitor the conduct of boards; furthermore, the fidelity of the board to the interests of the owners may be strengthened by resort to various bonding devices, such as share option schemes and the use of incentives; the threat of insolvency and the need to be seen as efficient for purposes of attracting capital through stock exchanges provide further methods of disciplining the directors: see further, Grantham, *supra* at pp 185-187.

⁴⁰ Grantham, *supra* at p 188.

⁴¹ *Ibid* at p 189.

⁴² *Ibid* at p 190.

⁴³ This is pointed out by Grantham, *ibid* at p 191. Uhrig noted that in government owned companies “...typically, the priorities of the board should be the priorities of government as the representative of the community. Unless limited by the legislative framework, governments...should have the capacity to direct the board to act in accordance with government priorities.” This is because, as Uhrig noted, “...despite the oversight of an authority being delegated to a board, Ministers will often remain accountable for its actions” ; see further, Uhrig Report, *Review of the Governance of Statutory Authorities and Office Holders*, Australian Government Publishing Service, Canberra, 2003 at p 42.

examining the development of China's corporate governance, Professor On Kit Tam suggested that the American and UK "outsider" control models of corporate law and governance were ill-suited to the "insider" based control structure of state-owned enterprises in China.⁴⁴ Nevertheless, Chinese legislators have continued to seek to replicate western private sector corporate models within PRC laws. Whilst the PRC Company Law has also allowed for the growth of private limited liability companies (with up to 50 shareholders; per Art 20), special rules were developed to cater for the interests of the State.

For example, PRC limited liability companies may also be "wholly state-owned companies", as provided for in Articles 64 to 72 of the Company Law. Such companies do not have a shareholders' meeting and its board of directors takes the place of such a shareholders' meeting (Art 66). Whilst the board of a wholly owned company is entitled (by Art 46) to exercise wide functions and powers (such as deciding upon the business and investment plans of the company), it remains the case that a State-authorized investment institution, or a government department so authorized by the State, is entitled to "exercise supervision and administration over the State-owned assets of the wholly State-owned company..." (Art 67); this includes the power to appoint and replace the members of the board and to appoint a chairman and vice-chairman of the wholly state-owned company (Art 68). Any state owned assets contributed to the company will not become part of the company's property as Article 4 provides that "[t]he ownership of State-owned assets in a company shall vest in the State." This applies both to limited liability companies and to the more broadly based "joint stock companies" that are also provided for in the Law. However, the Company Law does permit successful large wholly state-owned companies to exercise the rights of asset owners over state owned assets held by them, provided that this is authorised by the State Council (Art 72).

Normally, large corporate entities in China will be incorporated as "joint stock limited companies" which must have a registered capital of at least ten million yuan (Art 78); this is to be contrasted with the highest registered capital requirement for limited liability companies of half a million yuan (Art 23). However, in the case of joint stock companies, these must have at least one thousand shareholders who each hold shares to the values of at least one thousand yuan. At least the general public must hold 25% of the total shares of a listed company, except that this figure may be 15% in the case of larger listed companies with a share capital of more than 400 million yuan (Art 152). The sponsors of a joint stock company incorporated by way of a share offer, must subscribe for at least 35% of the company's shares, with the remainder

being available to the public (Art 63). However, in most of the top 100 PRC listed companies, the state will hold significantly more than 35% of the shares in the company. Companies seeking to offer shares to the general public need to gain official approval (Art 85).

The board of a joint stock company is deemed by Art 112 to be responsible to the shareholders meeting. It is also entitled to exercise various function and powers, such as "to decide on the business operation plans and the investment plans of the company." A joint stock company is required to convene a shareholders general meeting at least once a year (Art 104), although interim general meetings may also be convened from time to time (Art 105). The general meeting of shareholders in such a company is also vested with various "functions and powers"(by Art 103); these include the power "to decide upon policies on [the] business operation and [the] investment plans of the company" and the power "to elect and replace members of the board of directors and to decide upon matters concerning the remuneration of the directors" (per clauses (1) and (2) of Art 103). Where a listed company has a dominant state owned shareholder, there tends to be a low level of participation by other shareholders in such general meetings; it is therefore inevitable that the AGM has become something of a formality in such circumstances. The general meeting is usually presided over by the company Chairman. The chairman is in many ways a powerful figure in large state-owned Chinese companies and serves as the chief executive; he or she is also deemed to be "the legal representative of the company" (Art 113). The board of directors is only required to meet twice a year (Art 116). When the board is not in session, the chairman may be authorized to perform some of its functions and powers (Art 120).

In the case of larger listed companies with a substantial state shareholding, the chairman will have been effectively appointed by a controlling state organ with the support of the Communist Party. He or she may have come for a career as an official in government service and may move on to such a governmental position after ceasing to be the chairman. In the late 1990s the World Bank reported that senior officers in the company might also hold official government positions contemporaneously.⁴⁵

The Party is permitted by the Company Law to continue to play an important role within PRC companies⁴⁶, and this is especially so in the top 100 listed companies, particularly in regard to company personnel matters. Indeed, the fact that the Party Secretary within a Chinese listed company usually serves in one of the senior board position, such as the position of Chairman or General Manager, means that a high degree of party control has been maintained in government owned companies in China and, as a

⁴⁴ OK Tam, *The Development of Corporate Governance in China*, London, Edward Elgar, 1999. Also see generally, Jian Chen, *Corporate Governance in China*, London, RoutledgeCurzon, 2005.

⁴⁵ World Bank, *supra* at p 38.

⁴⁶ Article 17 of the Company Law provides that "The grass-roots organization of the Communist Party of China in companies shall carry out their activities in accordance with the Constitution of the Communist Party of China."

consequence, the independence of the board is likely to be much reduced. It has also been suggested that the dominance of the Party in many Chinese corporatized state owned enterprises has led to a considerable degree of corruption as the company lacks an adequate countervailing force of checks and balances.

It should be noted that Art 153 provides that the listing of a joint stock company requires the approval of the State Council or its authorised securities department (these powers have now been delegated to the CSRC). Listing has been sought after by many companies, but for some time listing has operated on the basis of a quota system controlled by the state, with a view to preventing too many listings which would soak up available capital. The 1998 PRC Securities Law now suggests that once some basic listing information has been provided to the CSRC (as set out in Art 45), the stock exchange will arrange to have the company listed within six months (Art 46). It is interesting to note that Art 44 of the Securities Law provides that the "State encourages companies that conform to industrial policies and meet the conditions for listing to have their shares listed."

In any event, the paucity of minority shareholder protection provisions in the PRC Company Law and in the Securities Law is problematic in the context of the dominant state owned shareholders; this has inevitably called the integrity of PRC listed companies into question, especially given the existence of large numbers of connected transactions that advantage the dominant shareholder and disadvantage the minority shareholders.⁴⁷ This has led to efforts to provide greater protection to minority shareholders, such as by the appointment of so-called "independent directors" to the board of listed companies.⁴⁸

Independent directors have been given the somewhat awesome task of seeking to ensure the integrity of the board (by monitoring related party transactions and serving as members of Audit Committees, as well as representing the interests of minority shareholders).⁴⁹ This has been done, not by amendment of the Company Law, which does not speak of independent directors as such, but by way of regulations issued by the CSRC, as the State Council authorized body responsible for the oversight of listed companies. Much has been written about the difficult challenge that has been given to these "independent directors" of state controlled listed companies.

In its review of the effect of the state as the principal owner in China's corporatized state owned entities, the World Bank concluded in 1997 that these state owned companies to varying degrees failed to satisfy each of the four key features of the corporation. Although much has happened in the intervening years since this report was first published, there is still much

in these findings that rings true. Interestingly, the Bank observed at that time that:

"With respect to establishment of a *separate legal identity*, there has been only a minor degree of corporatization...In the case of *limited liability*, there is a perception that the State's liability for SOEs is greater than its formal or legal shareholding. Moreover, an organizational blurring has occurred and this has given rise to widespread problems with the definition and allocation of responsibility for liabilities...*Centralized management*, another element of the modern corporation, is relatively well established – except that usually the corporate form envisions shareholders to come first and then the most competent management is chosen."

The World Bank report went on to add that :

"In China, centralized management existed *before* the company did in fact, before there were shareholders...In China, shareholders, as such, seem to have little, if any, influence on management. This will remain the case so long as the majority shareholder remains the same state agency and the same persons that in the old system appointed and gave orders to management. At the same time, management is often lacking the authority to deploy and dispose of the corporation's property...[Finally] Transferability of shares is available for only the small portion of companies whose shares are listed on the two stock exchanges..."

More recently, research published by the Shanghai Stock Exchange has also highlighted this problem by pointing to the conflict between the role of government as owner and regulator of listed companies. The Shanghai Stock Exchange report noted that:

As the immediate predecessor of China's market economy is a planned economy, the government inevitably becomes a key figure in corporate governance. On the one hand, the government enacts laws and regulations, sets up rules for the market, regulates the economic activities, and supervises the implementation of corporate governance institutions that it imposes on the companies. On the other hand, the government is a major shareholder of the company. The overlap and conflict of being both referee and player, combined with the inefficiency caused by pursuing political objectives instead of taking responsibility as a shareholder, are the apparent negative influence on governance qualities."⁵⁰

It should be added however, that despite recent announcements that a process of disposing of some state owned shares has begun⁵¹, the state owned shares of China's listed companies have usually not been tradeable on stock exchanges, although some

⁴⁷ Lu Tong, "Corporate Governance in China", at p 1, (mimeo), Chinese Academy of Social Sciences, Beijing.

⁴⁸ See further, M Wang, "The independent directorship system in China", (2004) 17 *Aust Jnl of Corp Law* 243-259.

⁴⁹ Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies issued by CSRC on 16 August 2001.

⁵⁰ Shanghai Stock Exchange, *ibid* at p 35.

⁵¹ See further Notice of China Securities Regulatory Commission on Relevant Issues of Pilot Reform of Equity Division of Listed Companies issued by CSRC on 29 April 2005.

generally small strategic investments by major foreign partners have been encouraged.⁵²

It is clear that the principal stumbling block facing the further development of corporate governance in Chinese listed companies is to be found in the dominance of the state as shareholder and the mixed messages that this sends about the usual principles of corporate law that are assumed to apply when the corporate form is used by private companies. The Shanghai Stock Exchange in its 2003 corporate governance report also highlighted the problematic nature of “misplaced government roles”.⁵³ The Exchange pointed out that the effect of the state as shareholder dominating government owned companies in China meant that the controllers of these companies were “governed by political incentives and individual utility maximization instead of shareholders’ value.”⁵⁴

This situation will probably require a cultural shift before there is a substantial change in the situation. One way of seeking to engineer this cultural change is through the use of guidelines and codes of conduct which are sensitive to the real situation and problems facing government owned companies. To some extent this is an extension of the idea of fiduciary duties that have been so important in fashioning relationships within the business corporation. At the present time, it is recognised in China that: “The lack of due diligence of the director and the management in performing their fiduciary duty leads to the sacrifice of the principal’s interest.”⁵⁵ International influences, such as the work of the OECD and its annual corporate governance dialogues with China may be effective in leading to a slow movement in this regard.

5. The place of principles and guidelines in the governance of government controlled companies: stabilizing the role of the state in corporate governance

Like all dichotomies, the public-private distinction is an inherently unstable one given the many ambiguities that arise where public purposes are implemented through what is characterised as a private corporate structure.⁵⁶ For example, the alleged greater independence from government of government owned corporations is sometimes simply a mask for ministerial political control.⁵⁷ It might also be said that there is a considerable difference in the conduct of government-owned companies depending upon the

level of control or shareholding that is held by government. A similar point may be made based on the degree to which the government owned corporation is seen to be involved in a strategically important industry. Ultimately however, where possible, government owned companies need to uncouple their commercial and non-commercial objectives if the integrity of the company is not to be undermined. Efforts to refine or finetune governance responsibilities and roles within the corporate structure have become increasingly common, as may be seen in efforts to develop softer or more flexible statements of rules and principles that are applicable to corporate governance⁵⁸. The OECD has led the way here. But Stock Exchanges⁵⁹, Audit and accounting bodies and bodies like Standards Australia⁶⁰ have also made important contributions to creating what is essentially a level playing field. In an attempt to enhance the integrity of the China’s state-owned enterprise oriented Company Law, the China Securities Regulatory Commission (CSRC) in January 2001 promulgated its “Code of Corporate Governance for Listed Companies in China”. This Code was largely based upon the *OECD Principles of Corporate Governance* (referred to hereinafter as the “OECD Principles”).⁶¹

The OECD Code was devised for companies that were essentially privately owned; interestingly, the OECD has now developed a separate Code for state-owned companies, recognising that state owned enterprises face distinctive governance challenges. This new code is known as the *OECD Guidelines on the Corporate Governance of State-owned Enterprises* (referred to hereinafter as the “OECD Guidelines”). Whilst these OECD Guidelines are intended to complement the OECD Principles of Corporate Governance, unlike the latter, they unashamedly “take the perspective of the state as an owner.”⁶² Arguably, China might have derived greater benefit from seeking to apply these Guidelines to its listed companies, given their current ownership structure. The preamble to the OECD Guidelines notes that:

“...SOEs also face some distinct governance challenges. One is that SOEs may suffer just as much from undue hands-on and politically motivated ownership interference as from totally passive or distant ownership by the state...More fundamentally, corporate governance difficulties derive from the fact that the accountability for the performance of SOEs

⁵² See further, Shanghai Stock Exchange, “Abstract, China Corporate Governance Report 2003” at pp 46-47.

⁵³ <http://rru.worldbank.org/Discussions/OpenFile.aspx?id=1284>.

⁵⁴ Ibid at p 48

⁵⁵ Ibid at p 57.

⁵⁶ See generally: C Stone, “Corporate Vices and Corporate Virtues: Do Public/Private Distinctions Matter?”, (1982) 130 *University of Pennsylvania Law Review*; and C Sampford, “Law, Institutions and the Public/Private Divide” (1992) 20 *Federal Law Review* 185-222.

⁵⁷ Paul Finn has referred to “the duplicitous mask of independence, which conceals direct political manipulation by ministers”, P Finn, “Public Trust and Public Accountability”, (1993) 65(2) *Australian Quarterly* 59. This manipulation may occur through the role played by the appointment of government officials as nominee directors to the boards of government owned corporations.

⁵⁸ See further, A Armstrong, “Corporate governance standards: intangibles and their tangible value” (2004) 17 *Aust Jnl of Corporate Law* 97-110.

⁵⁹ See for example, Australian Stock Exchange, “Principles of Good Corporate Governance and Best Practice Recommendations”, issued by the ASX Corporate Governance Council in March 2003.

⁶⁰ Standards Australia, *AS 8001-2003: Corporate Governance – Good governance principles*, 2004.

⁶¹ For an earlier discussion of these principles, see R Tomasic, “Good corporate governance: The international challenge”, (2000) 12 *Aust Jnl of Corp Law* 142-163.

⁶² *OECD Guidelines on the Corporate Governance of State-owned Enterprises*, p 2.

involves a complex chain of agents (management, board, ownership entities, ministries, the government), without clearly and easily identifiable, or remote, principals. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge.⁶³

The OECD Principles of Corporate Governance proclaimed that a company's "corporate governance framework should protect and facilitate the exercise of shareholders' rights" and went on to call for the "equitable treatment of all shareholders" and the recognition of the "...rights of stakeholders." In contrast, the OECD Guidelines emphasise the role of the state as owner. They begin by, *inter alia*, calling for "a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation."⁶⁴ Whilst also emphasising the need for the equitable treatment of all shareholders,⁶⁵ the Guidelines highlight the centrality of the role of the State as owner and generally note that: "The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness."⁶⁶

Under this broad framework, the OECD Guidelines urge that the state should be an active owner and consequently that it should seek to "exercise its ownership rights according to the legal structure of each company."

Some of the other guidelines that are urged by the OECD in regard to the position of the state as an owner are as follows: the government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy; the government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives; the state should let SOE boards exercise their responsibilities and respect their independence; the exercise of ownership rights should be clearly identified within the state administration. This may be facilitated by setting up a co-ordinating entity or, more appropriately, by the centralisation of the ownership function. The co-ordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.⁶⁷ This is a very important statement of considerations that might help to stabilise the role of the state in corporate governance. Applied to the impasse that currently faces many state-controlled

listed companies in China, these guidelines suggest useful pathways for further development.

These guidelines also set out some other important ideas that our research would suggest would be valuable in the context of PRC listed companies; these include financial reporting by listed SOEs "according to high quality internationally recognised standards", the separation of the role of the chair from that of the CEO and empowering boards to allow them to appoint and to remove the CEO.⁶⁸

6. Some Tentative Conclusions

This article has sought to identify some of the tensions that exist in government owned companies in Australia and especially in China. It has shown that the dominant position of the state as shareholder has the potential to undermine some fundamental features of the modern corporation. Traditionally there has been a heavy focus on conformance with rules and regulations in government owned companies, without adequate attention being given to performance issues. However, even this focus on conformance with rules, has been problematic as it has not gone far enough. This conformance/performance dichotomy presents a major challenge that has yet to effectively handle the legal problems identified above. International debates about appropriate standards to apply to the governance of government owned companies are very important as is the expression of this debate in the form of international standards or guidelines for such companies. In this regard, the problems found in China seem to be massive and provide instructive insights as to the limits of corporate governance in government owned companies. Best practice guidelines of the kind developed by the OECD and the Australian Audit Office provide a modest path forward, especially in regard to the management of conflicts of interest. However, at the end of the day, despite some wishful thinking about the convergence of private and government owned company models, there will remain some fundamental differences between these two types of company. The governance of government owned companies presents a challenge for integrated governance practices. At present, these organisations are torn between pursuing often contradictory goals. The challenge is to bring about greater integration within government owned corporations and to ensure that they operate in a less fragmented way. It is well established in the case law on the private corporation that directors need to perform their duties in the interests of the company as a whole and not merely in the interests of one shareholder or stakeholder group in the company. As we have seen, this has presented problems as companies have had mixed success in reconciling their commercial and non commercial goals.

⁶³ Ibid at p 3.

⁶⁴ Ibid at p 4.

⁶⁵ Ibid at p 6.

⁶⁶ Ibid at p 5.

⁶⁷ Ibid at p 5.

⁶⁸ Ibid at pp 8 and 9.