

Corporate Governance in State-Controlled Enterprises

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Abstract

This paper is an international comparison of corporate governance in state controlled enterprises, focusing on corporate governance in Telstra in Australia and China Telecom in China. By comparing and contrasting corporate governance in these two companies, this article explored corporate governance practices and mechanisms in partially listed state controlled enterprises under dramatically different socio-economic environments manifested in China and Australia. This article also explored the role of the Australian government and the role of the Chinese government in Telstra and China Telecom respectively and shed some lights on the underlying forces that have, up to date, shaped the governance of partially listed state controlled enterprises in China and Australia..

Introduction

A privatisation wave swept through Australia and China in the 1980s for vastly different reasons. In Australia's case, the sale of public assets was mainly influenced by the international privatisation trend in the 1980s (Ranald, 1996: 97); this trend began in 1986 and escalated during the late 1990s (APS Commission, 2003: 128). In China's case, partial privatisation of state-owned enterprises has been the core part of its mega economic and enterprise reform since the "open door" policy was adopted in 1978. Corporate governance in state controlled enterprises becomes more complicated after their partial privatisation. To help us understand the governance of those partially listed state controlled enterprises, this article explored corporate governance in Telstra and China Telecom under the vastly different socio-economic contexts of Australia and China respectively.

Background

The Case of Australia

Government Business Enterprises (GBEs) play an important role in the Australian Economy. For example, in the year of 1988-1989, they contributed 10% to the gross domestic product (GDP) and 6% to total employment (Economic Planning Advisory Council, 1990) in Australia. In the 1980s, a privatisation trend swept the world's most developed countries such as the UK, France, Italy and Japan (Clarke, 1994: 1) and in the late 1980s, Australia joined others to pursue privatisation as a way of

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improving the financial performance of its public sector (Browne, 1993). Furthermore, in the earlier 1990s, privatisation was proposed as one way to increase competitiveness and productivity in Australia. The government also realised that the conflict of interests for a GBE to be both the regulator as well as a player in the market. The Hilmer Committee (1993: 217) suggested that the key to increased efficiency came from privatisation and that it was therefore necessary to separate the regulatory function from the commercial function of a GBE.

After the privatisation of the Commonwealth Bank, Qantas and Australian National Railways etc. by the Federal government, and the gas and electricity companies such as PowerCor, and CityPower by the state governments in the earlier 1990s (Fairbrother et al., 1997), the privatisation of Telstra was finally on the agenda. In fact, the privatisation of the telecommunications industry was also closely related to deregulation. It was argued that the national competition policy should include reforming the regulations that unjustifiably restricted competition in the telecommunications industry (The Hilmer Committee, 1993: xvii).

As part of the deregulation of the telecom sector in Australia, the regulatory function of Telecom Australia (predecessor of Telstra) was transferred to an independent regulator – Australian Telecommunications Authority (AUSTEL) in 1989 (The Hilmer Committee, 1993). According to the Australian Communications Authority Act 1997, AUSTEL merged with the Spectrum Management Agency (SMA) to become the Australian Communications Authority (ACA) on 1 July 1997. The promulgation of the Australian Communications and Media Authority Act 2005 on 1 July 2005 marked the official merging of ACA and the Australian Broadcasting Authority (ABA) to form the Australian Communications and Media Authority (ACMA).

The Case of China

Since the ‘open door’ policy was adopted in China in 1978, the economy in China has gradually transformed from a socialist economy to the so-called ‘socialist-market economy’. The corporatisation and partial privatisation of the Telecommunications industry in China is part of its mega economic and enterprise reform which has been carried out in China since then.

The telecommunications industry in China was traditionally directly managed under the monopoly of the former Ministry of Postal & Telecommunications (MPT). It has long been perceived as one of the industries with strategic and military importance by the government (Pitt et al., 1996: 350). Perhaps because of this, the economic reform in the telecommunications industry has attracted a lot of controversy.

In the late 1980s and the earlier 1990s, there were often two different voices in the debate about reforming the telecom sector in China. The pro-reform clan argued that opening competition in the telecommunications industry would boost economic development and increase efficiency in China, especially in an information age, when China’s telecommunications industry was developing at an astonishing speed, accompanied by an exponential increase of sales and profit. On the other hand, the con group suggested that more competition would be detrimental to the government’s interest in reigning in the telecommunications industry; less government control could become a strategic disadvantage for the whole country. Not surprisingly, a lot of the resistance against the reform came from within the former MPT, as more competition would result in the loss of its highly lucrative monopoly power (Tan, 1994).

In 1998, MPT was also under reconstruction following the government’s massive plan to reform its ministries and spin off commercial activities associated with them as separate enterprises. This process sought to ensure that spun-off enterprises could eventually seek listing in the stock markets (Chen, 1998). In March 1998, the MPT merged with the Ministry of Electronic Industry (MEI) to become the Ministry of Information Industry (MII) (Zhang, 2000: 10); the management function of the MPT directly relating to the postal management was separated and managed under a newly established government department – State Post Bureau (under the MII).

Corporate governance in Telstra vs. China Telecom

The Case of Telstra

Telstra's history can be traced back to 1901, when the Postmaster-General's Department (PMG) was established to manage all domestic telephone, telegraph and postal services (Senate Environment Recreation Communications and the Arts References Committee, 1996b: 23). During its long history, Telstra was also transformed and renamed several times, including Telecom Australia, the Australian and Overseas Telecommunications Corporation and as Telstra since 1993 (Telstra, 2005). Telstra lost its monopoly power in the market when, in 1991, Optus was introduced into the long distance and mobile phone market (Australia Industry Commission, 1995: 142). In 1993, a third license was awarded to Vodaphone (Australia Industry Commission, 1995: 142). Since then, a few other competitors gained access to the Australian market to operate in data, fixed line and mobile areas. Overall, the Australian telecommunications market has indeed become one of the most open telecommunications market in the world (Barton and Teicher, 2000: 6).

Ownership Structure

The predecessor of Telstra, Telecom Australia, was corporatised as a government owned corporation in 1975 (Australian Public Service Commission, 2003: 212). The corporatisation process involved creating a legal structure for the enterprise in the form of a company with the government being the shareholder (Browne, 1993: 477). After being directly owned and managed by the government for more than 90 years, in 1997 Telstra was partially privatised, with 1/3 of its shares sold to the public. The partial sale was finally achieved after lengthy debate among the public as well as among the major political parties. A further 16.6% of Telstra's shares were sold to the public in 1999, with government controlling 50.1% of its shares (Telstra, 2005). The 50.1% is also the minimum requirement of the government ownership required by law (Australian Government Attorney-General's Department, 2005). Currently, the government shareholder's role is represented jointly by the Minister for Communications, Information Technology and the Arts and the Minister for Finance and Administration (Department of Communications Information Technology and the Arts, 2005).

The Role of the Government

The role of the government in the governance of Telstra changed gradually after it was privatised in 1997. Rather than directly managing Telstra, currently, the government only oversees the proper management of Telstra to insure public interests have been served (Australian Government Attorney-General's Department, 2005). As Telstra is still a partially privatised GBE, its board has the obligation to report to government on various issues as listed in Telstra Corporations Act 1991. For example, the board of Telstra must keep the Minister informed of its financial status, corporation plan and any other significant issues (Australian Government Attorney-General's Department, 2005). The responsible Minister, after consultation with the board may also give directions to Telstra to serve the public interest (Australian Government Attorney-General's Department, 2005).

The Board and the Management

The Telstra Corporation Act 1991 clearly stipulates some general requirements for appointment as a director of Telstra. For example, the chairperson of Telstra's board must be an Australian citizen, a majority of directors must be Australian citizens, and at least 2 directors must have knowledge of, or experience in, the communication needs of regional areas (Australian Government Attorney-General's Department, 2005: 40).

Telstra's annual report 2004 illustrated that apart from Telstra's CEO, who was also a director, its board was composed primarily of non-executive and independent directors. As a majority shareholder, the government did not directly appoint any government officials to the board. In fact, as suggested by Dawkins (1986: 2), most of the boards of government trading enterprises have long been dominated by private businessmen. Technically, the government still remained in control by appointing directors to the

board with its majority shareholding. In regards to the composition of its senior management team, all the nine senior executives were private businessmen with extensive commercial experience.

Interests of other Stakeholders

Apart from the shareholders, the board, the management, and the government, there are also other major stakeholders in Telstra, such as customers, employees, creditors and suppliers. The two most important groups among them are probably customers especially the rural communities and employees, whose interests are also closely related to the governance of Telstra. Clearly one of the main arguments to keep Telstra as a government controlled entity is its responsibility to fulfil Community Service Obligations (CSO), such as providing universal services including to the rural community at affordable prices (Dawkins, 1986: 4). This point has recently been re-emphasised by the former national party leader – Mr John Anderson (Wardill, 2005).

Another group of stakeholders are employees of Telstra, who are concerned that their interests will not be taken care of during the privatisation process. After all, the sale of Telstra is always political as well as sentimental. The job losses of employees has been one of the major public concerns of Telstra's privatisation (Senate Environment Recreation Communications and the Arts References Committee, 1996a: 1579, 1587, 1611). Official data showed that in the period of total two years ending 30 June 1998, staff numbers were reduced by more than 20 thousand (Prior, 1998: 61).

Despite some of the criticism of Telstra's management of stakeholders' interests, according to a global survey conducted by the Governance Metrics International (CCH, 2005), Telstra's governance was actually rated significantly higher than average for Australian companies in terms of criterion such as board accountability, shareholder rights, ownership base etc. This, in a way, indicated that overall, Telstra had a very good corporate governance system. However, with further privatisation of Telstra – sale of the third tranche of shares of Telstra in the near future, the governance structure of Telstra could also change dramatically.

The case of China Telecom

In 1994, perhaps under the influence of privatisation of the telecommunications sector all around the world (Pitt et al., 1996), and also as an effort by the government to reform and invigorate the telecommunications industry, the management of the fixed line telephone network and the mobile network was separated from the administrative function of the MPT and established as a legal enterprise under the MPT – China Telecom (People Daily Online, 2005). The pressure to push forward economic and enterprise reform in the telecom sector has also seen the establishment of the Department of Telecommunications Administration (DTA) within the MPT to oversee the extensive regulatory functions of MPT. However this reform was widely criticised, as a DTA controlled by the MPT was not seen as appropriately independent (Pitt et al., 1996: 360). This problem eventually disappeared in 1998, when the regulatory function of the telecommunications market was transferred to a newly developed Ministry – the Ministry of Information Industry (MII); at the same time, the supervision of the state interest in China Telecom and other telecommunications companies was also transferred to the State Trade and Economic Commission (STEC), the predecessor of the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council.

Back to 1994, while the regulatory functions were reformed within the MPT, in order to further increase competition and to drive efficiency in the telecommunications industry, another telecom operator, China Unicom was introduced into the market. China Unicom was formed under the auspice of the state council, with its capital contributed from the Ministry of Electronic Industry (MEI), the Ministry of Railways (MOR), the Ministry of Electrical Power (MOP) and thirteen other large state-owned enterprises (Pitt et al., 1996: 357). The establishment of China Unicom marked an age of a fundamental 'paradigm shift' in the development of the Chinese telecommunications industry (Pitt et al., 1996: 356), as China's telecommunications sector moved away from the strict monopoly to the so-called 'managed

competition' (Pitt et al., 1996: 348). At this stage, both China Telecom and China Unicom were state-owned enterprises controlled by different government interest groups.

Following the introduction of China Unicom to the market, four other companies have emerged: China Mobile, China Railcom, China Netcom and China Satcom. All these telecom companies were sourced from different government interest groups in China and some of them were formed after breaking up the original monopoly government player – China Telecom. For example, China mobile was separated from the then China Telecom in 1999, to focus on the mobile communications business; China Railcom originated from the Ministry of Railway in 2000; China Netcom incorporated the 10 provincial branches of the former China Telecom and two independent carriers – the China Network Communications Co Ltd and Jitong Communications (China Daily, 2003); China Satcom was set up combining the following corporations: China Telecommunications Broadcast Satellite Corp., China Orient Telecommunications Satellite Company Co, Ltd., China Space Mobile Satellite Telecommunications Co, Ltd., China Posts & Telecommunications Translation Service Corp., China Telecom (Hong Kong) and Chinasat Corporation (China Satcom, 2005).

The telecommunications companies in China were restructured in such a way that, on the one hand, the dominant government interest in the telecommunications industry was preserved; on the other hand, the 'managed competition' framework favoured by the Chinese government in its transition stage of economic and enterprise reform was reinforced. Given the roots and history of all six major players in the telecommunications market, China Telecom was chosen to serve as a comparison with Telstra.

Ownership Structure

China Telecom is listed both in the Hong Kong Stock Exchange and New York Stock Exchange (traded as American Depositary Shares) (China Telecom, 2004: 2). According to China Telecom's Annual Report 2004 (China Telecom, 2004: 45), as at 31 December 2004, 72.09% of its shares were owned by China Telecommunications Group Corporation. Three legal-persons owned a further 10.76% of China Telecoms' shares. All these shares were classified as 'domestic shares' and were not tradable in the stock markets. The remaining 17.15%, were listed in Hong Kong Stock Exchange (H shares). The share structure in China Telecom is called a split ownership structure and is very typical of state-owned enterprises transformed into listed companies in China.

The Role of the Government

China Telecommunications Group Corporation (the major shareholder of China Telecom) is a state-owned enterprise. In 1998, the supervision of China Telecommunications Group Corporation was transferred to STEC from the former MPT, following a general economic and enterprise reform plan to separate government functions from commercial activities. In 2003, the supervision of China Telecommunications Group Corporation was further transferred to SASAC of the State Council of China. Now SASAC is responsible for managing 172 companies (State-owned Assets Supervision and Administration Commission of the State Council, 2005), most of them were previously under the management of various government ministries.

The controlling interest of 72.09% represented by the government in China Telecom has huge implications. Through its dominant shareholding not only in China Telecom but also in other telecom companies, the government played an important role in reforming the telecommunications industry through its administrative measures. Nearly all six major telecommunications companies mentioned before are listed in the stock markets. However, because of the government's dominant shareholding in all these companies, all six companies are still treated as wholly state-owned enterprises most of the time. A typical example was that on 1 November 2004, the government swapped the top executives of China Telecom, China Mobile and China Unicom without explanation (People's Daily Online, 2005d, c). This episode illustrated that the Chinese government still maintained a very powerful position in managing state-owned enterprises transformed listed companies.

The Board and the Management

According to China Telecom's 2004 annual report (China Telecom, 2004), the management board of China Telecom is composed mainly of executive directors. Among the 15 directors of the company, 11 of them were executive directors, one was categorised as non-executive director, and three of them were categorised as independent directors, although their independence has been often questioned by outside observers. The chairman of the board was also the CEO of the company. Apart from the management board, China Telecom also had a supervisory board. The supervisory board was composed of 5 members. It was worth noting that both the management board and the supervisory board were mainly composed of former government officials, who now have taken up management positions in the government controlled listed company. Most of the executive directors still had their government ranking. This suggested that the current arrangement has only converted the title of previous government officials to directors, or managers, and there was no substantial change in the role each person used to be playing. This was consistent with the fact that the government has taken a 'gradualist approach' in its economic and enterprise reform.

The Interest of Other Stakeholders

Utilising the same governance framework employed in the analysis of Telstra, it could be argued that in the case of China Telecom, the two major stakeholder groups are also customers and employees. Because there are also other players in the telecommunications market in China, there is similar concern (as is the case of Telstra) that the players will 'cream skim' the market, which could leave the interests of the high-cost rural areas unserved (Pitt et al., 1996: 359).

In terms of the interest of employees, historically, state-owned enterprises provided the so-called 'cradle-to-grave' social services, which included providing life long employment, a generous pension, proper medical care and other social securities to its employees (Broadman, 2001). Although these arrangements will be gradually faded out as a proper social security system is established (Jia, 2004), it will take a considerable long time under China's 'gradualist' approach to achieve that.

In the case of China Telecom, after it was listed, there has *not* been any employee redundancy, simply because the job cuts have seldom been considered as an option. The reduction of employees was mainly achieved through natural attrition such as retirement. In terms of pension payment to retirees, the company has moved away from direct payment of pensions to its retirees, which is a normal practice for a state-owned enterprise before the economic and enterprise reform was carried out in China. According to China Telecom's 2004 annual report, the company has made contribution to retirement plans organised by municipal and provincial governments (China Telecom, 2004: 125). This illustrated that the company has gradually moved away from the old practice of direct payment of pensions to employees. Consistent with its old government function of providing social services to employees, the company also contributed 5%-10% of its net profit to a special fund to serve employee interest such as construction of dormitories, canteen and other staff welfare facilities (China Telecom, 2004: 111).

The Comparison and Contrast

Although both were triggered by the international privatisation trend, the partial privatisation of Telstra compared with that of China Telecom illustrated the different privatisation paths of the two companies associated with each company's socio-economic context. In Telstra's case, the privatisation was more or less driven by the efficiency argument, and partial privatisation moved Telstra one step closer to become a general market player. In China's case, apart from the 'market efficiency' argument, the partial privatisation of China Telecom was also closely related to the overall economic and enterprise reform in China which aims to separate government functions from economic management.

In terms of governance arrangements, the government's involvement in Telstra is clearly stipulated in various regulations and government will only give direction to Telstra to serve the public interest. In comparison, the governance of China Telecom demonstrated that the company was still more or less

treated as a wholly state-owned enterprise. The direction in China Telecom and how its reform will be carried out in the future still remains a purely government administrative decision.

Looking at the Future

With the Australian Government taking control of the senate on 1 July 2005, the full privatisation of Telstra is now back on the agenda,. Latest developments show that the total sell-off of Telstra could be decided by the Australian government as earlier as the end of May 2006 (Sainsbury and Lewis, 2006). At the same time, China has also started to tackle its split share structure problem. In May 2005, a trial of four companies was announced with plans to gradually sell off the non-tradable shares to the market (People's Daily Online, 2005b) and a further 42 companies were to join the trial in June 2005 (People's Daily Online, 2005a). By 2006, more than seven hundred companies listed in the Shanghai and Shenzhen Stock Exchanges announced their split share ownership structure reform plans. If China Telecom is to undertake the split share ownership structure reform in the future, then there could well be changes to its corporate governance practices and the role of the government in its governance arrangements. The likelihood of further developments in Telstra and China Telecom make this comparison case open for future analysis.

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