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**DEVELOPING A CORPORATE GOVERNANCE  
REGIME FOR STATE OWNED ENTERPRISES IN  
PAPUA NEW GUINEA**

**A Thesis**

**Submitted in Fulfilment of the Requirement  
for  
the Degree of Doctor of Philosophy in Law  
at the University of Waikato**



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**WAIKATO**  
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**Hamilton, New Zealand**

**2010**

## ABSTRACT

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Papua New Guinea (PNG) has a developing economy and the Government controls three quarters of it. Control, in a way, provides the Government with power to give effect to the aspirations of the people enshrined in the National Goals and Directive Principles. State Owned Enterprise (SOE) is one of the means that the Government utilizes to participate in the economy, particularly delivering goods and services to the people. SOEs are established as separate legal entities and intended to be independent of the government so that they can be efficient and/or profitable, replicating the private sector, in their role in production of goods and delivery of services. There is a principal and agent relationship in an SOE. On the one hand the government is a shareholder with multiple interests, including public interest considerations and on the other hand there is the management that is responsible for strategic decisions and operations, creating a principal and agent relationship. The important question in this relationship is to what extent the government, as principal, should be involved in the business and affairs of SOEs.

The use of SOEs by government creates controversies. Since Independence in 1975, SOEs have been increasingly facing problems in corporate governance. Some of the problems identified in PNG include situations where procedures are not complied with in appointing and terminating directors and chief executive officers (CEOs), most of which end up in court; responsible ministers, directors or CEOs involved in self-interested activities; and appointment of political associates and family members as directors and managers who do not have skills, knowledge or experience. These are issues in corporate governance; however they are not looked at from that perspective because corporate governance is a new concept that has never been substantively discussed in PNG. Thus, this study examines and records the law and practice of corporate governance, and identifies deficiencies and ways in which the corporate governance regime in SOEs can be improved.

Given the fact that corporate governance is a new phenomenon in PNG, the thesis made use of case study methodology. There were five SOEs selected for case studies. Two are under the category of statutory corporation and three under state company. These SOEs were selected for purposes of comparing and contrasting under their individual category and between the two categories. The data was collected through documents and semi – structured interviews. The participants in the interviews were senior managers, former and current directors and CEOs, and consumers of SOEs.

The research found many flaws of corporate governance in SOEs. These flaws were the consequence of lack of understanding and appreciation of corporate governance. Further, they were the consequence of inconsistencies between different laws, between laws and the practice, and deficiencies in the laws. The result of the research suggests first that the Government controls SOEs and is involved in both operational and policy matters of SOEs. Second, boards of SOEs are ineffective. Nearly all directors are on a part-time basis and lack understanding of the business and affairs of SOEs and their own roles and responsibilities. Third, the role of public institutions such as Ombudsman Commission and Public Accounts Committee is unclear among the participants interviewed. Consequently, the Government that controls SOEs is not held to account for its conduct in relation to them. Finally, the majority of consumers from each SOEs interviewed, stated that the quality and efficiency of services in SOEs are poor. This can partly be related to lack of good corporate governance.

## DEDICATION

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To Ruth Matui, my beloved mother, who used to wake up at 4.30am every morning to prepare me breakfast so that I could walk over kilometres to be in time for classes. To you I owe my deepest gratitude. To Matui Sagiwa, my late father who passed away on 15 September 2009, in the third year of my PhD programme. You have been an example of discipline, commitment and hard work. Your belief in me has been a source of my strength and motivation that led me this far. Both of you have unselfishly sacrificed your lives that I could have a better life. Words cannot express my gratitude. From the bottom of my heart, I thank you, both.

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The senior managers, the former and the current directors and chief executive officers, and consumers of state owned enterprises in Papua New Guinea have voluntarily surrendered their time and made themselves available and accessible for the interviews in Port Moresby. I make a special mention of the chairmen of Independent Public Business Corporation of Papua New Guinea and two statutory corporations that encouraged their officers to be available for interviews after realising the importance of the study for the country. Much of these interview data made up the thesis. I sincerely thank you for your time and effort.

The staff members of the University of Waikato are friendly, open and go out of their way to assist students to settle into the university environment and begin their study. I thank you for your support and generosity during my time at the University. I would like especially to acknowledge the Senior Law Librarian, Fiona Corcoran for an outstanding job of reading through this thesis. On the same note I acknowledge and thank Andrea Haines from Teaching and Learning Development Unit, University of Waikato, for her understanding and support.

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## ABBREVIATIONS

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<b>ASX</b>	Australian Securities Exchange
<b>ACE</b>	Autonomous Crown entities
<b>BGI Act</b>	Business Groups Incorporation Act 1974
<b>CE Act</b>	Crown Entities Act 2004
<b>CEC</b>	Crown entity companies
<b>CEO</b>	Chief Executive Officer
<b>CES</b>	Crown entity subsidiaries
<b>COMU</b>	Crown Ownership Monitoring Unit
<b>CPC</b>	Constitutional Planning Committee
<b>CSR</b>	Corporate Social Responsibility
<b>GOC</b>	Government Owned Corporation
<b>GOC Act</b>	Government Owned Corporations Act 1993
<b>ICE</b>	Independent Crown entities
<b>IMF</b>	International Monetary Fund
<b>IPBC</b>	Independent Public Business Corporation of Papua New Guinea
<b>LGI Act</b>	Land Groups Incorporation Act 1974
<b>MTDS</b>	Medium Term Development Strategy
<b>NBC</b>	National Broadcasting Corporation
<b>NGC</b>	Nue Guinea Kompagnie
<b>NGDP</b>	National Goals and Directive Principles
<b>NHC</b>	National Housing Corporation
<b>NSW</b>	New South Wales
<b>NZ</b>	New Zealand
<b>NZX</b>	New Zealand Exchange Limited
<b>OECD</b>	Organization for Economic Co-operation and Development
<b>OLIPPAC</b>	Organic Law on the Integrity of the Political Parties and Candidates
<b>PAC</b>	Public Accounts Committee
<b>PNG</b>	Papua New Guinea
<b>PPCSOE</b>	Parliamentary Privilege Committee on State Owned Enterprise
<b>SCI</b>	Statement of Corporate Intent
<b>SOC</b>	State Owned Corporation
<b>SOC Act</b>	State Owned Corporations Act 1989
<b>SOE</b>	State Owned Enterprise
<b>SOE Act</b>	State-Owned Enterprises Act 1986
<b>SOI</b>	Statement of Intent
<b>UK</b>	United Kingdom
<b>UNDP</b>	United Nations Development Programme
<b>USA</b>	United States of America

**PART I:**  
**INTRODUCTION**

# CHAPTER 1:

## INTRODUCTION

“Good corporate governance does not guarantee good performance but its absence usually indicates present or future problems.”<sup>1</sup>

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### 1.1 INTRODUCTION

Professor John Farrar succinctly emphasises the importance of corporate governance in society in the prologue stated above and that sheds light on the nature and the purpose of this study. This study is intended to identify the laws and practices of corporate governance in state owned enterprises (SOEs), document and identify factors that contribute to its problems, and suggest measures and guidelines for a good corporate governance framework. In doing so the study is not intended to be a blue-print for a lasting solution to corporate governance woes, but it is intended to address problems identified through case studies and also be a guide to solving future problems. Over the last 20 years, corporate governance has gained prominence and its discourse has become prevalent in both private and public sectors around the world due to globalisation and the collapse of large corporations.<sup>2</sup> This study generally focuses on corporate governance with particular emphasis on governance in SOEs in Papua New Guinea (PNG). It discusses the nature and definition of corporate governance, corporate governance in private and public sector corporations and corporate governance in SOEs in PNG.

In this chapter, SOE is defined to provide clarity to the nature and the type of organizations that are the subject of this study. This is followed by the discussion on the rationale for the research, objective of the research and the research questions. Then, the significance of the study is highlighted, what it means for PNG society and particularly SOEs in the country. Next, the overview of the

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<sup>1</sup> Farrar, J. H., *Corporate Governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) xxxix.

<sup>2</sup> Erik Banks gave examples of corporations that have collapsed due to corporate governance problems around the world. That does not include corporate collapse after 2004 and cases in Australia such as HIH. See Banks, E., *Corporate Governance, Financial Responsibility, Controls and Ethics*, (2004) 4 – 8.

thesis is discussed setting out various chapters and reasons for their inclusion, followed by the conclusion.

## **1.2 THE NATURE OF STATE OWNED ENTERPRISE**

This section discusses the definition and categories of SOEs and the types of SOEs whose corporate governance is the subject of this research. SOEs are also known by other names. In Queensland, they are known as government owned corporations and New South Wales, state owned corporations. Throughout this study the name SOE is used, however other names are used where appropriate. There are also different corporate forms of SOE. The type of corporate form adopted can influence their flexibility, degree of commercialisation and impact on the overall performance of SOE.

The definition of SOE varies. Aharoni identified three characteristics of SOEs.<sup>3</sup> First, an SOE is an enterprise and involved in production of goods and services for sale. Second, an SOE is part of the public sector and owned by government and thirdly an SOE has sales revenue that bears relation to costs. These characteristics apply to commercial SOEs where the government has 100 per cent shareholding and not a controlling interest of 51 per cent or above.

Bottomley stated that SOEs are those entities incorporated under general company legislation with substantial government control. He excludes statutory corporations, which are the subject of specific statutes and have potential for government and parliamentary input and scrutiny.<sup>4</sup> This implies that statutory corporations have similar status as government departments despite their character of separate legal personality.

SOEs can also be classified according to their legal structure. The three main corporate types are departmental enterprises, statutory corporations and state companies.<sup>5</sup> First, departmental enterprises are part of the government department and the minister has direct responsibility in its affairs. Its business affairs are run

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<sup>3</sup> Aharoni, Y., *The Evolution and Management of State Owned Enterprises*, (1986) 6.

<sup>4</sup> Bottomley, S., "Regulating Government-Owned Corporations: A Review of the Issues," (December 1994) 53(4), *Australian Journal of Public Administration*, 521 at 521.

<sup>5</sup> See discussions above n 3 at 13 – 16.

like a normal government department and managed by public servants. The management in this organization usually lacks flexibility and creativity and therefore cannot achieve reasonable economic success.<sup>6</sup>

Second, statutory corporations or public corporations are set up by a special Act of parliament and they are one hundred per cent state owned. Enabling legislation gives these organizations separate legal personality. This means that they can sue and be sued, own and dispose of property, and enter into contractual relationships under their corporate names. Since they are a hundred per cent owned by the state, the state has the onus of providing capital and covers any losses. Statutory corporations are subject to public control and accountability even though some employees of the organization may not be civil servants. The accountability takes the form of annual reports submitted to the relevant minister, to be presented before the parliament and subject to public law.<sup>7</sup>

And third, state companies are incorporated under company legislation and the state owns the majority shareholding. These organizations are subject to company legislation, constitution of the company, memorandum of association and other related laws. This means that managers are accountable to the board of directors, which is the proxy of the shareholders, and the board in turn is subject to the general meeting where their performance is measured on the basis of efficiency and profitability. State companies face the threat of winding up on application by creditors.<sup>8</sup>

The issue of whether an entity is an SOE is avoided when legislation specifically defines it. The PNG *Electricity Commission (Privatization) Act 2002* defines SOE as a company incorporated under the *Companies Act 1997* and has shares issued to ministers in trust for the state, a statutory body established by state, or a trust where the State or the Minister as trustee for the State owns all the beneficial interest in the assets of the trust.<sup>9</sup> Similarly, Queensland's *Government Owned Corporations Act 1993* defines a government owned corporation as a statutory

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<sup>6</sup> Hanson, A. H., *Public Enterprise and Economic Development*, (2<sup>nd</sup> edn., 1965) 337 – 342.

<sup>7</sup> Ibid at 342–351.

<sup>8</sup> Ibid at 351–356.

<sup>9</sup> *Electricity Commission (Privatisation) Act 2002*, s 2 (PNG).

corporation or state company.<sup>10</sup> In contrast section 617 of the Indian *Company Act of 1976* defines SOE as an entity “in which no less than 51 per cent of paid-up share capital is held by the Central Government and partly by one or more State governments”. The definition excludes statutory corporations and the government does not necessarily have to have 100 per cent shareholding.

The definition of SOE varies with different jurisdictions depending on the legislative provisions and the extent to which government participates in it. The common view is that an entity will be an SOE if the government has a controlling interest and direct influence on the entity. For purposes of this study SOEs are entities established by statutes or incorporated under company legislation, with separate legal personality with government having substantial control. Therefore, the categories of SOE that are the focus of this study are statutory corporations and state companies.

### **1.3 RATIONALE FOR THE RESEARCH**

The PNG Government controls a large part of the country’s economy, and SOEs are utilized as its agents to perform an important role of production and delivery of goods and services to the people. Many of the SOEs in PNG were the legacy of the colonial administration, and were inherited by the Government immediately after Independence. Government provided services with the use of SOEs either because the services were important for the people of PNG, there was no capitalist class of indigenous Papua New Guineans to obtain ownership of the corporations immediately after Independence, or the Government felt that it could not leave certain activities in private hands for the reason that the pursuit of profit maximization would leave many rural populations lacking vital services.

PNG has experienced the situation where services are withdrawn in rural areas when they are left in private hands. In 2000, the Government tested privatisation policy on the PNG Banking Corporation. The Bank of South Pacific (BSP) bought PNG Banking Corporation.<sup>11</sup> Consequently, many branches in rural townships such as Angoram, Maprik and Tari in PNG closed, and people either had to travel

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<sup>10</sup> *Government Owned Corporations Act 1993*, s 7(2)(3) (Qld).

<sup>11</sup> This was the first time in the short history of the country that a major state institution was privatised.

by air or long distance by road to the main towns to do banking. In areas where BSP was conducting business, many who were once customers of PNG Banking Corporation lost their accounts with the bank. Some of the reasons given by BSP were that these people could not sign signatures, maintain a minimum amount in their account or present some form of identification. My brothers in Angoram travel two hours by road to do banking in Wewak (the capital town of East Sepik Province). My mother was denied an account with BSP because she does not have an identification card.<sup>12</sup> Private companies cannot operate in rural areas because of fear of making a loss. Given the prevailing economic and social circumstances, SOEs are vital in PNG.

To date, Government continues to use SOEs. During the last thirty-five years since independence many government activities were corporatised. Despite corporatisation, SOEs are still affected by political interference. Successive governments seem to have the view that because the boards are appointed by them it gives them the right to direct or exert political influence on them. The following cases are cited as just some of the examples to identify corporate governance issues.

First, during my field trip to PNG from April to September 2008, the chief executive officer (CEO) of the National Housing Corporation was suspended from the position. When the CEO was on suspension all his loyal associates at the main office at Tokara, Port Moresby were sacked. The suspended CEO went to the National Court questioning the legality of his suspension. Second, in 2007, the son of the current Prime Minister was appointed to the board of directors of PNG Power Ltd. There was public outrage over the appointment, in which the Government was accused of nepotism. Third, in January 2008, the term of members of the board of the National Broadcasting Corporation expired and there was no appointment of new members for nearly a year. When I was in PNG for data collection I was only dealing with former directors, and even when I left towards the end of September 2008 new directors had not been appointed. Finally, people express, nearly every day, complaints and frustrations on the street and in

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<sup>12</sup> The bank was particular about identification cards. It must be a driver's license, passport or identification from a recognised organisation. My mother does not drive, does not have a passport and she is not formally employed.

the national newspapers of SOEs providing low quality and inefficient services. These are only some of the examples.

Many of these issues are corporate governance issues; however they are never seen from that perspective. Jonathan O'Ata, the Secretary of the PNG Institute of Directors (a newly established body) noted that:

There are...corporate governance issues of banks, family owned firms and state owned firms which are not well understood, nor are the nature and detriments of enforcement.<sup>13</sup>

This summarises the state of affairs of corporate governance in SOEs in PNG. Hence, this is the first study of its kind on corporate governance in PNG. This study is important, as it will initiate and contribute to the understanding, discussion, and greater awareness of corporate governance discourse in PNG.

#### **1.4 OBJECTIVE AND RESEARCH QUESTIONS**

The main objective of this study is to look into, and document, the law and practice on corporate governance in SOEs in PNG. Therefore, the main question is: what is the position of corporate governance in law and practice? In tune with the objective and the main question, the following specific questions are posed for further examination: a) how are shareholders held accountable in SOEs? b) how are directors and CEOs held accountable in SOEs? c) is lack of good corporate governance a factor contributing to ineffective delivery of goods and services to the people? In addressing these questions the study looks at the internal and external accountability mechanisms, particularly the hierarchical structure in SOEs, the role of public institutions, and roles and responsibilities of stakeholders in governance of SOEs. In addition, it examines the objectives that SOEs pursue and whether the public are satisfied with the efficiency and quality of the services.

#### **1.5 IMPORTANCE OF THE RESEARCH**

Corporate governance is a new concept in private and public sectors in PNG. Since PNG's Independence in 1975, public enterprises have played a pivotal role

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<sup>13</sup> O'ata, J., *Fostering Corporate Governance through a Strategic and Constructive Partnership for 2008 and Beyond*, [page 2] < [http://www.pngid.org.pg/downloads/Fostering\\_Corporate\\_Governance\\_through\\_Startegic\\_&\\_Constructive\\_Partnership.pdf](http://www.pngid.org.pg/downloads/Fostering_Corporate_Governance_through_Startegic_&_Constructive_Partnership.pdf) > at 19 February 2009.

in the development of the country and yet corporate governance is never discussed in public enterprises, even though they are corporations with boards, directors and management, and have many features similar to that of private sector corporations and its concomitant problems. This research is the first major piece of work that contributes to an understanding of corporate governance practice and law generally, and particularly on corporate governance in SOEs in PNG. The study re-examines the theory of agency under the doctrine of separation of ownership and control, and traces its relevance and application in private and public sectors generally and particularly in SOEs in PNG.

The research is important in several respects. First, it contributes to the empirical evidence on corporate governance in SOEs in PNG with respect to governance and accountability of relevant ministers, boards, directors and CEOs. Second, the study attempts to identify the laws on corporate governance in SOEs in PNG, and compare and contrast them against the practice to identify inconsistencies, deficiencies and lack of enforcement. Concurrently, an awareness can be established on some of these issues that may have caused problems in corporate governance, so that government and all stakeholders in the governance of SOEs can take appropriate actions to address them through various guidelines, rules, policies and legislations.

Third, the study can be used as a guide for policy and law makers such as the directors of SOEs, the Independent Public Business Corporation of PNG, relevant Ministers, Government and the Parliament, to make informed decisions about how to improve corporate governance in SOEs. The study would enable corporate governance to be considered and prioritized to ensure that SOEs become efficient and effective in order to realize their objectives. As a step forward some of the solutions are proposed in chapter 15 to address the issues of corporate governance identified in the study.

Finally, this study can also assist relevant Ministers, directors and CEOs and public institutions responsible for accountability such as the Public Accounts Committee, the Ombudsman Commission and the Department of Treasury to distinguish and change, where necessary, characteristics and practice of governance to ensure good corporate governance practice in SOEs.

## **1.6 OVERVIEW OF THE CHAPTERS**

The thesis is divided into six parts. Part I focuses on stakeholder theory and theory of agency, particularly the doctrine of separation of ownership and control, and the nature of the corporation and corporate governance. The whole study is about corporate governance, and corporate governance is at the heart of the doctrine of separation of ownership and control. Chapter 2 focuses on the stakeholder theory and agency theory and the doctrine of separation of ownership by discussing the reasons that gives rise to the separation of ownership and control. Particularly, it focuses on defining the concept of control as it would determine who controls corporations in the private sector discussed in Part II, the public sector in Part III and SOEs in PNG in Part V. Chapter 3 discusses the nature of the corporation and corporate governance. It focuses on the brief history of company law from the common law perspective, followed by the definition of corporation and different theories that explain the rationale of corporations. Chapter 3 ends with a discussion of the definition and principles of corporate governance. Corporate governance is about governance in a corporation, making discussion of the history of the corporation and the definition and various theories explaining the concept of the corporation essential to provide a foundation in further understanding the concept of corporate governance, hence they are discussed together in chapter 3.

There would be deficiency in the whole thesis if governance in private sector corporations is not discussed before looking at corporate governance in SOEs. This is because much of the discussion on corporate governance in SOEs is about SOEs emulating characteristics of efficiency and accountability similar to that of the private sector. Therefore, it is useful in any discussion of corporate governance in SOEs to begin with an examination of governance in private corporations to understand the characteristics and intricacy of corporate governance and its adoption in the public sector. Chapter 4 in Part II discusses corporate governance in private sector corporations, focusing on New Zealand (NZ) and Australia, including other jurisdictions such as the United Kingdom (UK), Germany and Japan for comparative purposes. Information in chapter 4 is compared and contrasted in Parts III and VI.

Part III discusses the concept of the state and corporate governance in the public sector. Any discussion of SOEs involves the state, therefore chapter 5 focuses on the concept and personality of the state, particularly the role that the state performs in the society and its use of SOEs. Many government activities are separated from government departments, and they are now managed separately either under SOEs that are created by special Act of parliament or incorporated under company legislation, however the government still maintains ownership in them. Corporatisation is the process that creates the separation of these activities. Chapter 6 discusses the definition and rationale for corporatisation and experiences of corporatisation in NZ. Discussion of corporatisation is important as all SOEs are corporatised entities, and it is important to highlight the definition and the fundamental reasons that underlie the undertaking of the corporatisation process. Chapter 7 ensues with a discussion on corporate governance in the public sector. It discusses corporate governance in SOEs in NZ, Queensland and New South Wales (NSW), looking at various laws that provide for corporate governance. Further, the chapter raises some of the issues, and compares corporate governance in the public sector with the private sector as discussed in Parts I and II. Importantly, chapter 7 further provides the basis for comparing and contrasting corporate governance in public enterprises in NZ, Queensland and NSW with corporate governance in SOEs in PNG, in Part VI.

The study of corporate governance in SOEs hinges on understanding the political structure and socio-economic circumstances of a country. In order to understand corporate governance in SOEs, an understanding of the role of the state and the socio-economic circumstances of a country are crucial. The state is the majority shareholder in SOEs and its focus is not on profit maximisation alone but also on public welfare. Chapter 8 discusses the State of PNG and its political circumstances, followed by chapter 9, which discusses major dilemmas of development and the role of the State in advancing socio-economic goals of the country. Chapter 10 discusses different types of corporations, SOEs and corporate governance in PNG. It highlights the history of corporations in PNG, the status of corporate governance and the rationale for state use of SOEs.

To improve corporate governance, it is important that the practice on the ground must be identified and compared with the regulatory framework to establish its

position in order for propositions to be made for improvement. Part V presents the case studies. It discusses the methodology of data collection and analysis, and the empirical data collected on selected SOEs on a field trip - undertaken between April and September 2008 in PNG. The selection of SOEs for the case studies was made to cover various government activities ranging from housing, broadcasting, telecommunication, and water supply, to production of and supply of electricity. Of the five SOEs studied, two are statutory corporations whilst others are state companies that are incorporated under PNG *Companies Act 1997* or its predecessor. These SOEs have different corporate forms depending on whether they are incorporated under the *Companies Act* or established by a special Act of parliament. These different types of SOEs are studied to identify generally the corporate governance framework and particularly the extent of the role of the Government. Chapter 11 presents the methodology of data collection; chapter 12 presents the case studies in statutory corporations, while chapter 13 presents the case studies in state companies.

For my research in PNG I was ably assisted by senior managers, directors and CEOs, both current and past, who generously gave time for interviews and provided written responses to interview questions. I had the assistance of three law students from the University of PNG. In addition, I was allowed to have access to some of the documents of SOEs such as annual reports, corporate plans, annual returns and company constitutions. A set-back was the lack of any literature on corporate governance in SOE in PNG and hence I could not compare primary data with the secondary data. However, the difficulty is outweighed by my curiosity in researching an area that has not been studied before. Also, it is interesting to be working on the thesis at the time when the PNG Government's focus in its "Medium Term Development Strategy" is on reforming the state's structure to focus on delivery of services to the rural populace. Ten million kina (an increase from 1.5 million kina) is allocated to each district through members of the electorate to provide services to the people. Members of the parliament are encouraged to use state agencies and institutions to deliver services to the people. SOEs are and will become vital in the delivery of goods and services to the people.

Finally, Part VI summarises the discussions in the thesis and recommends a way forward for corporate governance in SOEs in PNG. Chapter 14 of Part VI establishes the position of corporate governance looking at practice in Part V and the laws, and compares and contrasts the corporate governance in PNG with NZ, Queensland and NSW to identify the deficiencies in PNG. Chapter 15 looks at how corporate governance in SOEs can be improved in PNG by looking at external and internal accountability mechanisms, followed by the conclusion in chapter 16.

## **1.7 CONCLUSION**

I have defined SOEs and pointed out the types of SOEs that are the subject of this thesis, and outlined the research questions, and discussed the rationale, the importance and the aim of the research. Then I have outlined various chapters and their relevance and contribution to an understanding of the research aim and questions. SOEs are important for PNG given its political and socio-economic circumstances, and the fact that it is a developing country going through a transitional stage. If SOEs are to be successful in terms of being efficient and achieving their objectives, then corporate governance framework must be examined and if need be, improved. Hence, this study is carried out with the aim of documenting, analysing and identifying problems in corporate governance in SOEs, and makes recommendations for improvement.

**CHAPTER 2:**  
**THEORY OF AGENCY – SEPARATION OF OWNERSHIP  
AND CONTROL**

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**2.1 INTRODUCTION**

The aim of this thesis as introduced in chapter 1 is generally to discuss agency theory and examine its relevance and application in state owned enterprises (SOEs) in Papua New Guinea (PNG). The theory of agency, like the theory of the firm, attempts to explain diverse organizational and governance structures observable in a private sector corporation. It further argues that the relationship between management and the shareholder is contractual and that the management must serve the interests of the shareholder. The focus of this theory is on the management and the shareholders – the management is the agent and the shareholders are the principals, creating a fiduciary relationship between the principal and the agent. Generally, the focus of company legislation is geared towards maintaining fiduciary relationships through aligning the interest of management and shareholders. This is true for the *Companies Act 1993* (New Zealand), *Corporations Act 2001* (Australia) and *Companies Act 1997* (PNG).

This chapter provides a theoretical foundation for discussion of corporate governance in chapter 3 and other chapters in this study. It begins by looking at the theory of agency and the theme of separation of ownership and control, which includes discussion of the concept of control and agency costs, followed by discussion of recent studies that dispute the concept of separation of ownership and control as having any universal applicability. Then the concept of agency cost is discussed followed by the conclusion.

**2.2 AGENCY THEORY**

In agency theory, the principal is a person who delegates, through contract, to another person, the agent, to perform a service on behalf of the principal. The agent binds the principal on any contract undertaken within the scope of any

express, implied or apparent authority of the principal.<sup>1</sup> There are three assumptions that are at the core of agency theory.<sup>2</sup> They are that: a) all individuals, as human beings are self-interested and given the opportunity they will maximize their interests, b) human social life consists of exchanges, deals and agreements that are governed by the competitive self-interest of individuals, and c) “monitoring contracts is costly and somewhat ineffective, especially in organizations, thus encouraging self-interested behaviour, shirking, and cheating.”<sup>3</sup> The theory of agency is applied in a corporation to explain the relationship between the management and the shareholders. The result from the discourse is the doctrine of separation of ownership and control.

Agency theory applies in a corporation, but with some modification. The shareholders as owners in a corporation are the principals but they delegate the control of the company to the board. This delegation, which creates a separation of ownership and control, also creates agency problems. Where there is separation of ownership and control an attempt is made to ensure that the principal is faithfully served and the agent is properly compensated in order to align his or her interests, especially in situations where the agent’s interests do not coincide with those of the principal.<sup>4</sup> Hence, the theme of separation of ownership and control is parallel to the question of how directors can be made accountable to the shareholders. Corporate governance focuses on these issues.

### **2.3 SEPARATION OF OWNERSHIP AND CONTROL**

The fundamental debate on corporate governance in the private sector is the relationship between management and the shareholders, (the owners<sup>5</sup>) of the company. The issue that surrounds the relationship is the separation of ownership

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<sup>1</sup> Farrar, J. H., *Corporate Governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) 59; Jensen, M. C. and Meckling, W. H., “Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure,” (October 1976) 3(4), *Journal of Financial Economics*, 305 at 309; Fama, E.F., “Agency Problems and the Theory of the Firm,” (1980) 88, *Journal of Political Economy*, 288; Fama, E.F. and Jensen, M., “Separation of Ownership and Control,” (1983) 26(2), *Journal of Law and Economics*, 301.

<sup>2</sup> See Perrow, C., “Economic Theories of Organization,” in Wheeler, S., (ed.) *A Reader on the Law of the Business Enterprise*, (1994) 208 at 209.

<sup>3</sup> Ibid.

<sup>4</sup> Jensen and Meckling, above n 1.

<sup>5</sup> In strict legal terms shareholders are not owners of the company, but having ownership right in the shares. See Grantham, R., “The Doctrinal Basis of the Rights of the Company Shareholders,” (November 1998) 57, *Cambridge Law Journal*, 554.

and control of the company. Prior to 1932, there was a general assumption that directors were sufficiently accountable to shareholders. Accountability is ensured through appointment by shareholders at the general meetings and number of duties imposed on directors by various laws. In their seminal work on corporations in 1932, Berle and Means<sup>6</sup> highlighted, in their analysis that shareholders are owners of the company but the control of the company lies with the board and senior managers. Shareholders put finance into the company as investment and consequently obtain certain rights and powers, but they surrender their right of control of the corporation to qualified managers to act on their behalf.<sup>7</sup> As corporations grow large, more shares are sold, leaving large corporations with dispersed ownership of shares.

The dispersed ownership of shares is created by the need for capital. The increased trading activities and large size of the company is met by capital from a large, fractured and dispersed group of shareholders. Shares are not owned by a person in large numbers, such as a person owning one hundred per cent in a company, but in small portions by individual persons across the society. This inevitably leads to the control of the company passing from the shareholders to the managers. This separates ownership from control;<sup>8</sup> the separation creates a gap in control, which is filled by directors and managers.<sup>9</sup> As Thomas J noted “it is because of the separation of ownership from management in corporate theory and practice that directors are appointed to manage the company in the absence of the owners.”<sup>10</sup> Directors then appoint a chief executive officer to administer the day-to-day business and affairs of the company.<sup>11</sup> The management exercises the

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<sup>6</sup> Berle, A. A. and Means, G. C., *The Modern Corporation and Private Property*, (1932); compare Edward, E. S., *Corporate Control, Corporate Power*, (1981) ch 3, and Zeitlin, M., “Corporate Ownership and Control: the Larger Corporation and the Capitalist Class,” (1973 – 74) 79, *American Journal of Sociology*, 1073.

<sup>7</sup> This may be different in a small to medium size company where shareholders can also become directors, strategising and managing the affairs of the company.

<sup>8</sup> Separation between ownership and control maybe true for developed countries like UK and USA but may not be true for some developing countries like Indonesia and Malaysia where there is concentration of shareholdings. See Daniel, W.E., “Corporate Governance in Indonesian Listed Companies: a Problem of Legal Transplant,” (July 2003) 15(1), *Bond Law Review*, 318 at 327; Singam, K., “Corporate Governance in Malaysia,” (July 2003) 15(1), *Bond Law Review*, 288 at 292 – 293.

<sup>9</sup> Salim, M. R., “Legal Transplantation and Local Knowledge: Corporate Governance in Malaysia,” (December 2006) 20(1), *Australian Journal of Corporate Law*, 55 at 61.

<sup>10</sup> *Dairy Containers Ltd v NZI Bank Ltd* (1995) 7 NZCLC 260 783 at 260 794.

<sup>11</sup> Dine, J., *Company Law*, (5<sup>th</sup> edn., 2005) 153.

delegated power and is therefore subject to the board's scrutiny.<sup>12</sup> The board becomes the proxy of the shareholders who control the company.

Corporations characterized by separation of ownership and control strictly focus on the economic interest of shareholders or on maximizing interest of the shareholders. Thus, in a traditional company the sole objective of management is to increase the value of the company, which in turn increases the value of the shares and therefore a healthy dividends payment. The primary goal of shareholders is profitability and accordingly as agents, management is required to pursue profit maximization. Consequently, laws are developed which strictly focus on shareholder primacy.<sup>13</sup> The interest of broader constituents, sometimes referred to as stakeholders, becomes secondary.

### **2.3.1 Control of the Corporation**

Understanding of corporate control is vital in parallel to an understanding of ownership in a corporation. Control is a vague concept and is synonymous to power. Like power, vagueness lies in the probability that one can execute one's will regardless of resistance or probability, that by virtue of habituation, one's command will be obeyed by other persons.<sup>14</sup> Control is broadly defined as "the power to influence [OR] direct peoples' behaviour or cause of events".<sup>15</sup> Section 50AA (1) of the *Corporations Act 2001* (Australia) defines control as the capacity to determine the outcome of decisions about financial and operational policies. In a narrow and explicit term the American Law Institute's "Principles of Corporate Governance" defines control as:

The power, directly or indirectly, either alone or pursuant to an arrangement or understanding with one or more other persons to exercise a controlling influence over the management or policies of a business organization through the ownership of, or power to, vote equity interests through one or more intermediary persons, by contract, or otherwise.<sup>16</sup>

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<sup>12</sup> *Dairy Containers Ltd v NZI Bank Ltd* (1995) 7 NZCLC 260 783 at 260 794.

<sup>13</sup> See general discussion in Roe, M.J., "The Shareholder Wealth Maximization Norm and Industrial Organization," (2001) 149, *University of Pennsylvania Law Review*, 2063.

<sup>14</sup> Weber, M. and Parsons, T., *The Theory of Social and Economic Organization*, (1947) 152.

<sup>15</sup> *Oxford Dictionary of English*, (2<sup>nd</sup> edn., 2005) 377.

<sup>16</sup> American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, (vol. 1, 1994) 13, para. 1.08.

This definition applies in small to medium sized companies and proprietary companies and not in large listed companies where there is fractured and dispersed ownership of shares in which effective control is by a board of directors. James McConvill stated that "...the assumption that shareholders had ultimate control over directors due to the power to elect which directors they wanted was a myth, as the board had effective control over proxies and the agenda of general meetings and therefore had the 'real' say as to who were to be elected as directors".<sup>17</sup> Berle and Means argued that those who own large corporations do not control them and those who control them have less interest in their ownership. They further highlighted the attributes of control as follows:

Since direction over the activities of a corporation is exercised through the board of directors, we may say for practical purposes that control lies in the hands of the individual or group who have the actual power to select the board of directors, (or its majority), either by mobilising the legal right to choose them – 'controlling' a majority of the votes directly or through some legal device – or by exerting pressure which influences their choice. Occasionally a measure of control is exercised not through the selection of directors, but through dictation to the management, as when a bank determines the policy of a corporation seriously indebted to it.<sup>18</sup>

Therefore, control in a corporation refers to persons who have the power to appoint a board or management, or direct management. In a private corporation ownership does not necessarily determine control. Thus, control can be through selection of directors to the board or influence exerted on the management's decisions. These roles are exercised primarily by two entities – shareholders and directors. Shareholders select directors to the board and the board exercises control through the appointment of management. Control can also be through legal device, such as legislation which delegates power to control to certain stakeholders in a company. Further, Berle and Means identified five forms of control pertaining to a private corporation.<sup>19</sup> McDonough<sup>20</sup> summarises their discussion of control as follows:

- a. Private Ownership – this gives rise to control through complete ownership of the corporate form;
- b. Majority control – control that arises as a result of ownership of majority of shares;

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<sup>17</sup> McConvill, J., *Shareholder Participation and the Corporation: a Fresh Inter-Disciplinary Approach in Happiness*, (2006) 75.

<sup>18</sup> Berle and Means, above n 6 at 69–70.

<sup>19</sup> Ibid at 70–90.

<sup>20</sup> McDonough, D. D., "Corporate Governance and Government Owned Corporations in Queensland," (1998) 10(1), *Bond Law Review*, 278 at 292. McDonough was quoting from the revised edition of Berle, A. A. and Means, G. C., *The Modern Corporation and Private Property*, (revised edn., 1968) 66.

- c. Control through a legal device – the person who exercises the control does not own a majority of the issued shares but is nonetheless able to control the entity through for example the use of non – voting shares, super shares (as proposed in a relatively recent case of News Corporation Limited), or shares with weighted voting rights etc;
- d. Minority control – this is where the particular group only holds a small number of shares, however able to control the corporation. This can particularly be the case with public companies that have a large but scattered shareholder base such that the holder of perhaps as low a figure as 10% is able to exercise control.
- e. Management control – this occurs where the share is widespread and there is no single group that has minority control. Often this can be the case in public companies, the majority of shares in which are held by institutions. Management is left to control by default.

In *Farrar's Company Law*<sup>21</sup> the distinction was expressed in percentage terms of voting rights. This shows clearly how much control is exercised in a corporation.

In percentage terms control is:

a. Absolute	99 – 100%
b. Substantial	75 – 99%
c. Simple majority	51%
d. Negative	26%
e. Minority	up to 25%

A person with absolute and substantial control can pass any resolution, including both an ordinary and a special resolution at the general meetings. An ordinary resolution can be passed where there is simple majority control. A special resolution, in situation where the company legislation requires it, may only be passed with the support of other shareholders. Management control usually occurs in circumstances where there is no relationship between the shareholders and the management, and the control of the corporation is vested in the management. Minority control occurs in exceptional circumstances in corporations that have dispersed ownership where an individual or a small group having interest between 20 to 50 per cent, which is sufficient to control a company.<sup>22</sup> The control of a corporation may not necessary fall into the above category and can be determined by different circumstances in a particular society.

### **2.3.2 Universal Application of the Doctrine of “Separation of Ownership and Control”**

The doctrine of separation of ownership and control is not a common phenomenon experienced in corporations around the world. In some jurisdictions persons that have ownership of a corporation also have control of it. The

<sup>21</sup> Farrar, J. H. and Hannigan, B., *Farrar's Company Law*, (4<sup>th</sup> edn., 1998) 564.

<sup>22</sup> See Farrar, above n 1 at 46 – 49.

separation of ownership and control depends on the type of corporation, how large or small the corporation is and the jurisdiction that the corporation is in. For example, it is observed in the United States and other similar economies that separation of ownership and control has ceased to exist.<sup>23</sup> Although the term “cease” may not describe the reality, what is clear is that separation of ownership and control is not universal. In a paper *Corporate Ownership around the World*<sup>24</sup> the three Harvard economists argued that separation of ownership and control observed by Berle and Means is far from universal. The following features, amongst others, of ownership are observed in other parts of the world:<sup>25</sup>

- a. The widely held corporation is most common in countries with good regimes of shareholder protection.<sup>26</sup>
- b. Corporations with controlling shareholders rarely have other larger shareholders.
- c. Many of the largest firms are controlled by families.
- d. Family control is more common in countries with poor shareholder protection.
- e. In family-controlled firms there is little separation between ownership and control.
- f. State control is common, particularly in countries with poor shareholder protection.

In a developing economy one finds concentration of ownership; control is usually by majority shareholders.<sup>27</sup> The reasons for control by majority shareholders can be identified with safeguarding of property rights, quality of the law that exists in that jurisdiction and the efficiency of legal institutions.<sup>28</sup> Cultural factors also determine control of a corporation. For example, shareholders may surrender their right of control only to family members or relatives whom they trust and rely on to diligently perform their duties in a company.<sup>29</sup> Many jurisdictions like Australia

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<sup>23</sup> Observation was made dated back to 1976. See Eisenberg, M.A., *The Structure of the Corporation: A Legal Analysis*, (1976) 64; Stapledon, G.P., “Share Ownership and Control in Listed Companies,” (1999) 2, *Corporate Governance International*, 17.

<sup>24</sup> La Porta, R., Lopex-de-Silanes, F. and Shleifer, A., “Corporate Ownership around the World,” (1999) 54, *Journal of Finance*, 471.

<sup>25</sup> See Farrar, above n 1 at 548 – 549.

<sup>26</sup> The “widely held corporation” refers to a corporation that has wide and disperse ownership of shares.

<sup>27</sup> For example, in Indonesia there is a concentration of ownership in few families. It is the member of the family that will be tasked with the responsibility of controlling the corporation. See Daniel, above n 8 at 327.

<sup>28</sup> Above n 24.

<sup>29</sup> Singam, above n 8 at 296 – 297; In China, culture has very much influenced the way companies are managed. They do not see the concept of a separate legal personality and man being separate from a corporation but connected and imbued with overtones of reciprocal relations. See Lawton, P., “Berle and Means, Corporate Governance and Chinese Family Firm,” (October 1996) 6 (3), *Australian Journal of Corporate Law*, 348 at 356 – 360; See also Scott, J. P., “Corporate Control and Corporate Rule: Britain in an International Perspective,” (1990) 41, *British Journal of Sociology*, 351 at 371.

and New Zealand have a mixture of control types.<sup>30</sup>

In recent years there has been a large increase in institutional shareholdings.<sup>31</sup> The trend is toward a shift from fractured and dispersed ownership to concentrated ownership in shares.<sup>32</sup> The institutional shareholders now own a large stake in companies, forming concentrated ownership hence separation of ownership may appear to be no longer problematic. The number of institutional shareholders within a corporation is able to apply collective monitoring to ensure directors comply with their duties and achieve the objectives of the company, thereby reducing managerial agency problems.<sup>33</sup> However, many corporations around the world still have the phenomena of separation of ownership and control; even in institutional investment companies there is separation of ownership and control and passive shareholders. The point is that institutional investment does not completely end separation of ownership and control phenomena.

In public enterprises, a government controls through either majority ownership or through legal devices. The shareholders in public enterprises are the public. It is a strange situation that the people who have provided equitable interests through their taxes and for whose benefit the enterprise is established cannot have influence over the board. But insofar as democratic principles are concerned, the government holds shares as representatives on behalf of the people. Hence, shareholding ministers are primary shareholders by virtue of their office and they exercise control over public enterprises. The public does not exercise any form of direct control but indirectly through voting for representatives in general elections. To have a controlling interest in public enterprise can mean that a government:

- a. controls the composition of the board of directors;

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<sup>30</sup> See for example Shapira, G., "Corporate Control of New Zealand Listed Companies," (2006) 24(6), *Companies and Securities Law Journal*, 393 at 393 – 394; the same result in the earlier study in Shapira, G., "Ownership and Foreign Control of NZSE," (February 2003) 20(1), *Company and Securities Law Journal*, 56 at 57. See also Stapledon, above n 23.

<sup>31</sup> Farrar, above n 1 at 361 – 362.

<sup>32</sup> Coffee, J. C., "Liquidity Verses Control: The Institutional Investor as Corporate Monitor," (1991) 91, *Columbia Law Review*, 1277 at 1288.

<sup>33</sup> Roe, M. J., *Strong Managers, Weak Owners: the Political Roots of American Corporate Finance*, (1994) 182.

- b. casts or controls the casting of more than half of the votes that might be cast at a general meeting of the body; or
- c. controls more than half of the body's issued share capital.<sup>34</sup>

If the three situations mentioned above are present in a SOE it would be concluded that the government has control over the SOE. In addition other factors, such as whether the government participates in formulating a corporate plan and/or intervenes in directing the board and management in the implementation of government policies, or pursues self-interested activities from time to time, would be considered along with the three situations to determine whether the government has control over SOEs thereby establishing a situation where there is little or no separation between ownership and control. In identifying whether the state controls SOEs, corporate governance practices and the legal framework of the particular jurisdiction have to be examined. This is the object and focus of this thesis, which will document corporate governance practices and identify the extent to which the government controls SOEs.

Like SOEs, usually there is no separation of ownership and control in small to medium sized companies and proprietary companies.<sup>35</sup> However, where there is distinct separation of ownership and control, this creates concerns about how to align the interests of the shareholders and the management. Consequently the attempt of aligning two interests incurs agency costs.

## 2.4 AGENCY COSTS

The separation of ownership and control inevitably raises questions of governance.<sup>36</sup> The concern is that if management is given complete discretion to run the affairs of the company, it will not be accountable to shareholders.<sup>37</sup> This

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<sup>34</sup> Bottomley, S., "New Legislation for Commonwealth Government Owned Companies – Is it sufficient," (August 1995) 13(5), *Company and Securities Law Journal*, 331 at 332.

<sup>35</sup> Farrar, above n 1 at 53.

<sup>36</sup> Hansmann, H. and Kraakman, R. H., "What is Corporate Law?" in Kraakman, R. H. (ed.), *The Anatomy of Corporate Law: a Comparative and Functional Approach*, (2004) ch 1.

<sup>37</sup> The way to get around this is to regard directors as trustees of shareholders, as argued by Berle A., "Corporate Powers as Powers in Trust," (1931) 4, *Harvard Law Review*, 1049. This argument is seen as a flaw, as directors in a company can take a risk in making business decisions, whereas trustees are required to be cautious and avoid mistakes. This was discussed in the English case of *Re City Equitable Fire Insurance Co.* [1925] Ch 407, and the Australian case of *Daniels v Anderson* (1995) 16 ACSR 607.

creates a need to establish mechanisms to address the issue of governance; but this comes at a cost. The agency cost is the cost incurred to address the governance problem between the shareholders (principals) and the management (agent).<sup>38</sup> In any situation where one party is entrusted with the power to act on behalf of another agency costs will always be incurred.<sup>39</sup> The general assumption in agency cost theory is that owners and managers do not have the same interest. On one hand shareholders would like to see managers maximizing profit for the company, and on the other hand managers have their own objectives to pursue. Adam Smith explained that:

The directors...of companies...being the managers of other peoples moneys and not their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private co – partnery frequently watch over their own...Negligence and profusion, therefore, must always prevail more or less, in the management of the affairs of such a company.<sup>40</sup>

The end result is that shareholders make a loss if the managers are pursuing their own agendas apart from maximizing profit for the company. This calls for certain measures to be in placed to align the interest of shareholders and managers, concurrently reducing agency costs. As Posner warned:

Where there [is] no competition in product markets, no market for corporate control, no governance by directors and shareholders, and no law of fiduciary obligations, corporate managers would not be constrained to maximize corporate profits.<sup>41</sup>

Hansmann and Kraakman<sup>42</sup> gave a detailed discussion of the strategies to be adopted to combat agency problems. Three of the main strategies adopted to address agency costs are: monitoring through external markets; bonding devices; and monitoring management performance through corporate governance rules.

#### **2.4.1 External Markets**

The use of external markets for monitoring is a comparatively low–cost option among the three devices. The market performs a significant role in reducing

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<sup>38</sup> Jensen and Meckling, above n 1 at 308.

<sup>39</sup> Ibid.

<sup>40</sup> Smith, A., *The Wealth of Nations*, (1937) 699.

<sup>41</sup> Posner, R. A., *Economic Analysis of Law*, (6<sup>th</sup> edn., 2003) 434 – 435.

<sup>42</sup> Kraakman, R. H. and Hansmann, H., “Agency Problems and Legal Strategies,” in Kraakman, R. R., Davies, P., Hansmann, H., Hertig, G., Hopt, K. J., Kanda, H. and Rock, E. B. (eds.), *The Anatomy of Corporate Law: a Comparative and Functional Approach*, (2004) ch 2.

agency costs between the shareholders and the managers.<sup>43</sup> It is through the external market that assessment is made on the performance of the management and if necessary shareholders can take action accordingly. The judgment presented by the market can enable shareholders to inquire further into the dismal performance of the company, or discipline the management where necessary. The three main markets that perform a useful function for shareholders are the product market, capital market and market for corporate control.<sup>44</sup>

First, goods and services are sold in the product market in which companies compete with one another to sell their goods and services. The company that survives delivers to customers' demand "at the lowest price while covering costs".<sup>45</sup> The competition in the product market ensures that managers are focused on the objective of maximizing profits for the company.<sup>46</sup> The success of the company will depend on the productive and allocative efficiency of the company.<sup>47</sup> The demand for efficiency will ensure that management must not underperform. The product market provides useful and up to date information for shareholders to assess whether managers are controlling the company efficiently and at the same time pursuing its proper goals.

Second, capital market refers to a share market where shares are bought and sold. If a company is inefficiently managed, or managed in such a manner that the objectives of the company are not pursued, the value of the company will decline and instantaneously the decline in value will be reflected in the share prices.<sup>48</sup> The reduced share price would make it difficult for the company to raise capital. The reduced share price and the public reluctance to purchased shares reflect the

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<sup>43</sup> Farrar, J. and McCabe, B., "Corporatisation, Corporate Governance and Deregulation of the Public Sector Economy," (March 1995) 6(1), *Public Law Review*, 24. Whincop and Keyes agree to an extent that the market is a judgement of the performance of management; however they disagree on the fact that the market actively plays a role in reducing agency cost. See Whincop, M. J. and Keyes, M. E., "Corporation, Contract, Community: An Analysis of Governance in Privatisation of Public Enterprise and Publicisation of Private Corporate Law," (1997) 25(1), *Federal Law Review*, 51 at 60 – 65.

<sup>44</sup> There are others, such as the labour market for managers, auditors, institutional investors and corporate financial policy that may assist to align the interest of shareholders and managers. See Ramsay, I. M., (ed.) *Corporate Governance and the Duties of Company Directors*, (1997) 4 – 7.

<sup>45</sup> Fama, E. F. and Jensen M.C., "Agency Problems and Residual Claims," (1983) 26(2), *The Journal of Law and Economics*, 327 at 345.

<sup>46</sup> Above n 41 at 434 – 435.

<sup>47</sup> Cooter, R. and Ulen, T., *Law and Economics*, (4<sup>th</sup> edn., 2004) ch 2, A Review of Microeconomic Theory.

<sup>48</sup> Cheffins, B. R., *Company Law: Theory, Structure, and Operation*, (1997) 55 – 58.

performance of the management and is sufficient evidence that shareholders can use to discipline the management.

Thirdly, the market for corporate control is an avenue whereby a predator company, the acquirer, takes over a target company that is inefficiently managed and whose share prices “fall below the break up value of the company”.<sup>49</sup> The acquirer takes over the company with the conviction that it can efficiently manage the company.<sup>50</sup> The effectiveness of the takeover largely depends on the governments’ involvement in the takeover, and the managers’ defensive tactics to militate against the takeover in a market for corporate control.<sup>51</sup> For example, the government may legislate to prohibit the takeover, or directors may issue to themselves additional shares to enlarge their voting numbers so as to outweigh votes for a takeover. The predator company takes over the control of the company by removing the old management, which is under-performing; hence a takeover will, in a way, put a blemish on the reputation of the managers and will affect their future engagement as directors and managers. The threat of removal is a greater incentive for the management to pursue the proper goals of the company and manage it efficiently.

#### **2.4.2 Bonding**

In bonding, shareholders enter into arrangements or deals with management as an incentive to maintain their loyalty. Generally, managers who control the company are not entitled to profits or to have other interests in the company,<sup>52</sup> and may resort to slacking, shirking or theft.<sup>53</sup> The bonding arrangements align the interest of the shareholders and the management. This can either be in the form of promotions, pay for performance, incentive-based remuneration packages or by allowing managers to own shares in the company.<sup>54</sup> These options have their disadvantages. For example, stock options as a form of incentive contracting may create substantial opportunities for self-dealing by managers. Managers may use

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<sup>49</sup> Grantham, R., “The Governance of Government Owned Corporation,” (2005) 23, *Company and Securities Law Journal*, 181 at 187.

<sup>50</sup> Above n 44 at 6.

<sup>51</sup> Deakin, S. and Slinger, G., “Hostile Takeovers, Corporate Law, and Theory of Firm,” (1997) 24(1), *Journal of Law and Society*, 124 at 143.

<sup>52</sup> Berle and Means, above n 6 at 8 – 9.

<sup>53</sup> Farrar, above n 1 at 463 – 464.

<sup>54</sup> Above n 49 at 186.

information asymmetry between management and shareholders to maximize their own benefit.<sup>55</sup> Studies have also shown that even though performance-based compensation is seen as an efficient way of solving conflict between shareholders and management, in reality its effects are limited.<sup>56</sup>

These incentives act as motivation for managers to pursue the interests of the company. Bonding cost will be unnecessarily incurred if it cannot counterbalance “a reduction in residual cost, leading to a reduction in overall agency cost”.<sup>57</sup> This is a matter that parties have to assess.

### 2.4.3 Monitoring

In monitoring, shareholders scrutinize the performance of management. Monitoring by shareholders is difficult in companies where there is disperse ownership of shares. Large blockholders or concentrated shareholders tend to reduce agency costs and have power to influence management.<sup>58</sup> Large blockholders are relatively uncommon in countries like the US and the UK,<sup>59</sup> whereas they are dominant in large companies in Germany<sup>60</sup> and Japan<sup>61</sup>. Some corporations around the world have controlling shareholders. This is a typical phenomenon in Eastern Europe, Africa, East Asia and Latin American countries.<sup>62</sup> Evidence has shown that the relationship between blockholders and firm value is both positive and negative or sometimes not significant.<sup>63</sup> There is no significant

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<sup>55</sup> Shleifer, A. and Vishny, R., “A Survey of Corporate Governance,” (1997) 52(2), *The Journal of Finance*, 737; Yermack, D., “Good Timing: CEO Stock Option Awards and Company News Announcements,” (1997) 52, *The Journal of Finance*, 449.

<sup>56</sup> Kaplan, S., “Top Executives, Turnover, and Firm Performance in Germany,” (1994) 10(1), *Journal of Law Economics, and Organization*, 142; Kaplan, S., “Top Executives rewards and Firm Performance: A Comparison of Japan and United States,” (1994) 102(3), *Journal of Political Economy*, 510.

<sup>57</sup> Farrar, above n 1 at 464 – 465.

<sup>58</sup> Shleifer, A. and Vishny, R., “Large Shareholders and Corporate Control,” (1986) 94, *Journal of Political Economy*, 461.

<sup>59</sup> Roe, *Strong Managers Weak Owners: the Political Roots of American Corporate Finance*, above n 33 at 3.

<sup>60</sup> Franks, J. and Mayer, C., “Ownership and Control of German Corporations,” (2001) 14, *Review of Financial Studies*, 943.

<sup>61</sup> Berglof, E. and Perotti, E., “The Governance Structure of the Japanese Financial keiretsu,” (1994) 36, *Journal of Financial Economics*, 259.

<sup>62</sup> Shleifer and Vishny, “A Survey of Corporate Governance,” above n 55.

<sup>63</sup> Holderness, C., “A Survey of Blockholders and Corporate Control,” (April 2003), *Economic Policy Review*, 51.

relationship between the type of blockholder, (whether institutions, corporations or individuals) and firm value.<sup>64</sup>

In addition, shareholders can use many different monitoring devices without a direct presence, even in companies with concentrated shareholding. The adoption of monitoring devices would depend on either the cost of establishment and coordination or a system that would ensure good corporate governance within respective organizations. The main device is the board of directors. The board looks after the interests of shareholders. Studies show a mixed reaction to relations between a board's composition and size, a firm's performance and the quality of decisions. Studies have shown that when a board increases in size, agency problem increases.<sup>65</sup>

Other monitoring devices include the independent audit, the directors' annual report to the general meeting, the appointment of non-executive directors to the board and internal monitoring such as the internal audit.<sup>66</sup> The former two, as discussed in chapter 4, are compulsory as they are required under company legislation. Non-executive directors are important as they bring independence and expertise to the board,<sup>67</sup> nonetheless they are optional for some companies but compulsory for listed companies.<sup>68</sup> Evidence has shown there is little relationship between firm performance and board composition, using a portion of outside directors as a measure.<sup>69</sup> Directors also have fiduciary duties of good faith. Their breach can attract civil and criminal liabilities. These issues are further discussed in chapter 4.

#### **2.4.4 Agency Cost in a State Owned Enterprise**

Generally, SOEs are not exposed to external markets nor do they have bonding devices. They depend on monitoring mechanisms provided through legislation,

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<sup>64</sup> Mehran, H., "Executive Compensation Structure, Ownership and Firm Performance," (1995) 38, *Journal of Financial Economics*, 163.

<sup>65</sup> Jensen, M., "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems," (1993) 48, *The Journal of Finance*, 831.

<sup>66</sup> Farrar, above n 1 at 464 – 465.

<sup>67</sup> Bosch, H., *Corporate Practices and Conduct*, (3<sup>rd</sup> edn., 1995) 11 – 14.

<sup>68</sup> New Zealand Stock Exchange (NZX), *Listing Rules* (29 October 2003) NZX [para. 3.3] <[http://www.nzx.com/regulation/listed\\_issuer/newlist\\_26apr\\_3.pdf](http://www.nzx.com/regulation/listed_issuer/newlist_26apr_3.pdf)> at 26 October 2007.

<sup>69</sup> Klein, A., "Firm Performance and Board Committee Structure," (1998) 41, *Journal of Law and Economics*, 275; above n 64.

government and public institutions responsible for accountability that scrutinize the performance of the management. They are further discussed in chapter 7.

## **2.5 CONCLUSION**

The shareholders and the management are in a principal/agent relationship, as a result of the separation of ownership and control. Where there is separation of ownership and control in a corporation there will always be problems relating generally to governance, and particularly to aligning the interests of shareholders and management. Directors and managers who do not have a direct interest in corporations have an opportunity to pursue self-interest. The important struggle is how to align their interests. Apart from laws that monitor managers in performing their functions; aligning the interests of owners and managers through bonding or exposing them to external markets are some of the measures that try to align their interests. In doing so an agency cost is incurred. Usually the owners adopt devices that are costless. The whole exercise is an attempt to ensure that the board is accountable to the shareholders. Corporate governance, in a restricted sense, is trying to figure out how the board and management should be made accountable to the shareholders. The phenomenon of “separation of ownership and control” is not universal given different factors that exist in different jurisdictions. These factors may include cultural influences, protection of shareholders, legal protection, etc. In jurisdictions where there is a weak economic base or a developing economy there is poor shareholder protection. State control is common. Usually, there is little separation between ownership and control in state controlled enterprises. Many of the features in private sector corporations discussed in this chapter with regard to separation of ownership and control are absent in public sector corporations. These issues are further discussed in chapter 7.

This chapter establishes a theoretical foundation for discussions of corporate governance in chapter 3 and other chapters in this thesis. Corporate governance has become a fashionable concept in recent years and the issues surrounding it are prompted by the phenomena of separation of ownership and control. Hence, the discussion of agency theory and separation of ownership and control is essential

in this thesis to set the foundation for other discussions in relation to corporate governance.

# CHAPTER 3:

## THE NATURE OF THE CORPORATION AND CORPORATE GOVERNANCE

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### 3.1 INTRODUCTION

A company refers commonly to an association of individuals for a common or some common purpose<sup>1</sup> and when used in an economic sense it refers to an association of people with a common commercial purpose.<sup>2</sup> Corporations are an important medium through which businesses are conducted in different societies and it is an undeniable fact that corporations are important for the economic prosperity of a country.<sup>3</sup> The type of corporate form to be used is determined by prevailing ideology, political and socio-economic circumstances of a particular society. With the collapse of corporations and corporate failure becoming a global phenomenon, corporate governance has become a topical issue.

The basic aim in discussing corporate governance in this chapter is to identify its definitional ambit and further identify a system of governance that would ensure corporate efficiency. The discussion of corporate governance requires examining the history and nature of corporations, whose interest a corporation should serve, and how a corporation should be governed. This chapter focuses on these issues by looking at the nature of corporations in which the history of corporations and different theories explaining nature of a corporation is discussed, followed by the nature of corporate governance, in which the discussion is mainly based on the definition and principles of corporate governance. It has to be re-emphasized that this chapter is intended to discuss corporate governance. In order to understand corporate governance it is necessary to first understand the history of the

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<sup>1</sup> Halsbury, Hardinge Stanley Giffard, 1823-1921 and Hailsham of St. Marylebone, Quintin Hogg, 1907, *Halsbury's Laws of England*, (4<sup>th</sup> edn., 1973 – 1984) 11, para. 1.

<sup>2</sup> Davies, P. L. and Gower, L. C. B., *Gower & Davies: the Principles of Modern Company Law*, (8<sup>th</sup> edn., 2008) 3 – 4.

<sup>3</sup> There are two types of corporation. Corporation sole refers to “an incorporated series of successive persons” having a sole member whereas corporation aggregate is an incorporated group having several members. The example of corporation aggregate is incorporated company with several shareholders and corporation sole is “successive holders of some public office incorporated so as to constitute a single, permanent and legal person”. See Salmond, J. W. and Fitzgerald, P. J., *Salmond on Jurisprudence*, (12<sup>th</sup> edn., 1966) 308 – 309.

corporation and different theories explaining the concept of a corporation. They provide the basis in understanding corporate governance.

### 3.2 THE NATURE OF THE CORPORATION

The idea of the concept of a separate legal entity applying to an association of individuals has its genesis in the family unit dating back to Ancient Greece. Family units were used as a corporate form to trade with other families. Gradually, as occupations and means of production extended outside of the family, specialized responsibilities were vested in individual members of the family. The separate juristic entity moved from family unit to communities, towns and cities. Trade between towns and cities was organized at the municipal level. When specialized crafts developed within towns and cities, trade was then allocated to a craft guild. This was the commencement of the formal corporate entity.<sup>4</sup> Trading, using the corporate form, spread through the Greek and Roman Empires. The most advanced degree of development reached by corporations in Rome was similar to the status of corporations in England in the early part of the 15<sup>th</sup> century.<sup>5</sup> When the Roman Empire gradually collapsed, the notion of a corporation had already spread across Europe where the modern era of corporations began.<sup>6</sup> Hence, it can be generally stated that the concept of a separate legal personality can be traced to Roman law. Corporations were not used as a common business vehicle in England until the 19<sup>th</sup> century. The common heritage of the corporation from Roman law shared by English and continental laws is reflected in the fundamental resemblance of their corporate laws.<sup>7</sup>

During the Middle Ages corporate status was granted through Royal Charters upon petition only to public bodies such as boroughs, guilds of merchants and religious associations upon petition. From 1688 onwards, an auxiliary form of

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<sup>4</sup> Gillman, M. and Eade, T., *The Development of the Corporation in England: with emphasis on Limited Liability*, (Economics Discussion Papers, no. 9504, 1995) 2 - 3.

<sup>5</sup> Ibid at 3.

<sup>6</sup> Ibid at 5.

<sup>7</sup> Cochran, P.L. and Wartick, S.L., "Corporate Governance – A Review of the Literature," in Tricker, R. I., (ed.) *International Corporate Governance: Text, Readings and Cases*, (1994) 9; Blumberg, P. I., *The Multinational Challenge to Corporation Law: the Search for a New Corporate Personality*, (1993) 3.

incorporation by Act of parliament was initiated.<sup>8</sup> Like incorporation by charter, a group had to petition for incorporation by Act of Parliament. Incorporation was not of right as such: parliament applied discretion in conferring it.<sup>9</sup> The increased use of corporate form in trading activities from the 16<sup>th</sup> century and onwards increased, and this ostensibly led to demand for capital<sup>10</sup> and increase in solicitation of funds from the public.<sup>11</sup> This led to the creation of joint stock companies, which consisted of members who agreed to certain conditions, one of which was the freedom to transfer shares in the company. The structure and aims of the corporation then were dissimilar to modern corporations today.

The term “company” is misleading. The joint stock company was really a large partnership arrangement.<sup>12</sup> Those that were incorporated had perpetual existence, their acts were distinguished from members, their shares were easily transferable and they had a monopoly over trade. The members had unlimited personal liability where there was business failure.<sup>13</sup>

During the industrial revolution there was an increase in business and trading activities, which created need for capital. Corporations began seeking capital from the public to assist with funding the expansion of trading activities; however unlimited personal liabilities of members in corporations discouraged members of the public from investing in them. Many unincorporated corporations were established. Government realized that there were inherent dangers in raising capital from the public using unincorporated companies. There was concern that new companies were created to capture the rise in stock prices without underlying investment prospects.<sup>14</sup> The *Bubble Act 1720* came into existence with an objective of preventing the use of unincorporated associations as a medium of trading by investors and traders, and to, at the same time, “circumscribe the use of joint stock companies as they had led to widespread speculative public trading in

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<sup>8</sup> Cassidy, J., *Corporations Law: Text and essential Cases*, (2<sup>nd</sup> edn., 2008) 2.

<sup>9</sup> Gillies, P., *The New Corporations Law*, (2<sup>nd</sup> edn., 1992) 5.

<sup>10</sup> Ibid.

<sup>11</sup> Austin, R. P. and Ramsay, I. M., *Ford's Principles of Corporations Law*, (14<sup>th</sup> edn., 2010) 39.

<sup>12</sup> Above n 9 at 5.

<sup>13</sup> Gower, L. C. B., Davies, P. L. and Prentice, D. D., *Gower's Principles of Modern Company Law*, (6<sup>th</sup> edn., 1997) 15–18, 21.

<sup>14</sup> Above n 4 at 15.

the shares of those companies”.<sup>15</sup> It brought to an end unincorporated associations and encouraged incorporation through Royal Charter and by special Act of parliament.<sup>16</sup> The Act did not fulfil the intended purpose.<sup>17</sup> The rise in commercial pressure required an alternative corporate form of trading.

With lawyers’ ingenuity and the assistance of the Court of Chancery a medium, a “deed of settlement” was developed based on the concept of trust and partnership. The deed enabled the funds of the subscribers to be controlled by trustees, and contained mutual agreements between investors, the committee of directors and trustees, and was used as a separate juristic entity that could carry out commercial activities. Even though its usage was contrary to the requirements of the *Bubble Act* it met the economic needs of the country, hence it was tacitly allowed to be continued. The *Bubble Act* was the law (nonetheless it remained dormant for much of the 105 years) until 1825 when it was repealed by the *Bubble Repeal Act 1825*.<sup>18</sup>

The Gladstone Report on joint stock companies in 1844 resulted in the enactment of the *Joint Stock Companies Registration and Regulations Act 1844*. This Act is the ancestor of modern company law, but it was deficient in some important respects as it was missing important characteristics of modern company laws like limited liability.<sup>19</sup> The absence of limited liability can be understood from looking at business structure before the mid 19<sup>th</sup> century. The sole trader and partnership were the common corporate forms being used. Members were personally responsible for any business failures. The unlimited liability of the business restricted the public, especially those having no entrepreneurial experience, skill and knowledge from investing in business because of the fear of losing their entire wealth. In order to attract investment, business structures had to be reconsidered and an alternative needed to provide for it. Public demand compelled parliament to enact the *Limited Liability Act 1855*, which essentially limited the liabilities of members.<sup>20</sup> The provision of limited liability was incorporated under the reshaped

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<sup>15</sup> Above n 8 at 3.

<sup>16</sup> Above n 11 at 39 – 41; see also Farrar, J. H. and Hannigan, B., *Farrar's Company Law*, (4<sup>th</sup> edn., 1998) 18.

<sup>17</sup> Above n 8 at 3.

<sup>18</sup> Ibid at 3; above n 11 at 40 - 41; Ffrench, H. L., *Guide to corporations Law*, (4<sup>th</sup> edn., 1994) 5.

<sup>19</sup> Above n 13 at 38 – 39.

<sup>20</sup> Ibid at 40 – 46.

company law, the *Joint Stock Companies Act 1856*.<sup>21</sup> Although provided in the statute, the concept of the “corporation having a separate legal personality” was not given effect or recognized until the decision in *Salomon v Salomon & Co. Ltd*<sup>22</sup> by the House of Lords.

The amendments after 1856 were consolidated in a new amended Act of 1862. The consolidated Act has the short title *Companies Act 1862* and had much more depth and detail than the 1856 Act. The Act achieved a lot by encouraging capitalists to invest, and it removed the anxiety of incurring additional liability. The Act provides for memorandum and articles of association, which replaced the deed of settlement. The roles and responsibilities of directors and shareholders were clearly highlighted, and it enabled non-trading associations for philanthropic or social purposes to register.<sup>23</sup> The *Joint Stock Companies Act 1856* and the *Companies Act 1862* became the company legislation model for British colonies.

Today’s corporations can either be incorporated under company legislation or Act of parliament. Upon incorporation, a corporation becomes a separate legal entity and can either be a public or private corporation, depending on whether the state has a shareholding. The separate legal personality creates debates on whether an inanimate and abstract entity can be endowed with personality. This leads to the different theories that attempt to explain the nature of corporation.

### **3.2.1 Legal and Economic Theories of the Corporation**

Legal and economic theories of the corporation were developed in an attempt to explain the nature of a corporation. These theories explain the powers and functions that different stakeholders have in a corporation and provide justification for vesting power in corporate management. They also provide general understanding of the function of the corporation. Although discussions of these theories are in the province of jurisprudence, it is relevant in this thesis. Their discussion provides understanding of the nature of the corporation and the basis for vesting of powers in either the shareholders or the management. Legal theory encompasses fiction/concession, organic and contractual theories.

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<sup>21</sup> Above n 11 at 42; above n 13 at 44.

<sup>22</sup> *Salomon v Salomon & Co. Ltd* [1897] AC 22.

<sup>23</sup> Above n 13 at 46 – 48.

First, fiction theory is the first main doctrine that tries to explain a company under the common law system.<sup>24</sup> Under the theory, the corporation is a fictitious entity. A corporation is where human beings act in concert for a common purpose, create a fictitious entity that is separate and independent and that survives on its own.<sup>25</sup> Professor John Farrar explains that a corporation is “a fictitious person representing a group of persons but not identical with them. It is treated in law as a separate person”.<sup>26</sup> Originally, corporate legal personality is granted by the state and as such it can only be used for legitimate public purposes. Therefore, the state jealously guarded the companies through supervision and regulation by developing common law rules such as *ultra vires* to ensure the company performs within the requirement of statutes or charter of incorporation.<sup>27</sup>

Today, incorporation of a company is flexible, and formalities of incorporation are simple and easy. Further, corporations are incorporated not only for public purposes, but private purposes. Hence, to state that incorporation is a privilege or concession from the state may seem irrelevant today. The irrelevance of concessionary argument was recognized as early as the beginning of the 20<sup>th</sup> century.<sup>28</sup> The theory, however contributes valuable insight into understanding the nature of a company. It proposes that a corporation is a fiction, having legal capacity as if it were a real person. Consequently, it recognises a human side to corporation. The doctrine is analogous to a formula that commences with the natural concept of personality and adds certain groups and institution through law as persons having life and will as if they were human persons.<sup>29</sup> In this sense a corporation can be treated as either human or non-human depending on whether one of the representations is necessary and addresses a practical problem. The advantage in this approach is to discard unwanted consequences of legal personality that personify ethical elements of a legal person.<sup>30</sup>

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<sup>24</sup> See Maitland, F.W., “Introduction” to Gierke, O.F., *Political Theories of the Middle Age*, (1<sup>st</sup> edn., 1900) xxx – xxxi.

<sup>25</sup> Dicey, A.V., *Law and Public Opinion*, (1<sup>st</sup> edn., 1905) 165.

<sup>26</sup> Farrar, J., “Salmond and Corporate Theory,” (2008) 38(4), *Victoria University of Wellington Law Review*, 925 at 926.

<sup>27</sup> Stokes, M., “Company Law and Legal Theory,” in Wheeler, S., (ed.) *A Reader on the Law of the Business Enterprise: Selected Essays*, (1994) 80 at 89.

<sup>28</sup> Above n 24 at xxxviii.

<sup>29</sup> Wolff, H. J., “On the Nature of Legal Person,” (1938) 54, *Law Quarterly Review*, 494 at 506–507.

<sup>30</sup> *Ibid* at 501.

Second, contract theory which is an offshoot of fictional theory, agrees that the corporation is a fictitious entity and suggests in addition that it is in reality a private contractual arrangement between parties. In other words a corporation is a “nexus of contract”.<sup>31</sup> Through contract, power is granted to the management creating the agent principal relationship. However, to say that a company is a consensual agreement between shareholders is purely fictitious, as companies today are large and have dispersed ownership. Many of those owners are passive shareholders. Further, the contractual conception is in direct conflict with the common law concept of a company as a separate legal person independent of shareholders.<sup>32</sup>

Third, the organic theory regards a corporation as a natural person possessing the characteristics of a human being.<sup>33</sup> A corporation is “just as alive and just as capable of having a will as a human person”.<sup>34</sup> The theory attempts to humanize the corporation. The defect in organic theory is its unscientific approach to bequeathing an inanimate person with life, and it treats an analogy with human being as the basis of parallel reality. It is easy to borrow a biological concept, but difficult applying it to reality. Applying a biological concept make sense in some instances. For example, a company that resolves to dissolve commits suicide. On the other hand, generic terms such as life cannot be subdivided in two. It is inexplicable.<sup>35</sup> Further, the contention that a company can acquire its own shares and become its own member has no parallel correlation to a human person. How can a living body become its own member? Not only has it defeated logic, it has no parallel to a natural person. These and other issues have tormented organic theory, largely due to its lack of parallel realities.

Clearly, these different legal theories have positive and negative aspects in identifying the nature of a company. The contractual concept of a company legitimises the hierarchical structure within the company and vesting of powers on the board and management. In other words it is through freedom of contract that

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<sup>31</sup> Blumberg, above n 7 at 26 – 28.

<sup>32</sup> See *Salomon v Salomon & Co.* [1897] AC 22; *Ashbury Rly Carriage & Iron Co. v Riche* [1875] LR 7 HL 653.

<sup>33</sup> Above n 24 at xxvi.

<sup>34</sup> Above n 29 at 498.

<sup>35</sup> *Ibid* at 500 -501.

management is endowed with these powers. Difficulties experienced with contract theory lead to organic theory, which regards the company as a natural person. This justifies shareholders having limited liability and a board as an organ of the company. Fiction theory also regards the company as a separate person and supports the institution of limited liability; however its support of a company as a concession or privilege from the state is not necessarily a reflection of current realities.<sup>36</sup> Unlike organic theory, fiction theory is more cautious, and its profound advantage is in its elasticity, in treating certain bodies as a person or a non-person, and can easily reject the consequence of a non-legal person. All these theories namely contractual, organic and fiction theories have theoretical deficiencies however often they are pursued to an extent necessary to achieve a practicable outcome. In other words so long as the legal personality achieves a favourable outcome for investors and can easily resolve practical problems, theoretical deficiency is a non-issue. In addition, new writings in economics were developed to address the deficiencies not addressed by legal theories.

Ronald Coase, in his article, *The Nature of the Firm*,<sup>37</sup> examines the nature of the firm, particularly the question of why a firm exists. A firm is a team method of production that exists within an economic system. A normal economic system works itself through a process that is automatic, elastic and responsive. The process ensures that “supply is adjusted to demand and production to consumption”.<sup>38</sup> In an imperfect market a person would incur costs when making transactions. This cost is referred to as a “transaction cost” and it is incurred in “negotiating, monitoring and enforcing exchanges between parties”.<sup>39</sup> By definition a transaction cost refers to costs incurred participating in the market or “cost of effecting an exchange or other economic transactions”<sup>40</sup>. Transaction cost is naturally the result of the fact that in any market transactions there are uncertainties caused by the lack of information or opportunisms. To reduce the

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<sup>36</sup> Above n 27 at 90 – 93.

<sup>37</sup> Coase, R.H., “The Nature of the Firm,” (November, 1937) 4(16), *Economica*, 386; Coase, R. H., *The Firm, the Market, and the Law*, (reprinted edn., 1990) 33; see also Coase R.H., “The Nature of the Firm,” in Buckley, P.J. and Michie, J., (eds.) *Firms, Organizations and Contracts: a Reader in Industrial Organization*, (1996) 40.

<sup>38</sup> Coase was quoting Robertson D.H., *The Control of Industry*, (1928) in Coase, R.H., “The Nature of the Firm,” (November, 1937) 4(16), *Economica*, 386 at 387.

<sup>39</sup> Jones, G.R., “Towards a Positive Interpretation of Transaction Cost Theory: The Central Roles of Entrepreneurship and Trust,” in Hitt, M.A., Freeman, R.E. and Harrison, J.S., (eds.) *The Blackwell Handbook of Strategic Management*, (2001) 208 at 209.

<sup>40</sup> Rutherford, D., *Routledge Dictionary of Economics*, (1995) 467.

transaction costs of market exchanges firms establish long term relationships between parties, centrally control information in the firm and establish an entrepreneurial coordinator. In expressing Ronald Coase's proposition, Gareth Jones stated that "forming an organization and allowing an entrepreneur to control and direct resources, the costs of making transactions in the market or transaction costs are avoided".<sup>41</sup> In other words, having an entrepreneurial coordinator within a team (firm), replaces market transactions and market structure, and the coordinator directs production. This approach internalises market transaction in a firm, consequently reducing transaction costs.

There are also intensive discussions in economics on separation of ownership and control (as discussed in chapter 2),<sup>42</sup> the supervisory role of external markets and management role in control of corporation.<sup>43</sup> They concentrate on the issue of regulation and how firms can achieve economic efficiency. The reality is that firms face competition in a market and, in order to survive and grow, they must improve economic efficiency. To achieve economic efficiency is not only to improve technology in order to reduce costs of production, but improve corporate governance so as to provide transparency and accountability at the management level and reduce agency costs.<sup>44</sup> The disadvantage in a firm is having team members with divergent interests, and the firm has to incur costs in aligning these different interests. A firm is a team which consist of individuals; unfortunately it is more concerned with the overall productive outcome of the team as a whole and not individual performance. Consequently, a lack of emphasis on an individual's performance reduces incentives to motivate performance, and increases difficulty in supervising their work. It is important to have mechanisms in place to reduce the costs incurred by individuals in a firm. These mechanisms can be in the form of incentives, monitoring by external markets, and a hierarchical internal control.<sup>45</sup> Control structure within a firm ensures accountability of corporate actors and resultant corporate efficiency.

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<sup>41</sup> Above n 39 at 210.

<sup>42</sup> Berle, A. A. and Means, G. C., *The Modern Corporation and Private Property*, (1932); Fama, E.F. and Jensen, M.C., "Separation of Ownership and Control," (1983) 26(2), *Journal of Law and Economics*, 301.

<sup>43</sup> Manne, H., "Mergers and Market for Corporate Control," (1965) 73(2), *Journal of Political Economy*, 110; Fama, E.F. and Jensen, M.C., "Agency Problems and Residual Claims," (1983) 26(2), *Journal of Law and Economics*, 327.

<sup>44</sup> Fama and Jensen, "Separation of Ownership and Control," above n 42 at 302.

<sup>45</sup> Fama and Jensen, "Agency Problems and Residual Claims," above n 43 at 331 – 332.

The fundamental argument in economic theory is pointing out the fact that corporations are mediums through which transaction costs are reduced. But, equally important is ensuring proper accountability, through internal and external accountability mechanisms in a firm with a divergence of interests in order to reduce agency costs. Hence, the overall emphasis must not only be on team production to reduce transaction costs, but also on persons in the team to avoid agency costs. Corporate governance addresses the latter in focusing on the issues of governance and accountability of team members such as the directors and managers in a firm.

### 3.3 THE NATURE OF CORPORATE GOVERNANCE

Corporate governance became a topical issue in the 1990s and 2000s with the collapse of large companies around the world.<sup>46</sup> It is not only a topical issue for companies, lawyers, academics and regulators, but also international institutions such as OECD, IMF, World Bank and UNDP. It is now the buzzword of the 21<sup>st</sup> century. Professor John Farrar<sup>47</sup> explains its origin in his book *Corporate Governance: Theories, Principles and Practice*. The term “governance” has its genesis in the Latin words *gubernare* and *gubernator* “which refer to steering a ship and to the steerer or captain of the ship” and the French term *gouvernance*, which means “control and state of being governed”. Combining the definition of the three terms with the definition in the *Oxford English Dictionary*<sup>48</sup> means control in a good, orderly manner. Taking into account the term “corporate”, means that it is governance within a corporate entity.

Richard Eells used the term “corporate governance” for the first time in 1962.<sup>49</sup> Since then it has gained prominence and became a fashionable concept contributed to by a number of factors:

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<sup>46</sup> Clarke, F. L., Dean, G. W. and Oliver, K.G., *Corporate Collapse: Accounting, Regulatory and Ethical Failure*, (2<sup>nd</sup> edn., 2003) 3 – 7.

<sup>47</sup> Farrar, J. H., *Corporate Governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) 3.

<sup>48</sup> *Oxford Dictionary of English*, (2<sup>nd</sup> edn., 2005).

<sup>49</sup> Eells is from Columbia Business School and he discussed this in his book *The Government of Corporations*, (1962). See Farrar, *Corporate Governance: Theories, Principles and Practice*, above n 47 at 3.

- a. the separation of ownership and control as stated by Berle and Means<sup>50</sup>, causing the managerial revolution;<sup>51</sup>
- b. the fact that countries are heavily dependant on corporate forms to create prosperity for them; and
- c. the colossal effect that corporate collapse has on the stakeholders and society.<sup>52</sup>

Further, in recent years the whole perception of the “company’s sole objective of maximising profit for shareholders and company”<sup>53</sup> has changed. Society begins to see corporations from a different perspective; as representing the interests of other stakeholders apart from the shareholders.<sup>54</sup> The notion of corporate governance has changed to adopt the new concept of corporate management, concentrating on the internal relationship between groups and individuals.<sup>55</sup>

Corporate governance is a broad topic that extends to all relationships of corporate actors.<sup>56</sup> While there are volumes of literature, there is no one set definition.<sup>57</sup> Attempts made to set a working definition, have created numerous definitions, varying from one another, with none of them collectively accepted.<sup>58</sup> Corporate governance can be given both a narrow and a broad definition.<sup>59</sup> First, in a narrow sense corporate governance is defined as “the management of business enterprises organised in corporate form, and mechanism by which managers are

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<sup>50</sup> Berle and Means, above n 42.

<sup>51</sup> Baums, T., Buxbaum, R. M. and Hopt, K. J., *Institutional Investors and Corporate Governance*, (1994) Preface, I; OECD, *OECD Principles of Corporate Governance*, (revised edition, 2004) [Preamble] < <http://www.oecd.org/dataoecd/32/18/31557724.pdf> > at 31 October 2007.

<sup>52</sup> For example, in USA *Sarbanes–Oxley Act of 2002* was enacted after major corporate and accounting scandals that affected Enron, Tyco International, Adelphia, Peregrine Systems and WorldCom. The Act was intended to protect the investors and other stakeholders. See Holt, M. F., *The Sarbanes-Oxley Act: Costs, Benefits and Business Impacts*, (2008) 3 – 6; See the case of Enron in Lawrence, A. T. and Weber, J., *Business and Society: Stakeholders, Ethics, Public Policy*, (12<sup>th</sup> edn., 2008) 450 – 462.

<sup>53</sup> Above n 11 at 385 – 387 and 481 – 482.

<sup>54</sup> Farrar and Hannigan, above n 16 at 13 – 14.

<sup>55</sup> Du Plessis, J. J., McConvill, J. and Bagaric, M., *Principles of Contemporary Corporate Governance*, (2005) 4.

<sup>56</sup> Above n 11 at 183.

<sup>57</sup> Post, J. E., Preston, L. E. and Sauter-Sachs, S., *Redefining the Corporation: Stakeholder Management and organizational Wealth*, (2002) 18.

<sup>58</sup> Austin, R. P., Ford, H. A. J. and Ramsay, I. M., *Company Directors: Principles of Law and Corporate Governance*, (2005) 7.

<sup>59</sup> See the general discussion in Farrar, J., “Corporate Governance and Judges,” (July 2003) 15(1), *Bond Law Review*, 49.

supervised”<sup>60</sup>, “the system by which companies are directed and controlled”<sup>61</sup> or “corporate governance deals with ways in which suppliers of finance to corporation assure themselves of getting a return on their investment,”<sup>62</sup>. The two former focus on management and how it is to be directed in such a way for the benefit of the company, whilst the latter focuses on the shareholders and how the managers are to work towards meeting their expectations.

Secondly, the broad perspective of corporate governance is widely accepted and followed.<sup>63</sup> Broad definition is given in recent corporate governance reports and best practice recommendations. For example, the ASX’s *Corporate Governance Principles and Recommendations* (see Appendix U) defines corporate governance as “the framework of rules, relationships, systems within and by which authority is exercised and controlled in corporations.”<sup>64</sup> In other words corporate governance is a framework by which companies are directed and managed, and accountability in directing and managing the company. The HIH Royal Commission Report gave the following definition:

At its broadest, the governance of corporate entities comprehends the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. It includes the practices by which that exercise and control of authority is in fact effected. The relevant rules include applicable laws of the land as well as the internal rules of a corporation. The relationships include those between the shareholders or owners and the directors who oversee the affairs of the corporation on their behalf, between the directors and those who manage the affairs of the corporation and carry out its business, and within the ranks of management, as well as between the corporation and others to whom it must account, such as regulators. The systems and processes may be formal or informal and may deal with such matters as delegations of authority, performance measures, assurance mechanisms, reporting requirements and accountabilities.<sup>65</sup>

Similarly the OECD, through “OECD Principles of Corporate Governance” gave a broad definition of corporate governance as involving:

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<sup>60</sup> Above n 11 at 183.

<sup>61</sup> Committee on the Financial Aspects of Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance*, (1992) 15, para. 2.5.

<sup>62</sup> Shleifer, A. and Vishny, R., “A Survey of Corporate Governance,” (1997) 52(2), *The Journal of Finance*, 737 at 737.

<sup>63</sup> Murrin, L. S., *Public Sector and Private Sector Governance: vive la Difference*, (Paper presented to the IIR Corporate Governance Conference, Wellington, November 2001) 3.

<sup>64</sup> Australian Securities Exchange, *Corporate Governance Principles and Recommendations*, (2<sup>nd</sup> edn., 2007) [page 3] < [http://www.asx.com.au/about/corporate\\_governance/index.htm](http://www.asx.com.au/about/corporate_governance/index.htm) > at 17 January 2010.

<sup>65</sup> HIH Royal Commission, *The Failure of HIH: a Critical Assessment*, (April 2003) [Part Three – Directions for Future, para 6.1] < <http://www.hihroyalcom.gov.au/> > at 30 October 2008.

a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.<sup>66</sup>

Different definitions of corporate governance reflect a division on the issue of whose interest a corporation should serve, however the differences do not undermine the fact that corporate governance plays a significant role in ensuring the economic efficiency of a corporation. Importantly, different definitions reflect divergences of views on how to evaluate economic efficiency. There is a broader interpretation that focuses on different stakeholders and corporate actors, particularly employee welfare and public relations. On the other hand a restrictive view focuses on the shareholder as primary stakeholder, proposing that a company should be directed and controlled to maximise shareholders' economic interests.<sup>67</sup>

The broader interpretation is adopted in contract and stakeholder theories. These theories fundamentally justify corporations assuming more social responsibilities. As discussed above, contract theory provides that a corporation is a "nexus of contract" or is composed of a network of contractual relationship, which is either implicit or explicit between different participants such as shareholders, managers, bondholders, employees, suppliers and consumers.<sup>68</sup> In a contractual relationship there is a win/win situation or reciprocity of treatment. Due consideration must be given to all participants in a corporation. In contrast stakeholder theory focuses on corporate actors, but not on contract. Stakeholders are, either internal or external persons who have direct interest in the survival of the company and without their support the corporation would collapse. Internal stakeholders include shareholders and employees; external stakeholders are members of the public, government or consumers.<sup>69</sup> Society is a stakeholder, therefore a corporation cannot survive without its support.<sup>70</sup> A broad definition of corporate governance not only focuses on a company and its shareholders but other stakeholders, both internal and

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<sup>66</sup> OECD, *The OECD Principles of Corporate Governance*, (revised edition, 2004) [page 11] < <http://www.oecd.org/dataoecd/32/18/31557724.pdf> .> at 6 November 2007.

<sup>67</sup> Cooper, S., *Corporate Social Performance: a Stakeholder Approach*, (2004) 2.

<sup>68</sup> Gordon, J.N., "The Mandatory Structure of Corporate Law," (1989) 89 (Part 2), *Columbia Law Review*, 1549.

<sup>69</sup> Carroll, A.B. and Buchholtz, A.K., *Business & Society: Ethics and Stakeholder Management*, (6<sup>th</sup> edn., 2006) 23.

<sup>70</sup> Alkhafaji, A.F., *A stakeholder Approach to Corporate Governance, Managing in a Dynamic Environment*, (1989) 3.

external, who are affected by the activities of the company in one way or another.<sup>71</sup>

The narrow interpretation of economic efficiency is advanced under shareholder theory and it focuses on shareholders. This is the capitalist economic view that a corporation must be governed to maximise shareholders economic interests (see chapter 2).<sup>72</sup> The shareholders are investors and their primary concern is to maximise value on their investment. The economic efficiency of a corporation must be measured on whether there is an increase in the shareholders' profit and that means the primary aim of corporate governance must be about how a corporation should be governed to maximise profit for shareholders. It follows that corporate failure is the consequence of diverting from the main focus of maximising return for the shareholders investment. The narrow definition of corporate governance focuses only on the relationship of the company with its shareholders, and accountability of management to the shareholders.<sup>73</sup>

In the final analysis corporate governance can be defined as a process in place to ensure management behaves responsibly and accountably in pursuing the objectives of the company, concurrently giving equal treatment to the interests of all stakeholders of the corporation.<sup>74</sup> The definition takes account of voluntary measures adopted by corporations today to balance social wellbeing for people, ecological quality for the planet and profit for economic prosperity.<sup>75</sup> James McConvill *et al* re-emphasises the definition through identifying the components.

Corporate governance:

- a. is a process of controlling management;
- b. takes into consideration the interests of internal stakeholders and other parties who can be affected by the corporation's conduct;
- c. aims at ensuring responsible behaviour by the corporations; and
- d. has the ultimate goal of achieving the maximum level of efficiency and profitability for a corporation.<sup>76</sup>

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<sup>71</sup> Solomon, J. and Solomon, A., *Corporate Governance and Accountability*, (2004) 12 – 15.

<sup>72</sup> Thompson, A. A. and Formby, J. P., *Economics of the Firm: Theory and Practice*, (6<sup>th</sup> edn., 1993) 241.

<sup>73</sup> Above n 71 at 12 – 15.

<sup>74</sup> See above n 55 at 6 -7.

<sup>75</sup> Cramer, J., *Corporate Social Responsibility and Globalisation: an Action Plan for Business*, (2006) 14.

<sup>76</sup> Above n 55 at 7.

In recent years principles of corporate governance were developed to provide for good corporate governance in individual jurisdictions and organisations. Attempts have been made to distinguish and explicate the core principles of good corporate governance practice at both a national and international level. At the national level corporate governance principles can be seen in the Cadbury Report, 1992,<sup>77</sup> the UK Combined Code on Corporate Governance (see Appendix V),<sup>78</sup> Australian Stock Exchange Corporate Governance Council's Corporate Governance Principles and Recommendations (see Appendix U),<sup>79</sup> and the South African King Report (2002)<sup>80</sup>. At the international level the OECD exhaustively lays out corporate governance principles for private corporations and guidelines for public corporations, however they are non-binding (see Appendices R and S).<sup>81</sup> The OECD member countries or others are not compelled to adopt these principles and guidelines; nevertheless it is important for them to do so to ensure good corporate governance practice. Endeavours made by various organizations to formulate a single corporate governance formula for all organizations failed. Generally, in life there is no "one size fits all" and this is also true for corporate governance principles. The objective at the end, with these principles is to achieve efficiency and/or profitability in a particular jurisdiction or organization. Concerned parties must choose and apply principles, which can help solve corporate governance woes in their respective jurisdictions or organizations.

Achieving efficiency is not analogous to achieving profitability; however successful achievement of the former would have a follow on effect on the latter. Hence, the emphasis in corporate governance is to achieve both. Diversion in pursuing these objectives is largely caused by a shift in control from shareholders to the board and management as a direct consequence of separation of ownership

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<sup>77</sup> Above n 61 at 16, para. 3.2.

<sup>78</sup> Financial Reporting Council, *Combined Code on Corporate Governance*, (June 2006) < <http://www.frc.org.uk/corporate/combinedcode.cfm> > at 22 February 2008.

<sup>79</sup> Australian Securities Exchange, *Corporate Governance Principles and Recommendations (Guidelines)*, (2<sup>nd</sup> edn., 2007) < [http://www.asx.com.au/about/corporate\\_governance/index.htm](http://www.asx.com.au/about/corporate_governance/index.htm) > at 18 January 2010.

<sup>80</sup> Institute of Directors in South Africa, *Executive Summary of the King Report 2002*, (March 2002) < <http://www.corporatecompliance.org/Content/NavigationMenu/International/SouthAfrica/KingCommitteeCorporateGovernanceExecutiveSummary2002.pdf> > at 22 February 2008.

<sup>81</sup> OECD, *OECD Principles of Corporate Governance*, (revised edition, 2004) [Preamble] < <http://www.oecd.org/dataoecd/32/18/31557724.pdf> > at 31 October 2007; OECD, *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, (2005) in OECD, < [http://www.oecd.org/document/33/0,3343,en\\_2649\\_34847\\_34046561\\_1\\_1\\_1\\_37439,00&&n-USS\\_01DBC.html](http://www.oecd.org/document/33/0,3343,en_2649_34847_34046561_1_1_1_37439,00&&n-USS_01DBC.html) > at 15 July 2010.

and control. The shift in control inevitably creates an agency cost (see chapter 2), which is incurred in an attempt to align the interest of the owners and the managers.

### 3.4 CONCLUSION

Discussion of the nature of corporation traces the important highlights in the history of the corporation. It is clear looking at the history that public investment was limited, so too was the market in which corporations operated and corporate governance problems were less serious. With the increase in commercial activities and the unrestricted access to a wider market the demand for capital increased and different corporate forms were adopted; inclusive in involving the public, and limiting their liability encouraged more investment. This encourages large investment by the public. The Common law history of the corporation highlights the prominent role that law has performed in developing the concept of the corporation, particularly through adopting models to enhance corporate value, concurrently safeguarding social values of fairness, justice and social good. Legal justification of its nature left theoretical deficiencies. Economic theory provides an interesting insight to the nature of the firm. However, the doctrine does not fully explain that nature.

The corporation is a fictitious entity and it is controlled through human agents. The collapse of corporations brings focus on different actors involved in controlling and directing them. This brings to prominence discussion of corporate governance by lawyers, academics, governments and international organizations, thus making it a fashionable concept. Extensive discussion in the literature and other forums have not identified a concrete definition collectively accepted, however it is clear that corporate governance is about how a corporation is controlled and directed to achieve optimal economic outcome. Good corporate governance framework requires establishing proper mechanisms to ensure transparency, accountability and integrity. However, “good corporate governance does not guarantee good performance but its absence usually indicates present or future problems.”<sup>82</sup>

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<sup>82</sup> Farrar, *Corporate Governance: Theories, Principles and Practice*, above n 47 at xxxix.

**PART II:**

**CORPORATE GOVERNANCE IN THE  
PRIVATE SECTOR**

## CHAPTER 4:

# CORPORATE GOVERNANCE IN PRIVATE SECTOR CORPORATIONS

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### 4.1 INTRODUCTION

A corporation is an abstraction and can only act through two primary organs; namely shareholders and the board of directors. Shareholders invest in a company through the purchase of shares. They are regarded as proprietors of the company.<sup>1</sup> As persons with vested interests in the company they have the right of control of the corporation, however they surrender that right to directors to act on their behalf (see chapter 2). The law recognizes this fact through conferral of certain powers and functions on them to protect their personal interests and to ensure that directors are accountable to them through the company.

Corporatised entities, namely state owned enterprises (SOEs) are intended to replicate the characteristic of private sector corporations (see chapter 6). Therefore, understanding corporate governance in the private sector must be a prerequisite to understanding corporate governance in the public sectors (see chapter 7), hence this chapter. Discussion in this chapter forms the basis on which the role of government as shareholders and management of an SOE, as outlined in chapter 7, is compared and contrasted. Further, this chapter is important as it forms the basis on which the role of the government in SOEs in Papua New Guinea is analyzed in Part VI. This chapter discusses corporate governance in the private sectors in New Zealand (NZ), Australia and other jurisdictions. Corporate governance structure can be categorized into hard laws, hybrid laws and soft laws.<sup>2</sup> This chapter focuses on hard laws but also makes references to the other two categories of laws.

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<sup>1</sup> Many writers and commentators still state that shareholders have ownership right over a corporation because of their shareholding in the company. For example Christopher Bevan stated that “ownership of a company, being an inanimate personality, is by a shareholding in a company”. See Bevan, C., *Corporations Law*, (5<sup>th</sup> edn., 2002) 77.

<sup>2</sup> Farrar, J.H., *Corporate Governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) 3 – 4.

## 4.2 CORPORATE GOVERNANCE IN NEW ZEALAND

New Zealand's *Companies Acts* of 1933 and 1955 were based on the versions of English *Companies Acts* of 1929 and 1948, respectively. In 1978, the country decided to follow the Australian *Uniform Companies Act*. Later, despite its economic relations with Australia, NZ opted for the Canadian models of the *Canada Business Corporations Act 1985* and Ontario's *Business Corporations Act 1990*.<sup>3</sup> Following the proposal of the NZ Law Commission, the *Companies Act 1993* was enacted,<sup>4</sup> reflecting the North American model.<sup>5</sup>

Amongst other things, the *Companies Act* provides for the corporate governance structure, which comprises of shareholders, a one tier board and management. The directors are proxies of the shareholders and they are delegated with the responsibility of supervising and managing the company through a board of directors, headed by the chairperson. In some companies, depending on size, directors delegate their managerial responsibilities to the management, which is headed by a chief executive officer (CEO). The *Companies Act* provides for the powers and functions of directors and the rights and remedies of shareholders. Further, private sector corporations are subject to external markets (see chapter 2).

### 4.2.1 Directors

A director is not only a person who is validly appointed through an appointment process but also other persons who perform the functions of a director.<sup>6</sup> Section 126(1)(a) of the *Companies Act* defines a director as “a person occupying the position of director of the company by whatever name called”. This definition implies that it is the function that determines who a director is and not the name.<sup>7</sup> The definition is wide covering the *de facto* controller of the company, a person

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<sup>3</sup> See McDermott, J., *Understanding Company Law*, (2005) 3 - 4; Grantham, R. and Rickett, C. E. F., *Company and Securities Law: Commentary and Materials*, (2002) 38 – 44.

<sup>4</sup> New Zealand Law Commission, *Company Law Reform and Restatement*, (Report No. 9, June 1989) para. 20.

<sup>5</sup> New Zealand Law Commission, *Company Law Reform: Transition and Revision*, (Report No. 16, September 1990) xvii.

<sup>6</sup> See the discussion in the following cases: *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30 at 90 – 91; *Standard Chartered Bank of Australia Ltd v Antico* (1995) 18 ACSR 1 at 65 – 71.

<sup>7</sup> Bruce, M., *Rights and Duties of Directors*, (7<sup>th</sup> edn., 2005) 3.

who is acting under the delegation of the board, a shadow director and, in some cases, a shareholder of a company.<sup>8</sup>

Society is now increasingly placing demand on directors to perform; hence government demands a greater accountability from directors through legislation such as the *Companies Act* and the *Takeover Act 1993*. The *Companies Act* particularly, provides for how the directors should conduct themselves whilst doing business and controlling the affairs of the company. The Act provides for individual director's duties, amongst others, to:

- a. act in good faith and in the best interest of the company;<sup>9</sup>
- b. exercise power for proper purpose;<sup>10</sup>
- c. exercise the care, diligence and skill of a reasonable director in the same circumstances;<sup>11</sup> and
- d. disclose certain interests of directors.<sup>12</sup>

The directors are also required to comply with duties that are expressed to apply to the whole board. For example, the duty to prepare annual reports and send them to shareholders.<sup>13</sup> The *Companies Act* is not intended to be a code of directors' duties and does not mention that it abrogates common law duties. Hence, the common law on directors' duties still applies.<sup>14</sup> Given the wide and complex nature of the powers and functions of directors, they need to be educated on them. The NZ Institute of Directors conducts courses for chairpersons and directors. This at least informs the directors of their roles and responsibilities, and trains potential directors.

Unlike the Australian Stock Exchange (ASX), the NZ Stock Exchange (NZX) does not have corporate governance standards, but its listing rules requires companies listed on NZX to provide in their reports "a statement of any corporate

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<sup>8</sup> In *Re Hydrodam (Corby) Ltd* [1994] 2 BCLC 180 at 182 – 184, Millett J discusses the test for determining different kinds of directors.

<sup>9</sup> *Companies Act 1993*, s 131.

<sup>10</sup> *Companies Act 1993*, s 133.

<sup>11</sup> *Companies Act 1993*, s 137.

<sup>12</sup> *Companies Act 1993*, s 140.

<sup>13</sup> *Companies Act 1993*, s 209.

<sup>14</sup> *Benton v Priore* (2003) 9 NZCLC 263,055 at 263,063.

governance policies, practices and processes, adopted or followed by the issuer”<sup>15</sup>. The directors are required to comply with this requirement. NZ’s Securities Commission published a report in a handbook, *Corporate Governance Principles and Guidelines* (see Appendix W)<sup>16</sup> which requires all companies which have an economic impact in NZ, especially listed companies, to comply with the principles and guidelines provided in the handbook. The report provides for:

- a. ethical standards;
- b. board composition and performance;
- c. board committees;
- d. reporting and disclosure;
- e. remuneration;
- f. risk management;
- g. auditors;
- h. shareholder relations; and
- i. stakeholder interests.

Further, companies and their directors are required to comply with standards of corporate governance under the *Companies Act*, company constitutions and company charters.

#### **4.2.2 The Board and Management**

As stated above, NZ has a one tier board structure that is hierarchically above the management. The board is the proxy of the shareholders and is given the power to manage the company. The chairperson, who is appointed from non-executive directors, heads the board. Section 128(1) of the *Companies Act* provides that the business and affairs of a company must be managed by or under the direction or supervision of the board of the company. The provision is broad and clearly points out the fact that the board has both supervisory and management responsibilities. Usually, the board performs a supervisory role, and managerial functions are delegated to the management. A board can have executive directors, but NZ

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<sup>15</sup> New Zealand Exchange, *NZAX Listing Rules*, [Listing Rule Number 10.5.5(h)] < <http://www.nzx.com/market-supervision/rules/nzax-listing-rules> > at 18 January 2010.

<sup>16</sup> Securities Commission, NZ., *Corporate Governance in New Zealand, Principles and Guidelines – A Handbook for Directors, Executives, and Advisers*, (16<sup>th</sup> March 2004) < <http://www.sec-com.govt.nz/publications/list.shtml> > at 20 January 2010.

practice is inclined towards reducing their numbers and having non-executives directors serving on the board.<sup>17</sup> A company may have all non-executive directors. The issue with having all non-executive directors is the fact that their power may not be complemented by a corresponding knowledge of the company.

Directors act through the board, and the resolution of the board becomes the resolution of the company on a matter in question. The board acts where directors are required to act collectively. The directors must comply with the duties where it is expressed to be applied to the whole board of the company. For example:

- a. the duty to prepare an annual report and send it to individual shareholders;
- b. the duty to deliver an annual return to the registrar;<sup>18</sup>
- c. the duty to ensure that the auditor has access to records and receives notice of meetings;<sup>19</sup>
- d. the duty to ensure proper accounting records are kept;<sup>20</sup> and
- e. the duty to ensure that adequate measures exist to prevent and detect the falsification of records.<sup>21</sup>

In companies that have constitutions, the boards' powers and functions are provided in them. Many companies in NZ are beginning to have a formal corporate governance charter that sets out the powers and functions of the board. This is influenced by the trend of companies being required to report corporate governance account in the annual reports.

The *Companies Act* does not provide for powers and functions of the chairperson and CEO. This is where the company constitution, company charters and the NZ Securities Commission's *Corporate Governance Principles and Guidelines* become important, especially where there are deficiencies in the *Companies Act* or other laws. The NZ *Best Practice Statement*, following the Cadbury Report (1992) set out the role of the chairperson and the CEO and recommended the separation of CEO and chairperson so that there is an independent element on the

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<sup>17</sup> Korn/Ferry International, *Boards of Directors in Australia and New Zealand 2000*, (2000).

<sup>18</sup> *Companies Act 1993*, s 214.

<sup>19</sup> *Companies Act 1993*, ss 206 and 207.

<sup>20</sup> *Companies Act 1993*, s 194.

<sup>21</sup> *Companies Act 1993*, s 190 (2).

board with a leading director.<sup>22</sup> The tendency in NZ today is to reduce the number of executive directors on the board.<sup>23</sup>

#### 4.2.3 Shareholders

Ownership of shares confers certain rights and powers within the company that give rights against the company, directors and other shareholders.<sup>24</sup> Ownership of shares enables shareholders to become owners of the company, however it does not enable absolute ownership over the company and its assets. Dixon J explained that “[p]rimarily a share in a company is a piece of property conferring rights in relation to distributions of income and of capital”.<sup>25</sup> The *Companies Act* provides for the rights of shareholders and remedies where either the company or directors breach the requirement of the company’s constitution or the Act. Under s 104 shareholders exercise many of their rights and powers through annual general meetings or special meetings or pass special resolutions in lieu of the meeting.<sup>26</sup> Section 36(1)(a) provides that ownership of shares in a company confers the right to one vote at a company’s meeting on any resolution that includes right to:

- a. appoint or remove a director or auditor;
- b. adopt a constitution;
- c. alter the company's constitution, if it has one;
- d. approve a major transaction;
- e. approve an amalgamation of the company under s 221 of the *Companies Act*; and
- f. put the company into liquidation.

The rights vested in shareholders under s 36(1) are not absolute and can be “negated, altered, or added to by the constitution of the company or in accordance with the terms on which the share is issued”.<sup>27</sup> Further, the company or the shareholders cannot alter some rights vested in the shareholders by the *Companies Act*. These are, in other words, mandatory rights. The mandatory rights are:

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<sup>22</sup> Above n 2 at 347.

<sup>23</sup> Above n 17.

<sup>24</sup> Wotherspoon, S., “Property by any other Name: The Trouble with Shareholder Claim in Australia,” (February 2007) 81, *The Australian Law Journal*, 75.

<sup>25</sup> *Peters’ America Delicacy Co. Ltd v Heath* (1939) 61 CLR 457 at 503 – 504.

<sup>26</sup> *Companies Act 1993*, ss 120, 121 and 122.

<sup>27</sup> *Companies Act 1993*, s 36 (2).

- a. the right to be given reasonable opportunity to deliberate on the management of the company that requires questioning, discussing or commenting on any issues about the management;<sup>28</sup>
- b. the right to be given the “minority buy-out rights”;<sup>29</sup>
- c. the right to be served with notice of a meeting;<sup>30</sup>
- d. the right to be given annual reports and financial statements;<sup>31</sup>
- e. the right to request information held by the company;<sup>32</sup>
- f. the right to inspect records;<sup>33</sup> and
- g. the right to seek a remedy in court.

The important right of shareholders is to seek remedies in court. The shareholders can resort to court if there is unfair prejudice or to take personal action for breach of duty owed to them by directors<sup>34</sup> or company<sup>35</sup>. An unfair prejudicial action can be taken by a shareholder for “courses of conduct amounting to an unjust detriment to the interests of a member or members of the company”.<sup>36</sup>

Personal action may be taken to ensure compliance and payment of compensation.<sup>37</sup> Section 169(1) allows shareholders to bring personal actions, particularly under s 169(3), for breach of duty to supervise share register,<sup>38</sup> duty to disclose interests<sup>39</sup> and duty to disclose share dealings<sup>40</sup>. This is not exhaustive, as stated under s 169(3) that it is not “limiting” subsection one, which means that personal actions for duties owed to the shareholders provided in the *Companies Act* applies. A shareholder can also take derivative action on behalf of the company, however in order to do so the shareholder must meet the requirement under s 165(2)(3) of the *Companies Act*. A derivative action is only taken if the board decides against bringing an action on behalf of the company. Further, other

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<sup>28</sup> *Companies Act 1993*, s 109 (1).

<sup>29</sup> *Companies Act 1993*, s 110.

<sup>30</sup> *Companies Act 1993*, s 125.

<sup>31</sup> *Companies Act 1993*, ss 209 (1) and 211 (1) (b).

<sup>32</sup> *Companies Act 1993*, s 178.

<sup>33</sup> *Companies Act 1993*, s 216.

<sup>34</sup> *Companies Act 1993*, s 169.

<sup>35</sup> *Companies Act 1993*, s 171.

<sup>36</sup> *Thomas v H W Thomas Ltd* [1984] 1 NZLR 686 at 693.

<sup>37</sup> Beck, A. and Borrowdale, A., *Guidebook to New Zealand Companies and Securities Law* (7<sup>th</sup> edn., 2002) 293.

<sup>38</sup> *Companies Act 1993*, s 190.

<sup>39</sup> *Companies Act 1993*, s 140.

<sup>40</sup> *Companies Act 1993*, s 148.

remedies where a shareholder can seek an order from the court include putting the company into liquidation,<sup>41</sup> or applying for an order for injunction to prevent the company or a director undertaking an act.<sup>42</sup> The right to pursue court action against the company, and other rights, come to an end if the company becomes non – existent.<sup>43</sup>

The rights of the shareholders can also be enforced by NZX for those companies that are listed on NZX. NZ has the NZ Shareholders Association (NZSA), which was formed to uphold shareholders’ interests and to raise the quality of corporate governance. NZSA engages in shareholder activism and that can raise the performance of directors and the overall quality of corporate governance in NZ’s private sector.

The *Companies Act* focuses solely on the interest of shareholders, with the exception of creditors when the company is in liquidation. Although, there have been debates on sustainable development<sup>44</sup> and discussions on ethics and stakeholders’ interests,<sup>45</sup> in which business and corporations were asked to take into account stakeholder interests, there are no debates or any substantial discussion on corporate social responsibility (CSR).<sup>46</sup> NZ is lagging behind Australia in terms of taking full notice of CSR.

### 4.3 CORPORATE GOVERNANCE IN AUSTRALIA

Prior to Australia’s Federation in 1902 each of its colonies had their own company legislation that was modeled on the British *Companies Act 1862*. There was no uniform company legislation for the Commonwealth of Australia. This was largely prevented by the High Court decision in *Huddart Parker & Co. v*

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<sup>41</sup> *Companies Act* 1993, s 241(4)(d).

<sup>42</sup> *Companies Act* 1993, s 164(2) b).

<sup>43</sup> Above n 24 at 76.

<sup>44</sup> The sustainable development is promoted by New Zealand Business Council for Sustainable Development. See Boston, J., “Post – 2012: Towards a new Global Climate Treaty,” in Boston, J., (ed.) *Towards a new Global Climate Treaty: Looking beyond 2012*, (2007) 3 at 31; See generally Chapman, R., Boston, J. and Schwass, M., *Confronting Climate Change – Critical Issues for New Zealand*, (2006).

<sup>45</sup> New Zealand Securities, *Corporate Governance in New Zealand*, (18<sup>th</sup> February 2004) [Guidelines One and Nine] < <http://www.seccom.govt.nz/publications/documents/governance-principles/index.shtml> > at 12 January 2009.

<sup>46</sup> Above n 2 at 498 – 502.

*Moorehead*<sup>47</sup>. The court gave a narrow interpretation to s 51(xx) of the Australian *Constitution* by stating that Commonwealth does not have power to legislate with respect to the creation of corporations.<sup>48</sup> Lack of any uniform legislation creates inexpediency and inefficiency in interstate commerce, hence prompting the need for reform. Consequently, a co-operative scheme between the Commonwealth and the states was arranged with the *Uniform Companies Act 1961* that was adopted by each state between 1961 and 1962 based on Victorian model.<sup>49</sup> From the co-operative scheme, the *Corporations Act* was passed by the Federal Parliament in 1989. However, *Corporations Act* incorporated many of the practices of the co-operative scheme and it was detailed and complex. Several challenges were made to those practices on the basis of constitutional validity.<sup>50</sup> Faced with increasing uncertainty on the validity of the key provisions of the *Corporations Act*, the states surrendered to the Commonwealth power to enact corporation law, in August 2000. The following year the new *Corporations Act* came into effect in July 2001, becoming the first national corporate law.<sup>51</sup>

Compared to NZ, Australia has a well-developed self-regulatory system. ASX has its listing rules, code standards of good corporate governance and statements of accounting practice for listed companies.<sup>52</sup> Further, there are a number of reports on “corporate practice and conduct” that review the functions of boards, giving advice on corporate governance with regard to listing requirements and providing general advice and guidelines to directors.<sup>53</sup> Furthermore, there are organizations such as the Investment and Financial Services Association that provide proposals on sound corporate governance practice for its members.<sup>54</sup> These arrangements make Australia much more developed in self-regulation. This is to be expected as

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<sup>47</sup> *Huddart Parker & Co. v Moorehead* (1909) 8 CLR 330 at 354.

<sup>48</sup> See discussion of s 51 (xx) and *Huddart parker & Co. v Moorehead* in Corcoran, S., “Corporate Law and the Australian Constitution: A History of Section 51 (xx) of the Australian Constitution,” (1994) 15(2), *Journal of Legal History*, 131.

<sup>49</sup> Cassidy, J., *Corporations Law: Text and Essential Cases*, (2<sup>nd</sup> edn., 2008) 4.

<sup>50</sup> See *Re Wakim* (1999) 163 ALR 270; *R v Hughes* (2000) 171 ALR 155.

<sup>51</sup> Above n 49 at 5 – 7.

<sup>52</sup> ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, (2<sup>nd</sup> edn., August 2007) in ASX < [http://www.asx.com.au/about/corporate\\_governance/revise\\_d\\_corporate\\_governance\\_principles\\_recommendations.htm](http://www.asx.com.au/about/corporate_governance/revise_d_corporate_governance_principles_recommendations.htm) > at 26 January 2010.

<sup>53</sup> See Hilmer, F.G., *Strictly Boardroom*, (2<sup>nd</sup> edn., 1998); Bosch, H., (ed.) *Corporate Practices and Conduct*, (3<sup>rd</sup> edn., 1995).

<sup>54</sup> Investment and Financial Services Association (IFSA), *Guidance Note No. 2 – ‘Blue Book’ – Guidelines on Corporate Governance for Fund Managers and Corporations*, (October 2004) in IFSA <<http://www.ifsa.com.au/public/content/ViewCategory.aspx?id=619>> at 5 January 2009.

private companies are more significant in Australia and it has larger private companies operating than NZ.

Like NZ, private companies in Australia are exposed to external markets. That means they are subject to the managerial market, the market for corporate control and the share market, for those listed on ASX. Private companies can also be subject to bonding and monitoring devices. Monitoring mechanisms established under the *Corporations Act* are discussed below with references, from time to time, to other rules, guidelines and reports.

#### **4.3.1 Directors**

Section 9 of the *Corporations Act* defines the term “director” widely, embracing persons who perform the functions of a director. The definition extends to any officer of the company. Hence, the senior employees and senior executives and officers within the middle management come under the definitional ambit of s 9. Justice Owen, in the HIH Royal Commission Report, was surprised to find that middle-management were making governance decisions and yet could not be held accountable under company legislation.<sup>55</sup> Section 9 basically attempts to address that reality to ensure that these officers do not escape liability under the Act.

The duties of directors are provided for far more comprehensively under the *Corporations Act*. They are clearer, to the extent that cases or common law and equity are not necessarily required. Some of the main duties of a director provided under the *Corporations Act* are:

- a. duty of care and diligence;<sup>56</sup>
- b. duty of good faith;<sup>57</sup>
- c. duty not to use a position or information to gain personally or cause detriment to corporations;<sup>58</sup>

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<sup>55</sup> HIH Royal Commission, *Vol. 1: The Failure of HIH: A Corporate Collapse and its Lessons*, (April 2003) [Part 3, para. 6.4] < <http://www.hihroyalcom.gov.au/finalreport/index.htm> > at 7 January 2009.

<sup>56</sup> *Corporations Act 2001*, s 180.

<sup>57</sup> *Corporations Act 2001*, s 181.

<sup>58</sup> *Corporations Act 2001*, ss 182 and 183.

- d. duty relating to related party transactions;<sup>59</sup>
- e. duty relating to requirements for financial reports;<sup>60</sup>
- f. duty to prevent insolvent trading;<sup>61</sup> and
- g. duties relating to continuous disclosure.<sup>62</sup>

These duties ensure that individual directors perform to certain standards, irrespective of whether they are executive or non-executive directors. Breaches of these duties attract civil liability. In addition, s 184 of the *Corporations Act* creates a criminal offence for reckless or intentional dishonesty in exercising a duty of good faith.

### 4.3.2 The Board and Management

Like NZ, Australian companies have a one tier board that comprises of executive and non-executive directors. The tendency in Australian private companies has been to reducing the number of executive directors on the board so that there is an equal number of executive and non-executive directors.<sup>63</sup> Non-executive directors include independent directors. Directors make decisions through the board. Resolutions of the board are based on the collective and majority decisions of the directors, and take effect as the resolution of the company on a matter in question.<sup>64</sup>

The role of the board is provided under s 198A (1) of the *Corporations Act 2001*, which states that business of the company is to be managed by or under the direction of the board. The provision leaves open the issue of specificity of the role of the board and how they are different from the management. In the NSW case of *AWA Ltd v Daniels*<sup>65</sup> at first instance Rogers J stated that a board only deals with matters of high policy and non-executive directors only meet once a month to consider major policies. As a result “senior management is, in the true sense of the word, exercising the powers of decision and of management which in

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<sup>59</sup> *Corporations Act 2001*, Part 2E.

<sup>60</sup> *Corporations Act 2001*, Part 2M.2 and 2M.3.

<sup>61</sup> *Corporations Act 2001*, Part 5.7B.

<sup>62</sup> *Corporations Act 2001*, Chapter 6CA.

<sup>63</sup> Above n 17.

<sup>64</sup> *Corporations Act 2001*, s 248G(1).

<sup>65</sup> *AWA Ltd v Daniels* (1992) 10 ACLC 933.

less complex days used to be reserved for the board of directors”.<sup>66</sup> Further Justice Rogers outlined the duties of a board as follows:<sup>67</sup>

- a. to set the goals of the corporation;
- b. to appoint the chief executive of the corporation;
- c. to oversee the plans of managers for the acquisition and organization of financial and human resources towards attainment of the corporation’s goals; and
- d. to review at reasonable intervals the corporations progress towards attaining its goals.

Although he was criticized for mingling the responsibilities of the board with that of the management,<sup>68</sup> Justice Rogers was stating the reality in large corporations in Australia and around the world where managements of large companies are also performing a supervisory role. What is important to point out about roles of the board and the management is that the board must not meddle in the affairs that should be dealt with by management and the management must not deal with matters that the board should deal with.<sup>69</sup> This is not necessarily stating that the board should exclusively perform the responsibility of the board. In certain large corporations the company’s constitution may delegate to the management the supervisory or management role traditionally performed by the board.

Clarity is required for the roles and responsibilities of board and management. Usually company constitutions and other company documents such as company charters provide for them. In addition, reports,<sup>70</sup> guidelines,<sup>71</sup> books,<sup>72</sup> and

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<sup>66</sup> *AWA Ltd v Daniels* (1992) 10 ACLC 933 at 998.

<sup>67</sup> *AWA Ltd v Daniels* (1992) 10 ACLR 933 at 1013 per Rogers CJ and applied in *Daniel & Ors v AWA Limited* (1995) 13 ACLR 299 at 662 per Clarke and Sheller JJA.

<sup>68</sup> *Daniels v Anderson* (1995) 13 ACLC 614.

<sup>69</sup> Bosch, H., *Conversations with a New Director*, (1997) 16.

<sup>70</sup> Bosch, *Corporate Practices and Conduct*, above n 53 at 8 – 9.

<sup>71</sup> For example, see Investment and Financial Services Association (IFSA), *Guidance Note No. 2 – ‘Blue Book’ Guidelines on Corporate Governance for Fund Managers and Corporations*, (October 2004) in IFSA < <http://www.ifsa.com.au/public/content/ViewCategory.aspx?id=619> > at 26 January 2010.

<sup>72</sup> Hilmer, above n 53 at 25 - 48; Francis, I., *Future Direction – The Power of the Competitive Board*, (1997) 78.

corporate governance principles and recommendations<sup>73</sup> greatly assist by providing clarity to the roles and responsibilities of the board and management. The commonalities that appear from these documents are the key roles of the board that include: supervision and monitoring; strategic thinking; policy formulation; accountability; and monitoring the board's own effectiveness.<sup>74</sup>

The *Corporations Act* does not clearly provide for the roles and responsibilities of CEO. The Act did provide for the role of the chairperson, but merely states that the role of the chairperson is to preside over meetings.<sup>75</sup> A chairperson in a modern company does a lot more than presiding over meetings. In *ASIC v Rich*<sup>76</sup> Austin J stated that the special responsibilities of the chairperson were to:

- a. ensure that the board addressed the soundness and the underlying financial position of the company;
- b. require there to be a functioning and effective finance and audit committee independent of the executive directors;
- c. require the board to establish a process of internal review and the accounting and financial systems; and
- d. assess whether information supplied to him [the chairperson] and the board was accurate.

Further, there are books,<sup>77</sup> rules and best practice guidelines<sup>78</sup> that assist with explaining the distinctive roles and responsibilities of the chairperson. The CEO and the chairperson have a distinctive role that is different from each other, and

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<sup>73</sup> ASX Corporate Governance Council, *Corporate Governance Principles and Recommendation*, (2<sup>nd</sup> edn., August 2007) [Principle One] in ASX < [http://www.asx.com.au/about/corporate\\_governance/revised\\_corporate\\_governance\\_principles\\_recommendations.htm](http://www.asx.com.au/about/corporate_governance/revised_corporate_governance_principles_recommendations.htm) > 26 January 2010.

<sup>74</sup> See discussions in Farrar, above n 2 at 355 – 360.

<sup>75</sup> *Corporations Act 2001*, s 248E.

<sup>76</sup> *ASIC v Rich* (2003) 44 ACSR 341.

<sup>77</sup> Cadbury, A., *The Company Chairman*, (2<sup>nd</sup> edn., 1995); Bosch, H., *Conversations Between Chairmen*, (1999).

<sup>78</sup> Bosch, *Corporate Practices and Conduct*, above n 53 at 15 - 16; Investment and Financial Services Association (IFSA), *Guidance Note No. 2 - 'Blue Book' – Guidelines on Corporate Governance for Fund Managers and Corporations*, (October 2004) in IFSA < <http://www.ifsa.com.au/public/content/ViewCategory.aspx?id=619> > at 26 January 2010; ASX Corporate Governance Council, *Corporate Governance Principles and Recommendation* (2<sup>nd</sup> edn., August 2007) in ASX [Recommendation 2.3] < [http://www.asx.com.au/about/corporate\\_governance/revised\\_corporate\\_governance\\_principles\\_recommendations.htm](http://www.asx.com.au/about/corporate_governance/revised_corporate_governance_principles_recommendations.htm) > at 26 January 2010.

both are embedded with delegated power from the board to administer the company and board, respectively.<sup>79</sup>

### 4.3.3 Shareholders

The *Corporations Act* recognizes the rights of shareholders as investors and owners of shares in a company. Increasingly, many companies in Australia have institutional shareholders, such as pension funds, insurance companies and investment companies, which hold a significant stake in a number of companies. These shareholders play a greater role in influencing the management in its many decisions, and they influence the company to focus on the short-term interest of shareholders. Generally, shareholders' rights are provided under the *Corporations Act*. Some of the main rights of shareholders are:

- a. the right to vote;<sup>80</sup>
- b. the right to appoint and remove directors;<sup>81</sup>
- c. the right to requisition and call general meetings and propose resolutions;<sup>82</sup>  
and
- d. the right to information and accounts.<sup>83</sup>

Many shareholders' rights are exercised through voting and resolutions in the annual general meetings.<sup>84</sup> Where there is a breach of their rights, shareholders can enforce them through courts of law. Like NZ, court actions can be by virtue of prejudicial, derivative or personal action.<sup>85</sup>

The *Corporations Act*, like the *Companies Act* is shareholder oriented, except in liquidation where creditors' interests are taken into account. This means that the company's main objective is to advance the interest of shareholders through profit maximization. However, recent debates on a company's CSR were triggered by

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<sup>79</sup> Bosch, *Conversations Between Chairmen*, above n 77 at 26.

<sup>80</sup> *Corporations Act 2001*, Chapter 2G.

<sup>81</sup> *Corporations Act 2001*, Chapter 2D.

<sup>82</sup> *Corporations Act 2001*, Chapter 2G.

<sup>83</sup> *Corporations Act 2001*, Chapter 2M.

<sup>84</sup> *Corporations Act 2001*, Part 2G.2.

<sup>85</sup> For example, enforcement can be under Part 2F.1A (derivative action); Part 2F.1 (oppressive conduct) and s 1324 (injunctions) of *Corporations Act 2001*.

the case of James Hardie Ltd.<sup>86</sup> The “Corporations and Markets Advisory Committee” and the “Joint Parliamentary Committee” considered the CSR of companies, however decided that corporations should take appropriate measures themselves on the matter.<sup>87</sup> Companies, therefore have an option of adopting a code of conduct that provides for CSR.<sup>88</sup> Consequently, CSR has yet to be recognized under legislation to be given effective enforcement.

#### 4.4 CORPORATE GOVERNANCE IN OTHER JURISDICTIONS

This part considers corporate governance in other jurisdictions. The discussion below covers UK, Germany and Japan. The UK model of corporate governance is similar to NZ and Australia but not identical. The German and Japanese models are significantly different to that of the UK; however they are also not similar to one another.

##### 4.4.1 The United Kingdom Model

The UK was the first country to be industrialized. It developed the first corporate economy and the resulting corporate law was adopted by its colonies around the world, and influenced the development of corporate law in the US and Germany. The hallmark of its economy is a belief in individualism and freedom of contract.<sup>89</sup> This, in essence, defines its corporate law and governance systems. The governance system is about the relationship between owners and the managers and how managers can maximize profit on behalf of the shareholders. Directors are given the task of maintaining accountability. When corporations grew bigger, ownership became dispersed and the separation of ownership and control became inevitable, creating agent and principal relationships.

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<sup>86</sup> See discussion on James Hardie Ltd in Farrar, above n 2 at 497 – 498.

<sup>87</sup> Lumsden, A. and Fridman, S., “Corporate Social Responsibility: The Case for a Self-Regulatory Model,” (2007) 25, *Company and Securities Law Journal*, 147; See ASX Corporate Governance Council, *Corporate Governance Principles and Recommendation*, (2<sup>nd</sup> edn., August 2007) in ASX [Principle One and Nine] < [http://www.asx.com.au/about/corporate\\_governance/revise\\_corporate\\_governance\\_principles\\_recommendations.htm](http://www.asx.com.au/about/corporate_governance/revise_corporate_governance_principles_recommendations.htm) > at 26 January 2010.

<sup>88</sup> CSR is recommended for adoption by companies listed on ASX. See ASX Corporate Governance Council, *Corporate Governance Principles and Recommendation*, (2<sup>nd</sup> edn., August 2007) in ASX [Principle 3] < [http://www.asx.com.au/about/corporate\\_governance/revise\\_corporate\\_governance\\_principles\\_recommendations.htm](http://www.asx.com.au/about/corporate_governance/revise_corporate_governance_principles_recommendations.htm) > at 26 January 2010.

<sup>89</sup> Quoted from Corporate Governance Forum of Japan (1999) in Solomon, J. and Solomon, A., *Corporate Governance and Accountability*, (2004) 172.

Consequently, the main characteristics of corporate governance in the UK are the separation of ownership and control and how the interests of owners can align with that of the management.

Corporate governance in UK relies heavily on self-regulation. An earlier example is the City of London Takeover Code. After 1990 there were several reports that recommended self-regulation. The Cadbury Report (1992)<sup>90</sup> was set up to address the financial aspect of corporate governance. The report recommended three corporate governance principles of transparency, accountability and integrity. The principles were criticized as broad and not specific in addressing particular issue. The Greenbury Report (1995)<sup>91</sup> was established to examine executive remunerations. Amongst other things, it made policy recommendation to be adopted by listed companies. The Hampel Report (1998)<sup>92</sup> re-visits the two reports above, and focuses on their positive contributions to date. The report was particular in its emphasis, and instead of “box ticking” it focused on corporate governance guidelines and principles. The Higgs Report (2003)<sup>93</sup> examined the role and effectiveness of non-executive directors and amongst other things, recommended equal numbers of executive and non-executive directors on boards. These reports were highly influential documents that emphasized the importance of self-regulation and also recommended corporate governance principles that must be adopted by companies to avoid threat of legislation. The recommendations from these reports and others are reflected in the UK Combined Code, which was published in 1998 and revised in 2003 following the Higgs Report, and lately revised in 2009 (Appendix V).<sup>94</sup> The Code currently serves as a norm for good corporate governance in listed companies.

Like NZ and Australia, corporations in the UK have a one tier board that consists of executives and non-executive directors, but in the UK a board usually consists

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<sup>90</sup> Committee on the Financial Aspects of Corporate Governance, and Cadbury, A., *Report of the Committee on the Financial Aspects of Corporate Governance*, (1992).

<sup>91</sup> European Corporate Governance Institute, *Greenbury Report (Study Group on Directors' Remuneration)*, (15<sup>th</sup> July 1995) < [http://www.ecgi.org/codes/code.php?code\\_id=131](http://www.ecgi.org/codes/code.php?code_id=131) > at 6 January 2008.

<sup>92</sup> European Corporate Governance Institute, *Hampel Committee, Final Report*, (January 1998) < [http://www.ecgi.org/codes/documents/hampel\\_index.htm](http://www.ecgi.org/codes/documents/hampel_index.htm) > at 6 January 2009.

<sup>93</sup> Higgs, D., *Review of the Role and Effectiveness of Non-executive Directors*, (January 2003) < <http://www.berr.gov.uk/files/file23012.pdf> > at 6 January 2009.

<sup>94</sup> Financial Reporting Council, “The UK Corporate Governance Code,” (June 2010) in Financial Reporting Council, < <http://www.frc.org.uk/corporate/reviewCombined.cfm> > at 15 July 2010.

of more than 50 per cent of non-executive directors.<sup>95</sup> A non-executive director is a chairperson for all three jurisdictions. This is different to the USA where the CEO is often the chairperson.<sup>96</sup> The role of the non-executive members have become broader and more onerous, with greater importance placed on corporate governance. The UK has taken a step further towards recognizing CSR.<sup>97</sup> It is not archetypal of a country that emphasizes and upholds individualism and sanctity of contract; however given the current reality, a change in focus from shareholders to other stakeholders is necessary. CSR provision in the legislation raises many other legal issues.<sup>98</sup>

#### 4.4.2 The German Model

The German model of corporate governance is different from the Anglo-American model in that it is an insider system or relationship based system of corporate governance. There is a high level of ownership concentration in the hands of families, banks and other companies.<sup>99</sup> Banks are the biggest lenders and investors in companies,<sup>100</sup> and hold seats on supervisory boards as shareholders or as proxies.<sup>101</sup> This enables banks to have close ties and great influence over the companies. Under the German *Constitution* the government allows banks some freedom not only from lending but also other important services to the companies.<sup>102</sup>

The hallmark of the German model of corporate governance is a two-tier board structure with a supervisory board and management board. The supervisory board consists of the representatives of shareholders and employees. Its main function is

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<sup>95</sup> Goergen, M. and Renneboog, L., "Why are the Levels of Controls (so) different in German and UK Companies? Evidence from initial Public Offerings," in Fredeliksust van, F.R.A.I., Ang, J.S. and Sudarsanam, P.S., (eds.) *Corporate Governance and Corporate Finance - A European Perspective*, (2008) 191 at 194.

<sup>96</sup> Banks, E., *Corporate Governance, Financial Responsibility, Controls and Ethics*, (2004) 36.

<sup>97</sup> See *Companies Act 2006*, s 172(1), (UK).

<sup>98</sup> See Farrar, above n 2 at 495 – 497.

<sup>99</sup> See Barca, F. and Becht, M., (eds.) *The Control of Corporate Europe*, (2001) 319; Schmidt, R.H., "Corporate Governance in Germany: An Economic Perspective," in Krahn, J.P. and Schmidt, R.H. (eds.) *The German Financial System*, (2004) 386 at 394.

<sup>100</sup> Schmidt, above n 98 at 395.

<sup>101</sup> Prigge, S., "A Survey of German Corporate Governance," in Hopt, K.J., Kanda, H., Roe, M.J., Wymeersch, E. and Prigge, S., (eds.) *Comparative Corporate Governance: the State of the Art and Emerging Research*, (1998) 943.

<sup>102</sup> Clarke, T. and Bostock, R., "Governance in Germany: The Foundations of Corporate Structure?" in Keasey, K., Thompson and Wright, M., (eds.) *Corporate Governance: Economic and Financial Issues*, (1997) 242.

to supervise the management board, including the power to appoint and remove its members, call shareholders' meetings and provide a report to shareholders on the auditor's report. On the other hand the main function of the management board is to manage the company.<sup>103</sup>

Further, co-determination is also an important aspect of corporate governance in Germany.<sup>104</sup> The employees and unions elect their representatives to the supervisory board to be involved in decision-making on their behalf.<sup>105</sup> This ensures companies are not only maximizing profit but also taking into account the interest of employees, and other stakeholders.<sup>106</sup> The number of employee representatives on a board can be one third or half of the members on the board. In some industries where there is an equal number of shareholder and employee representatives, the shareholders are given the right to appoint a chairperson, hence tilting power slightly toward the shareholders.<sup>107</sup>

Concentrated ownership restricts the "free rider" problem of corporate control experienced in jurisdictions with dispersed ownership of shares, ensures active corporate control,<sup>108</sup> and provides private benefit. However, private benefits can be at the expense of corporate efficiency. Further, if the laws of the jurisdiction do not protect minority shareholders, concentrated ownership would be at the disadvantage of minority shareholders.<sup>109</sup> Strong market forces are gradually

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<sup>103</sup> Petri, M., *Comparative Corporate Governance: Shareholders as a Rule-Maker*, (2005) 252-253.

<sup>104</sup> Co-determination was recognised by *Co – Determination Act* of 1976. See Borsch, A., *Global Pressure, National System: how German Corporate Governance is changing*, (2007) 46. Co - determination has been a subject of criticism. Companies question co-determination arrangement as infringing the ownership rights. Labour representation "causes ritualization of meeting that precludes an open and potentially controversial exchange of views". See above n 100 at 966. See also Alkhafaji, A.F., *A Stakeholder Approach to Corporate Governance: Managing in a Dynamic Environment*, (1989) 32 – 34.

<sup>105</sup> Pistor, K., "Co-determination: A Socio-political Model with Governance Externalities," in Blair, M.M. and Roe M.J., (eds.) *Employees and Corporate Governance*, (1999) 163 at 182-183.

<sup>106</sup> Jackson, G., Hopner, M. and Kurdelbusch, A., "Corporate Governance and Employees in Germany: Changing Linkages, Complementarities, and Tensions," in Gospel, H.F. and Pendleton, A., (eds.) *Corporate Governance and Labour Management: an International Comparison*, (2005) 89-93.

<sup>107</sup> Plessis, J. du and Sandroock, O., "The Rise and Fall of Supervisory Codetermination in Germany?" (2005) 16, *International and Commercial Law Review*, 67 at 70.

<sup>108</sup> Shleifer, A. And Vishny, R., "Large Shareholders and Corporate Control," (1986) 94, *Journal of Political Economy*, 461.

<sup>109</sup> La Porta, R., Lopes-des-Silanese, F. and Shleifer, A., "Corporate Ownership around the World," (1999) 54, *Journal of Finance*, 471.

forcing changes in German corporate governance to a market based system,<sup>110</sup> to meet commercial globalization and importantly to attract investment from global markets as the “system could not ultimately provide German companies with the capital they needed to compete in a global marketplace”<sup>111</sup>. Thus, changes were made to transform Germany’s fragmented, small and high cost market into a transparent and liquid market to attract institutional and corporate investment from outside Germany. Further, the financial market reform was in tune with the European Single Market, and to attract direct foreign investment.<sup>112</sup>

#### 4.4.3 The Japanese Model

The Japanese model of corporate governance is a distinctive and successful model in its own right. The governance structure emulates the German model on corporate law and USA on securities regulation.<sup>113</sup> First, the board structure of Japanese companies is a hybrid of one-tier and two-tier board structure. All members of the board are insiders, appointed from the management ranks. They are either lifetime employees or ex-employees of banks, affiliated companies or government ministries. The companies have a statutory auditor who is appointed by shareholders, and performs a similar role to that of Germany’s supervisory board.<sup>114</sup>

Second, the companies are identified within a corporate group with a leading bank. Within the corporate group there is a relationship with a leading bank, trading relationships between the companies and interlocking shareholdings and directorship.<sup>115</sup> The bank lends and invests in the companies within the conglomerate and also performs a significant role of disciplining the managers. The investment by banks creates substantial ownership in the companies and this

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<sup>110</sup> See general discussion in Gordon, J.N., “Convergence of Shareholder Capitalism,” in Milhaupt, C.J., (ed.) *Global Markets, Domestic Institutions*, (2003) 214; see also Schmidt, above n 98 at 416.

<sup>111</sup> Monks, R. A. G. and Minow, N., *Corporate Governance*, (3<sup>rd</sup> edn., 2004) 231.

<sup>112</sup> Borsch, above n 103 at 53 - 55.

<sup>113</sup> Above n 2 at 528; Milhaupt, C.J., “Historical Pathways of Reform: Foreign Law Transplants and Japanese Corporate Governance,” in Hopt, K.J., Wymeersch, E., Kanda, H. and Baum, H., (eds.) *Corporate Governance in Context: Corporations, States, and Markets in Europe, Japan, and the US*, (2005) 53 at 55 – 58.

<sup>114</sup> Charkham, J.P., *Keeping Good Company: a Study of Corporate Governance in Five Countries* (1995) 92 – 93.

<sup>115</sup> Sheard, P., “Interlocking Shareholdings and Corporate Governance in Japan,” in Aoki, M. and Dore, R.P., (eds.) *The Japanese Firm: The Sources of Competitive Strength*, (1994) 310.

creates a special relationship between the banks and the corporations. As a result, banks see themselves in long-term relationships with corporations and feel obliged to rescue them when they are in trouble.<sup>116</sup> The advantage of a corporate group is the increase in information flow and reduction in incentive problems faced by arms' length contract dealings and it therefore increases the efficiency and reduces the cost of corporate governance.<sup>117</sup>

Thirdly, Japanese companies have passive or stable shareholders.<sup>118</sup> Having a bank and corporate group system with cross shareholding between companies creates an incentive for the main shareholders to be stable.<sup>119</sup> Stable shareholders include other companies in corporate group, major creditors and customers and suppliers. Shares in a company do not only ensure control of the corporation, but also maintain relationships within the group.<sup>120</sup> Stable shareholders look at long-term interest. The environment for long-term interest is also created by distinctive characteristics of the Japanese corporate system of lifetime employment, and the reality of companies being treated as social institutions provides incentives for managers to consider their strategic priority to be in their company's long-term interest rather than short term.<sup>121</sup>

Like Germany, Japan has been moving towards a market-based system of corporate governance.<sup>122</sup> Since 1980, the roles of banks in corporate governance have become less important as there was deregulation of financial markets and as corporations accrue internal funds. Further, corporations extended their production network outside of Japan, which changes the relationship between customers and suppliers, hence their representation on the board.<sup>123</sup> However,

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<sup>116</sup> Consequently stock markets have not really developed in Japan. See Kanda, H., "Trends in Japanese Corporate Governance," in Hopt, K.J. and Wymeersch, E., (eds.) *Comparative Corporate Governance: Essays and Materials*, (1997) 185 at 190.

<sup>117</sup> See further discussion on information flow in corporations in Jensen, M.C. and Meckling, W.H., "The Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure," (October 1976) 3(4), *Journal of Financial Economics*, 305.

<sup>118</sup> See the discussions in Ramseyer, J.M., "Cross-shareholding in the Japanese *keiretsu*," in Gordon, J.N. and Roe, M.J., (eds.) *Convergence and Persistence in Corporate Governance*, (2004) 348.

<sup>119</sup> Above n 114 at 318.

<sup>120</sup> Hoshi, T., "Japanese Corporate Governance as a System," in Hopt, K.J., Kanda, H., Roe, M.J., Wymeersch, E. and Prigge, S., (eds.) *Comparative Corporate Governance: The State of the Art and Emerging Research*, (1998) 847 at 860.

<sup>121</sup> See discussion above n 115.

<sup>122</sup> Citing Cooke, T.E. and Sawa, E. (1998) in Solomon and Solomon, above n 89 at 171.

<sup>123</sup> Above n 119 at 872.

many of the important features such as the corporate group, and interlocking shareholding and directorship, are still present in Japanese corporate governance framework, making it still unique.

#### **4.5 CONCLUSION**

Like the UK, NZ and Australia establish companies to pursue interests on behalf of shareholders. Companies are shareholders' companies and they are known as the owners of the company. The directors are appointed to control the company as stewards and agents of the shareholders. The appointment of directors creates separation of ownership and control. As a result, the focus of corporate governance in the three jurisdictions is on how to align the interests of shareholders with that of the managers. These jurisdictions have corporate governance structures that consist of one-tier boards and the management. Much corporate governance is left to self-regulation. The UK has gone a step further by giving statutory recognition to CSR. On the other hand the German and Japanese models of corporate governance are stakeholder orientated. The German model has a two-tier board structure, with concentrated shareholding. Employees, creditors, suppliers and customers monitor the performance of the corporation. The Japanese model of corporate governance is typically known for its lifetime employment and corporate group. Within the corporate group there is cross-shareholding and cross-directorship, and the leading bank monitors companies in the group. The objectives of companies in Germany and Japan are advancing the interests of shareholders and other stakeholders and the long-term viability of companies.

The corporate governance of each country is influenced by ideologies, history and/or their culture. These factors have defined whether the focus of the company should be on shareholders only, or shareholders and other stakeholders of the company. Corporate governance is changing in jurisdictions that are discussed above. Given the changing environment of commercial globalization and economic integration, pressured convergence in some jurisdictions, however variations in corporate governance still remain. The corporate governance system of one jurisdiction is not superior to another. Each system is established to address problems experienced in that society. These different corporate governance

systems share some commonalities despite major differences. For example, non-executive directors on boards of companies in the UK, Australia and NZ perform similar roles to the supervisory board in Germany. Also, there is ownership concentration in large companies in these jurisdictions in the form of institutional shareholding like Germany and Japan.

SOEs have a similar structure to private sector corporations and they draw upon many traditional corporate governance principles. However, their compositions, objectives and accountability processes are different. Corporate governance issues relating to the public sector are discussed in chapter 7.

**PART III:**

**CORPORATE GOVERNANCE IN THE  
PUBLIC SECTOR**

## **CHAPTER 5:**

### **THE ROLE AND PERSONALITY OF THE STATE**

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#### **5.1 INTRODUCTION**

The term “state” is easy to use and yet difficult to define. Although legal and political theorists have views of what the concepts of state are, they are nonetheless not conclusively and collectively accepted. At the international level, international lawyers have set out guidelines to distinguish a state from a non-state. At the domestic stage, the use of the term is not explicit and at times overlaps with other terms such as nation and the Crown. This chapter provides a prelude to chapter 7 on the role of the state in a state owned enterprise (SOE), chapter 8 on the role of the state in Papua New Guinea (PNG) and chapter 10 on the role of state in SOEs in PNG. The chapter discusses the rationale of state, history and personality of the Crown, followed by the relationship of Crown and SOEs. Then discussion of state and Crown follows with the conclusion.

#### **5.2 RATIONALE OF THE STATE**

Society like any contrivance is subject to endless progression. It developed from the nomadic way of life to primitive community, city-state, empire, nation, and to the modern state today. At various stages of development the state acquired different characteristics that vary in structure, composition and power networks. Feudalism was essentially the characteristic of societies in Europe where land was given in return for military service. Feudal kingdoms had a hierarchical structure where people were servants of lords. The servants promised faithfulness in service to the lords in return for protection. This created a mutual relationship of service in return for protection and justice. Out of feudalism emerged monarchies with a very tight grip on powers. Monarchies evolved into either revolutionary republics or constitutional monarchies. Absolute monarchism went through an evolutionary process that involved confrontation and negotiation, sometimes by a gradual process, to obtain the status of constitutional monarchy.<sup>1</sup> Different theories, such

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<sup>1</sup> MacCormick, N., *Questioning Sovereignty: Law, State, and Nation in the European Commonwealth*, (1999) 17 – 18.

as social contract, were enunciated to explain how the state is created, and to justify the power structure and composition of the state.<sup>2</sup>

Social contract explains how people establish a state and maintain social order. Social contract refers to a fictitious agreement between citizens and the state. The agreement obliges citizens to obey the laws and authority of the ruler. The ruler in turn agrees to protect the rights of the citizens.<sup>3</sup> The result is a state with a ruler, who protects the rights of the people and maintains peace and order. John Locke applied social contract to advance the liberty of individuals in the society. According to Locke important rights of individuals are the right to life, liberty and private property. Social contract enables men to create a political society and surrender their power to the government. The government agrees to protect individuals within the society. Locke further advocated the notion of democracy whereby the majority can elect to strip certain rights of individuals, including property rights of people within the society.<sup>4</sup> This must be done in the best interest of the society. Locke related sovereignty with the people – government is made by and for the governed (that is the people).<sup>5</sup>

Thomas Hobbes also advocated the notion of social contract. However, he saw men living in a state of nature, where predominantly they were in a state of war in which everyone is at odds with each other. Reason dictates that there was the need for peace and avoidance of unending insecurities of war. Men agreed with the ruler to obey her unconditionally and surrendered all their natural rights to her. The ruler agreed to rule and maintain peace and order in the society. If the ruler does not fulfil her obligation she can be overthrown and new ruler inaugurated. Allegiance is then shifted to the new ruler. Hobbes saw the sovereign as an individual, a ruler or a monarch whilst society is similar to state.<sup>6</sup> Hobbes advocated authority.

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<sup>2</sup> In Political Science and sociology different theories such as absolutist, constitutional, ethical, class and pluralist theories were employed at different stages of the history to gain an understanding of state. See discussion by Vincent, A., *Theories of the State*, (1987); see also Dryzek, J.S. and Dunleavy, P., *Theories of the Democratic State*, (2009) Part I.

<sup>3</sup> Campbell, T. D., *Justice*, (2<sup>nd</sup> edn., 2001) 92 – 93.

<sup>4</sup> Friedmann, W., *Legal Theory*, (5<sup>th</sup> edn., 1967) 122 – 125.

<sup>5</sup> Hague, R. and Harrop, M., *Comparative government and politics: an Introduction*, (7<sup>th</sup> edn., 2007) 25.

<sup>6</sup> Above n 4 at 120 – 122.

Jeremy Bentham and John Austin supported Hobbes' theory without the fiction of social contract.<sup>7</sup> They argue that people are in the habit of obedience to the command of the common superior. A person who is habitually obeyed is a sovereign and the law is a command from those who are habitually obeyed. Therefore government is a sovereign. The state on the other hand is a collegiate governing entity with a sovereign and subordinates with delegated powers and functions. This recognises the aggregate nature of the state. In addition, Hans Kelsen identified the state as analogous to a corporation. He argues that the state is really a territorial legal order personified, and is used as a point of imputation of public legal acts. In this sense the state is akin to a corporate entity composed of government and its subordinates in representative form.<sup>8</sup>

These different theorists justify centralized authority, the state, and the reasons for people's allegiances. But in the UK, constitutional principles have dispensed with the notion of state and instead predominantly use the Crown.<sup>9</sup> As stated by Bentham and Austin, the Crown is a sovereign. Legal personality is imposed on the Crown and it serves as a central organizing principle of government. The Crown "personifies the executive government of the country"<sup>10</sup>. Legal personality is encapsulated with constitutional history, and particularly associated with the monarch.<sup>11</sup> However, over the years the Crown's public powers (that is legislative, executive and judicial power) were curtailed when they were at odds with the society's interest, leading ultimately to a representative government based on citizens voting for a member of parliament.

### 5.3 HISTORY OF THE CROWN

The history of the monarchy goes back to the medieval era. The King was the ruler of the people and not the territory. Kingship subsisted as long as strength, in the sense of military strength, and control was maintained.<sup>12</sup> Gradually, the position of the Crown changed from an all-powerful active participant in

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<sup>7</sup> Offei, S., *Basic Jurisprudence and Legal Philosophy*, (1998) 33 – 37 and 41 – 43.

<sup>8</sup> Kelsen, H., *Pure Theory of Law*, (2<sup>nd</sup> revised edn., 1967) 219 – 312; Above n 1 at 19 – 22.

<sup>9</sup> Turpin, C.C., *British Government and the Constitution: Text, Cases and Materials*, (5<sup>th</sup> edn., 2002) 12 – 14.

<sup>10</sup> *BBC v Johns* [1965] Ch 32 at 79.

<sup>11</sup> Reference to a monarch in a restricted sense refers to a state governed by a single absolute hereditary ruler. See Bogdanor, V., *The Monarchy and the Constitution*, (1995) 1.

<sup>12</sup> Lyon, A., *Constitutional History of the UK*, (2003) 1- 4.

governance to a passive by-stander. From 1215 onwards in England, the Crown's role was dramatically extinguished by some major events – some of which are discussed below.

Under King Richard 1 and his brother King John, England was committed to unnecessary wars. While the wars advanced the influence of the kings abroad, they heavily affected the ministers and the barons who had to work hard to provide funding, and the public who had to contribute heavily in taxes and levies to support the wars. The barons were bitter over the burden of taxation and feudal obligations. They began preparations for revolt if the King did not accede to laws and liberties that they demanded. Realizing that there were no other options, the King assented to their demands (Articles of Barons), which then were reduced to a charter.<sup>13</sup> In 1215, the charter was formally recognized and called *Magna Carta*. Some see the *Magna Carta* as the result of an attempt to reach consensus with the rebellious minority.<sup>14</sup> Regardless, two important principles were enunciated in this document. First, the sovereign was as much under the rule of law as his or her subjects, and secondly, the rights of individuals took precedence over the personal wishes of the sovereign. The *Magna Carta* was the general declaration of the rule of law.

Then there were some major events from the 17<sup>th</sup> to the 18<sup>th</sup> centuries. These major events affected the relationship of the monarch and parliament. This period is referred to as “Glorious Period” and it lasted from 1688 – 1714.<sup>15</sup> During the “Glorious Period” King William III and Queen Mary II like their predecessors, committed Britain to unnecessary wars that were of no direct benefit to the country. This incurred debts and caused great anxiety amongst members of parliament. In response, the parliament enacted the *Act of Settlement 1701*, which amongst other provisions prohibited Britain from defending foreign territory for foreign princes.<sup>16</sup> The actions of the parliament protected the national interest, and concurrently curtailed the powers of the King.

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<sup>13</sup> Howard, A.E.D., *Magna Carta, Text and Commentary*, (1964) 4 – 8.

<sup>14</sup> Above n 12 at 50.

<sup>15</sup> O'Gorman, F., *The Long Eighteenth Century: British Political and Social History, 1688-1832*, (1997) chapter 2, 29 – 64.

<sup>16</sup> *Ibid* at 36 – 43.

By the 18<sup>th</sup> century the monarchy could only influence parliament. Ministers became powerful and their role was seen as more than advisors to the Crown. The sovereign's obligation was to accept their advice despite how unpalatable it appeared to the sovereign.<sup>17</sup> By the 19<sup>th</sup> century the sovereign was no longer in a position to oppose a determined government. First, such a situation was contributed to by rising power and influence of the press and various interest groups focused on different issues and causes, which began shaping political agendas and gradually dividing Britain between reformers and conservatives. These dynamics developed into the party system which further restricted the powers of the sovereign. A government enjoying a parliamentary majority and maintaining discipline over its members was able to make a sovereign accept its resolution. Second, when the *Reform Acts* of 1832 and 1867 were passed, they changed the electoral system, created more seats in the House of Commons, and enabled more individuals to vote. The focus of the representatives was on their constituency and party politics. As stated above, when a powerful political party or parties were determined and resolute on issues, it was difficult for the Crown to exercise discretion in terms of decision-making. Consequently, this drastically undermined the sovereigns' power.<sup>18</sup>

At the dawn of the 20<sup>th</sup> century Queen Victoria became the longest serving monarch, eclipsing 63 years when she died in 1901. During her reign the monarchy went through a major functional transformation from one of having a major role in the national politics to that of performing a symbolic role.<sup>19</sup> The historical reasons for curtailing the powers of the Crown lay in the fact that these continuously exercised powers were not in the best interest of the people. Hence, gradually there was a change from reference to, and recognition of, the Crown as a sovereign to the government. Logically, a government is the representative of people making people the ultimate sovereigns. The constitutional principles in the UK and other Commonwealth countries, which are not republic or which do not have their own monarchies, still use the Crown instead of the state. The Crown has two political personalities.

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<sup>17</sup> Above n 11 at 9 – 12.

<sup>18</sup> Chrimes, S.B., *English Constitutional History*, (4<sup>th</sup> edn., 1967) 126 – 134; above n 11 at 9 – 18.

<sup>19</sup> Above n 12 at 636.

## 5.4 PERSONALITY OF THE CROWN

A human person possesses two personalities, namely human and legal personalities. These personalities do not necessarily coincide with each other.<sup>20</sup> The Crown also has these personalities. A king or queen is a human having the natural capacity on one hand, and being both the head and representative of the state on the other. This highlights the distinction between the natural and political capacity of the Crown. The natural capacity refers to the mortal body that is subject to infirmities that come by nature or accident, and imbecility of infancy and old age.<sup>21</sup> This refers to the attributes of the Crown as a human person. The Crown also has political and legal attributes, which are categorized as corporation sole and corporation aggregate.

### 5.4.1 Corporation Sole

The body politic nature of the king is invisible, indivisible, illimitable and cannot be born or die of old age or be affected by natural defects and imbecilities of the natural body. The king, who is a natural person, is invested with this body politic that magnifies and perpetuates its person and identity.<sup>22</sup> This identity was described as a corporation sole. The corporation sole is a concept that originated in the 16<sup>th</sup> century from ecclesiastical law to protect the proprietary interest of the church.<sup>23</sup> The concept establishes a permanent subject and created “an enduring estate in parish”.<sup>24</sup> The status of corporation sole was adopted and conferred on the king or queen in the 17<sup>th</sup> century to prevent vacancies on the throne and to preserve the possessions of the Crown.<sup>25</sup> Consequently, the transposition of the concept to the king provided a permanent metaphysical entity that enabled devolution of the king’s public estate to his successors in office.<sup>26</sup>

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<sup>20</sup> See discussions in, Duff, P.W., “The Personality of an Idol,” (1927) 3, *The Cambridge Law Journal*, 42; see also Salmond, J.W. and Fitzgerald, P. J., *Salmond on Jurisprudence*, (12<sup>th</sup> edn., 1966) 298 – 299.

<sup>21</sup> Holdsworth, W.S., Burke, J., Potten, E., Goodhart, A.L. and Hanbury, H.G., *A History of English Law*, (vol.4, reprinted edn., 1966) 202.

<sup>22</sup> Quoted above n 21 at 203.

<sup>23</sup> Maitland, F.W., “The Crown as Corporation,” (1901) 17, *Law Quarterly Review*, 131 at 131.

<sup>24</sup> Maitland, F.W., Runciman, D. and Ryan, M., *State, Trust, and Corporation*, (2003) 11 -15; Joseph, P.A., *Constitutional & Administrative Law in New Zealand*, (3<sup>rd</sup> edn., 2007) 609.

<sup>25</sup> Blackstone, W. and Kerr, R.M., *Commentaries on the Laws of England*, (vol.1, reprinted edn., 1857) 469 – 470.

<sup>26</sup> Above n 23 at 131.

A corporation sole is not a formally incorporated entity that arises through prerogative or parliamentary grant, but is recognized by the common law of England.<sup>27</sup> The concept was formally recognized in 1861 when the House of Lords in *A-G v Kohler*<sup>28</sup> explicitly identified the Crown as corporation sole as having perpetual succession. A king or queen as corporation sole can own property, give orders and impose sanctions. These must not be interpreted as acts of a human person but of the Crown. When the king or queen dies, property passes to the successor and the successor is also bound by the acts of the predecessor. It becomes problematic when colonized territories become independent and yet retain the Crown as head of state.<sup>29</sup>

The Crown was previously thought to be indivisible, and the same Crown was applied throughout British empires and colonies. Therefore to use corporation sole to refer to the king or queen makes sense. Independence of former British territories raises the question of whether the Crown, the corporation sole, can be separated and divided. Courts have established that once a local government is established, the Crown's responsibility is devolved to that government.<sup>30</sup> This recognizes the divisibility of the Crown. But the enduring metaphysical concept of corporation sole could not provide for the monarch's role that was removed from the person of Crown to other persons such as the executive government and the parliament.<sup>31</sup>

#### 5.4.2 Corporation Aggregate

The government's obligation to provide appropriate services to the people came about through the emergence of society as it gradually changed from that of controlled state to provider state,<sup>32</sup> from a discrete law and order state to a welfare state, which involves public service, especially with indeterminable functions of

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<sup>27</sup> *Suttons Hospital*, 77 ER 960 at 968 – 969, 29b.

<sup>28</sup> *A-G v Kohler* (1861) 9 HLC 654 at 671.

<sup>29</sup> *NZ Maori Council v A-G* [1994] 1 NZLR 513 at 517 (PC); *Secretary of State for Foreign and Commonwealth Affairs; Exp Indian Assn of Alberta* [1982] QB 892; *A-G (UK) v Wellington Newspapers Ltd* [1988] 1 NZLR 129 (HC & CA).

<sup>30</sup> *NZ Maori Council v A-G* [1994] 1 NZLR 513 at 517 (PC); *Secretary of State for Foreign and Commonwealth Affairs; Exp Indian Assn of Alberta* [1982] QB 892; *A-G (UK) v Wellington Newspapers Ltd* [1988] 1 NZLR 129 (HC & CA).

<sup>31</sup> Allison, J.W.F., *A Continental and Distinction in the Common Law – A Historical and Comparative Perspective on English Public Law*, (1996) 76.

<sup>32</sup> Hill, M.J., *The State Administration and the Individual*, (1976) 29 – 44.

providing health, education, social security and infrastructural services.<sup>33</sup> The exercise of the Crown's power that was transferred to other bodies that did not deserve the analogous privileges and immunities, began causing problems.<sup>34</sup> There was a need for an all embracing concept.

Maitland, in 1900, in an attempt to address the theoretical vacuum, stated that the term Crown not only referred to royal corporation sole but also to the King and the Commonwealth.<sup>35</sup> He regarded the Crown as a corporation aggregate. The idea of a corporation aggregate was suggested to include public bodies that conduct themselves like the Crown or carry out activities that were supposed to be performed by the Crown. The corporation aggregate refers to an incorporated group having several members as oppose to corporation sole that refers to "an incorporated series of successive persons having a sole member".<sup>36</sup> The difficulty with the concept of corporation aggregate, is determining whether an entity is a public body.

Different criteria are used to determine a public body under common law. Public function is one of the tests being used to assess whether an entity is a public body. In essence, the test determines whether an entity performs a public function. Although seen to be problematic,<sup>37</sup> the public function test is still being applied today to determine whether an entity is a public body. Further, courts under common law also apply a "control test" to determine the nature and degree of control that a minister or government department exerts over a body to determine whether it comes under the umbrella of the Crown.<sup>38</sup> Usually, a body that is able to exercise significant discretion which is independent of ministerial discretion, or discretion of a government department, is not a public body. Control in this context refers to a *de jure* and not *de facto* control.<sup>39</sup>

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<sup>33</sup> Above n 31 at 83.

<sup>34</sup> Bradley, A.W. and Ewing, K.D., *Constitutional and Administrative Law*, (14<sup>th</sup> edn., 2007) chapter 32, 806 - 807; Laski, H.J., "The Responsibility of State in England," (1919) 32, *Harvard Law Review*, 447.

<sup>35</sup> Above n 23.

<sup>36</sup> Salmond and Fitzgerald, above n 20 at 308.

<sup>37</sup> *Commissioner of Inland Revenue v Medical Council of NZ* [1997] 2 NZLR 297 at 326 – 327 (CA).

<sup>38</sup> *Commissioner of Inland Revenue v Medical Council of NZ* [1997] 2 NZLR 297 (CA) at 326 – 327.

<sup>39</sup> Hogg, P.W. and Monahan, P., *Liability of the Crown*, (3<sup>rd</sup> edn., 2000) 336; *Bank voor Handel en Scheepvaart NV v Administrator of Hungarian Property* [1954] AC 584 at 617 (HL).

Many private sector entities that are performing public functions or are controlled by a government department, can easily qualify as public bodies applying the two tests. Consequently, the Australian High Court went further by taking a pragmatic and yet restrictive approach by asking the question of whether “a body performing a particular function enjoy the privileges and immunities of the Crown”.<sup>40</sup> In actuality the Crown immunity test merely complements the two common law tests to determine whether an entity is a public body. To prove whether an entity is entitled to “Crown immunity” or is subject to public scrutiny, the two common law tests are to be applied to determine whether it is a public body. This is further discussed below.

## **5.5 RELATIONSHIP OF THE CROWN AND STATE OWNED ENTERPRISE**

The three tests, namely, the control and public purpose tests and whether a body enjoys immunities of Crown must be examined in their context. First, Crown immunity or protection does not only apply to public bodies but private persons. That means that Crown immunity is not a conclusive test to determine whether an entity is a public body. For example private contractors who are not servants or agents of the Crown are entitled to Crown immunity.<sup>41</sup> The protection is given in these situations where the interest of the Crown would be prejudiced if the act of private persons, acting on behalf of the Crown, are held to be subject to legislation.

Legislation may specifically provide whether an SOE is entitled or not entitled to Crown immunity, or provide that an SOE represents or not represents the Crown. For example, legislation in Queensland and New South Wales clearly declares that SOEs do not represent the state.<sup>42</sup> NZ’s *State Owned Enterprises Act 1986* is silent on the matter. Even with a clear stipulation, Crown immunity in Australia would not take an immediate effect in the light of the decision in *Bropho v Western Australia*<sup>43</sup>. The decision of the court made it no longer necessary for

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<sup>40</sup> *Townsville Hospitals Board v Townsville CC* (1982) 149 CLR 282 (HCA).

<sup>41</sup> *Lower Hutt City v A – G* [1965] NZLR 65(CA); *Wellington City Corporation v Victoria University of Wellington* [1975] 2 NZLR 301 (SCI); *Commonwealth v Bogle* (1953) 89 CLR 229 (HCL).

<sup>42</sup> *Government Owned Corporations Act 1993*(Qld), s 154; *State Owned Corporations Act 1989* (NSW), ss 9 and 20F.

<sup>43</sup> *Bropho v Western Australia* (1990) 171 CLR 1.

statutes to provide that the state is bound to a particular declaration on state immunity. This therefore means that in considering state immunity in the light of statutory provisions different circumstances including the content and purpose of the legislative provisions and the characteristics of the body must be identified in determining whether an entity is entitled to the Crown's immunity.<sup>44</sup>

It logically follows that even if an entity is subject to the Crown's immunity it would not be considered to be a public body unless other circumstance are taken into account to recognize the entity as a public body before the Crown immunity applies. In such circumstance the degree of control and the nature of the function of the SOE would determine whether SOEs are public bodies and therefore entitled to Crown immunity. It is clear with government departments that they attract immunity when they are exercising the powers of the government. SOEs however are not automatically entitled to Crown immunity even with the expressed provision of their immunity. Whether they are entitled to Crown immunity would depend on the degree of control by government or the nature of function that they perform.

In looking at the degree of control by government one is substantially determining the extent of control that government has over an SOE and the independence that the SOE has in performing its function. The government's substantial control over an SOE is significant in determining whether an SOE is a public body and therefore entitled to Crown immunity. Control by government includes (chapter 2):

- a. the power to appoint directors of SOEs;
- b. the extent of powers of shareholding ministers;
- c. the ability of government ministers to direct the board of SOEs;
- d. exemption of the entity from paying tax;
- e. the obligation to execute functions of public character; and
- f. the power to pass by-laws.

Further, the nature of an SOE's function may also determine whether an SOE may be entitled to Crown immunity, which may be attracted to some activities but not

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<sup>44</sup> *Bropho v Western Australia* (1990) 171 CLR 1 at 23.

all. SOEs that are involved largely in business and commercial activities may not attract Crown immunity. Commercial undertakings are within the ambit of the private sector where competitive neutrality is a norm. The success of an SOE would depend on effective competition. Extending Crown immunity would disrupt the forces of free market that ensure the efficiency and effectiveness of an organization.<sup>45</sup> This is true in situations where SOEs are exposed to external market forces and do not have a monopoly over the market. SOEs may also undertake several government services under community service obligations, not for profit under the direction of the government with government subsidization. It is still arguable whether an SOE is entitled to Crown immunity when performing community service obligations. The issue here is whether the entire SOE's activities are focused on commercial or community services and not sporadic community service obligations performed once a year.

An SOE that has substantial control by government and has a major part of its activities "public purpose oriented" meets both the common law control test and the public purpose test respectively, and therefore it is a public body. As a public body it is subject to public scrutiny by public institutions such as an ombudsman commission and public accounts committee (unless being excluded by expressed provision in a statute). However, a statutory provision making an SOE entitled to Crown immunity does not in itself necessarily make the entity a public body and consequently subject to public scrutiny.

SOEs are difficult to determine even after applying the above tests. For example, in NZ, an SOE is not an emanation of the Crown or state, however it is publicly owned. Applying the concept of control as discussed above (and chapter 2) it is clear that the government controls SOEs. Understandably, the Court of Appeal in *Commissioner of Inland Revenue v Medical Council of NZ*<sup>46</sup> considered an SOE as part of the Crown. This is further confirmed by the fact that SOEs are subject to the *Public Finance Act 1975*, the *Ombudsman Act 1975* and the *Official Information Act 1982*. Conversely, it may be argued that SOEs are commercial entities and have operational independence; therefore they are not public bodies.

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<sup>45</sup> Courts are generally inclined against extending the Crown's immunity to public bodies that are competing commercially in the private sector. See *Tamlin v Hannaford* [1950] 1 KB 18 (CA).

<sup>46</sup> *Commissioner of Inland Revenue v Medical Council of NZ* [1997] 2 NZLR 297 at 327 – 331 (CA).

Further, the fact that they are subject to public laws is a policy decision and must not be taken into account to determine its categorization as a public body.<sup>47</sup> The opposing arguments are cogent, leaving the issue of whether an SOE is a public body in a conundrum. However, what is clear is that corporatisation puts SOEs on a commercial footing while maintaining public ownership (chapter 6). Hence, SOEs are required to perform the public function of providing services to the people.

## 5.6 THE CROWN AND THE STATE

Many commonwealth countries use the term state instead of the Crown. Hence, legal personality is imposed on the state and not the Crown, and the state serves as a central organizing principle of government. According to Article One of *Montevideo Convention on Rights and Duties of States 1933* the state must possess four characteristics of a permanent population, a defined territory, a government and the capacity to enter into relations with other states.<sup>48</sup> What is a state in the context of a society? As noted earlier, social contract theory states that people surrender their rights to the state and the state becomes a sovereign. Sovereign is identified with the common interest and will of the people, and this means it is infallible, indivisible, illimitable and unrepresentable. Government therefore is not a sovereign.<sup>49</sup> Consequently the Crown, the head of the government, is not a sovereign but a part of the state. The government, as an agent of the state, has a fiduciary duty to protect the rights and interests of individuals.<sup>50</sup> By submitting their will to the state, individuals inculcate in the state public power to protect their rights and therefore they legitimize the state's intervention in the life of a society. Thus, the state serves as a central organizing principle of government. For example, section 99 of PNG's *Constitution* provides that the authority and jurisdiction of the people shall be exercised by the national government. The representative of the Queen is part of the government and performs only the ceremonial role (see chapter 8). Therefore state in PNG is a

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<sup>47</sup> Joseph, above n 24 at 594.

<sup>48</sup> Bishop, W. W., *International Law: Cases and Materials*, (3<sup>rd</sup> edn., 1971) 301. See also discussion in McCorquodale, R. and Dixon, M., *Cases and Materials on International Law*, (4<sup>th</sup> edn., 2003) 136 – 138.

<sup>49</sup> Above n 4 at 125 - 125.

<sup>50</sup> Freeman, M. D. A., *Lloyd's Introduction to Jurisprudence*, (8<sup>th</sup> edn., 2008) 107 - 109.

collegiate governing entity that represents people and functions through the government and its agents.

The use of the term state instead of Crown solves problems that are associated with the application of corporation sole personality of the Crown in a foreign state. However, states in any jurisdictions participate through other persons to perform public functions. Consequently, questions of whether an entity that performs a public function is a public body, or whether persons who perform public functions are entitled to state immunity, lingers and needs to be answered on a case-by-case basis. In these cases the two common law tests are still relevant. Some of these issues are revisited in chapter 15.

## **5.7 CONCLUSION**

There are different theoretical explanations of the formation of the state. In the UK the Crown is used instead of the state. The Crown has a long history dating to the medieval era. Over decades, the Crown developed two legal personalities. First, the corporation sole was used to transpose to the king a permanent metaphysical entity that would provide for the devolution of the king's public estate to the king's successor in office. It becomes problematic when former colonies of Britain become independent and maintain the Crown as head of state and when the role of Crown is extended and delegated in a welfare society. Second, a corporation aggregate was adopted to bring within the ambit of the Crown those bodies that perform delegated responsibilities; however the concept has its problems. Notwithstanding, the different tests developed to identify public bodies, and with different pronunciations in legislation and case laws, have left the question unanswered.

The role of the state becomes an issue when it extends its functions into the private sector domain with the use of SOEs that have the status of a separate legal personality. Several questions can be posed about SOEs. Are they public bodies? Can the act of directors, managers and responsible ministers bind the state? Can the officers and responsible ministers be subjected to public scrutiny? Can officers including the minister responsible for SOEs enjoy state immunity? These issues

have not conclusively been dealt with. Chapter 15 discusses whether SOEs are public bodies for purposes of public scrutiny in PNG.

## CHAPTER 6:

### CORPORATISATION AND STATE OWNED ENTERPRISE

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#### 6.1 INTRODUCTION

History is rich with instances of the state using its power to enter into the private sector domain. The state's participation in the economy is not a new phenomenon<sup>1</sup> and can be traced, firstly, back to the Renaissance<sup>2</sup>. State participation in the economy can even be seen during the biblical era where Joseph (the Prime Minister) erected a big government warehouse in the first seven good years in Egypt in anticipation of the next seven years of drought.<sup>3</sup> Furthermore, state participation in the economy can be seen after the disastrous recession of 1929 and during World War One and Two where governments took control of the economy.<sup>4</sup> Particularly, after World War Two there was wide spread growth of state owned enterprises (SOEs) in industrialized countries.<sup>5</sup> The increase in SOEs was made possible by nationalization. Toninelli explains that:

The policies [of nationalization] aimed, on one hand, at 'the removal of sectoral imbalance and catching-up with full employment' and, on the other, at 'the enlargement of the public sector in order to down-size monopolistic and rent positions as well as to build infrastructures and strengthen the interest and welfare of the community'.<sup>6</sup>

In recent years, due to increasing globalization, immense pressure is placed on the public sector to be economically efficient. Consequently, the public sectors have moved away from nationalization to commercialization by adopting private sector management techniques and structure. Commercialization involves corporatisation and privatization.<sup>7</sup> Corporatisation is a hybrid of nationalization

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<sup>1</sup> *Halsbury's Laws of England* (4<sup>th</sup> edn., 1973) vol. 9(2).

<sup>2</sup> See discussion by Reinert, E. S., "The Role of the State in Economic Growth," in Toninelli, P. M., (ed.) *The Rise and Fall of State-Owned Enterprise in the Western World*, (2000) 73.

<sup>3</sup> Academy Enterprises, Inc., *The Study Bible*, (1993) Exodus, chapter 41.

<sup>4</sup> Toninelli, P. A., "The Rise and Fall of Public Enterprise," in Toninelli, P. A., (ed.) *The Rise and Fall of State-Owned Enterprise in the Western World*, (2000) 3 at 14; See also Aharoni, Y., *The Evolution and Management of State Owned Enterprises*, (1986) 1 – 2.

<sup>5</sup> Vernon, R. and Aharoni, Y., (ed.) *State-Owned Enterprise in the Western Economies*, (1981) 8.

<sup>6</sup> Toninelli, above n 4 at 18.

<sup>7</sup> Farrar, J.H., *Corporate Governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) 457.

and privatization; hence, it is seen as a precursor to privatization.<sup>8</sup> Studies have shown that SOEs have not performed as well as private corporations in terms of economic efficiency and profitability;<sup>9</sup> it is this, which has justified privatization - privatization is seen as a solution. Professor Wiltshire described corporatisation as a “holding paddock for enterprise destined for privatization”<sup>10</sup>. Others see corporatisation not as a means to an end (privatization) and that corporatised entities such as SOEs are part of the corporate landscape and they have an important role to play in society.<sup>11</sup>

This chapter discusses definition and rationality of corporatisation, and looks at corporatisation experiences in Australia and New Zealand (NZ). The chapter is important as it puts in perspective the rationale for the state’s continuous participation in the economy and also provides a prelude to chapter 7.

## 6.2 DEFINITIONS OF CORPORATISATION

Corporatisation is defined as a process whereby change is made to the organization rather than transfer of ownership,<sup>12</sup> particularly conversion of “government business enterprise into a firm which is similar in its objectives to a private firm while retaining government ownership of the enterprise”<sup>13</sup>. In other words corporatisation enables “trading activities”<sup>14</sup> under government

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<sup>8</sup> Political interference is inherent in corporatised entities, consequently making the call for privatization persuasive. See Farrar, J. and McCabe, B., “Corporatisation, Corporate Governance and the Deregulation of the Public Sector economy,” (March 1995) 6(1), *Public Law Review*, 24.

<sup>9</sup> Boardman, A.E. and Vining, A. R., “Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed and State Owned Enterprises,” (April 1989) 32(1), *Journal of Law and Economics*, 1. Studies have also shown that reform through commercialization and privatization has adjusted the characteristics of boards of SOEs and increased their effectiveness. See Bozec, R., Zeghal, D. and Boujenoui, A., “The Effect of the Reform of Canadian State-Owned Enterprises on Major Corporate Governance Mechanisms,” (2004) 63(2), *Australian Journal of Public Administration*, 79.

<sup>10</sup> Wiltshire, K., “Privatisation and Corporatisation,” in Stewart, R. G., (ed.) *Government and Business Relations in Australia*, (1994) 202 at 217.

<sup>11</sup> Skeel, D. A. Jr., “Virtual Privatization: Governance Reform for Government Owned Firms,” in Whincop, M. J., (ed.) *From Bureaucracy to Business Enterprise: Legal and Policy Issues in the Transformation of Government Services*, (2003) 91 -92.

<sup>12</sup> As opposed to privatization where public ownership is transferred to private ownership either through selling assets or selling shares. See Duncan, I. and New Zealand Institute of Economic Research, *Public Enterprise Reform in New Zealand since 1984*, (Working paper 91/10, 1991) 16.

<sup>13</sup> Allars, M., “Private Law But Public Power: Removing Administrative Law Review from Government Business Enterprises,” (March 1995) 6(1), *Public Law Review*, 44 at 45.

<sup>14</sup> Trading activities refers to buying and selling of goods and services at a price.

departments to be transferred to corporatised entities.<sup>15</sup> Section 13 of Queensland's *Government Owned Corporation Act 1993* (GOC Act) defines corporatisation broadly as a structural reform process:

- a. where the conditions and structure of a designated government entity is changed so that it operates on a commercial basis in a competitive environment;
- b. which maintains public ownership; and
- c. which allows government, as an owner on behalf of the people to set financial and non-financial targets and community service obligations.

In a narrow legal sense corporatisation is a process whereby “the government transfers some aspects of its operation to an incorporated entity. The entity may be incorporated under special Act of parliament, as with statutory corporation or [as in the case of state company,] under Corporations Law”<sup>16</sup>. Hence, corporatisation does not necessarily involve incorporation under company legislation. These definitions highlight the fact that ownership remains with the government, however the conditions and structure of an entity are changed to enable certain government activities be performed separately from direct government control, to ensure they operate in a competitive market and/or are efficient. However, the government is required to monitor the board and management of SOEs on behalf of the people.

In a democratic society, government is the representative of the people. It is the trustee shareholder in SOEs acting on behalf of the residual owners - the people. Management is accountable to the board and the board in turn is accountable to the government. Ultimately, the government is accountable to the people through parliament. In addition, an SOE may be subjected to scrutiny by public institutions such as an ombudsman commission, or auditor general. This would depend on the rules and legislative requirements of a jurisdiction.

### **6.3 RATIONALITY OF CORPORATISATION**

There are different ideologies that influence corporatisation. Two of them play a prominent role in influencing the drive to corporatisation. First, in socialist

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<sup>15</sup> Not only trading activities are corporatised, but other public sector organizations which are involved in performing social, welfare and regulatory functions. This shows that an organization need not be seeking profit to enjoy the benefits of corporatisation. Through corporatisation an organization can be efficient and accountable to achieve other outcomes.

<sup>16</sup> Bottomley, S., “Corporatisation and Accountability: the Case of Commonwealth Government Companies,” (March 1997) 7(2), *Australian Journal of Corporate Law*, 156 at 156.

countries public ownership continues to dominate the national economy and remains influenced by Karl Marx's socialist and communist ideologies. Marx foresaw a time in history where the common good of the society would be best served when the capitalist system being replaced with socialist and communist systems in which public ownership is combined with heightened productivity.<sup>17</sup> Communism advocates a planned national economy and public ownership. China, North Korea and Cuba are conspicuous examples of countries that continue to largely embrace Marx's socialist ideology. The national economies of these countries are dominated by public ownership, and often, socialist objectives are pursued at economic cost. Although socialist objectives are noble and benefit society, the issue of economic efficiency, and quality of service, including the waste of public money through lack of managerial accountability and bureaucratic control of the public sector, pressured governments to reconsider public ownership. The solution to these problems is to introduce corporate autonomy and remove government control of public enterprise. Consequently, Russia and China (as early as the late 1970s and during the 1980s) have gradually moved towards adopting a capitalist philosophy of market economy.

The problems in public ownership have, secondly, led to the recent movement of corporatisation and privatization influenced by the current economic literature about the agency theory of the firm. Agency theory is one of the factors that has influenced corporatisation and privatization in NZ and Australia.<sup>18</sup> The theory is discussed in chapter 2; however suffice to surmise that separation of ownership and control creates an agency problem. Agency cost is incurred in using an agent in control of a corporation. Agency cost is severe in public enterprises due to a lack of well-defined property rights, absence of external markets, absence of clear internal hierarchical governance structure, and clear transparency and accountability mechanism. Through corporatisation an attempt is made to adopt some of the characteristics analogous to that of private sector enterprise but maintaining the ownership.

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<sup>17</sup> Pipes, R., *Property and Freedom*, (1<sup>st</sup> edn., 2000) 55.

<sup>18</sup> New Zealand Business Roundtable, Jennings, S., Begg, S. and Cameron, R. L., *State Owned Enterprises: Issues of Ownership and Regulation*, (1988) 20 – 22.

It is the belief in the superiority of the marketplace and the efficiency in private sector corporations that drove the SOE reform process in NZ and Australia.<sup>19</sup> Particularly, in NZ corporatisation was meant to establish a corporate form that would improve efficiency of SOEs in both commercial and non-commercial activities and ensure accountability of management in an attempt to maximise the value of SOEs using limited resources.<sup>20</sup> In doing so SOEs are intended to promote the interest of the public by way of benefits through efficient use of resources.<sup>21</sup>

Deane<sup>22</sup> identified six key principles of corporatisation as a basis for the reform of SOEs in NZ. Of the six, four of them include clarifying the objectives of management, providing management autonomy, improving the monitoring and assessment of managers and instituting effective rewards and sanctions for managers.<sup>23</sup> First, the managers of an SOE are meant to have a single and clear objective, which would provide a clear and unambiguous direction, assists in monitoring, and improves accountability in management. Further this prevents inconsistent political pressure being exerted on the managers from time to time. This, in the end would ensure that the commercial and non-commercial objectives of SOEs' are achieved without any excuses from managers about political pressure or vague and multiple objectives.

Second, the managers are meant to be given autonomy over the management of SOEs, which means to make decisions necessary to meet the objectives of the SOE with regard to major investment and strategic decisions, including recruitment, remuneration and dismissal and other day-to-day business and affairs of the SOE. The government's responsibility is to the overall performance of SOEs, leaving managers, who have intimate knowledge of the firm to focus on the day-to-day operation of the SOE. This is basically to insulate the managers from external interference.

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<sup>19</sup> Taggart, M., "Corporatisation, Privatization and Public Law," (June 1991) 2(2), *Public Law Review*, 77 at 79.

<sup>20</sup> Above n 18 at 2.

<sup>21</sup> Efficiency requires competition so that it maximizes the benefit to the consumers. See Wells, P. K., *The New Zealand State Owned Enterprise Model: Issues of Competition and Social Obligation*, (vol. 6, no. 2, November 1998) 67.

<sup>22</sup> Deane, R. S., *Corporatisation and Privatization: a Discussion of the Issues*, (1989) 6 – 8.

<sup>23</sup> Two other key elements of the reform of SOEs include increasing the competitive neutrality of input markets, and increasing competitive pressures on output markets.

Third, management should not be left without scrutiny. Their performance needs to be closely monitored against the stated objectives of the SOE and it is the role of the board of directors to ensure that the managers are performing their duties and fulfilling the objectives of the SOE. The minister monitors the overall performance of SOEs with Treasury providing assistance in the monitoring of financial matters. In addition, management must provide a statement of corporate intent and half yearly and annual reports to the minister.

And fourthly, as incentives for managers, there should be rewards and sanctions. Salaries are linked to performance with bonuses for good performance and dismissal for bad performance as a way of sanction. The rewards and sanctions are meant to be a natural follow on from monitoring managers. Although SOEs in NZ have undergone reform based on the above model they were not highlighted in the *State-Owned Enterprises Act 1986* (SOE Act).

States in Australia adopted similar principles.<sup>24</sup> For example, s 16 of Queensland's *Government Owned Corporations Act 1993* specifically provides that the key principles of corporatisation for an SOE are to clarify its objectives; have an autonomous management and authority; be strictly accountable for its performance, and be operating in a competitive environment.<sup>25</sup> Further, s 14 states that the overall aim of corporatisation is to enhance economic performance and improve the ability of the government to achieve social objectives through improving efficiency, effectiveness and accountability. Corporatised legislation gives effect to these principles.

## **6.4 CORPORATISATION EXPERIENCES**

In the last 20 years NZ and Australia subjected the public sector to commercialization following the example in the UK, as part of the micro-economic reform. Commercialization involves promoting structural reform, a competitive market, and reforming industrial relations. A private sector model was examined to identify characteristics that would be adopted to address high

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<sup>24</sup> Hilmer, F.G. and Independent Committee of Inquiry into Competition Policy in Australia, *National Competition Policy*, (1993) 300.

<sup>25</sup> *Government Owned Corporation 1993* (Qld) s, 19.

budget deficiencies,<sup>26</sup> and ensure efficiency of service delivery.<sup>27</sup> Privatization and corporatisation were adopted to address some of these problems. NZ, like the UK, favours privatization whereas the Australian states have been reluctant to privatize, instead generally finding favour with corporatisation. The prevalent view in Australia is that SOEs have an important role to perform and are not a mere means to privatization. Corporatisation can ensure “efficient use of resources, an appropriate return on public capital and more efficient management”.<sup>28</sup>

The varying views of different jurisdictions are reflected in their SOE legislation. NZ’s *State Owned-Enterprises Act 1986* (SOE Act) is a short piece of legislation. It only provides for the government’s control of SOEs and accountability. The *Government Owned Corporations Act 1993* (Qld) and *State Owned Corporations Act 1989* (NSW) have more detail than the SOE Act and they provide for the legal structure, governance and accountability of SOEs, and provide for both statutory corporation and state companies (see chapter 7). Corporatisation (or privatization) is motivated by different objectives that depend on prevailing socio-economic and political circumstances. NZ was the first country in the South Pacific to embark on corporatisation. The discussion below examines further the corporatisation experience in NZ.

#### **6.4.1 Corporatisation: New Zealand’s Experience**

The fourth Labour Government of 1984-1990 and National Government of 1990-1999, influenced by British experience, predominantly drove corporatisation in

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<sup>26</sup> Spicer, B., Emanuel, D. M. and Powell, M., *Transforming Government Enterprises: Managing Radical Organisational Change in Deregulated Environments*, (1996) 2; In Australia, the Hilmer Committee was tasked to come up with a report on National Competition Policy. It recommended elimination of government monopolies and introduction of competition in the public sector to improve efficiency; especially those that are involved in trading activities. See above n 24 at 124 – 137 and 295.

<sup>27</sup> Spicer, Emanuel and Powell, above n 26 at 2.

<sup>28</sup> Farrar, above n 7 at 462 – 463.

NZ.<sup>29</sup> Previously governments traditionally operated through government departments and statutory authorities to provide goods and services. Statutory authorities were created in situations where provision of goods and service required independence from direct control by government, especially for goods and services that are provided on a market.<sup>30</sup> Prior to reform in 1984, the NZ Government played a major role in providing administrative and social services and owned and operated trading activities until the early 1980s. Government participation in trading activities was motivated by a number of factors, which include the absence of a domestic private sector, the promotion of public works, and inadequate performance of the existing institutions or a combination of these factors.<sup>31</sup>

Public sector reform was commenced in 1984. It was initiated by the Treasury's report "Economic Management"<sup>32</sup> that recommended a change to the government's involvement in trading activities. Generally, corporatisation was undertaken in NZ because of poor productivity and growth performance since the mid-1970s, and influence from the western world embracing economic liberalization.<sup>33</sup> In making recommendations for change, Treasury gave its reasons for SOEs' unsatisfactory performance. First, the objectives of SOEs were vague and at times conflicting. They were required to achieve both social and commercial objectives without government subsidization of the former, causing management to cross-subsidize, incurring costs which resulted in disadvantage to SOEs as any gain in commercial activities was lost in cross subsidization. And there was an absence of proper guidance in circumstances where there was conflict. Second, the special privilege and constraint imposed on SOEs in their working environment distorted their performance and their appraisal. And thirdly,

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<sup>29</sup> Farrar and McCabe, above n 8 at 27. The National Party stands for the principles, amongst others, of private enterprise and reward for individual effort, whereas Labour stand s for more government involvement in the economy. It was a surprise to many when the Labour Party initiated and pursued corporatisation and privatization. See New Zealand Labour, "Policy – Labour Manifesto 2008," (2008) in *New Zealand Labour*, < <http://labourparty.org.nz/policy/>> at 5 October 2009; New Zealand National Party, "What National stands for," in *The National Party*, < <http://www.national.org.nz/About/standsfor.aspx> > at 5 October 2009.

<sup>30</sup> Quiggin, J., "Governance of Public Corporations: Profits and the Public Benefit," in Whincop, M. J., (ed.) *From Bureaucracy to Business Enterprise: Legal and Policy issues in the Transformation of Government Services*, (2003) 28.

<sup>31</sup> See others also discussed by Duncan, I. and Bollard, A., *Corporatisation and Privatization: Lessons from New Zealand*, (1992) 7.

<sup>32</sup> New Zealand Treasury, *Economic Management*, (1984) 279 – 284.

<sup>33</sup> See others discussed above n 31 at 5 – 6.

management was divorced of its mandate to make decisions and was consequently not held accountable for the operation of SOEs. These problematic issues require solution.

In 1985, the Minister of Finance, Roger Douglas published five key principles as part of the program for corporatisation and commercial liberalization.<sup>34</sup> These principles were meant to reorganize state trading activities and improve efficiency.<sup>35</sup> One of the devices utilized in the reorganization and reducing problems in SOEs is the SOE Act. Its main objectives are to: “specify principles governing the operation of State enterprises; and authorise the formation of companies to carry on certain Government activities and control the ownership thereof; and establish requirements about the accountability of State enterprises, and the responsibility of Ministers”.<sup>36</sup> Upon enactment the SOE Act:

- a. separates commercial activities from advisory and statutory activities;
- b. provides for a clear statement of objectives with respect to commercial activities;
- c. clarifies the role of the [state] Shareholding Ministers as residual claimant[s]; and
- d. provides explicit contracting between the government and SOEs for those activities or services deemed necessary for the government to achieve its social objectives.<sup>37</sup>

Essentially, an SOE is meant to operate as a successful business.<sup>38</sup> In doing so it must be profitable, be a good employer and demonstrate a sense of social responsibility. By separating commercial and non-commercial objectives, it is intended that SOEs would focus principally on commercial objectives.<sup>39</sup> Section 7 of the SOE Act, provides that if government advises the SOE to undertake non-commercial activity, it must be compensated for doing so.<sup>40</sup> This is intended to ensure that the SOE operates on an equal footing with other private sector enterprise and not to be given any preferential treatment because it is government owned.<sup>41</sup> Also, this demonstrates the fact that the whole intention of the SOE Act

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<sup>34</sup> See the five key principles in Spicer, Emanuel and Powell, above n 26; See also Wettenhall, R., “Corporation and Corporatization: Administrative History Perspective,” (March 1995) 6(1), *Public Law Review*, 7 at 9.

<sup>35</sup> These principles are provided under s 4 of the *State-Owned Enterprise Act 1986* (NZ).

<sup>36</sup> See the preamble of the *State-Owned Enterprises Act 1986* (NZ).

<sup>37</sup> Spicer, Emanuel and Powell, above n 26 at 183 -184.

<sup>38</sup> *State-Owned Enterprises Act 1986*, s 4.

<sup>39</sup> Galvin, B. and Victoria University of Wellington, Institute of Policy Studies, *Corporatisation and Privatisation: Completing the Revolution?* (papers presented at a seminar held on 3 September 1987 in the Michael Fowler Centre, 1987) 2 – 3.

<sup>40</sup> *State-Owned Enterprise Act 1986*, 7.

<sup>41</sup> Alam, M., Wells, P. K. and University of Waikato, Dept. of Accounting, *Control Systems of Government-Owned Business Enterprises: a Critical analysis of the New Zealand Model*, (Working paper series no. 62, 1999) 8; see also above n 18 at 7.

is to establish the SOE as a successful commercial enterprise. The implication is that the SOE is not obliged to provide social services, and its decision not to do so may not be subject to judicial review as it is a commercial decision.<sup>42</sup> An SOE can then focus on the main commercial objectives which can easily be measured, and eradicate chances of any excuse of having too many objectives, or of objectives being affected by government directions.<sup>43</sup> Theoretically s 7 can also allow government to intervene anytime using social objectives as a justifying factor.<sup>44</sup>

Many have acknowledged that corporatisation has rolled back the role of the state in the production of goods and services, exposed SOEs to market forces, and allowed government to focus on its traditional role of governance.<sup>45</sup> The concurrent effect of rolling back the role of the state improves the performance of corporatised entities; making them become competitive in the market. Despite the good intentions of corporatising, which are to enable management to emulate the competitive management strategies of private corporation so that the outcome of its performance would reflect productivity in the form of efficiency and/or profitability, corporatised entities can never fully emulate the characteristic of the private sector (see chapter 7). Despite this, corporatised entities have an important role to play in any society. The heavy emphasis on the use of private sector standard shrouds the real essence of importing efficiency into the public sector. As King noted “the use of private sector benchmarks to assess public firms obscures the real issue of efficiency: how can the public managers of government business enterprises [or government owned corporations] best be motivated to act in the broader interests of society?”<sup>46</sup>

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<sup>42</sup> *Northern Regional Health Authority v Human Rights Commission* [1998] 2 NZLR 218; *The Wellington Regional Council v Post office Bank Ltd*, High Court, Wellington, 22 December 1987, CP 720/87.

<sup>43</sup> Above n 18 at 7.

<sup>44</sup> Above n 41 at 10.

<sup>45</sup> Richardson R., “Governance: Promoting Sound Development – Management Lessons from New Zealand,” in Asian Development Bank (ed.), *Governance: Promoting Sound Development Management*, (1997) 21 at 28.

<sup>46</sup> King, S. P., “Corporatisation and the Behaviour of Government Owned Corporation,” in Whincop, M. J., (ed.) *From Bureaucracy to Business Enterprise: Legal and Policy Issues in the Transformation of Government Services*, (2003) 43 at 45.

NZ has immensely benefited, in terms of profitability immediately after the reform.<sup>47</sup> The current Government's expectation of SOEs is profitability.<sup>48</sup> Profitability is an inherent consequence of the efficiency of the corporation. SOEs also have a community service obligation and they are required to be efficient in pursuing these obligations; however, previous situations experienced in government departments and statutory entities are still present in SOEs such as control by government. Hence, efficiency can be compromised. As a result, there was a recommendation for revamping of the public sector through privatization,<sup>49</sup> which NZ has been pursuing since the 1990s. The advantage in government involvement in SOEs is that it ensures community service obligations are pursued.

## 6.5 CONCLUSION

The general move towards commercialisation and particularly corporatisation of the public sector is influenced by a number of factors. The most important factors include the collapse of former planned economies and economic inefficiencies experienced in public sector enterprises. Corporatisation maintains public ownership and provides mechanisms whereby economic efficiency is improved. Further, the process adopts private sector management technique and structure into the public sector, to ensure efficiency and/or profitability. Governments that attempt to generate profit, concurrently ensuring public accountability appear to face predicaments. The inevitability of maintaining public ownership in corporatised entities is continuous government influence in SOEs either direct or indirect and that may hinder profit maximisation.

In NZ, economic efficiency and profitability were the main objectives that drove the Labour Government to corporatise many of its public enterprises. Many problems in the public sector still sprout given the fact that there is still public ownership with multiple interests. The fact that public ownership is maintained means that an SOE may not fully realize the objectives of efficiency and profitability. Corporatisation experience in NZ has indicated that although improvement has been evident, the job is far from complete. Consequently, NZ

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<sup>47</sup> Kelsey, J., *Rolling Back the State: Privatization of Power in Aotearoa*, (1993) 30 – 31.

<sup>48</sup> Power, S., "Ministers seek better performance from SOEs," (Port Moresby, 9<sup>th</sup> April 2009) in *The National*, < <http://www.national.org.nz/Article.aspx?ArticleId=29712> > at 5 October 2009.

<sup>49</sup> Farrar and McCabe, above n 8 at 27.

has proceeded ahead with privatisation of selected public enterprises. Not meeting the standards of private sector corporations must not make corporatised entities be seen as inferior. They have an important role to play in societies.

## **CHAPTER 7:**

### **CORPORATE GOVERNANCE IN PUBLIC SECTOR ENTERPRISES**

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#### **7.1 INTRODUCTION**

This chapter discusses corporate governance in public sector corporations in New Zealand (NZ) and Australia, particularly focusing on the *Crown Entities Act 2004* (CE Act) and *State-Owned Enterprises Act 1986* (SOE Act) for NZ, the *Government Owned Corporations Act 1993* (GOC Act), Queensland and the *State Owned Corporations Act 1989* (SOC Act) for New South Wales (NSW). The chapter is important as it discusses the roles and responsibilities of various stakeholders in the governance of state owned enterprises (SOEs) in NZ and two major Australian states, and identifies persons who are in control of SOEs. The discussion here will assist with comparing and contrasting corporate governance in the public sector in Papua New Guinea. This chapter discusses corporate governance of the public sector in NZ, followed by Queensland and NSW. Then a comparison of corporate governance in public and private sector corporations follows before the conclusion. For the purposes of this chapter SOE includes a government owned corporation (GOC) and state owned corporation (SOC). In discussing SOEs in Queensland and NSW, GOC and SOC is used respectively.

#### **7.2 CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES - NEW ZEALAND**

The legal structure, governance and accountability of SOEs in NZ are provided under the SOE Act and the CE Act. SOEs that are listed in the SOE Act are publicly owned and independent commercial entities. The SOE Act introduces a business model for the trading function of the NZ Government, with the intention that these SOEs listed under the SOE Act would generate annual returns to the public accounts (see chapter 6).<sup>1</sup> These SOEs have enabling legislation and are incorporated under the *Companies Act 1993*. On the other hand the CE Act applies to statutory corporations and state companies and generally provides for

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<sup>1</sup> Joseph, P. A., *Constitutional & Administrative Law in New Zealand*, (3<sup>rd</sup> edn., 2007) 593 – 594.

non-commercial entities. The discussion begins with corporate governance in non-commercial SOEs followed by commercial SOEs.

### **7.2.1 Corporate Governance in Non-Commercial State Owned Enterprises**

SOEs under the CE Act are called “Crown entities” and they are non-commercial public enterprises (although some can be involved in limited commercial activities). Before 2004, Crown entities comprised of *ad hoc* statutory bodies that were governed under constituent legislation. The only standard provision was under the *Public Finance Act 1989* that provides for reporting by each Crown entity and other legislative provisions were under constituent Acts.<sup>2</sup> Section 3 of the *Public Finance Act* defines Crown agency but did not provide for list of bodies that come within the definitional ambit. This resulted in the enactment of CE Act. The Act was intended to provide “...a consistent framework for the establishment, governance, and operation of Crown entities and to clarify accountability relationships between Crown entities, their board members, their responsible Ministers on behalf of the Crown, and the House of Representatives...”<sup>3</sup> Crown entities were arranged under five categories.<sup>4</sup> They are:

- a. Statutory entities
- b. Crown entity companies (CEC)
- c. Crown entity subsidiaries (CES)
- d. School boards of trustees
- e. Tertiary education institutions

CEC and CES are incorporated under the *Companies Act 1993* and they also have enabling legislation. Crown entity subsidiaries are controlled by other Crown entities, whether by CEC or statutory entities. Statutory entities are also classified into three categories.<sup>5</sup> They are:

- a. Crown agents
- b. Autonomous Crown entities (ACE)

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<sup>2</sup> Goddard, D.J. and New Zealand Law Society, *Crown Entities Act 2004*, (2005) 3.

<sup>3</sup> *Crown Entities Act 2004*, s 3.

<sup>4</sup> *Crown Entities Act 2004*, s 7.

<sup>5</sup> *Crown Entities Act 2004*, s 7 (1)(a).

c. Independent Crown entities (ICE)

Crown agents must respond to the direction of the responsible ministers to give effect to government policy and they are under a statutory duty to comply.<sup>6</sup> A responsible minister may direct an ACE to have regard to government policy; however the ACE is under no statutory obligation to comply,<sup>7</sup> whereas ICEs are generally independent of government policy.<sup>8</sup> Statutory entities and CEC are listed under Schedule 1 and 2 of the CE Act, respectively. Corporate governance in statutory entities and CEC are discussed below.

### 7.2.1.1 The Government

The CE Act specifically prescribes the role of responsible ministers. The role of responsible ministers for CEC and statutory companies is to oversee and manage the relationship between the state and Crown entities and perform their statutory responsibilities. Statutory responsibilities include:<sup>9</sup>

- a. appointment and removal of directors;
- b. giving of directions to the entity;
- c. review the operations and performance of the entity;
- d. request information from the entity;
- e. participate in the process of setting and monitoring the entity's strategic direction and targets; and
- f. other matters provided in the CE Act or another Act.

In statutory entities, the responsible ministers can also determine the remuneration of some members.<sup>10</sup> Some of these roles of the responsible ministers are further discussed below. Clearly, the role of government in Crown entities is a full “hands on” approach. This is understandable given the essential services that such entities are providing.

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<sup>6</sup> *Crown Entities Act 2004*, ss 103 and 114.

<sup>7</sup> *Crown Entities Act 2004*, ss 104, 113 and 114.

<sup>8</sup> *Crown Entities Act 2004*, s 105.

<sup>9</sup> *Crown Entities Act 2004*, ss 27 and 88.

<sup>10</sup> *Crown Entities Act 2004*, s 27(1).

### 7.2.1.2 The Board

Responsible ministers appoint members of the board of the Crown agent and autonomous Crowns entity whereas the Governor General, on the recommendation of the responsible minister, appoints board members of an ICE.<sup>11</sup> The candidate for the appointment must be a person who has the appropriate knowledge, skills and experience to achieve the objective of a statutory corporation. In addition, the appointment must aim at promoting diversity on the board.<sup>12</sup> The responsible ministers may use their discretion to remove a board member of a Crown agent at anytime;<sup>13</sup> however, they cannot simply remove board members of ACEs or ICEs. The minister must justify by reasons the removal, as a decision to remove may be subjected to judicial review.<sup>14</sup> There is more constraint with the removal of a board member of an ICE. The minister may only remove the board member upon just cause, which the legislation states includes misconduct, inability to perform the functions of office, or neglect or breach of duties.<sup>15</sup>

The appointment of board members of CECs must meet any statutory requirements, including the company's constitution.<sup>16</sup> The shareholding ministers must appoint persons with appropriate knowledge, skills and experience and also the appointment should promote diversity in board membership.<sup>17</sup> It is not clear under the Act who appoints chief executive officers (CEOs).

The duties of board members are clearly specified under the CE Act. Section 25 provides that the board of a statutory entity is the governing body and must exercise powers and perform functions in accordance with the CE Act and the entity's Act. Board members have collective duties to ensure that:

- a. the entity must act consistently with the objectives, functions, statement of intent, and output agreement;<sup>18</sup>
- b. functions must be performed efficiently, effectively, and consistently with

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<sup>11</sup> *Crown Entities Act 2004*, s 28(1) (2).

<sup>12</sup> *Crown Entities Act 2004*, s 29.

<sup>13</sup> *Crown Entities Act 2004*, s 36.

<sup>14</sup> *Crown Entities Act 2004*, ss 37 and 41.

<sup>15</sup> *Crown Entities Act 2004*, s 40.

<sup>16</sup> *Crown Entities Act 2004*, s 89(1).

<sup>17</sup> *Crown Entities Act 2004*, s 89(2).

<sup>18</sup> *Crown Entities Act 2004*, s 49.

- spirit of service to the public;<sup>19</sup> and
- c. the entity must operate in a financially responsible manner.<sup>20</sup>

In addition, board members have an individual duty:

- a. to comply with the CE Act and the entity's Act;<sup>21</sup>
- b. to act with honesty and integrity;<sup>22</sup>
- c. to act in good faith and not at the expense of the entity's interests;<sup>23</sup>
- d. to act with reasonable care, diligence and skill;<sup>24</sup> and
- e. not to disclose information.<sup>25</sup>

Collective duties are owed to the responsible ministers. Failure to perform these duties would enable the responsible minister to take action,<sup>26</sup> whereas individual duties are owed to both responsible ministers and the Crown entities. The minister can remove a board member whereas a Crown entity can only take court action against a board member for violation of individual duties.

Further, CECs are managed by, and under the direction and supervision of, the board in accordance with s 128 of the *Companies Act 1993*.<sup>27</sup> Board members have a collective duty to act consistently with objectives, functions, statement of intent, and output agreement,<sup>28</sup> and they have individual duties to comply with the CE Act and the entity's Act.<sup>29</sup> Further, individual members are subject to duties under Part 8 of the *Companies Act 1993*.<sup>30</sup> Board members are accountable to the shareholding ministers.<sup>31</sup> The collective duties of directors are owed to

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<sup>19</sup> *Crown Entities Act 2004*, s 50.

<sup>20</sup> *Crown Entities Act 2004*, s 51.

<sup>21</sup> *Crown Entities Act 2004*, s 53.

<sup>22</sup> *Crown Entities Act 2004*, s 54.

<sup>23</sup> *Crown Entities Act 2004*, s 55.

<sup>24</sup> *Crown Entities Act 2004*, s 56.

<sup>25</sup> *Crown Entities Act 2004*, s 57.

<sup>26</sup> *Crown Entities Act 2004*, s 58.

<sup>27</sup> *Crown Entities Act 2004*, s 86.

<sup>28</sup> *Crown Entities Act 2004*, s 92.

<sup>29</sup> *Crown Entities Act 2004*, s 95.

<sup>30</sup> *Crown Entities Act 2004*, s 87(3).

<sup>31</sup> *Crown Entities Act 2004*, s 87(2).

shareholding ministers,<sup>32</sup> whereas individual responsibilities are owed to both shareholding ministers and the Crown entities.<sup>33</sup>

### 7.2.1.3 Accountability

There are several ways of ensuring accountability in Crown entities, apart from providing a standard for individual and collective duties of board members. First, the CE Act provides that every Crown entity has to have a statement of intent (SOI). Generally, a SOI promotes the public accountability of Crown entities.<sup>34</sup> Section 141 of the CE Act clearly specifies what is to be included in an SOI of each Crown entity. It is the responsibility of Crown entities to prepare SOI before the start of each financial year.<sup>35</sup> The ministers participate in the draft of the SOI by specifying the particular form that an SOI should have, or propose any changes that should be made to an SOI.<sup>36</sup> The changes suggested by the minister must be incorporated.<sup>37</sup> Even if there are any changes made by the Crown entities after the ministers' endorsement, the ministers must be informed of the changes so that they can make any suggestions (if any).<sup>38</sup>

Second, at the end of each financial year Crown entities are required to prepare and submit annual reports to the responsible ministers.<sup>39</sup> Section 151 of the CE Act provides for the form and content of the annual report. Third, ministers have greater power to review the operation and performance of Crown entities and obtain information from them. The responsible ministers have the power to review the operations and performances of Crown entities anytime.<sup>40</sup> The Crown entity must provide the minister with the information required. Further, the minister can at anytime request information about the operation and performance of the entity, which must be provided.<sup>41</sup>

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<sup>32</sup> *Crown Entities Act 2004*, s 94(1).

<sup>33</sup> *Crown Entities Act 2004*, s 95(2).

<sup>34</sup> *Crown Entities Act 2004*, s 138.

<sup>35</sup> *Crown Entities Act 2004*, s 139(1).

<sup>36</sup> *Crown Entities Act 2004*, s 145.

<sup>37</sup> *Crown Entities Act 2004*, s 147.

<sup>38</sup> *Crown Entities Act 2004*, s 148.

<sup>39</sup> *Crown Entities Act 2004*, s 150.

<sup>40</sup> *Crown Entities Act 2004*, s 132.

<sup>41</sup> *Crown Entities Act 2004*, s 133.

Fourth, all Crown entities are subject to whole of government direction from the Minister of State Services and the Minister of Finance jointly. The direction of the two ministers is given only to support the whole of government approach and to improve public services, and is not given to individual Crown entities.<sup>42</sup> Even an ICE, which is an independent entity, is required to comply with the direction from the two ministers.

Finally, Crown entities are audited by the Auditor-General<sup>43</sup> and are subject to financial review by parliamentary Select Committees as part of the annual appropriation process. In addition they are subject to the *Public Finance Act 1989*,<sup>44</sup> the *Ombudsmen Act 1975* and the *Official Information Act 1982*.<sup>45</sup>

## **7.2.2 Corporate Governance in Commercial State Owned Enterprises**

As discussed in chapter 6, corporatisation is intended to ensure that SOEs perform in an efficient and accountable manner and to become successful businesses by meeting their community service and commercial obligations.<sup>46</sup> Although the community service obligation is clearly provided under s 4 of the SOE Act, courts, when asked to provide interpretative guidance for the section have given prominence to commercial obligations.<sup>47</sup> This section focuses on the governance and accountability under the SOE Act.

### **7.2.2.1 The Government**

The Government owns shares in an SOE through two shareholding ministers,<sup>48</sup> namely the Minister of Finance and the responsible Minister.<sup>49</sup> The shareholding ministers are given various powers and functions under the SOE Act apart from the ones provided under the *Companies Act 1993* as shareholders (see chapter 4).

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<sup>42</sup> *Crown Entities Act 2004*, s 107.

<sup>43</sup> *Crown Entities Act 2004*, s 156.

<sup>44</sup> *Crown Entities Act 2004*, s 176.

<sup>45</sup> *Crown Entities Act 2004*, s 131.

<sup>46</sup> *State-Owned Enterprises Act 1986*, s 4.

<sup>47</sup> For example, see *Auckland Electricity Power Board v Electricity Corporation of New Zealand* [1994] 1 NZLR 551.

<sup>48</sup> *State-Owned Enterprises Act 1986*, s 10.

<sup>49</sup> *State-Owned Enterprises Act 1986*, s 2.

They are accountable to Parliament,<sup>50</sup> in exercising their powers and performing their functions.

Shareholding ministers appoint and remove directors of SOEs. Appointment and removal processes are not provided under the SOE Act. All commercial SOEs are incorporated under the *Companies Act 1993* therefore are subject to the Act. As shareholders the ministers appoint and remove directors on behalf of the Government on the recommendation of the SOE Advisory Unit, Treasury Office and the SOE Steering Committee and refer to the Cabinet for ratification.<sup>51</sup> The directors are appointed based on their business experience, skills in certain disciplines such as finance or accounting, or ability to represent certain interest groups such as unions or farmers, and few others are appointed purely for political reason(s).<sup>52</sup>

Shareholding ministers have a greater role in the formulation of the statement of corporate intent (SCI). The SCI sets out objectives that must be achieved within each financial year. The board of an SOE formulates and submits the draft SCI to shareholding ministers before the commencement of each financial year.<sup>53</sup> The ministers examine the statement and comment on it where necessary and forward it to the board. The SOE Act does not set the limit in the discretion of the shareholding ministers to comment and modify SCI. The risk is that the ministers can make wholesale change. Consequently, it would be illusory to say that SCI is the responsibility of the board. After considering the comments made by the shareholding ministers, the board submits the final statement back to them for endorsement.<sup>54</sup> An SCI consists of corporate objectives, the scope of activities, accounting policies, performance targets, estimated returns, commercial valuation and other information.<sup>55</sup> The SCI replaced the mixed, inconsistent, discretionary

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<sup>50</sup> *State-Owned Enterprises Act 1986*, s 6.

<sup>51</sup> State-Owned Enterprises Advisory Unit and New Zealand Office of the Minister for State-Owned Enterprises, *The Minister for State-Owned Enterprises*, (1990) 17 – 18; Duncan, I. and Bollard, A., *Corporatization and Privatization: Lessons from New Zealand*, (1992) 28; Spicer, B., Emanuel, D. M. and Powell, M., *Transforming Government Enterprises: Managing Radical Organisational Change in Deregulated Environments*, (1996) 20 – 21.

<sup>52</sup> Duncan and Bollard, above n 51 at 28.

<sup>53</sup> *State-Owned Enterprises Act 1986*, s 14(1).

<sup>54</sup> *State-Owned Enterprises Act 1986*, s 14(4).

<sup>55</sup> *State-Owned Enterprises Act 1986*, s 14(2).

and sometimes, non-monitoring objectives with clear, consistent, commercial and measurable objectives, which set the operational scope of an SOE.<sup>56</sup>

Further, the shareholding ministers have the power to request any information from the board to be supplied to them or supplied to a third party.<sup>57</sup> The fact that the SOE has to meet social responsibility commitments requires greater information flow for the government to be informed of the progress. The shareholding ministers can, by written notice to the board of a “new SOE”<sup>58</sup>, determine the amount to be paid as dividend after consulting the board.<sup>59</sup> The Act is silent on old SOEs under schedule one. In this case it seems that board makes declaration of dividends for SOEs under schedule 1 of the SOE Act, meeting the requirement under the *Companies Act 1993*.<sup>60</sup> If this is the case then it is a proper approach as declaration of dividends is a commercial decision and must be left to the board and the management, rather than shareholders, unless the company constitution provides otherwise, and if so the board must recommend such payment for declaration to be made.

### 7.2.2.2 The Board

The specific roles of individual directors are not provided under the SOE Act. Since all SOEs enlisted under the SOE Act are incorporated under the *Companies Act 1993* the directors are subject to powers and functions under the *Companies Act*. But in general terms s 5(2) of the SOE Act stipulates that all decisions relating to the operation of a state enterprise shall be made by or pursuant to the authority of the board of the state enterprise in accordance with its SCI. The provision endows the board with day-to-day decisions in implementation of the SOE’s objectives but provides condition for that decision – only in accordance with the SCI. The board is then accountable to the shareholding ministers.<sup>61</sup>

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<sup>56</sup> Duncan and Bollard, above n 51 at 24 – 25.

<sup>57</sup> This excludes any information about individual employee or customer of SOE. See *State-Owned Enterprises Act, 1986*, s 18(1) (2).

<sup>58</sup> *State-Owned Enterprises Act 1986*, sch. 2.

<sup>59</sup> *State-Owned Enterprises Act 1986*, s 13(1)(b)(2).

<sup>60</sup> *Companies Act 1993*, s 52; see also Borrowdale, A., *Duties and Responsibilities of Directors and Company Secretaries in New Zealand*, (2<sup>nd</sup> edn., 1995) 159 – 160.

<sup>61</sup> *State-Owned Enterprises Act, 1986*, s 5(3).

The general function of making decision emulates the board in the private sector, but raises further question of the specific functions of the board. The specific role of the board is not expressly provided under the SOE Act. This means that their powers and functions are provided under the entity's Act, the *Companies Act 1993* or indirectly through complying with the requirement of submitting annual reports and meeting the obligations under the SCI. The *Companies Act* is not of much help as it also has broad provision on functions of the board.<sup>62</sup> However, as persons in position of trust, any boards are subject to case law rules on the legal obligation of those persons who are fiduciaries.<sup>63</sup>

The SOE Act does not provide for the appointment and the roles of chief executive officer (CEO) in an SOE. In practice, like a private corporation, the board appoints and terminates the CEO.<sup>64</sup> The appointment responsibility renders to board disciplining power, which concomitantly ensures accountability.

### **7.2.2.3 Accountability**

The submission of reports to shareholding ministers is an important requirement under the SOE Act. At the end of each financial year the board is required to submit an annual report on the operation of the SOE, financial statements and an auditor's report to the shareholding ministers.<sup>65</sup> In the middle of the year the board must also submit a half-yearly report.<sup>66</sup> The responsible minister presents all the reports and documents to Parliament, including the SCI, annual report and audited financial statements and auditors' reports on financial statements.<sup>67</sup> Annual and half-yearly reports will be compared against SCIs,<sup>68</sup> to see whether SOEs have achieved their aims for the period.

Corporatisation has only eliminated some of the bureaucratic control of SOEs. They are still subject to the *Official Information Act*, the Ombudsman's Office

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<sup>62</sup> *Companies Act 1993*, s 128.

<sup>63</sup> Corcoran, S., "The Legal Liability of the Statutory Board – Public Corporations Act 1993 (SA)," (1993) 10(1), *Corporate and Business Law Journal*, 95 at 98.

<sup>64</sup> Spicer, Emanuel and Powell, above n 51 at 20 – 21.

<sup>65</sup> *State-Owned Enterprises Act 1986*, s 15(1).

<sup>66</sup> *State-Owned Enterprises Act 1986*, s 16(1).

<sup>67</sup> *State-Owned Enterprises Act 1986*, s 17(2).

<sup>68</sup> *State-Owned Enterprises Act 1986*, ss 15(2)(a) and 16(2).

and financial assessment and advice from the Department of Treasury.<sup>69</sup> In 2009, the “Crown Ownership Monitoring Unit” (COMU)<sup>70</sup> was established as a unit in the Department of Treasury to provide advice to shareholding ministers on the performance of SOEs and Crown companies, and recommends qualified persons to be appointed as directors, and generally monitors the performance of SOEs. COMU is administratively attached to the Department of Treasury and its function is different, however it complements the role of the Department of Treasury.<sup>71</sup> Further, the Auditor-General audits all SOEs,<sup>72</sup> however in certain cases the responsible minister appoints an additional auditor after consultation with the Auditor-General.<sup>73</sup>

SOEs are subject to the *Ombudsmen Act 1975* (OA) and the *Official Information Act 1982* (OIA). They were subject to review in 1990.<sup>74</sup> The review by the special Select Committee on SOEs recommended their continuous application in SOEs. In upholding their role the Committee stated that:<sup>75</sup>

The OA and OIA provide a measure of accountability for the public, particularly on matters that affect individuals and which the other SOE accountability processes do not address, and to remove the jurisdiction of the two Acts would result in a significant loss in public confidence in the Government’s oversight of the SOEs.

The factors that ultimately decided their continuous application, despite their commercial objective, is their role in the community and the ownership of SOEs. In other words the people of NZ still owned them hence it is important for them to be subject to these public laws and state institutions.

### 7.2.3 Summary

Unlike SOEs, Crown entities are still subject to a parent department. The parent department makes an agreement with responsible ministers on how the Crown

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<sup>69</sup> Duncan and Bollard, above n 51 at 27 – 28.

<sup>70</sup> COMU is the amalgamation of ownership monitoring, appointments and governance functions of the Treasury and the former Crown Company Monitoring Advisory Unit (CCMAU) into an integrated unit of the Treasury on 23<sup>rd</sup> November 2009.

<sup>71</sup> Department of Treasury, “Crown Ownership Monitoring Unit,” in *The Treasury*, < <http://www.treasury.govt.nz/statesector/soes> > 18 May 2010.

<sup>72</sup> *Public Audit Act 2001*, ss 5 and 14.

<sup>73</sup> *State-Owned Enterprises Act 1986*, s 19.

<sup>74</sup> *State-Owned Enterprises Act 1986*, s 31.

<sup>75</sup> Select Committee, New Zealand House of Representatives, *Report of the State-Owned Enterprises (Ombudsmen and Official Information Acts) Committee* (1990) [1.22A, para. 4.2].

entity is to be monitored. For example, the Broadcasting Commission of NZ is an ACE and comes under the responsibility of the Broadcasting Minister and is monitored by the Department of Culture and Heritage.<sup>76</sup> Similarly, Television NZ Ltd is a CEC and has two responsible ministers, namely the Ministers of Broadcasting and Finance. It is monitored by the Department of Treasury, COMU and the Department of Culture and Heritage.<sup>77</sup> On the other hand SOEs are commercial entities, incorporated under the *Companies Act* and have two shareholding ministers. COMU administers and monitors with the shareholders and not the parent department. For example, NZ Post Ltd is an SOE and has two shareholding ministers, namely the Ministers of Finance and Post Ltd. Unlike the SOE Act, the CE Act clearly provides for the roles and responsibilities of responsible ministers, the board and board members. Both the CE Act and the SOE Act have similar provisions on accountability. The CE Act is unclear on the appointment and role of the CEO. What appears from the two Acts is that the ministers under the CE Act have much more control than ministers under the SOE Act. Control varies with different form of Crown entities.

### **7.3 CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES - AUSTRALIA**

#### **7.3.1 Corporate Governance in Government Owned Corporations - Queensland**

The reasons for corporatisation in Queensland are similar to NZ. The Labour Government in Queensland drove corporatisation out of the desire to place SOEs on a commercial basis in a competitive environment.<sup>78</sup> Corporatisation is intended to improve efficiency, effectiveness and accountability of the GOC. Consequently, this is intended to improve the overall economic performance and ability of the Government to achieve social objectives;<sup>79</sup> particularly to provide key services. The key principles of corporatisation are to provide clarity of objectives, management autonomy and authority, strict accountability for

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<sup>76</sup> *Broadcasting Act 1989* (NZ), part 4, sch. 1.

<sup>77</sup> *Television New Zealand Act 2003*.

<sup>78</sup> Queensland Treasury Department, *A Green Paper on Government Owned Enterprises*, (August 1990) 4.

<sup>79</sup> *Government Owned Corporations Act 1993*, s 14.

performance and competitive neutrality.<sup>80</sup> Section 17 of the GOC Act gives equal prominence to commercial and community service obligations.<sup>81</sup>

GOC is defined as a government entity established by an Act or incorporated under the *Corporations Act 2001* and declared by regulation to be a GOC.<sup>82</sup> That means a GOC can be either a statutory GOC or a company GOC. After the major amendment in 2007 to the GOC Act, statutory GOCs were converted to company GOCs. The GOC Act largely provides for company GOCs. The following provides reasons for the amendment: “amendments to the GOC Act updated it for current company law requirements and made all GOCs subject to regulation and oversight by the Australian Securities and Investments Commission. To effect this reform, all statutory GOCs have been converted to company GOCs”.<sup>83</sup> As a result the GOC Act largely provides for company GOCs and transitional arrangements before becoming a company GOC. The corporate governance framework of company GOCs is discussed below.

### **7.3.1.1 The Government**

The Government is the owner of GOCs. The portfolio minister and minister for GOCs are shareholders in company GOCs.<sup>84</sup> They control company GOCs in compliance with the *Corporations Act 2001*. In addition, GOCs are subject to additional control under the GOC Act. First, the Governor-in-Council (Cabinet) appoints directors of GOCs.<sup>85</sup> The question of who removes directors is uncertain. If the *Corporations Act 2001* were to be complied with, this would mean shareholding ministers, and not the Governor-in-Council, remove directors.

Second, apart from the *Corporations Act 2001*, GOCs are subject to additional controls under the GOC Act. Shareholding ministers can direct the board under certain circumstances. The Act ensures that directors have adequate freedom to operate GOCs; however shareholding ministers have the final say in the ultimate

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<sup>80</sup> *Government Owned Corporations Act 1993*, s 16.

<sup>81</sup> Compare this with s 4 of *State-Owned Enterprises Act 1986* (NZ).

<sup>82</sup> *Government Owned Corporations Act 1993*, s 5.

<sup>83</sup> Queensland Government, Office of Government Owned corporations, “Amendments to Government Owned Corporation 1993,” in *Queensland Government*, <  
<http://www.ogoc.qld.gov.au/current-issues/amendgocact.shtml> > at 4 July 2009.

<sup>84</sup> *Government Owned Corporations Act 1993*, s 78.

<sup>85</sup> *Government Owned Corporations Act 1993*, s 89.

and general direction of GOC. The Act empowers the shareholding minister with reserve power to direct the board to perform a community service obligation.<sup>86</sup> In addition, shareholding ministers have reserve powers with regard to notifying the board of GOCs of public sector policies,<sup>87</sup> and written direction to the board of matters in the public interest from time to time.<sup>88</sup> The board must comply with the directions from the shareholding ministers.<sup>89</sup> Further, shareholding ministers may give written direction to prevent GOC disposing off specified assets.<sup>90</sup> The board has the obligation to inform shareholding ministers on whether following their direction would result in insolvency.<sup>91</sup>

Third, the responsible ministers can issue guidelines about the form and content of the corporate plan.<sup>92</sup> The board formulates the corporate plan and submits it to the shareholding ministers.<sup>93</sup> The shareholding ministers can request the board to reconsider or consider it in the light of other matters,<sup>94</sup> or can direct the board to modify the corporate plan where necessary.<sup>95</sup> Shareholding ministers exercise similar power with regard to the SCI.<sup>96</sup> Before giving direction for a corporate plan and an SCI, shareholding ministers must consult the board. The corporate plan sets policy objective that GOCs are to adopt over a medium term period. That is usually three to five years. The SCI provides short-term goals to be achieved annually. The guidelines in the corporate plan are similar to subordinate legislation.<sup>97</sup> The legislative requirement makes it mandatory that the requirement of the corporate plan must be complied with.<sup>98</sup> In the process of drafting the corporate plan and the SCI, negotiation occurs between the board of directors and the shareholding ministers. The final plan is an agreement between both parties. Section 7(2) of the GOC Act noted: “It is intended that the statement of corporate intent should represent an agreement between the GOC’s board of directors and

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<sup>86</sup> *Government Owned Corporations Act 1993*, ss 112 and 113.

<sup>87</sup> *Government Owned Corporations Act 1993*, s 114.

<sup>88</sup> *Government Owned Corporations Act 1993*, s 115.

<sup>89</sup> *Government Owned Corporations Act 1993*, ss 114(2) and 115(2).

<sup>90</sup> *Government Owned Corporations Act 1993*, s 138.

<sup>91</sup> *Government Owned Corporations Act 1993*, s 116

<sup>92</sup> *Government Owned Corporations Act 1993*, s 96(1).

<sup>93</sup> *Government Owned Corporations Act 1993*, s 97.

<sup>94</sup> *Government Owned Corporations Act 1993*, s 98.

<sup>95</sup> *Government Owned Corporations Act 1993*, s 101.

<sup>96</sup> *Government Owned Corporations Act 1993*, ss 107, 108 and 111.

<sup>97</sup> *Government Owned Corporations Act 1993*, s 96(3).

<sup>98</sup> The Queensland’s *Financial Administration and Audit Act 1977* also requires corporate plan to be provided by the public sector organizations.

its shareholder Ministers”.<sup>99</sup> An SCI is analogous to a contract whereby the board makes an undertaking to fulfil the objectives provided in it.

### 7.3.1.2 The Board

The GOC Act did not provide for the duties of individual directors. That means that directors of corporations incorporated under the *Corporations Act 2001* are subject to the Act and the common law, however in exercising their duty they must have regard to the application of the GOC Act.<sup>100</sup> The board:<sup>101</sup>

- a. is responsible for the GOC's commercial policy and management;
- b. ensures that, as far as possible, the GOC achieves, and acts in accordance with, its statement of corporate intent and carries out its objectives outlined in its statement of corporate intent;
- c. accounts to the GOC's shareholders for its performance as required by this Act and other laws applying to the GOC;
- d. ensures that the GOC performs its functions in a proper, effective and efficient way.

The board appoints a CEO of the GOC with prior written approval of shareholding ministers.<sup>102</sup> The CEO is an officer under the *Corporations Act* hence subject to the Act.

### 7.3.1.3 Accountability

The GOC Act sets out a series of procedures which directors are required to comply with in informing responsible ministers and the Government regarding the operation of GOCs. The Act requires the board to submit annual reports to shareholding ministers along with additional reports at different intervals during the year. This includes quarterly reports.<sup>103</sup> The annual report has a standard content.<sup>104</sup> This does not exclude the board from providing other information under s 122 of the GOC Act to the ministers. The reports would enable responsible ministers to compare directors' reports and achievements of a GOC

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<sup>99</sup> Galvin, B., Victoria University of Wellington and Institute of Policy Studies, *Corporatization and Privatisation: Completing the Revolution?* (Papers presented at a Seminar held on 3 September 1987 in the Michael Fowler Centre, 1987) 5.

<sup>100</sup> *Government Owned Corporations Act 1993*, s 123.

<sup>101</sup> *Government Owned Corporations Act 1993*, s 88.

<sup>102</sup> *Government Owned Corporations Act 1993*, s 92.

<sup>103</sup> *Government Owned Corporations Act 1993*, ss 119.

<sup>104</sup> *Government Owned Corporations Act 1993*, s 120.

against an SCI in order to be informed of the operation of GOC and how much that has been achieved.<sup>105</sup>

GOCs are subject to Part 2, Division 7 of Queensland's *Financial Administration and Audit Act 1977* on financial statements and annual reports.<sup>106</sup> Further, the GOCs are required to provide the Auditor-General with financial statements prepared in compliance with the *Corporations Act 2001*,<sup>107</sup> and must submit it to the shareholding ministers as part of the annual report.<sup>108</sup> The report is then tabled in Parliament for examination.<sup>109</sup> The Auditor-General audits the accounts of GOCs. The Auditor-General's role is not of control but one of accountability.<sup>110</sup> But, GOCs are not subject to the office of Ombudsman.<sup>111</sup>

In addition to accountability requirements under the GOC Act, all GOCs are required to comply with various "GOC Policies and Guidelines"; one of which is "Corporate Governance Guidelines for Government Owned Corporations" (see Appendix T).<sup>112</sup> Further, GOCs must provide in annual reports a section on corporate governance.<sup>113</sup>

### **7.3.2 Corporate Governance in State Owned Corporations – New South Wales**

NSW was the first state in Australia that followed the example in NZ in undertaking the corporatisation process. NSW's *State Owned Corporations Act 1989* (SOC Act) came into effect three years after NZ's SOE Act. The Act defines a state owned corporation (SOC) as a company SOC or statutory SOC,<sup>114</sup> and provides greater detail for both types of SOC. The principle objectives of the two

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<sup>105</sup> *Government Owned Corporations Act 1993*, s 120 (1)( c).

<sup>106</sup> *Government Owned Corporations Act 1993*, s 118.

<sup>107</sup> *Government Owned Corporations Act 1993*, sch. 1(46F).

<sup>108</sup> *Government Owned Corporations Act 1993*, sch. 1(46J).

<sup>109</sup> *Government Owned Corporations Act 1993*, sch. 1(46K).

<sup>110</sup> Coates, J., "Government-Owned Companies and Subsidiaries: Issues in Accounting, Auditing and Accountability," (March 1990) 49(1), *Australian Journal of Public Administration*, 7 at 11.

<sup>111</sup> *Government Owned Corporations Act 1993*, s 157.

<sup>112</sup> Queensland Government, Office of Government Owned Corporation., "GOC Polices and Guidelines," in *Queensland Government*, < <http://www.ogoc.qld.gov.au/goc-policies/index.shtml> > at 4 July 2009.

<sup>113</sup> Queensland Government, Office of Government Owned Corporation., "Corporate Governance Guidelines for Government Owned Corporation," (February 2009) [p4] in *Queensland Government*, < <http://www.ogoc.qld.gov.au/goc-policies/index.shtml> > at 17 July 2010.

<sup>114</sup> *State Owned Corporations Act 1989*, s 3.

SOCs is to operate as successful businesses and in doing so must operate efficiently as comparable businesses, exhibit a sense of social responsibility and comply with ecologically sustainable development where their activities affect the environment.<sup>115</sup>

### 7.3.2.1 The Government

There are two shareholders of SOC, called voting shareholders.<sup>116</sup> They hold shares in trust for the State.<sup>117</sup> The State Treasurer automatically becomes the shareholder but a minister is appointed by the Premier to be the second shareholder. In addition, the portfolio minister is responsible for the affairs of statutory SOC and provided with certain responsibilities under the SOC Act (see below).

Shareholding ministers have extensive responsibilities. First, they need to be consulted on the SCI after it has been drafted by the board and submitted. Any changes proposed by shareholders must be incorporated into the draft. In addition, the shareholding ministers can give written notice to include or remove certain matters from the SCI.<sup>118</sup> Second, on request the board must supply to the voting shareholders of a company SOC,<sup>119</sup> or the portfolio minister of a statutory SOC,<sup>120</sup> any information relating to the affairs of the SOC. The Act is not specific on the type of information, so that means any information. Third, a minister may direct the company SOC with regard to non-commercial activities with the approval of the Treasurer even if the SOC considers it to be not in its commercial interest. The SOC must comply with the direction.<sup>121</sup> A minister refers to any minister. In a statutory SOC the portfolio minister may direct the corporation when it comes to dealing with non-commercial activities.<sup>122</sup> Fourth, acquisition or disposal of assets or sale or disposal of the main undertakings in SOC must be with the written approval of the voting shareholders.<sup>123</sup> And fifth, in statutory SOC, the portfolio

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<sup>115</sup> *State Owned Corporations Act 1989*, ss 8 and 20E.

<sup>116</sup> *State Owned Corporations Act 1989*, ss 3 and 20H.

<sup>117</sup> *State Owned Corporations Act 1989*, sch. 2, clause 3 (2); sch.6, clause 3 (2).

<sup>118</sup> *State Owned Corporations Act 1989*, s 21.

<sup>119</sup> *State Owned Corporations Act 1989*, s 29(1).

<sup>120</sup> *State Owned Corporations Act 1989*, s 29(2).

<sup>121</sup> *State Owned Corporations Act 1989*, s 11.

<sup>122</sup> *State Owned Corporations Act 1989*, s 20N.

<sup>123</sup> *State Owned Corporations Act 1989*, ss 20 and 20X.

minister has the power to notify the board of any public sector policies,<sup>124</sup> and give directions in the public interest.<sup>125</sup>

Clearly, the shareholders can intervene and deal with some of the operational matters, even to the extent that voting shareholders have to make an agreement with the board on the amount of dividends and the time the dividend is to be paid.<sup>126</sup> In addition, the Treasurer may request statutory SOCs to pay any amounts in dividends.<sup>127</sup> The above shows that the government, including voting shareholders and any other ministers, can give direction to SOCs.

### **7.3.2.2 The Board**

The voting shareholders appoint directors in company SOCs,<sup>128</sup> whereas in statutory SOCs, the Governor appoints directors on the recommendation of voting shareholders.<sup>129</sup> The staff director is a full time director and is appointed by a Select Committee which consist of two members nominated by voting shareholders and two members nominated by Unions NSW.<sup>130</sup> The CEO may also be appointed as a director in a statutory SOC.<sup>131</sup> Voting shareholders appoint and remove a director as a chairperson in a statutory corporation.<sup>132</sup> The Governor appoints the CEO of a statutory SOC on the recommendation of the portfolio minister. But such an appointment cannot be effected without recommendation from the board.<sup>133</sup> Further, the Governor may remove the CEO with the recommendation of the board.<sup>134</sup>

The board and management of a company must comply with the *Corporations Act 2001*. The board of a statutory SOC is responsible for operational decisions of the SOC whilst the CEO is responsible for the day-to-day management of the

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<sup>124</sup> *State Owned Corporations Act 1989*, s 20O.

<sup>125</sup> *State Owned Corporations Act 1989*, s 20P.

<sup>126</sup> *State Owned Corporations Act 1989*, sch.2, clause 5.

<sup>127</sup> *State Owned Corporations Act 1989*, s 20P.

<sup>128</sup> *State Owned Corporations Act 1989*, sch.2, clause 3(6).

<sup>129</sup> *State Owned Corporations Act 1989*, s 20J(2).

<sup>130</sup> *State Owned Corporations Act 1989*, sch.2, clause 4; sch.8, clause 4.

<sup>131</sup> *State Owned Corporations Act 1989*, s 20J(5).

<sup>132</sup> *State Owned Corporations Act 1989*, sch.8, clause 2.

<sup>133</sup> *State Owned Corporations Act 1989*, s 20K.

<sup>134</sup> *State Owned Corporations Act 1989*, sch.8, clause 6.

operation.<sup>135</sup> The board of a statutory SOC may require the CEO to enter into a performance agreement.<sup>136</sup> The directors of a company are required to comply with duties under *Corporations Act 2001*,<sup>137</sup> however in doing so they must have regard to the SOC Act.<sup>138</sup> The duties of directors in a statutory SOC are provided under schedule 10, part I. These duties generally cover the fiduciary duty and duty of care.

### 7.3.2.3 Accountability

The board of a statutory SOC is accountable to the voting shareholders in the manner set out in the SOC Act and the constitution of the corporation.<sup>139</sup> On the other hand the board of a company SOC is accountable to voting shareholders in accordance with the *Corporations Act 2001*. All SOCs are required to submit a half-yearly report<sup>140</sup> in which, amongst other things, they have to set out the extent to which objectives in SCIs are achieved.<sup>141</sup>

The SOCs must submit annual reports. Sections 24 and 24A of the SOC Act provide for matters that are to be included in the annual reports of statutory SOCs and company SOCs respectively. Statutory SOCs must submit an annual report that complies with the *Public Finance and Audit Act 1983* and the *Annual Report (Statutory bodies) Act 1984*.

The Auditor-General audits the accounts of all SOCs. If the Auditor-General feels that any matters arise that require the attention of Parliament then the Auditor-General must submit a special report to Parliament.<sup>142</sup> Parliament also receives other reports and documents from a minister. That means any minister and not necessarily the shareholding minister. These documents include the constitutions of a SOC, the SCI, a copy of the annual report, the audited financial report, and the Auditor-General's report on that financial report.<sup>143</sup> The Public

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<sup>135</sup> *State Owned Corporations Act 1989*, s 20L.

<sup>136</sup> *State Owned Corporations Act 1989*, sch.9, clause 4.

<sup>137</sup> *State Owned Corporations Act 1989*, sch.10, clause 13(1).

<sup>138</sup> *State Owned Corporations Act 1989*, sch.10, clause 13 (1)(b).

<sup>139</sup> *State Owned Corporations Act 1989*, sch.6, clause 3(6).

<sup>140</sup> *State Owned Corporations Act 1989*, s 23.

<sup>141</sup> *State Owned Corporations Act 1989*, s 23(2).

<sup>142</sup> *State Owned Corporations Act 1989*, s 25.

<sup>143</sup> *State Owned Corporations Act 1989*, s 26.

Accounts Committee can also investigate the accounts of a SOC.<sup>144</sup> This is irrespective of whether a SOC is a company SOC or a statutory SOC.

### 7.3.3 Summary

There are commonalities, discussed above, feature in the legislation in NZ, Queensland and NSW with regard to structure, governance and accountability. The laws in the three jurisdictions provide:

- a. for state companies;
- b. that shareholders hold shares in trust for the state;
- c. for commercial and non – commercial objectives;
- d. for SCIs and their content;
- e. that shareholders must be consulted in drafting SCI;
- f. for submission of annual and half-yearly reports and their contents;
- g. for submission of annual and half-yearly reports to the shareholders;
- h. that shareholders can direct SOEs in the payment of dividends; and
- i. for the role of the Auditor-General in SOEs;

There are also differences observed in the three jurisdictions. These include the following:

- a. NSW provides for statutory corporations and state companies in the same legislation, whereas in NZ these come under two different Acts. In Queensland statutory corporations are seen as transitional entities after a 2007 amendment whereas in NSW the legislation treated both types of SOCs as having important functions to perform and provide in detail for their governance and accountability.
- b. Two shareholding ministers in NZ and Queensland are the Minister of Finance and the minister responsible for SOEs, whereas in NSW shareholders are the State's Treasurer and a minister appointed by the Premier. In addition, statutory SOCs in NSW have a portfolio minister who is provided with specific responsibilities under the SOC Act.

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<sup>144</sup> *State Owned Corporations Act 1989*, s 28.

- c. NZ and NSW legislation provides clearly for reports and documents that need to be laid before the parliament.
- d. Queensland and NZ provide for the role of an Ombudsman Commission but not NSW. NSW legislation provides for the role of the Public Accounts Committee but not NZ and Queensland. They may have been discussed in other legislation and documents; however this observation is made looking particularly at the SOE legislation discussed above.

The reporting requirements for SOEs in the three jurisdictions are more onerous than for private sector corporations. This is a clear expression of tension between the desire of government to maintain control and concurrently allowing SOEs to operate as independent enterprises.

## **7.4 CORPORATE GOVERNANCE IN PRIVATE SECTOR AND PUBLIC SECTOR CORPORATIONS**

SOEs are corporations. As discussed in chapter 6 the aims of corporatisation are to separate the activities of SOEs from the control of government, and to adopt the characteristics of efficiency and accountability to ensure the effectiveness of all SOEs and profitability for some (especially the state companies). Corporatisation ensures that SOEs are exposed to external market forces so that management adopts the competitive, strategic and efficient spirit of private sector corporations. The significant question is to what extent corporate governance structures in SOEs have replicated that of private sector corporations. This segment compares corporate governance in private and public sector corporations.

### **7.4.1 Bonding Mechanism**

As discussed in chapter 3 the bonding arrangement is one of the ways to ensure that the interests of managers align with that of the owners. The common strategy under bonding is pay for performance. Pay strategy is never applied in NZ and Australia, although it was recognized in some of the reports as one of the devices

to be applied.<sup>145</sup> There are difficulties in trying to apply a pay for performance strategy.

The first difficulty lies in assessing the quality of managers' performance and providing incentives for them to improve. An SOE usually operates in a regulated environment and its market is relatively fixed. Managers have little control over the variables that determine the productivity of an SOE.<sup>146</sup> The absence of tradable equity creates no incentive for the market to monitor an SOE. This creates an arm's length relationship with the shareholding ministers and the ultimate accountability to parliament.<sup>147</sup> Thus, the introduction of bonding devices, such as an increase in salary, will not contribute in an effective way to increasing the value of an SOE. Further, unlike private corporations, a board member in an SOE will never have any chance of acquiring residual ownership interests.<sup>148</sup> In other words they cannot purchase shares. Consequently, SOE boards and managers have weaker incentives than private corporations.

Second, unlike a private sector corporation the management in an SOE is required to pursue broad objectives provided under SCI. This "weakens the link between the manager's diligence and firm's performance"<sup>149</sup>. The rationale for managerial incentive can be questioned in an SOE. For example, take again the increase in salary of a CEO. It is unclear whether through this device the CEO is required to increase the value of the SOE, given other social justice and equity objectives.<sup>150</sup> Government, as the shareholder, has different objectives such as community services for an SOE to pursue. As a result of multiple objectives pursued by an SOE, its real value cannot be properly assessed to reward managers for the SOE's performance.

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<sup>145</sup> See Percy Allen, secretary of New South Wales Treasury (1989), referred to in Farrar, J. H., *Corporate governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) 470.

<sup>146</sup> Skeel, D. A. Jr., "Virtual Privatization: Governance Reform for Government Owned Firms," in Whincop, M. J., (ed.) *From Bureaucracy to Business Enterprise: Legal and Policy Issues in the Transformation of Government Services*, (2003) 91 at 96 – 97.

<sup>147</sup> New Zealand Business Roundtable, Jennings, S., Begg, S. and Cameron, R. L., *State -Owned Enterprises: Issues of Ownership and Regulation* (1988) 9.

<sup>148</sup> A government owns shares in SOEs through two shareholding ministers because of their position as ministers responsible for SOEs or as a Minister of Finance. Shareholding ministers are not required to transfer these shares. See *State-Owned Enterprise Act 1986*, s 11.

<sup>149</sup> Above n 146 at 97.

<sup>150</sup> King, S. P., "Corporatisation and the Behaviour of Government Owned Corporation," in Whincop, M. J., (ed.) *From Bureaucracy to Business Enterprise: Legal and Policy Issues in the Transformation of Government Services*, (2003) 43 at 46 – 47.

And thirdly, unlike private sector corporations where there is no public statement of corporations' intentions, (rather a private corporation's business intentions are monitored and disciplined by the market) the detailed SCI setting out the business intentions of an SOE limits creativity and innovation.<sup>151</sup> The managers' true worth cannot be assessed on "doing what they are being told to do". Hence, there is no creativity and innovation.

Where there is no incentive, the possibility of shirking, slacking or theft is high without scrutineers such as shareholding ministers and the Auditor-General. To that extent the shareholding ministers' participation would reduce residual costs if they are not themselves involved in diversion through collusion. However, if incentives are put in place, most SOEs lack true market value. This is in stark contrast to a listed public firm that has a share price which reflects its value. Most SOEs operate in monopolized markets or do not have shares on stock markets where a firm value can be established. Therefore, maximizing the value of SOEs would be a vain effort. In other words there is no true value whereby the increased value can be assessed.<sup>152</sup>

#### **7.4.2 External Markets**

In chapter 3 it is identified that external markets perform an important role in terms of accountability. However, in the public sector there are no external markets by which the performance of SOEs can be monitored. Most SOEs have a monopoly over their markets. The external monitors refer, amongst others, to managerial market, product market, share market and market for corporate control.

First the managerial market is non-existent. The government, based on political affiliation, and taking into account communitarian interests, appoints directors and managers. Professional directors and managers who are appointed on merit from private corporations are not used to direct shareholder participation in the control of SOEs and this would cause tension between the government and the

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<sup>151</sup> Above n 147 at 9.

<sup>152</sup> Above n 150 at 45 – 46.

management. This is one of the reasons that discourage managers from taking up office in SOEs. Private sector managers would be reluctant to take up offers to be managers in SOEs where they perceive the possibility that they may be subject to political persuasion. Their reluctance protects their reputation as professional managers with future prospects of being employed.

Second, SOEs do not compete in a competitive market; hence there is no product market. This may be the result of “statutory monopoly, or because of the market failure to provide the goods or services in question at an acceptable price, then the product market will not exert any discipline over the management of the entity”.<sup>153</sup> Where SOEs are exposed to competitive markets they are subject to market forces. The organization would not survive if it fails to create wealth. This would then lead to insolvency and liquidation. However, the government usually does not allow liquidation to occur taking into account public interest considerations, such as ensuring employment of its citizens.<sup>154</sup>

Third, most SOEs in NZ and Queensland have two shares under the trust of two shareholding ministers. The shares are not traded on the stock market, and therefore SOEs are not subject to share market scrutiny. Skeel Jr noted that:

the shares of the government cannot be bought and sold, managers of SOE do not face the same capital market pressures. For instance, they do not receive the same market signals, as managers of private firm.<sup>155</sup>

And fourthly, most SOEs operate in a monopolized environment and there is no market for corporate control. Takeover is unlikely or at best impossible given the fact that most SOEs have monopoly over their market. Also, SOEs have government as the only shareholder and it is a legislative requirement that the shareholding ministers must not transfer shares.<sup>156</sup> The absence of a market for corporate control through takeover means that management cannot be disciplined. The absence of a market for corporate control is a serious disadvantage to low cost monitoring, which would have been imported into an SOE. Assuming that

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<sup>153</sup> Farrar, above n 145 at 468.

<sup>154</sup> Above n 146 at 95.

<sup>155</sup> Ibid.

<sup>156</sup> *State-Owned Enterprises Act 1986* (NZ), s 22; *Government Owned Corporations 1993*(Qld), ss 82 and 83.

there is a market for corporate control, most SOEs do not have a market value by which they can be assessed for takeover.

A lack of low cost external monitors theoretically means a corporation will not reduce agency costs and therefore residual costs. However, the fact that shareholding ministers can request any information from SOEs any time ensures greater information flow to the shareholders.<sup>157</sup> Without external markets, the flow of information in SOEs is important to ensure the shareholding ministers keep themselves properly abreast with SOE business, markets and any new technology adopted so that negotiation of an SCI is realistic, and appropriate expectation is set against which the performance of an SOE can be assessed.<sup>158</sup> Further, in an SOE a request for information by shareholding ministers and the availability of such information provide vital information to investigate and enforce a breach of fiduciary and statutory duties, and can enable new ministers to be informed about the affairs of the company. Furthermore, the information requested can be used to seek advice from a third party to hold the board accountable.<sup>159</sup> Without information efforts to ensure accountability would be in vain.<sup>160</sup> Hence, easy access of ministers to company information can enable them to monitor the performance of directors, and SOEs in achieving their objectives.

### 7.4.3 Monitoring Mechanism

Unlike, private sector corporations, management in an SOE is not directly accountable to owners (the public), and owners cannot exert direct influence on management in anyway. Without a bonding device and external markets, SOEs rely on government and the board for monitoring. The monitoring by these stakeholders has its disadvantages. The “shareholding ministers are ... politicians and are part of the political process which is often driven by short-term fiscal and political imperatives”.<sup>161</sup> A political system creates incentives that are different from the owners of SOEs and the objectives of SOE;<sup>162</sup> hence SOEs can easily be

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<sup>157</sup> Aronson, M., “Ministerial Directions: The Battle of Prerogatives,” (March 1995) 6(1), *Public Law Review*, 77 at 86.

<sup>158</sup> Spicer, Emanuel and Powell, above n 51 at 188.

<sup>159</sup> Ibid at 189.

<sup>160</sup> Blanchard, J., “Corporate Accountability – Lessons from Democracy,” (July 1997) 7(3), *Australian Journal of Corporate Law*, 326 at 327.

<sup>161</sup> Spicer, Emanuel and Powell, above n 51 at 188.

<sup>162</sup> Above n 147 at 32.

used for immediate political gain. Further, unlike private corporations, politicians do not have personal claim to the profits of SOEs or are interested in efficient organizational performance. In addition, with their busy schedules politicians cannot spend sufficient time scrutinizing the performance of SOEs.<sup>163</sup>

Even if there is motivation to provide strict and close monitoring it would not be compelled by the quest for profit as in private corporations but by political imperatives. Political imperatives that compel government to intervene usually disregard agency costs. In the private sector the establishment of a monitoring mechanism is assessed on whether it would incur an agency cost and that the benefits of agency cost would outweigh residual costs. Professor John Farrar explained:

A private owner will not insist on extra monitoring if the cost of implementing and administering arrangements outweigh the likely benefits. A government however has other priorities: in particular, it is concerned to minimize the risk of political scandal which might result in the event of any waste being uncovered, even waste that would not be pursued in the private sector because of the enforcement costs. Political considerations might compel the government to insist on higher standard of accountability in the entities that it controls notwithstanding the cost of doing so.<sup>164</sup>

The board is an important organ in an SOE. The board ensures that management is accountable and the objectives of the corporations are pursued. The board becomes effective if it is provided with powers, such as the power to appoint a CEO to hold the management accountable. However, the board tends to be ineffective when the appointment of members is made based on political affiliation, to reward loyalty and support. Usually these directors lack knowledge and experience.

After looking at the distinction between corporate governance in private and public sector, it is explicit that an SOE would not fully replicate the characteristics of the private sector in ensuring accountability. In an SOE, the government has an important accountability role in monitoring.

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<sup>163</sup> Spicer, Emanuel and Powell, above n 51 at 187.

<sup>164</sup> Farrar, above 145 at 467.

## 7.5 CONCLUSION

The comparative discussion that has been provided makes it clear that there is considerable government control over SOEs. The shareholding ministers, under their respective pieces of legislation, have greater say in the formulation of SCIs and appointment of directors, they receive annual, quarterly and half-yearly reports, inform the board of government policies to be implemented from time to time, and request information from time to time. Boards perform a subservient role. Other political involvement is limited to monitoring. The role of departments and other government agencies has been reduced, but those that are still involved with SOEs have a restricted role in monitoring and audit. Applying the concept of control discussed in chapter 2, there is clearly little separation of ownership and control. SOE legislation was created to provide a degree of separation of the activities of SOEs from the state but state also has an incentive to control the SOEs. The legislation attempts to allocate control rights over SOEs between the relevant ministers, shareholders and the board, the accountability of control rights over SOEs and provides means whereby SOEs can become efficient and effective, and/or maximise profit.

This chapter has shown that SOEs would not replicate the corporate governance model of the private sector as long as the government is the owner. Even developing effective proxy strategies in SOEs will not resemble strategies that are adopted in private sector corporations. SOEs do not have bonding devices or external market control mechanisms. Notwithstanding, government's active participation in the control of corporation and its duty of ensuring accountability can curtail any agency costs that may arise. This means that the advantage of active government participation can reduce agency cost of SOEs and therefore residual costs. The agency problem may inevitably arise when responsible ministers lack motivation in monitoring the management or begin colluding with the board or the management to divert an SOE's resources or finances for political support or self-interest. This problem is augmented through the appointment of government allies as members of boards and CEOs of SOEs. But the government would not commit malfeasance knowing that it is accountable to the people through parliament. But when parliament and state institutions are weak and

ineffective in monitoring, this can allow the relevant ministers and/or management to get involved in self – interested activities.

Despite, not being able to fully replicate features of the private sector, SOEs in NZ have operated efficiently as reflected in profitability (chapter 6). This reveals the fact that when there is clear stipulation of the objectives of SOEs, roles and responsibilities of stakeholders in governance, and effective accountability, result in efficiency and profitability.

**PART IV:**

**THE STATE OF PAPUA NEW GUINEA,  
DILEMMAS OF DEVELOPMENT AND  
CORPORATIONS**

## CHAPTER 8:

### POLITICAL DEVELOPMENT AND THE STATE OF PAPUA NEW GUINEA

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#### 8.1 INTRODUCTION

The indigenous people have lived in Papua New Guinea (PNG) for over 50, 000 years.<sup>1</sup> The assertion is that some migrated from South East Asia through the western part of Indonesia and settled in New Guinea while others migrated eastward through to the Solomon Islands, Fiji, Vanuatu and New Caledonia.<sup>2</sup> The groups of people settling in these countries are now called the Melanesians.<sup>3</sup> The coastal villagers had occasional contact with Asian traders from the 16<sup>th</sup> to the 15<sup>th</sup> century.<sup>4</sup> The Chinese in particular had a long history with South East Asia for hundreds of years. They had contact with indigenous people in and around the area long before the European explorers.<sup>5</sup> The recorded contact of indigenous Papua New Guineans with expatriates was as early as the 16<sup>th</sup> century,<sup>6</sup> particularly with explorers and navigators from Europe between the 16<sup>th</sup> and 18<sup>th</sup> centuries.<sup>7</sup> The traders and explorers had no interest in settlement or colonization. Colonization then ensued in the 1900s by Great Britain and Germany and recently, under Australian colonial administration, PNG gained Independence.

This chapter discusses the establishment of the State of PNG and its government and issues that are associated with governance. It focuses on the brief history of PNG and the political development before Independence (16 September 1975), the Government of PNG, the political parties, the political philosophy and the problems that affect the political status in PNG in the form of political instability, corruption and institutional incapacity, and finally it sets out the conclusion.

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<sup>1</sup> Griffin, J., Nelson, H. and Firth, S., *Papua New Guinea, a Political History*, (1979) 1.

<sup>2</sup> Waiko, J. D., *A Short History of Papua New Guinea*, (1993) 2; Oliver, D.L., *The Pacific Islands*, (revised edn., 1961) chapter II.

<sup>3</sup> Melanesia comes from the Greek word 'melas' which means black. See *Oxford Dictionary of English*, (2<sup>nd</sup> edn., 2005) 1094.

<sup>4</sup> Turner, A., *Historical Dictionary of Papua New Guinea*, (vol. 37, 2<sup>nd</sup> edn., 2001) xxxv; Turner, M.M., *Papua New Guinea: the Challenge of Independence*, (1990) 2.

<sup>5</sup> Oliver, above n 2 at 104 - 105; Wu, D.Y.H., *The Chinese in Papua New Guinea, 1880-1980*, (1982) 17.

<sup>6</sup> Sillitoe, P., *Social Change in Melanesia: Development and History*, (2000) 15.

<sup>7</sup> Turner, *Historical Dictionary of Papua New Guinea*, above n 4 at xxxvi.

## 8. 2 COLONIZATION

Since the middle of the 19<sup>th</sup> century the island of New Guinea was divided into three parts. The west (West Papua) was Dutch territory and subsequently became part of Indonesia. The eastern part was further divided into two. The north was called New Guinea and was German territory, administered by German New Guinea Company. Germany annexed New Guinea in November 1884. Otto Von Bismarck celebrated Germany's sovereignty over New Britain (an island off the mainland of New Guinea) with 200 marines.<sup>8</sup>

The southern part was called Papua and was a British Protectorate until 1905, three years after Australia federated.<sup>9</sup> Papua was annexed in 1873 by Commodore J E Erskine.<sup>10</sup> The actual proclamation of Papua as a British Protectorate was in 1884, the same year German's sovereignty was declared over New Britain. Germany administered New Guinea until its defeat in the First World War. The administration of New Guinea was given to the League of Nations as a "Trust Territory". In 1921 New Guinea came under Australian administration as a Mandate under the covenant of the League of Nations until PNG's Independence in 1975.<sup>11</sup> Twenty-eight years after 1921 the Australian Federal Parliament enacted a new law, the *Papua and New Guinea Act 1949* to administer the two territories.<sup>12</sup>

When PNG gained Independence in 1975, it was not as Papua and New Guinea, but Papua New Guinea to recognize that the two territories had become a united and independent state. PNG, now on the world map, is located on the eastern part of the Island of New Guinea. On the Western part of the island is West Papua, occupied by the Indonesians. PNG borders four countries; on the north, the Federated State of Micronesia, to the south, Australia, to the east, the Solomon

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<sup>8</sup> Firth, S., *New Guinea under the Germans*, (1983) 7.

<sup>9</sup> Price Waterhouse & Co., *Doing Business in Papua New Guinea*, (1989) 1- 2.

<sup>10</sup> Mugambwa, J. T. and Amankwah, H. A., *Land Law and Policy in Papua New Guinea*, (2<sup>nd</sup> edn., 2002) 1; Mugambwa, J. T., Amankwah, H. A. and Muroa, G., *Land Law in Papua New Guinea*, (2001) 2.

<sup>11</sup> Downs, I., *The Australian Trusteeship, Papua New Guinea, 1945-75*, (1980) Introduction XIII.

<sup>12</sup> Pitts, M., *Crime, Corruption & Capacity in Papua New Guinea*, (2002) 20.

Islands, and to the west, Indonesia. The map in figure 8.1 shows the geographical territory of PNG and its international borders.

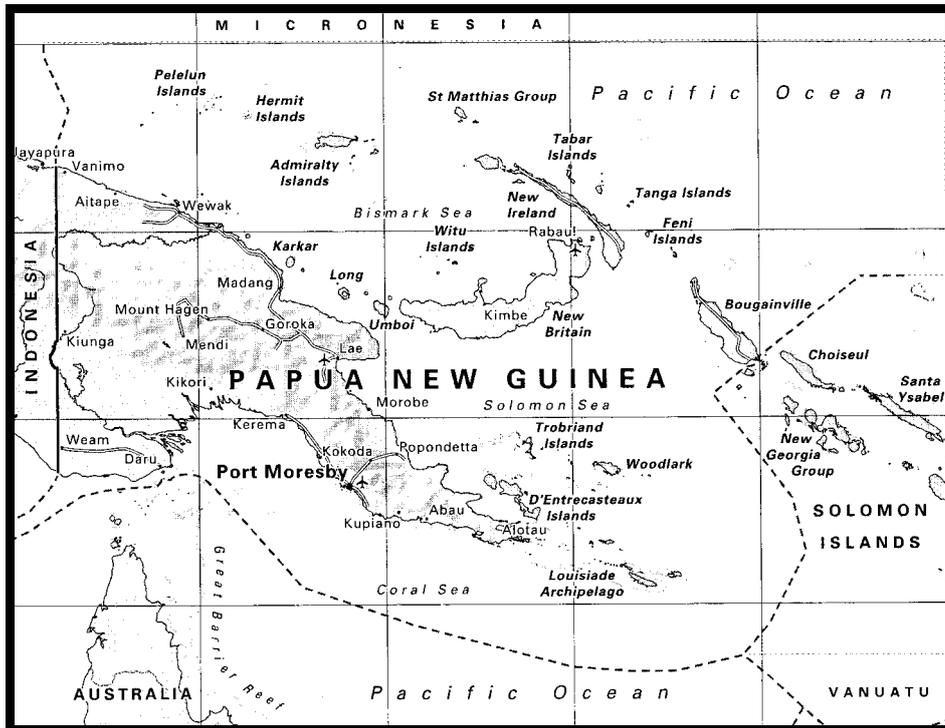


Figure 8.1 Map of Papua New Guinea

PNG, off its mainland, has four large islands: Bougainville and Buka, New Britain, New Ireland and many smaller islands spreading across the coastline of the mainland. It has many mountains and valleys, fast flowing rivers, lakes and white sandy coastlines. The highest mountain, Mt Wilhelm is located in Simbu Province with a height of 4, 700 metres. It has the second longest mountain range (Owen Stanley Range) in the Pacific extending from West Irian, inside Indonesia to the tip of PNG. The largest rivers in PNG are the Sepik, Fly, Kikori, Purari and Ramu. The country is blessed with beautiful beaches, untouched jungles, vegetations and swamplands with many inorganic resources like gold, silver, copper and oil.

### 8.3 THE ROAD TO STATEHOOD

The progress towards an independent State of PNG was swift. It was a little over 10 years before Independence that a handful of Papua New Guineans were given

an opportunity to be members of the legislature. Many of them lacked knowledge of why they were in the House of Assembly (Parliament) and of the purpose of the House of Assembly. Many people doubted that there would be independence within a space of 10 years.<sup>13</sup> Henry Okole described the process as “PNG evolved from a colony to an independent state in roughly the time a human being achieves adulthood”<sup>14</sup>.

The Legislative Council (Parliament) was first established in 1951. It had six representatives from Papua and New Guinea. In 1964 the name changed to the House of Assembly and the elected representatives increased to 54. These were representatives from the special and open electorates. In 1968, the members of the House of Assembly increased to 84, and for the first time the regional seats were created. In 1972, the elected representative in the House of Assembly increased to 100.<sup>15</sup> The year 1972 was also important, as it was the year that brought in the leaders like Sir Michael Somare who would determine the destiny of the country.

The formulation of the PNG *Constitution* took place between 1972 and 1974. In 1972 a Constitutional Planning Committee (CPC)<sup>16</sup> was appointed and approved by the House of Assembly and it was both the Committee of the government and the Committee of the House of Assembly.<sup>17</sup> The CPC consisted of PNG citizens.<sup>18</sup> The purpose of the CPC was to develop and draft a *Constitution* so that there was a transfer of executive and legislative power from Canberra to PNG. The CPC traveled extensively around all parts of PNG collecting views from the people in its consultation process.<sup>19</sup> The reason for such an exercise was for the development of a homegrown *Constitution*.<sup>20</sup> The idea of having a homegrown

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<sup>13</sup> Wu, above n 6 at 133.

<sup>14</sup> Okole, H., “Institutionalisation Processes,” in Gomex, B., (ed.) *Papua New Guinea Year – 2006*, (2006) 12 at 14.

<sup>15</sup> Ibid.

<sup>16</sup> There was another committee, the “select committee of the House of Assembly” appointed in 1960. Its job was largely to make recommendations for the changes to the elected House of Assembly or an executive government.

<sup>17</sup> Momis, J., “The Constitutional Planning Committee and the Constitution,” in Jessep, O., Regan, A. J. and Kwa, E.L., (eds.) *Twenty Years of the Papua New Guinea Constitution*, (2001) 19 at 19.

<sup>18</sup> Narokobi, B., “The Constitutional Planning Committee, Nationalism and Vision,” in Jessep, O., Regan, A. J. and Kwa, E.L., (eds.) *Twenty Years of the Papua New Guinea Constitution*, (2001) 25.

<sup>19</sup> Somare, M., “Reflections on Constitution-Making,” in Jessep, O., Regan, A. J. and Kwa, E.L., (eds.) *Twenty Years of the Papua New Guinea Constitution*, (2001) 15 at 15.

<sup>20</sup> Ibid.

*Constitution* was conceived long before the formation of the CPC. The indigenous leaders aspired to a politically homegrown *Constitution* that is unique to PNG.<sup>21</sup> This is done with an intention that the *Constitution* would sever colonial ties while at the same time reflecting the wishes of the people of PNG. On 27 June 1974, the draft report of the CPC was presented to the House of Assembly and it was adopted after much discussion on the many matters it contained.<sup>22</sup>

Within two years, the CPC had wide consultations with the people of PNG and the report tendered to the House of Assembly is a nationalistic document reflective of the views of the people.<sup>23</sup> The homegrown nature of the *Constitution* is reflected in the preamble of the PNG *Constitution* where it proclaims that “we, the people of Papua New Guinea...establish this sovereign nation...declare ourselves to be the Independent State of Papua New Guinea”. These words make undoubtedly explicit that the text and the authority of the PNG *Constitution* purport to come from the people, making it the supreme law. Therefore there is no higher law than the *Constitution*. Using Hans Kelsen’s<sup>24</sup> words the *Constitution* is a *grundnorm* (or basic norm) given its autochthonous nature and form, and therefore the supreme law. This means that any other laws that are inconsistent with it are ineffective and invalid to the extent of inconsistency.<sup>25</sup> On 16 September 1975 the new state of PNG adopted the new *Constitution*. It provides for the Head of State, organs of the government and other constitutional offices.

#### **8.4 GOVERNMENT OF PAPUA NEW GUINEA**

The PNG political system is based on the Westminster model. It has a parliamentary system of government with a party system and a written *Constitution*. The *Constitution* establishes the structure and form of government, rule of law, National Goals and Directive Principles (NGDP) and recognizes the

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<sup>21</sup> Regan, A.J., “Introduction,” in Jessep, O., Regan, A. J. and Kwa, E.L., (eds.) *Twenty Years of the Papua New Guinea Constitution*, (2001) 1 at 4 – 5.

<sup>22</sup> Hegarty, D., “May – August 1974,” in Moore, C. and Kooyman, M., (eds.) *Australian Journal of Politics and History - A Papua New Guinea Political Chronicle 1967-1991*, (1998) 220 at 222; see also the issue that CPC report raised in Hegarty, D., “September – December 1974,” in Moore, C. and Kooyman, M., (eds.) *Australian Journal of Politics and History - A Papua New Guinea Political Chronicle 1967-1991*, (1998) 227 at 227 – 232.

<sup>23</sup> Chalmers, D. R. C. and Paliwala, A. H., *An Introduction to the Law in Papua New Guinea*, (2<sup>nd</sup> edn., 1984) 107.

<sup>24</sup> Bix, B., *Jurisprudence: Theory and Context*, (3<sup>rd</sup> edn., 2003) 56 -59.

<sup>25</sup> *Constitution of PNG*, s 11.

Crown as the Head of State. The Government consists of a National Parliament, National Executive and National Judicial System.<sup>26</sup> Elections are held after every five years to determine representatives from electorates and provinces and the party that would form the next government. After Independence, PNG had a centralized form of government until 1977 when the *Constitution* was amended and governmental powers were delegated to the provincial governments.<sup>27</sup> Despite delegation the National Government is still the powerful entity. In 1995 the provincial government structure was removed by the *Organic Law on Provincial Governments and Local-level Governments* to improve governance and the delivery of goods and services direct to the people at the local level.<sup>28</sup> This is done in response to “poor management of many provincial governments and suspension of so many of them for gross financial mismanagement and/or break down of administration”.<sup>29</sup> The change in the structure of the provincial government completely centralized the power and gives unhindered control to national representatives from the national to the local level. All members of the National Parliament are also members of provincial assemblies<sup>30</sup> and the regional member who is a member of the National Parliament becomes the governor and chairperson of the provincial assembly<sup>31</sup>.

#### **8.4.1 The Executive Government**

The executive government comprises the Head of State, the National Executive Council (NEC), and the government ministers who are supported by the administrative system. The Queen of the United Kingdom (or any of her successors) is the Head of State, represented by the Governor General who is endowed with the privileges, powers and functions of the Head of State.<sup>32</sup> The Governor General only acts in accordance with the advice of the ministers and the Cabinet.

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<sup>26</sup> *Constitution of PNG*, s 99.

<sup>27</sup> *Constitution of PNG*, Part VIA.

<sup>28</sup> Gelu, A., *The Quest for Good Governance: A Survey of Literature on the Reform of Intergovernmental Relations in Papua New Guinea*, (2008) 59 – 62.

<sup>29</sup> Regan, A. J., “The Politics of Provincial Government,” in May, R. J., Regan, A. J. and Ley, L., (eds.) *Political Decentralisation in a New State: the Experience of Provincial Government in Papua New Guinea*, (1997) 56 at 69.

<sup>30</sup> *Organic Law on Provincial Governments and Local-level Governments*, s 10.

<sup>31</sup> *Organic Law on Provincial Governments and Local-level Governments*, s 14.

<sup>32</sup> See ss 82 and 83 of the *PNG Constitution*.

The executive government is a powerful entity in the country; however it is only accountable to the Parliament through the ministers. It is the constitutional right of the Parliament to be able to probe the Government through questions, motions and resolutions and petitions.<sup>33</sup> Unfortunately, parliamentary sittings have often been postponed,<sup>34</sup> and where there are sittings the reality is that a number of members sign in for purposes of receiving their sitting allowance and after few minutes the House is empty. Further, the number of debates and questions has decreased since Independence in 1975. The annual reports of various officers and bodies such as state owned enterprises are required to be tabled in Parliament so that the Parliament is kept up to date about the management and affairs of the institutions.<sup>35</sup> Presentations of reports in Parliament have declined (see Part V). Issues in reports are only raised when questions are asked in Parliament.

#### **8.4.2 The Administrative System**

The administrative system is made up of responsible ministers who are political heads and government departments. Departments consist of civil servants, headed by departmental secretaries who are appointed by the Government. The minister is accountable to Parliament for any acts or omissions of the department and the civil servants. Administrative matters in relation to the public servants are managed by Public Service Commission. The Commission is established under s 190 of the *Constitution*, and s 191 provides for its powers and functions. The powers of the Commission originally were:

- a. to ensure the efficient management and control of the National Public Service;
- b. responsibility for all personal matters connected with national public service;
- c. to keep the State services under continuous review; and
- d. to advise, on its own initiative or on request, the NEC and any other state service on organizational matters and the co-ordination of effort in relation

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<sup>33</sup> *Constitution of PNG*, s 111.

<sup>34</sup> Narokobi, B., "Parliamentary Reform for Good Governance," in Sullivan, N., (ed.) *Governance Challenges for PNG and the Pacific Islands*, (2004) 108 at 112.

<sup>35</sup> Kwa, E.L., *Constitutional Law of Papua New Guinea*, (2001) 62.

to conditions of employment to avoid wastage and duplication of resources.

These powers, especially those under a, b, and c, were however significantly reduced by *Constitutional Amendment No. 8 of 1986*. The power that remains is the right to be consulted by the executive government before appointments are made to senior public service positions. Government usually ignores this procedural requirement making appointments without required consultations. Many of these cases ended up in court.<sup>36</sup> The reality is that the Government appoints associates who may not be appropriately qualified for such high positions of authority.<sup>37</sup> Removing the powers of these important constitutional offices allows the Government to do things without being taken to account. Government departments are known for rampant abuse and corrupt practices. People are losing faith in the system of government that the country inherited with continuous corrupt practices and no solutions. In 2007, the Prime Minister with senior departmental heads and the Secretary of Defence transported the fugitive, Moti, an Australian citizen to the Solomon Islands, using a government plane belonging to the State. A Commission of Inquiry was established to investigate this. The Commission of Inquiry implicated the Prime Minister and senior officials of the Defence Force.<sup>38</sup> In 2006 millions of Kina were stolen from the Department of Treasury. The Government appointed a commission of inquiry then suspended it three times.<sup>39</sup> The final report has not been acted on. Those who were implicated have not yet been held to account. These scandals involving government officials including the prime minister undermine public confidence in the Government. Despite this, the Government continues to be involved in all aspects of the economic life of the country.

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<sup>36</sup> See for example *Geno v PNG* [1993] PNGLR 22; *Public Services Commission v PNG* [1994] PNGLR 603; *NEC v PEA* [1993] PNGLR 264.

<sup>37</sup> New Zealand Herald, "PNG Heads of Bank – illiterate," in *The New Zealand Herald*, (Wednesday, September 24, 2008) B3.

<sup>38</sup> Tannos, J., "Probe on PM Tabled," in *Post Courier*, (Port Moresby, 4<sup>th</sup> March 2010) < <http://www.postcourier.com.pg/20100304/thhome.htm> > at 4 March 2010.

<sup>39</sup> Somare, M., "Interim Report of the Commission of Inquiry into Department of finance," in *Prime Minister of Papua New Guinea*, (13<sup>th</sup> May 2008) < <http://www.pm.gov.pg/speeches/32-financecoiintreport> > at 8 March 2010; ABC – Radio Australia, "PNG Inquiry Reveals Finance Department Corruption," in *ABC – Radio Australia*, (5<sup>th</sup> March 2010) < <http://www.radioaustralia.net.au/pacbeat/stories/201003/s2838082.htm> > at 8 March 2010.

The state intervenes through public ownership and regulation of public enterprise. Given the weak economy base, Government basically controls the economy through public ownership and not so much by regulation. Much of the regulation in the private sector is on the mining companies. This is because the biggest income of the country is generated through mining. State owned enterprise is one of the forms which the State uses to participate in the economy; however one of the biggest problems in SOEs is the problem of accountability. Since Independence in 1975, there is still confusion and there are questions over whether public accountability mechanisms apply on SOEs. This is not to say that PNG's *Constitution* has not provided for public accountability mechanisms.

There are 21 constitutional offices established under the PNG *Constitution*, including the three arms of the Government, which are required, in principle, to keep checks and balances on each other. The PNG *Constitution* also sets out other constitutional offices such as the Ombudsman Commission, Auditor General (AG), and Parliamentary Committees to ensure accountability in government departments and SOEs. That is not to mention others<sup>40</sup> that perform important roles in extending state services and ensuring transparency and accountability in state organs and agencies. Many of these state institutions lack resources and cannot perform their responsibilities. For example, the function of the Public Accounts Committee (PAC) is to investigate the public accounts of PNG.<sup>41</sup> However, owing to a lack of funding the PAC has been redundant. Since the Prime Minister, Sir Michael Somare, took office in 2002 he activated PAC through financial assistance to perform its constitutional duties. The Auditor General lacks resources and sufficient funding, hence outsources auditing responsibilities to private firms. The Ombudsman Commission also lacks funding and many cases that are brought to its notice are often not investigated. The lack of resources and funding are largely due to the policies and priorities of the ruling parties and the government of the day.

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<sup>40</sup> The other Constitutional Offices are given here with various provision of the *Constitution* that establish and empower them: Citizenship Advisory Committee ss 75 – 76; Electoral Boundaries Commission s 125; Electoral Commission s 126; General Constitutional Commission s 260; Law Reform Commission sch 2.13 – 2.14; Magisterial Services s 173; Parliamentary Services s 132; Public Prosecutor ss 176 – 177; Public Solicitor ss 176 -177; Salaries and Remuneration Commission s216A; National Economic and Physical Commission s187; Police Force ss196 – 197; Defence Force ss196 -197 and Public Service Commission ss190 – 193 – see also *Constitutional Amendment No. 8 1986*.

<sup>41</sup> *Constitution of PNG*, ss 118, 215 and 216.

There are few political parties such as the National Alliance, forming governments that have concrete policy objectives of how they would like the country to be governed. They strive to ensure their policy objectives are formulated into the national plan by the Department of Planning and copies sent to all departments and governmental bodies for implementation. The national plan is formulated taking into account policy directives of the ruling parties and the Government, and it must be in harmony with the NGDP.<sup>42</sup>

### **8.4.3 Act of the State**

As noted in chapter 5, the State is not simply the government or the Head of State (Crown) but ultimately the representative of the people of PNG. Consequently, the State refers to the people of PNG. The act of the executive government, bureaucrats or any public body is an act of the State or the people. However, there are other public bodies that come within the control of ministers and government departments that perform governmental activities. These activities are delegated through franchise, contract or legislation. It becomes problematic when trying to attribute an act of State to these entities. For example, SOEs that are established by statutes or incorporated under the *Companies Act 1997* are independent and possess a separate legal personality but the Government owns them on behalf of the people. What would be the extent of Government control to make these entities a public body? Should the actions of directors and managers be attributed to that of the State, or should they enjoy the privileges and immunities reserved for the State? These issues have not been clarified in PNG. They are further discussed in chapter 15.

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<sup>42</sup> For example, one of the policies of the National Alliance Party (a majority party currently in government) focuses on rural development. This is in line with goal 5 of the National Goals and Directive Principles: “Integral Human Development”. This policy is captured in the *Medium Term Development Strategy 2005 - 2010*, a document formulated by the Department of Planning in consultation with the Government. As a result of this policy and strategy the Government established Micro - Finance offices at towns in the rural areas and allocated 10 million Kina, an increase from 1.5 million Kina, to each members of the electorate to use for developmental purposes in their electorates. See Government of Papua New Guinea, *Medium Term Development Strategy 2005 – 2010*, (2004) at 11.

## 8.5 POLITICAL PARTIES

PNG used to have a fluid political party system. Many of them do not have a strong support base, and tangible and attainable goals.<sup>43</sup> The national members used to have no party loyalty. Some commentators refer to them as “yoyos and political prostitutes”.<sup>44</sup> Change of membership is frequent, especially approaching the 18-month period when a vote of no confidence in the government is permitted. Consequently, one of the causes of the lack of development is political instability. Some commentators have blamed political instability for the lack of investment in PNG.<sup>45</sup> Businesses do not want to operate in an unpredictable environment where the Government is changed through changes in membership of political parties. Changes in Government also changes policies and that can affect businesses.

The instability of political parties appears to be a perennial problem, partly contributed to by the absence of a nationalist movement.<sup>46</sup> This is not to dismiss the few political parties formed before and immediately after Independence that still actively contribute to the democratic process and the welfare of the parliamentary system in PNG. For example, the PANGU party was formed before the Self-Government in 1973 and on Independence produced the first Prime Minister and continues to be active after 35 years of Independence.

The main root causes leading to political instability are jockeying for political positions. The Prime Minister is constantly under threat to please members within the coalition in order to maintain his/her position, thus focus is diverted from important issues of policy formulation and implementation to maintaining power and prestige. An attempt was made by the legislature to stabilize political parties, and to ensure that parties become ideologically oriented, and concentrated on the

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<sup>43</sup> Laki, J., “Integrity of Political Parties,” (July – December 2000) 2(30), in The National Research Institute, (ed.) *Issues and Trend in National Development – Searchlight on Papua New Guinea*, (2001) 35 at 35.

<sup>44</sup> Sikani, R., “Governance in Retrospect,” (January – June 2001) 1(31), in Boeha, B. and Robins, J., (eds.) *Issues and Trends in National Development – Searchlight on Papua New Guinea*, (2002) 39 at 39.

<sup>45</sup> Manning, M., *Factors Contributing to the Lack of Investment in Papua New Guinea: A Private sector Survey*, (Discussion paper No. 74, 1999).

<sup>46</sup> Hegarty gave three reasons for this phenomenon. Hegarty, D., “The Political Parties,” in Amarshi, A., Good, K. and Mortimer, R., (eds.) *Development and Dependency: the Political Economy of Papua New Guinea*, (1979) 187 at 188 – 190; See also May, R.J., *State and Society in Papua New Guinea: the First Twenty-Five Years*, (2001) 128; and Okole, H., “Political Reform – Will it change the System?” in Gomex, B., (ed.) *Papua New Guinea Year – 2005*, (2005) 52 at 53.

realization of their policy objectives. This led to the enactment of the *Organic Law on the Integrity of Political Parties and Candidates* (OLIPPAC) in 2001.

OLIPPAC sets out explicit guidelines for the formation of the Government, addresses major issues of corrupt practices like funding of members and candidates,<sup>47</sup> and compels members to maintain political party membership. The law restricts and regulates the movement of members of Parliament from one political party to another. A member who is sponsored by a political party is to maintain membership with the political party until three months before the writ is issued for the next general election.<sup>48</sup> An independent member, who is elected into Parliament, joins a party to remain with it until three months before the issue of the writ.<sup>49</sup>

OLIPPAC was first tested in 2002. It was enforced during the general elections and the formation of the government after general elections. An attempt was made unsuccessfully to overthrow the Government in 2003, 2009 and 2010 through votes of no confidence. This shows that there are still loopholes in the law that requires reconsideration and amendment to prevent a situation that might lead to political instability. OLIPPAC, on one hand brings a certain measure of stability but at the same time undermines good governance and integrity because its enforcement has seen a “gradual rise in ‘executive dominance’ both in decision making and in parliamentary debate and politics”<sup>50</sup>. This increases the power of the political party. Further, the effect of OLIPPAC is that any lack of trust in a minister who is a member of a party shows a lack of confidence in the whole party. Should the Prime Minister decide that issues need addressing with a particular minister, he/she must also consult with the minister’s party. Thus, a minister of the department or a minister responsible for SOE can continue with corrupt practices if other accountability mechanisms do not hold him or her to account.

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<sup>47</sup> Hriehwazi, Y., “Integrity Law changes Political Landscape,” in Gomex, B., (ed.) *Papua New Guinea Year – 2003*, (2003) 7.

<sup>48</sup> A central fund is created where all monies contributed to the parties are made transparent. See *Organic Law on the Integrity of Political Parties and Candidates*, Part 6, Funding Political Parties.

<sup>49</sup> See *Organic Law on the Integrity of Political Parties and Candidates*, s 65.

<sup>50</sup> Meaurio, T., “Rise in Executive Dominance,” in *The National*, (Port Moresby, 9<sup>th</sup> July 2008) 23.

## 8.6 POLITICAL PHILOSOPHY

The attitudes and behaviors of people towards politics are reflected in political institutions and public policies. These are affected by a number of influences. One of the significant influences is the custom of the people. PNG has many different customary practices and clan affiliation, and over 800 different languages in a population of over six million people. To date people still have very strong ties to their customs and this basically governs their daily lives. Bernard Narokobi calls the prevailing custom the “Melanesian Way”.<sup>51</sup> Despite coming from different customary backgrounds people have an open mind about the fact that other people have different customs from theirs, and try to accommodate them. At the same time they strive to find commonalities that are shared between their customs and those of others so that these commonalities become a “pulling factor” and a common denominator in their relationship.

Before Independence, the people had the common objective of breaking away from the colonizers to become an independent society. This provided them with a common objective to pursue, which in the process united them as one people despite differences in their customs.<sup>52</sup> After Independence in 1975, the common goal was achieved. The people required new and common objectives, and direction that would enable them to work together as one people. Out of the CPC’s wisdom common aspirations of the people were engaged and enshrined in PNG’s *Constitution* as the NGDP. The PNG *Constitution* recognizes the custom that governs the affairs of the people from time immemorial as part of the laws under s 9 of PNG’s *Constitution*, and various laws called for customary practices to be recognized.<sup>53</sup> As a result, having been colonized for nearly a century, people are continually struggling with the systems and ideologies left by the colonizers and new ideas being introduced on the one hand and custom on the other.

Currently, the society is doing a balancing act of picking and choosing from the introduced system and customary laws in order to establish a system that is workable and appropriate for PNG society as a whole. This process results in

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<sup>51</sup> Narokobi, B., *The Melanesian Way*, (1980) vii.

<sup>52</sup> Ibid at 25.

<sup>53</sup> Through the *Customs Recognition Act 1963*.

conflicts<sup>54</sup> that prevent the country from progressing. The “Melanesian Way” has become a “sacred cow” that prevents society from moving toward modernity by clashing with new ideas, creating conflicts, hence dilemmas of development (see chapter 9) continue to be experienced.<sup>55</sup> However, the Melanesian Way has served PNG well from time immemorial in maintaining relationships and peace and order in society.

Many lessons can be learnt from the custom and cultures of the people. The people of PNG have always lived a subsistence way of life and more than 80 per cent of them still do today. Much of the communal ideology is seen in practice in the villages. Every family that has a garden shares the produce from the garden with everyone in the village. Those that go hunting or fishing and come home with a catch share with everyone in the village. Loyalty and respect for one another is a norm. Elders are people with authority and they are respected and looked up to for advice and direction. These people have lived long enough to have studied the climate and the movement of animals and fish, and are in a position to advise on when to make a garden and go hunting or fishing. The elders are well acquainted with custom. The village people go to them for advice and they also mediate over disputes. These are “big men” in Melanesian custom. Consequently, when the concept of state was introduced in 1975 people had no problem in grasping the idea.

PNG communities were always organized as states but on a smaller scale. They are now looking up to the State as a benefactor, parent or guardian. This creates a paternalistic attitude. The national politician depicts the “big man” in Melanesian custom and, according to the people, has responsibility directly to them. Inevitably, these politicians have the mentality and morality of providing for their followers – the members of the clan and voters. As a result instead of involvement in public services, the domain of their activities is in a spectacular version of

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<sup>54</sup> For example, a big man under custom provides for the whole clan or tribe. When a person becomes a politician or a managing director he appoints the clan members, or misappropriates to help support the clan or tribe, leading to corrupt practices. See Kombako, D., “Corruption as a Consequence of Cultural and Social Idiosyncrasies in a Developing Society,” in Ayius, A. A. and May, R. J., (eds.) *Corruption in Papua New Guinea: Towards an Understanding of Issues*, (No. 47, 2007) 27 at 33 – 36.

<sup>55</sup> Kilmister, L., “Kill the Sacred Cow – the Melanesian Way,” in *Post Courier*, (Port Moresby, 24<sup>th</sup> February 2009) < <http://www.postcourier.com.pg/20090224/tuhome.htm> > at 25 February 2009.

“pork-barrelling”.<sup>56</sup> Many of these politicians lack formal education and that ostensibly leads to a lack of understanding of their roles and responsibilities.<sup>57</sup>

During colonial rule PNG experienced two wars. The second war had a great impact on the lives of the people. Their involvement in the war was not because of any conviction but through loyalty to their colonizers.<sup>58</sup> This, amongst other things, facilitated co-operation from Australia in granting Independence when the drive for Independence was initiated in PNG. Independence of the country occurred after 25 years when the world was geared towards welfarism. Thus, when PNG adopted its *Constitution* it focused on the welfare of the people. This is reflected generally in PNG’s *Constitution*, and particularly under the NGDP.

The State of PNG inherited much of the social and economic undertakings from Australia immediately after Independence. The whole focus of the State is on health, education, communications, agriculture and infrastructural development, and housing for public servants in an attempt to meet the NGDP. Given the wide range of developmental and welfare needs of the society the State is not only using departmental enterprises but statutory corporations and state companies in the production and delivery of goods and services to the people. The welfare state affects the stability of the political regime in a sense that the public may confuse their political self-interest (based on ideology) and welfare linkages. This easily lends a certain degree of volatility to political preference and fragmentation of political choice. For example, since Independence, politics has been personified as a form of economic enrichment in PNG. Paula Brown stated that “people have come to regard government as the major...source of opportunity and finance. Having a friend in national government is seen as necessary for economic success.”<sup>59</sup> This shows that the focus of Government and political parties on welfare issues has confounded public conception of political self-interest and public welfare linkages against economic self-interest.

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<sup>56</sup> Douglas, B., *Weak States and Other Nationalisms: Emerging Melanesian Paradigms?* (Discussion paper No. 3, 2000) 8.

<sup>57</sup> Morgan, M., *Cultures of Dominance: Institutional and Cultural Influences on Parliamentary Politics in Melanesia*, (Discussion paper No. 2, 2005) 8.

<sup>58</sup> See Nelson, H., *Fighting for her Gates and Waterways: Changing Perceptions of New Guinea in Australian Defence*, (Discussion paper No. 3, 2005) 1.

<sup>59</sup> Brown, P., “The Simbu Election,” in Oliver, M., (ed.) *Eleksin: The 1987 National Election in Papua New Guinea*, (1989) 245 at 245.

The political parties in PNG have no foundation in ideologies other than promises of providing goods and delivering services.<sup>60</sup> Their formation is with the primary aim and practical consideration of gaining access to the resources of the country.<sup>61</sup> For example, a political party having members who hold a ministerial portfolio enables loyal supporters to be rewarded through various appointments to state institutions and departments. Some political parties do not develop distinctive policies.<sup>62</sup> This explains the inconsistencies and lack of direction in their policies. As a result many are formed before elections and fade as fast as they appear immediately after elections.<sup>63</sup> After seven elections there is a culture of the “hand out” mentality. During campaigns political parties host functions, buy votes to lure support, and make outrageous promises of the benefits that they would bring if they were given power.<sup>64</sup> The popular custom of the “wantok system” is manipulated where “gift and exchange system is adapted to election campaign food, beer and money distribution” to lure votes.<sup>65</sup> General elections are occasions that people look forward to receiving benefits in one form or another. When parties win an election they spend half of the five-year term trying to recoup the expenses incurred during campaigns. Consequently, they become involved in corrupt practices to recoup their election expenses while people would be awaiting action on the promises that they make during campaigns. Unfortunately, the policies of political parties will only consist of “promises” as long as the culture of “hand out mentality” subsists. People are demanding from their political leaders, money for travel, funeral, wedding ceremonies, etc. and the demand on leadership has reached epidemic proportion.<sup>66</sup> As long as party and government policies are based on promises of infrastructure development etc., people will continue to have “hand out” mentality.

Pressure groups can influence the direction of the Government in terms of directing policies; however they are less influential in PNG than their counterparts in New Zealand and Australian where they participate in political process to

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<sup>60</sup> Dorney, S., *Papua New Guinea: People, Politics and History since 1975*, (revised edn., 2000) 46.

<sup>61</sup> Reilly, B., *Democracy and Diversity: Political Engineering in the Asia-Pacific*, (2007) 65 – 66.

<sup>62</sup> Hegarty, “The Political Parties,” above n 46 at 187 – 188.

<sup>63</sup> Above n 43 at 35 – 36; Narokobi, “Parliamentary Reform for Good Governance,” above n 34 at 110.

<sup>64</sup> Narokobi, “Parliamentary Reform for Good Governance,” above n 34 at 110.

<sup>65</sup> Above n 59 at 245.

<sup>66</sup> Narokobi, B., *Leadership in PNG*, (2005) 30.

influence policymaking by political parties or government. The interest groups such as unions, non-governmental organizations, PNG Transparency International and women's groups do influence government policies; however their impact is somewhat limited. Generally, the lack of effective participation by interest groups is contributed to by a lack of information and the growing complexity and technical knowledge involved in modern decision-making in governmental processes. In order to make policy decisions the Government receives advice from government institutions such as the Department of Planning and Finance or the Department of Treasury or other private institutions that can provide technical advice. Further, in PNG, there are rival community groups. They do not influence Government and party policies but compete against one another over resources.<sup>67</sup>

Interest groups are an important avenue through which the public participates in governmental processes apart from the general elections. Active participation by interest groups may have some impact on the policy directions of political parties and the government in PNG to divert from having policies based on promises to ideologies. To be effective they must realize their relevance.

## **8.7 POLITICAL INSTABILITY, CORRUPTION AND INSTITUTIONAL INCAPACITY**

PNG cannot go forward if it cannot address some of the factors that affect its political status, which is affected by political instability, corruption within Government and weak state institutions. The three are related and must be addressed in order to pave the way for the good governance and for the efficient delivery of goods and services to the people to improve their lives.

First, political instability began when PNG gained Independence. From Independence in 1975 until 2010 PNG has had 11 different governments in its 35 year history. In every parliamentary term since Independence and up to the 2007 election, politicians were able to capitalize on votes of no confidence under s 145 of PNG's *Constitution* to vote out the legitimately and popularly elected Government by the people, and replace it with a Government that the parliamentarians themselves formed through political jockeying by political

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<sup>67</sup> Above n 61 at 16 – 17.

parties and individual politicians.<sup>68</sup> No government formed through a vote of no confidence was ever returned to government after a general election. Political instability has often been pointed out to be the main cause of the lack of delivery of goods and services to the people. It is also argued to be the reason for the lack of foreign investments in PNG,<sup>69</sup> the lack of good governance, and the cause of corruption.<sup>70</sup>

The first vote of no confidence was by Sir Julius Chan against Sir Michael Somare's Government in 1983 and the last was by Sir Mekere Morauta against Sir Bill Skate in 1999. Since 2000, the Organic Law on the Integrity of Political Parties and Candidates has provided assistance in regulating the conduct of political parties and individual politicians, to avoid political jockeying. Despite the law, attempts are still made to replace Governments through votes of no confidence. The latest unsuccessful attempt was on 20<sup>th</sup> July 2010. This was an attempt to replace Sir Michael Somare's Government.<sup>71</sup> Somare's Government benefited from the integrity law thereby allowing it to complete, in full, its second term of office.

Second, corruption has become a perennial problem in the society. It has gone from endemic to pandemic and is yet to reach rampant stage. It is localized at the political leadership level, permeates to the senior bureaucratic level and has become pandemic at all layers of the bureaucracy.<sup>72</sup> Corruption, amongst other things, includes nepotism, political appointments not based on merit, interference by politicians in the administration, receiving of commissions or kickbacks, the abuse of power or misuse of funds.<sup>73</sup> Since Independence, corruption has consumed millions of Kina that are allocated for developmental purposes. Despite major investigations, corruption continues to have a detrimental impact on

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<sup>68</sup> Siaguru, A., *In-House in Papua New Guinea: The Great Game*, (2001) 28 – 34.

<sup>69</sup> Above n 45.

<sup>70</sup> Duncan, R., "Papua New Guinea Economic Survey: A Scoreboard for the Morauta Administration," (2001) 16(2), *Pacific Economic Bulletin*, 1 at 6.

<sup>71</sup> World News – Australia, "High Drama as Somare survives PNG Vote," in SBS < <http://www.sbs.com.au/news/article/1306852/Somare-no-confidence-vote-sparks-PNG-chaos> > at 20 August 2010

<sup>72</sup> Above n 68 at 144 -145.

<sup>73</sup> Hevie, J. C., "Forms of Corruption," in Ayius, A. A. and May, R. J., (eds.) *Corruption in Papua New Guinea: Towards an Understanding of Issues*, (No. 47, 2007) 17 at 19 – 20.

investment and development.<sup>74</sup> Further, corruption increases poverty, threatens national sovereignty and is closely linked to crime.<sup>75</sup> Not surprisingly, in 2003 PNG was listed as one of the most corrupt countries in the world, ranking at 118<sup>th</sup> out of 133 countries and in 2004 it ranked 102<sup>nd</sup> out of 143.<sup>76</sup> In 2006, PNG remained a corrupt country ranking 130<sup>th</sup> out of 163.<sup>77</sup> By 2009, the corruption ranking had not improved. It remains a corrupt country ranking at 154 out 188 countries.<sup>78</sup> The Ombudsman Commission has been effective in holding to account those involved in corrupt practices, but it lacks funding and resources to investigate many other cases.

The report on corruption does not look good for PNG in the eyes of the international community, especially the international aid donors. The sad reality is that corruption is eating away at the fabric of society. Different international organizations pressured government to adopt policies addressing corruption. As one of the conditions for loans the World Bank requested that the Government reviews contracts which it undertakes with logging companies that are involved in corrupt dealings, and reviews the terms of moratorium on new logging agreements. Due to the lack of governmental consent on the terms, the loan agreement was suspended in 2004.<sup>79</sup> Developed states such as Australia and New Zealand were concerned that the possibility of corruption would propel PNG to a “failed state”, attempt to help the country. In addition to the financial aid that Australia provides to PNG, it initiated the Enhanced Co-operation Programme (ECP) to assist state services, especially police and customs services, to improve their efficiency.<sup>80</sup> The ECP did not last long. It was declared null and void on

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<sup>74</sup> Ayius, A. A., “An Overview of Corruption,” in Ayius, A. A. and May, R. J., (eds.) *Corruption in Papua New Guinea: Towards an Understanding of Issues*, (No. 47, 2007) 1.

<sup>75</sup> Pitts, M., “Crime and Corruption – does Papua New Guinea have Capacity to Control it?” (2001) 16(2), *Pacific Economic Bulletin*, 127.

<sup>76</sup> Transparency International, *Global Corruption Report in 2004*, (2004).

<sup>77</sup> Larmour, P., *Evaluating International Action against Corruption in the Pacific Islands*, (Discussion paper No. 1, 2007) 4.

<sup>78</sup> Transparency International – The Global Coalition against Corruption, “Corruption Perception Index, 2009,” in *Transparency International – The Global coalition against Corruption*, (2009) < [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2009/cpi\\_2009\\_table](http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table) > at 11 March 2009.

<sup>79</sup> Above n 77 at 7 – 8.

<sup>80</sup> Many have questioned ECP as being based on concern for Australia’s security rather than concern for corruption or failed state. This especially occurred after 9/11 when Australia began taking an active role in the affairs of small island states in the Pacific. See Patience, A., *The ECP and Australia's Middle Power Ambitions*, (Discussion paper No.4, 2005).

constitutional grounds.<sup>81</sup> In PNG, there is a realization that measures were needed to combat corruption. Several recommendations were put forward that include:

- a. strengthening the electoral system;
- b. regulating political parties and candidates; and
- c. strengthening constitutional institutions.

The Government enacted a new electoral law and a new organic law with an objective of strengthening the political parties and the candidates, giving effect to the first and second recommendations.<sup>82</sup> With regard to the third recommendation, a proposal was submitted for a body to be solely responsible for combating corruption. It was first mooted in 1998 as the only solution, which would cure corruption in PNG.<sup>83</sup> With the assistance of the World Bank the proposal for an Organic Law (with a copy of the law) for an Independent Commission against Corruption was submitted to the National Parliament. The proposed Organic Law addresses issues such as bribery of members of parliament, disclosure of official secrets, corruption and abuse of office, secret commissions and even conspiracy to commit any of these offences.<sup>84</sup> There was no serious effort made to have the law passed. Passing the law would affect the personal interest of politicians. The current Government under Sir Michael Somare is silent on these recommendations although it was elected to office on promises to fight corruption. Clearly their personal interest takes priority over the well being of the nation. These recommendations, with the draft laws, are collecting dust on parliamentary shelves.

Thirdly, in PNG there is a general perception that the State has weak institutions that are incapable of performing their functions, contributing to a consensus that PNG is a weak State. These institutions are unable to control and eliminate corruption, deliver goods and services to the people and withstand political turmoil that follows after the change of government. The people often blame

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<sup>81</sup> Above n 77 at 9.

<sup>82</sup> These are the *Organic Law on National and Local-level Government Elections* and the *Organic Law on the Integrity of Political Parties and Candidates*.

<sup>83</sup> Boeha, B., "Corruption, National Security and Outsourcing," in Boeha, B. and Robins (eds.), *Trends in National Development: Searchlight on Papua New Guinea*, (No. 28, 2000) 70 at 75.

<sup>84</sup> Donigi, P., "Appropriate Information for Combating Corruption," in Ayius, A. A. and May, R. J., (eds.) *Corruption in Papua New Guinea: Towards an Understanding of Issues*, (No. 47, 2007) 49 at 51 – 52.

Government and the state institutions for the lack of tangible development in the country. Problems that contributed to institutional incapacity are identified to be:

- a. a lack of properly qualified and trained human power;
- b. insufficient funds;
- c. political interference;
- d. a lack of institutional infrastructure;
- e. a lack of co-ordination; and
- f. unrealistic political promises.

Others blame weak state institutions on the adoption of state institutions that were designed from a foreign perspective without taking into account the local circumstances in PNG.<sup>85</sup> Political interference is serious and on the increase in PNG, including interference in SOEs that are meant to be independent of political interference. Other state institutions such as the Public Accounts Committee that are supposed to hold responsible ministers accountable are weak and incapable of performing their responsibilities.

Weak state institutions are a great concern for the government and aid donors.<sup>86</sup> The Government and aid donors depend largely on state institutions to deliver goods and services to the people. Hence, Australia through AusAid is delivering aid services direct to the people in partnership with non-governmental organizations instead of government agencies. This has caused tension between the Australian and PNG governments. In the late 1990s, the PNG Government, with the support of the aid donors introduced the Public Sector Reform Program. The objectives of the program are to:

- a. improve the critical process of decision-making and management;
- b. redefine and refocus the efforts and resources of the Government in its core functions;
- c. strengthen the capacity of the state agencies in managing the operations of government; and
- d. improve the delivery of basic goods and services.

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<sup>85</sup> Phillpot, R., "Government Performance, Social Capital and Ethnicity: Understanding Provincial Development in Papua New Guinea," (2002) 17(2), *Pacific Economic Bulletin*, 69.

<sup>86</sup> World Bank, *Papua New Guinea: Improving Governance and Performance*, (1999) 125; AusAid., *Economic Survey of Papua New Guinea*, (1997).

A review of the program was undertaken in 2000. Commenting on the status of the program, the former Chief Secretary, Robert Igara<sup>87</sup> warned that the success of the program would depend on:

- a. political stability;
- b. stability of leadership within state institutions;
- c. sufficient time (about 3 years) to be allowed for the program to mature;  
and
- d. the building up of relevant expertise and experience within agencies.

The Government took Igara's comments seriously. The second factor was given effect in 2004 with the enactment of the *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004* to ensure that heads of government institutions are competent to hold office, in order to avoid the corrupt practice of appointing political cronies to these important state institutions. In other words the Act ensures merit-based appointments. The legislation provides for the appointment and removal processes for the heads of government and statutory bodies and criteria where they can be appointed or removed. As discussed in Part V the procedures are often not followed.

Although critical comments like the above can be made or criticisms directed at weak state institutions, corruption or political instability, the people and the Government of PNG are resilient and are continually striving to find ways of addressing these problems to ensure that the two precious commodities of democracy and rule of law are maintained, and the lives of the people are improved.<sup>88</sup> In other words democratic processes remain despite predictions that the country would go into a state of anarchy. The Judiciary is impartial and effective, the Ombudsmen Commission is still effective despite a lack of funding,

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<sup>87</sup> Igara, R., "Implementing the Government's Structural Reform Program," in Institute of National Affairs., *Proceedings of the National Development Forum 2000* (2000) 33.

<sup>88</sup> Annual development forums are held involving government, the public sector and members of the community to identify developmental problems and to design developmental programs to address them. These proceedings are captured in booklet form. See Institute of National Affairs., *Proceedings of the National Development Forum: Reconstruction and Development through Partnership*, (1999); Institute of National Affairs., *Proceedings of the National Development Forum 2000; Reconstruction and Development, Lets act Locally*, (2000).

and other state institutions and agents are still performing their fundamental obligations amidst a cloud of mismanagement and corrupt practices.

PNG has been called a failed state in the past by commentators who have themselves failed to appreciate the fact that like any developing country, PNG is facing dilemmas of development. However, it still has a vibrant government, state services and law enforcement agencies that continue to perform in the society.<sup>89</sup> Facing dilemmas of development as a developing nation does not make a state a failed state (chapter 9). Despite this, the State and the people of PNG have accepted the tag of failed state and are continually working on addressing major national issues such as weak state institutions, corruption and political instability that affect the fabric of the society.

## 8.8 CONCLUSION

PNG encountered traders and explorers from different countries and was colonized by three different countries. The Westminster model of government was adopted from Britain. The political structure adopted since Independence 1975 has yet to effectively produce the results envisaged by CPC. Changes have been made through laws on the structure of government to enable effective delivery of goods and services; however individuals and groups have exploited loopholes in the system for their own gain. State institutions and agencies are vital in a transitional economy like PNG. But the state's active participation in the economy does not result in the effective delivery of goods and services. Having a good system is one thing, and having good people working in the system is another.

SOEs are an important medium through which a government delivers goods and services to the people. In order for SOEs to effectively and efficiently achieve their objectives they have to be independent and have an effective government that probes and scrutinize their performance. They also need effective public institutions that ensure that they are accountable for their performance. Hence, this chapter examines the State of PNG and its government structures, their powers and functions. Further, it highlights the fact that the State of PNG is to be equated

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<sup>89</sup> Singirok, J., "Whether or not Papua New Guinea is a Failing State," in Sullivan, N., (ed.) *Governance Challenges for PNG and the Pacific Islands*, (2004) 98 – 107.

with the people and not the government. Furthermore, it provides the context in understanding the role of SOEs in a developing economy, and the extent to which the government of PNG controls SOEs discussed in chapters 10, 12, 13 and 14.

## CHAPTER 9:

### DILEMMAS OF DEVELOPMENT

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#### 9.1 INTRODUCTION

Papua New Guinea (PNG), like any third world country, is faced with many challenges of development. It has to confront globalisation, economic crises, political crises, poverty and environmental degradation. Faced with these dilemmas and challenges it has been formulating strategies and identifying effective means of delivering goods and services to the people. Every year the Government works on a constrained budget. Essential services such as education and health are sometimes overlooked because there are not enough funds for the provision of these services, or where they are provided, there is misuse through corrupt practices. Successive governments have come up with economic policies to bring sustainable improvement to the lives of the people. Often these policies do not come to fruition.

This chapter discusses the various developmental issues faced by PNG. The focus is on population, education, health, environment and economic development in PNG. This chapter is necessary, as it will provide background information on the developmental issues faced by PNG, and concurrently show that given the state of development in the country it is vital for government participation in the delivery of goods and services. Thus, state owned enterprises (SOEs) have an important role to perform in PNG's developing economy. Many of these SOEs are involved in the production and delivery of goods and services to the people. They are vital in a developing economy where a country still faces many dilemmas of development.

#### 9.2 POPULATION

In year 2005 the population of PNG was estimated to be at 5.9 million.<sup>1</sup> This was to be predicted by the increase over the last 25 years. The population was 3

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<sup>1</sup> Pacific Star Ltd, "Statistics," in Gomez, B., (ed.) *Papua New Guinea Year Book 2006*, (2006) 159.

million in 1980; in 1990 3.7 million and by 2000 it was 5.1 million.<sup>2</sup> The population is increasing at the rate of 3.5 per cent every year.<sup>3</sup> It is estimated that if the current mortality and fertility rate is maintained, by 2020 the population of PNG will reach the 10.2 million mark.<sup>4</sup> This is an alarming rate of growth and if the Government does not plan for the increase it will have detrimental social and economic implications. The bulk of the population, about 85 per cent, is living in the rural areas using subsistence means<sup>5</sup> of living and about 45 per cent of the population are children under the age ranges of 0 – 4 years. If the Government is not serious in controlling the population increase, it will have much bigger problems to deal with in the future. Population and social issues cannot be separated from each other. They are intertwined, hence must be considered together under the national development plan.<sup>6</sup>

Some of the problems PNG faces are caused by population increase. Lack of planning in considering increases in population of the rural communities causes rural–urban migration where people are migrating into towns and cities in search of better social services such as health, and a better quality of life.<sup>7</sup> Often they do not find a better life as they lack trade skills and knowledge to do professional jobs. In some areas of PNG the increase in population is exhausting limited resources. Land shortage, depletion of resources such as fish, and trees for houses is putting a strain on relationships, and frequently results in tribal fights.<sup>8</sup>

The increase in population is caused by a number of factors. One of the reasons is to do with property ownership, particularly land. Nearly 97 per cent of land in PNG is customarily owned<sup>9</sup> and needs to be transferred to future generations. A

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<sup>2</sup> National Statistics Office of Papua New Guinea, *Papua New Guinea 2000 Census: Final Figures*, (2002) 3.

<sup>3</sup> Papua New Guinea Government, *Papua New Guinea National Assessment: Response to Rio and Agenda 21* (PNG Country Report to the World Summit on Sustainable Development in Johannesburg), (2002) 7.

<sup>4</sup> Ibid.

<sup>5</sup> “Subsistence means” includes gardening, fishing and hunting.

<sup>6</sup> United Nations Development Programme (UNDP), *State of the World Population 2004*, (2004).

<sup>7</sup> Soweï, J., “Population and Development in Papua New Guinea,” (July – December 2002) 2(34), in Boeha, B. and Robins, J., (eds.) *Issues and Trends in National Development – Searchlight on Papua New Guinea*, (2003) 74 at 75.

<sup>8</sup> Tribal fighting is a common practice that has gone on for many years in PNG. National Parliament enacted *Inter-Group Fighting Act 1977* to combat the problem. The Act has yet to be effectively enforced.

<sup>9</sup> Mugambwa, J. T. and Amankwah, H. A., *Land Law and Policy in Papua New Guinea*, (2<sup>nd</sup> edn., 2002) 118.

clan or tribe sees it as important to have as many children as possible so that they can occupy the unused land. Having more children will ensure security over private property and land, and provide security from attacks from other tribes and clans.<sup>10</sup> Further, better health is also considered one of the reasons for the population increase.<sup>11</sup>

The Government planning, decisions on infrastructural development and delivery of goods and services must take population into account. Population must be considered in determining policies. Recently the Government became aware of the importance of population and its overall social and economic implications. It has taken measures to address this by adopting a 14-year policy on population.<sup>12</sup> The policies address issues like integration, which calls on the Government and its agencies and other stakeholders<sup>13</sup> to integrate population in their developmental planning.<sup>14</sup> Whether this has been effected has not been seen however, what is conspicuous is that law and order problems with unemployment have increased with the increase in population.<sup>15</sup>

The Government's population policy aims to reduce the annual population growth from 3.5 per cent to 2 per cent by year 2020.<sup>16</sup> The Government should not only seek to decrease the population size but address the social and economic needs of the population. Policies must be in place to create more employment to absorb graduates from the universities and colleges into the work force, divert more funds into the development of infrastructure in rural areas to prevent rural-urban migration, and revitalize the redundant minimum wages board so that it performs its duty of considering minimum wages for employees. Dealing with these issues will lead to addressing law and order problems that are evident in PNG. Population increase must be addressed along with these other causes of societal concerns.

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<sup>10</sup> Above n 7 at 76.

<sup>11</sup> Ibid at 74.

<sup>12</sup> Department of Planning and Monitoring, *National Population Policy 2000 – 2010*, (1999) 61 – 112.

<sup>13</sup> Like the Non – Government Organization, international organizations and private companies.

<sup>14</sup> Above n 12 at 110.

<sup>15</sup> Above n 7 at 76 – 77.

<sup>16</sup> Above n 12 at 11.

### 9.3 EDUCATION

The literacy rate in PNG is low compared to other developing countries in the South Pacific.<sup>17</sup> The literacy rate in 2004 was at 57.3 per cent.<sup>18</sup> The importance of literacy and education has compelled the Government to undertake a major overhaul of the education system. The result, within the 10-year period from 1992 to 2002 shows that “schools have increased by 175 per cent, enrolments have doubled, and the number of teachers has increased by 70 per cent”.<sup>19</sup>

By 2000 PNG had six universities and other smaller colleges around the country. The total number of students attending universities and colleges was 13, 637.<sup>20</sup> That was two per cent of the population. The number of students attending universities was 8, 121. That is 0.1 per cent of the total population. Not many students who attend elementary and primary schools enter universities and colleges. The Government envisaged increasing the intake into universities. In 1997, the University of Divine Word, University of Vudal, University of Goroka and the Pacific Adventist University were converted to universities by various Acts of parliament.<sup>21</sup> This was done to give effect to the Government’s basic policy on education provided in the 1996 White paper on Higher Education, Research, Science and Technology.<sup>22</sup>

Since 1997, the number of secondary schools has increased to 30 and they are graduating every year at around 19, 000 students. Unfortunately, the higher

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<sup>17</sup> Look at other countries such as Samoa and Fiji that have literacy rate of 99 per cent and 93 per cent, respectively. See Secretariat of the Pacific Community, “Literacy rate of 15 – 24 year olds,” < [http://www.spc.int/prism/mdg/map\\_literacy.html](http://www.spc.int/prism/mdg/map_literacy.html) > at 14 June 2009; also Commonwealth Education Online, “Samoa,” < [http://www.cedol.org/cgi-bin/items.cgi?\\_item=static&\\_article=200611151024125109](http://www.cedol.org/cgi-bin/items.cgi?_item=static&_article=200611151024125109) > at 14 June 2009.

<sup>18</sup> World Bank, “Papua New Guinea Data Profile,” < <http://devdata.worldbank.org/external/CPProfile.asp?SelectedCountry=PNG&CCODE=PNG&CNAME=Papua+New+Guinea&PTYPE=CP> > at 9 April 2007.

<sup>19</sup> World Bank, “Papua New Guinea Public Expenditure and Service Delivery,” < <http://siteresources.worldbank.org/INTPAPUANEWGUINEA/Resources/Ex-Summary-PESD-Report.pdf> > at 9 April 2007.

<sup>20</sup> Pacific Star Ltd, “Statistics,” in Gomez, B., (ed.) *Papua New Guinea Year Book -2007*, (2007) 173.

<sup>21</sup> The two oldest universities are the University of PNG and PNG University of Technology established under the *University of Papua New Guinea Act 1983*, and the *Papua New Guinea University of Technology Act 1986*. The other Universities were established in 1997 and 1999 under the following legislations: *Pacific Adventist University Act 1997*, *University of Goroka Act 1997*, *University of Vudal Act 1997* and *Divine Word University Act 1999*.

<sup>22</sup> Kereme, P., “Higher Education Policy in Papua New Guinea: Vision, Challenges and Policy Focus,” in River, J., (ed.) *The Role of Universities in Developing World: Building New Futures*, (Proceedings of the 3<sup>rd</sup> Huon Seminar) (2000) 20.

learning institutes can only take in 2500 students, and many among the 19, 000 students become “drop outs”.<sup>23</sup> By increasing the number of universities and colleges would cater for more students who are leaving grades 10 and 12. The idea is noble; however unequal consideration is given to various levels of education. The policy direction of increasing the number of students at the secondary high school level did not equate with the facilities at the universities to accommodate the increasing number of students. There is increasing demand placed on lecturers to impart high quality education; however there is no reciprocal commitment on the part of the Government in terms of extra funding so that more classrooms can be erected, equipment purchased, and support services provided. Although, the state universities are autonomous bodies under the respective Acts of parliament, Government is obliged to fund them to meet their overall objectives in education.

The universities have their own internal problems. Student and staff unrest has been the major issues. There have been stand-offs between university administrations and the students, or the members of staff and university administrations. This leads to disruption of classes. In 2010, students went on strike at the University of Goroka and the classes were suspended for six weeks.<sup>24</sup> The Government was unable to intervene, as it is not permitted to under the Acts of Parliament.<sup>25</sup> The 2007 unrest between the PNG University of Technology and its staff members has prompted the minister responsible to submit a proposal to the National Executive Council to amend the law to allow the minister to intervene where there is unrest at a university.<sup>26</sup> Government intervention may compromise academic freedom. Universities must not be politicized and their freedom of academic criticism, research and free impartation of knowledge must be maintained. However, other measures taken by the Government to address literacy problems are commendable.

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<sup>23</sup> Ibid.

<sup>24</sup> Noho, B., “UOG to Solve Problem and Resume Classes,” in *Post Courier*, (Port Moresby, 10<sup>th</sup> March 2010) < <http://www.postcourier.com.pg/20100310/wehome.htm> > at 25 March 2010.

<sup>25</sup> For example *University of Papua New Guinea Act 1983*, ss 8 and 23; *University of Goroka Act 1997*, s 9.

<sup>26</sup> Korugl, P., “Government Move to Take Over National Universities,” in *The National*, (Port Moresby, 3<sup>rd</sup> January 2007) < <http://www.thenational.com.pg/032107/nation2.htm> > at 21 April 2007.

The important step taken by the Government is the realization that there is a need for better and quality education for its people and it has taken some positive measures towards improving education and general literacy. Secondary and higher education were not the only areas the Government is looking at. It has also focused its attention on the elementary and primary education and vocational schools around the country.<sup>27</sup> The Medium Term Development Strategy (MTDS) 2003 – 2007 is reassuring, with a plan that Government would increase the budget for basic education from K101.8 million in 2003 to K103.2 million in 2006. The Government is explicit that it would cater for such things as, elementary teacher training, improve primary school infrastructure; improve rural education facilities, teacher training, literacy and awareness and technical and vocational training.<sup>28</sup> Further, “A National Plan for Education 2005 – 2014” sets out a road map for education in PNG, with a strong recognition of custom and quality education.<sup>29</sup> Many of the grand ideas encapsulated in the MTDS have not been realized.

There are other critical issues in education that still need to be looked into. The World Bank report under “Papua New Guinea Public Expenditure and Service Delivery”<sup>30</sup> identified some important and perennial problems in PNG. Physical facilities of schools are on the decline, and this increases with the remoteness of the school. Many schools do not have electricity, or water or basic textbooks or a library for students. School funding is another area that cripples many schools. Most school funding is sourced from school and project fees. Governments, occasionally distribute grants, unfortunately many schools especially those in remote areas do not receive these grants. The free education policy of the Government has positive results, which increases the enrolment of the students; however, the policy itself is questionable. Is the Government genuine about the

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<sup>27</sup> Primary schools used to be grade 1 to grade 6. With the overhauling of the education system primary schools are now grades 1 to 8 and secondary high schools are grades 9 to 12. Efforts are made to create new curriculum materials for primary schools. The new educational approach is to equip students with life skills to prepare them to adapt into society. See Papua New Guinea Government, *The State of Education in PNG*, (2002); Papua New Guinea Government, *Papua New Guinea National Education Plan 1995 – 2004*, (vol. A & B, 1996) and Papua New Guinea Government, *Brief for Honourable Michael Laimo, MP, Minister for Education*, (2002).

<sup>28</sup> Government of PNG, *The Government Medium Term Development Strategy 2005 – 2010*, (2004) 24; Government of PNG, *The Government Medium Term Development Strategy 2003 – 2007*, (2004) 60.

<sup>29</sup> Department of Education, *A National Plan for Education 2005 – 2014*, (2004) v and vi.

<sup>30</sup> World Bank, “Papua New Guinea Public Expenditure and Service Delivery,” < <http://siteresources.worldbank.org/INTPAPUANEWGUINEA/Resources/Ex-Summary-PESD-Report.pdf> > at 9 April 2007.

policy and is it sustainable, or is it a seasonal political benevolence? These and many more issues such as disparity between male and female education,<sup>31</sup> teachers not attending classes, delay in the payment of salary and under-payment of teachers are some of the interrelated problems that needs to be looked into and addressed.<sup>32</sup>

There is a lot more that Government needs to do at the basic educational level to fulfil the much-needed improvement that is clearly outlined in the MTDS. Some of the tangible benefits are seen through the establishment of elementary schools and the setting up of more secondary high schools. Concurrently an equal effort, resources and concentration should be diverted to higher education to see the establishment of facilities so that lecturers can effectively discharge their primary duty of teaching and research.<sup>33</sup> The way forward is to address financial, infrastructural and technical problems at the basic educational, high school and tertiary education levels, and ensure that they complement one another.

#### **9.4 HEALTH**

Health issues are of major concern for PNG. The majority of the population is living in the remotest part of the country, and is in desperate need of primary health care. There are many reasons for inadequate provision of health services, including insufficient funds, lack of transport or the misappropriation of funds allocated to the Health Department. Two of the major obstacles are centralization of decision-making and lack of transparency. The basic health service is of utmost importance to the country and yet the policy and legislative framework put in place are not effectively implemented. Consequently, the country is rated amongst the worse in the South Pacific island countries in terms of the overall health of its people.<sup>34</sup>

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<sup>31</sup> World Bank, "Gender Analysis in Papua New Guinea," (1998) *The World Bank*, < <http://siteresources.worldbank.org/INTPAPUANUEWGUINEA/Resources/chapter+2+Key+Thematic+Issues.pdf> > at 9<sup>th</sup> April 2007.

<sup>32</sup> World Bank, "Papua New Guinea Public Expenditure and Service Delivery," < <http://siteresources.worldbank.org/INTPAPUANUEWGUINEA/Resources/Ex-Summary-PESD-Report.pdf> > at 9 April 2007.

<sup>33</sup> Guy, R., "How Many Marks for the Education Budget?" (July – December 2000) 2(30) in Boeha, B. and Robins, J., (eds.) *Issues and Trend in National Development: Searchlight on Papua New Guinea*, (2001) 49 at 51 - 52.

<sup>34</sup> Papua New Guinea Government, *Health Vision 2010: National Health Profile*, (vol. III, Part I, 2000) 2.

In 1997, the *National Health Administration Act* was passed as a step towards ensuring the effective delivery of health services.<sup>35</sup> The Act is the culmination of previous policies, which have never been effectively implemented. Through the legislation, it is intended, that parties involved in the decision-making and delivery process will be compelled to act. Importantly the Act establishes the National and Provincial Health Board to oversee the implementation of national policies and to co-ordinate the delivery of health services to the people. This establishment is long overdue but a step in the right direction that will ensure the fulfilment of the health needs of the people.

Subsequent to the *National Health Administration Act* different governments have adopted health policies. In 2001, the Government adopted a ten year National Health Policy, which points to areas where Government is lacking in effective delivery and where it could intervene to ensure 80 per cent people living in rural areas receive basic health service. In 2002, the new Government sets out MTDS 2002 -2007 and health was the main priority.

There are other serious issues in health that the country must continuously deal with. Undoubtedly the HIV/AIDS pandemic is a major concern to the Government and the people. In 1997, *National Aids Council Act* was enacted to give a formal, legislative status to an autonomous<sup>36</sup> body set up to administer HIV/AIDS matters. The Aids Council is tasked with the aim of preventing, controlling and eliminating the transmission of HIV, and to have in place procedures to minimize the personal, social and economic impact of the HIV infection and the disease of AIDS.<sup>37</sup> By 2003, the population of HIV/AIDS infected people was increasing at an alarming rate. The victims of the virus were shunned and ignored, even ostracized by their own family members. In 2003 the *HIV/AIDS Management and Prevention Act* was enacted. It protects victims of HIV/AIDS from discriminatory practices by other people. Despite the Government's attempt to prevent HIV/AIDS, it is increasing annually among the

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<sup>35</sup> See s 3 of *National Health Administration Act 1997* for the basis of the enactment.

<sup>36</sup> Section 3 of the *National Aids Council Act 1997* established the National Aids Council and gives it a status of legal personality.

<sup>37</sup> *National Aids Council Act 1997*, s 4.

population. The current Government has put in place the “National Strategic Plan on HIV/AIDS 2006 – 2010”<sup>38</sup> to deal with the issue.

The emphasis on HIV/AIDS should not reduce the significance of preventing other diseases such as cancer, tuberculosis (TB) and malaria. Malaria has caused more deaths in PNG than all other diseases combined and continues to do so. Tuberculosis is another chronic disease which affects a large majority of the population. In 2007, the Health Department adopted a “Stop TB Strategy” to successfully detect and treat the disease.<sup>39</sup> Most of these strategies have yet to be implemented.

## 9.5 POVERTY

Poverty has never been considered to be an issue in PNG. Like any new concepts people have to be educated to understand poverty and its relevance. Earlier it was conceived that poverty was a lack of food, water and shelter and the Government had the impression that poverty did not apply to PNG. The vast majority of the people lived in rural areas, cultivating land, and there was a supply of food, water and shelter. This is a narrow and restrictive view of poverty. Poverty has many faces and it can include a lack of food, water, adequate shelter, deteriorating physical structure, poor health services, inaccessibility to health services, and a rise in the rates of mortality and high unemployment. For the last 20 years the Government has realized that poverty is an acute problem in PNG and it is an issue that needs addressing. The Millennium Development Plan highlighted poverty as one of the issues that the Government needs to address.<sup>40</sup> In MTDS 2005–2010 the Government prioritizes the alleviation of poverty as one of its key policy goals.<sup>41</sup> The international donors also require that poverty alleviation should be included in the developmental plan as a condition of eligibility for a loan.<sup>42</sup> PNG must show evidence that steps have been taken to alleviate poverty in order to be eligible for a loan.

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<sup>38</sup> National Aids Council, *National Strategic Plan on HIV/AIDS 2006-2010*, (January 2006) .

<sup>39</sup> The National, “TB Strategy the only Cure,” in *The National*, (Port Moresby, 13<sup>th</sup> April 2007) < <http://www.thenational.com.pg/041307/nation26.htm> > at 13 April 2007.

<sup>40</sup> United Nations Development Programme, *Millennium Development Goals – Progress Report for Papua New Guinea 2004*, (2004) 10 – 13.

<sup>41</sup> Government of PNG, *The Government Medium Term Development Strategy 2005 – 2010*, above n 28 at 25 – 26.

<sup>42</sup> World Bank, *A sourcebook for Poverty Reduction Strategies*, (vol. 1, 2002) 3.

Low-income earners live in rural areas, and others live at the periphery of towns and cities and are involved in small-scale commercial activities like trade stores, petty services like painting and maintenance and other trading activities. Much of the Government's budgetary allocation has been diverted towards manufacturing and commercial activities.<sup>43</sup> The budgetary allocation for rural areas in health, education and infrastructural development is either exhausted at the national level or, if it trickles down to the rural level, it becomes inadequate to complete the intended project.

Another important concern is the impact of poverty on women and children, particularly women who play an active role for survival in and out of the home. Poverty has immense effect on women, who have to struggle every day either through subsistence farming or low paid jobs and/or long hours, to have food on the table for their family. Unfortunately, government policies on poverty do not give special recognition to the poverty status of women in PNG, or provide means where women can improve their welfare. To a limited extent, the Department of Education is encouraging more girls to attend schools and national leaders have supported reserving seats in the national Parliament specifically for women,<sup>44</sup> however this is not enough, and only a start to improve the current poverty level of women.

Successive governments formulated policies on poverty without identifying groups of people in acute poverty level and their economic characteristics. Implementation of policy is another important concern. It is one thing to have a well written policy but it is another to implement it. The Government has an ambitious goal of reducing poverty by half from 43.7 per cent.<sup>45</sup> There are obstacles that it has to deal with in the implementation of poverty alleviation policy. First, there needs to be a working criterion to assess poverty. At the moment there is no national standard. Second, there is no clear estimation or documented evidence of the numbers of people who are at an acute poverty level,

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<sup>43</sup> Most monies put into commercial sectors are to revamp SOE which go through bad debts.

<sup>44</sup> Nanol, F., "PNG Leaders' Summit Support Seats for Women," in *ABC – Radio Australia*, (19<sup>th</sup> August 2009) < <http://www.radioaustralia.net.au/pacbeat/stories/200908/s2660909.htm> > at 30 March 2010.

<sup>45</sup> This is the 1998 rate taken from, Papua New Guinea Government, *Papua New Guinea National Assessment: Response to Rio and Agenda 21*, above n 3 at 7.

and the provinces in the country that have high poverty rates. Further, there is no clear understanding of the causes and effect of poverty. Given the lack of proper assessment and documentation of these issues, it will not be possible to have appropriate initiatives to address them. Consequently, eradication of poverty will be a vain effort.

## 9.6 LAW AND ORDER

Crime is a serious violation of law and is of grave concern to the peace and stability of the society. Crime in PNG refers to many forms of criminal activities, ranging from theft, robbery, arson, fraud, rape, murder and extortion, to white collar crime committed by leaders through the embezzlement of thousands and millions of Kina from the Government coffers. Crime in PNG has hampered development.<sup>46</sup>

The lawless situation also affects business prosperity, deters foreign investment, increases cost structure of the economy, and directly inhibits economic growth.<sup>47</sup>

In the last 30 years crime has grown out of proportion because the Government is not seeing it as a developmental issue but as a problem for the police. Many government resources are diverted to the police through recruitment and training to curb crime. For example in the 2000 and 2001 budgets alone, the law enforcement agencies received a substantial increase in their annual budgetary allocation,<sup>48</sup> and they receive an occasional increase in their salary when they demand it.<sup>49</sup>

Law and order can be seen in many forms. It can be seen through the high rate of break-and-enter crimes that occur on a daily basis. This is obvious in Port Moresby and other towns and cities with big high-rise spike fences built around

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<sup>46</sup> Sikani, R., "Crime and Development in Papua New Guinea," (July – December 2000) 2(30), in Boeha, B. and James Robins, J., (eds.) *Issues and Trend In National development, Searchlight on Papua New Guinea*, (2001) 53.

<sup>47</sup> Sikani, R., "The Law and Order 2001 Budget," (July – December 2000) 2(30), in Boeha, B. and Robins, J., (eds.) *Issues and Trend In National Development, Searchlight on Papua New Guinea*, (2001) 63.

<sup>48</sup> Ibid at 64.

<sup>49</sup> Safihao, J., "Cops cash in," in *Post Courier*, (Port Moresby, 15<sup>th</sup> October 2009) < <http://www.postcourier.com.pg/20091015/news01.htm> > at 27 October 2009; See also Post Courier, "PNG Police to Get Pay Rise," in *Pacific Business Online*, (Port Moresby, 15<sup>th</sup> October 2009) < <http://www.pacificbusinessonline.com/papua-new-guinea/story/14297/png-police-get-pay-rise> > at 27 October 2009.

residential houses. Too many break-and-enter crimes occur on a daily basis that police find it difficult to deal with them, and victims are reluctant to report these matters knowing that police may not be able to address them. Vandalism of public property is obvious from the debris lying around in towns and cities. Frustration over government policies or decisions is expressed through the destruction of public properties like hospital and school buildings, or by burning down public buildings. Rape is on the increase in PNG. Politicians are involved in committing these crimes and try to use money to silence victims and their relatives from reporting the matters to the police. Media through reporting can control such crimes; unfortunately they do not reveal the names of the politicians involved.<sup>50</sup> On a daily basis national newspapers report murder and stealing.

Many causes are attributed to criminal problems and societal disorder. In the main, people find it hard to cope with the rapid modernization combined with interaction with the rest of the world in a land with diverse customs, cultures and languages.<sup>51</sup> Participation in social, economic and political development has allowed people to detach themselves from Melanesian values and ways of doing things.<sup>52</sup> Changes brought about by developments affect social fabric of the communities. The Melanesian custom of respect for elders, women and children is eroding. Elders who used to maintain law and order in the villages have become things of the past. Youths are roaming streets and freely committing endless crimes. Police use of brutal force, unfortunately escalates further violation of rules and social norms, and not even correctional justice enforced by correctional service institutions is of any assistance in preventing crimes.

The correctional justice system does not make a distinction between first time offenders and serial offenders, petty crime and serious crime, and reformatory and punitive justice. Cells in PNG are crowded, unhygienic and unfit for human

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<sup>50</sup> For example, in Post – Courier, “\$40M in MP’s Account,” in *Post Courier*, (Port Moresby, 2<sup>nd</sup> July 2008) 1 and 3.

<sup>51</sup> PNG has more than 800 languages spoken by clans and tribes within the population of six million people.

<sup>52</sup> Sikani, R., “The Law and Order 2001 Budget,” above n 47 at 63.

habitation.<sup>53</sup> Instead of having a prison system where inmates become better citizens to be released back into society, they become worse than their earlier person upon entering the cell.<sup>54</sup> No appropriate systems of rehabilitation have been developed and a lack of funds mean that probation and parole officers are unable to assist and supervise offenders when they are allowed to live in the community.

Crime must be regarded as a social problem and the Government must have a strategic plan in place to prevent it.<sup>55</sup> The social and economic plan must take this into account and address the hopes, aspirations and expectations of the younger generation, because it is this generation that is the cause of much of the disorder in the society and the prison is full of them.<sup>56</sup> Government policy must make them become participants in the economic development so that they are not made to feel as spectators. Penalties for “white collar crimes” are too lenient and inadequate as deterrence; as a result leaders continue committing crimes and are allowed to run for public office after their convictions.<sup>57</sup> This questions the credibility of public office and people are gradually losing trust in the leadership. The laws have to change so that a person must not occupy public office after conviction of a criminal offence.

## 9.7 ECONOMIC DEVELOPMENT

PNG is the richest country in the South Pacific in natural resource and yet its economic performance has been mixed since the late 1980s and 1990s. Internal and external factors contribute to economic woes. Generally, globalization

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<sup>53</sup> For example, in Buka the prisoners made a public appeal to be given better condition in cells. See Post Courier, “Inmates in Buka Decry Conditions,” in *Post Courier*, (Port Moresby, 30<sup>th</sup> April 2007) < <http://www.postcourier.com.pg/20070430/mohome.htm> > at 30 April 2007. The Judge of the Supreme and National Court of PNG cleaned cells after making several calls that were not being acted on by the Police. See Arlo, J., “Judge cleans Wabag Cells,” in *Post Courier*, (Port Moresby, 9<sup>th</sup> March 2010) < <http://www.postcourier.com.pg/20100316/tuhome.htm> > at 30 March 2010.

<sup>54</sup> Sikani, R., “Crime Prevention and Development,” (July – December 2000) 2(30), in Boeha, B. and Robins, J., (eds.) *Issues and Trend In National Development, Searchlight on Papua New Guinea*, (2001) 56 at 56 – 58.

<sup>55</sup> Ibid at 56.

<sup>56</sup> Sikani, R., “Crime and Development in Papua New Guinea,” above n 46 at 54 -55.

<sup>57</sup> For example, national politicians such as Ted Diro, Tom Amiau and Roy Yaki were found guilty, served their three-year terms and contested again in the general election and won. See Kanekane, J. R., “Tolerance and Corruption in Contemporary Papua New Guinea,” in Ayius, A. A. and May, R. J., (eds.) *Corruption in Papua New Guinea: Towards an Understanding of Issues*, (No. 47, 2007) 23 at 23.

introduces its share of problems but a particularly negative development in commodity prices and unfavorable trade conditions and others have contributed to economic stagnation. Internally, a series of natural disasters, inappropriate policy regimes, fiscal failures and civil war in Bougainville from 1989 to 1999 have all contributed to negative economic growth and macroeconomic instability.<sup>58</sup>

In 1972, in the period of Self-Government<sup>59</sup> under Somare, Eight Aims were set out as development goals.<sup>60</sup> These aims were established to achieve equitable and sustainable growth, protection of environment and use of natural resources for the benefit of all. These goals are reflected in the current National Goals and Directive Principles in PNG's *Constitution*. In tune with these goals, PNG's economic policies "were characterized by fiscal discipline, stable prices and responsible governance".<sup>61</sup> Within the first four years after Independence Government pursued a hard currency strategy where there was tight control over expenditure that resulted in real per capita public sector outlays.<sup>62</sup> In 1994, the hard budget currency was abandoned and the Kina was floated to achieve external balance but flotation did not achieve the intended goal.

In trade, PNG had an open-economic policy before Independence. After Independence this policy was adopted and pursued with liberal stance on the use of exchange controls, foreign investment, imports, and employment of foreign labour. Due to pressure from business groups the protectionist policies were adopted in the early 1980s to protect domestic business interests.<sup>63</sup> In the 1990s the country reverted back to trade liberalization. Although the open-economic policy is directly contrary to the National Goals and Directive Principles, the

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<sup>58</sup> United Nations Development Programme – PNG, *Millennium Development Goals – Progress Report for Papua New Guinea 2004*, (2004) 7 – 8.

<sup>59</sup> Self-Government refers to the Government between 1972 and 1975 that consisted of elected locals after administrative powers were transferred from Canberra to Port Moresby. The reason for allowing locally elected Papua New Guineans to govern themselves was to prepare the country for a fully independent sovereign Government in 1975.

<sup>60</sup> World Bank Country Economic Report, *Papua New Guinea: Its Economic Situation and Prospects for Development*, (1978) 66; See also Fitzpatrick, P., "The Making and Unmaking of the Eight Aims," in King, P., Lee, W. and Warakai, V., (eds.) *From Rhetoric to Reality: Papua New Guineas Eight Point Plan and National Goals after a Decade*, (1985) 22.

<sup>61</sup> National Research Institute, *Economic Policy making in Papua New Guinea*, (No. 101, 2005) 9.

<sup>62</sup> Garnaut, R., "The First 25 Years of Searching for Development," (2000) 15(2), *Pacific Economic Bulletin*, 29 at 32.

<sup>63</sup> Ibid.

Government still pursues this policy today.<sup>64</sup> So there has not been one stable and steady course of action. The changes in trade and economic policies are the result of changes in successive governments. The current Government still pursues the open–economic policies.

PNG is blessed with natural resources. These include, gold, copper, oil, gas, timber, fisheries, coffee, cocoa, oil palm, copra and others. The mining and petroleum sectors bring in large revenue for the country; however the money is not used for sustainable projects in fisheries or agriculture, or invested in a consolidated account for use in the future after non-renewable resources are exhausted. Agriculture is the least developed sector since Independence, although indigenous people are excellent farmers, having a long history of farming in the Pacific dating back over 10, 000 years.<sup>65</sup> Previous governments have given less consideration to agriculture. Recently, the current Government is vocal in developing the agriculture sector and has taken some of the necessary steps in policy formulation.<sup>66</sup> Apart from agriculture the country has the second largest tropical rainforest in the world and is characterized by extra ordinary biodiversity. Further, it has an exclusive economic zone of 3.1 kilometers that harbours abundant tuna resources. These areas have lacked proper policy guidelines and a sufficient budgetary allocation to make appropriate and sustainable use of them.

Despite its abundance of resources half the population is still living in poverty - partly caused by lack of employment and low wages. The country has a centralized wage – setting mechanism. The Minimum Wages Board (MWB) and the Unions play an important role in setting minimum wages. The MWB was last convened in 1992 and remain redundant until 1999.<sup>67</sup> Many employees are still on low wages. The wages are inadequate to meet the increasing cost of living and rising inflation. With unemployment considerably high and increasing, it is hard for these employees to vacate their low paid jobs, and people who are unemployed

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<sup>64</sup> Goal 3 of National Goals and Directive Principles.

<sup>65</sup> The site where the first agricultural activity took place 10, 000 years ago was put on the World Heritage listing. See The National, “Waghi Valley site makes World Heritage listing,” in *The National*, (Port Moresby, 9<sup>th</sup> July 2008) 1 and 2.

<sup>66</sup> Ministry of Agriculture and Life Stock, *National Agriculture Development Plan 2007 – 2016*, (vol. 1 & 2, 2007); Ministry of Agriculture and Life Stock, *Agriculture Investment Incentives and subsidies (Green revolution) Policy*, (2003).

<sup>67</sup> Gumoi, M., “1999 Minimum Wages Board Determinants: The Need for Totality in Adversity,” (March 2000) in Boeha, B. and Robins, J., (eds.) *Trends in National Development, Searchlight on Papua New Guinea*, (No. 28, 2000) 4 at 4.

resort to illegal activities such as theft to survive, hence contributing to law and order problems. The current minimum wages must be reviewed and employment opportunities must be created for people. The onus is on the Government.

PNG can fully realize its economic potential but it must address law and order problems, maintain its infrastructures (particularly roads), encourage investment in mining and petroleum, and develop and implement good policies in agriculture, forestry and fisheries.<sup>68</sup> If there is prudent economic planning and implementation from Independence people would not be asking the question: “where has all the wealth gone”?<sup>69</sup>

## 9.8 CONCLUSION

PNG cannot move forward if it cannot address its social and economic woes. These are serious problems that need to be immediately addressed. Government has come up with fashionable policies, good on paper and yet failed to implement them. The literacy rate is low, the poverty rate is high, and the law and order problem is out of hand. Economic problems equate with high unemployment. These signs indicate that the Government is slowly losing its grip on the society. Development cannot be left in private hands, and goods and services cannot expect to be delivered, with more than 80 per cent of the population still living in rural areas (although it can decide from time to time to leave certain activities in private hands). This makes the role of SOEs important in PNG’s developing economy. Using SOEs would separate the Government from its activities, and simultaneously allow Government to only have a say in community services obligations of SOEs.

Government has responsibility to the society, especially the rural community - in providing goods and services. This responsibility calls for the Government to meet its third national goal of equality and participation where it declares that all citizens have an equal opportunity to participate in, and benefit from, the development of the country. Given the current social and economic dilemmas, the

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<sup>68</sup> Mawuli, A., “Economic Decline and Policy Failure,” (July – December 2002) 2(34), in Boeha, B. and Robins, J., (eds.) *Issues and Trends in National Development, Searchlight on Papua New Guinea*, (2003) 13.

<sup>69</sup> Lupari, I., “Where has all the wealth gone?” in *Post Courier*, (Port Moresby, 6<sup>th</sup> November 2009) < <http://www.postcourier.com.pg/20091106/frhome.htm> > at 6 November 2009.

Government needs to take control of the situation by either implementing its policies or coming up with policies to address some of these dilemmas. Government has a responsibility to people to use all means such as SOEs to achieve its aims and address the dilemmas of development.

**CHAPTER 10:**  
**CORPORATIONS AND CORPORATE GOVERNANCE IN**  
**PAPUA NEW GUINEA**

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**10.1 INTRODUCTION**

Companies have been operating in Papua New Guinea (PNG) long before Independence, 1975. The first big company was incorporated in Germany and carried on business in PNG during a significant part of the 19<sup>th</sup> and early 20<sup>th</sup> century, followed by two other big Australian companies. Nue Guinea Kompagnie (NGK) was the German company that was mainly involved in cash crops and operated in Rabaul with its business activities along the coast of New Guinea. The two Australian companies were involved mainly in mining based in Morobe Province. PNG was under colonial administration of Germany, Great Britain and Australia. Germany and Great Britain occupied New Guinea and Papua from 1884 until the early part of the 20<sup>th</sup> century. After Australia became a federated state it took over the administration of Papua from Britain and eventually New Guinea after World War One. Many of the laws adopted, including company law, were a reflection of its colonial links. Australian law had a significant influence on PNG law before Independence; hence many of the laws were adopted from Australia. This is also true for the company law. The laws of PNG and Australia have some characteristics similar to English law as both countries were colonized by Britain. The purpose of this chapter is to provide a brief history of companies and highlight background information on rules of corporate governance in PNG generally and particularly governance in state owned enterprise (SOE).

The first part of the chapter examines company law and corporate governance before and after Independence, 16 September 1975. The discussion acknowledges the role of major companies in the early development of the country, and the position of corporate governance rules in PNG legal system. The final part ensues with a

discussion on corporate governance in SOEs and why government continues to effectively participate in the economy with the use of SOEs.

## 10.2 COMPANY LAW AND CORPORATE GOVERNANCE

PNG is a developing country. The society is divided into urban and rural sectors. More than 85 per cent of people in the society live a subsistence way of life in rural communities on land that is 97 per cent customarily owned. Customary law that has been practiced from time immemorial still governs the life of people living in the rural areas, and there is very little commercial activity in these places. In remote areas like Karamui in Simbu Province and Telefomin in Sandaun Province people still practice a barter system. There are no commercial activities or small-scale commercial activities (if any). The concept of the company is still foreign to many rural-based people.

Despite the fact that the concept of the corporation is not well known in the country, corporations have a long existence in PNG, contributing to the social and economic development of the society. The history of corporations began in England. The modern company law that is applied in Commonwealth countries began taking shape after the *Bubble Act 1720*. The Act hindered growth of any joint stock companies.<sup>1</sup> With lawyers' ingenuity and the assistance by the Court of Chancery a new medium, the "deed of settlement" was developed based on the concept of trust.<sup>2</sup> After over 100 years later *Joint Stock Companies Registration and Regulation Act 1844* was enacted having all the features of modern company law except that members did not have limited liability. The *Limited Liability Act 1855* was enacted, limiting personal liability of members.<sup>3</sup> The House of Lords affirmed the limited liability and separate

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<sup>1</sup> Austin, R. P. and Ramsay, I. M., *Ford's Principles of Corporations Law*, (14<sup>th</sup> edn., 2010) 39 - 41, paras. 2.110 and 2.120.

<sup>2</sup> The deed enabled the funds of subscribers to be controlled by trustees and contained mutual agreements between investors, the committee of directors and trustees and used as a separate juristic entity that could carry out commercial activities. Even though its usage was contrary to the requirements of the *Bubble Act* it was meeting the economic needs of the country, hence allowed tacitly to be used.

<sup>3</sup> Cassidy, J., *Corporations Law: Text and Essential Cases*, (2<sup>nd</sup> edn., 2008) 3 - 4, para 1.30.

legal personality of companies in *Salomon v Salomon and Co Ltd*<sup>4</sup>, giving recognition to de facto private companies. Subsequently, the 1855 Act was repealed then incorporated into the *Joint Stock Companies Act 1856*.<sup>5</sup> Nearly 20 years later, after 1844, English company law was consolidated in the *Companies Act 1862*,<sup>6</sup> which became the company legislation model for British colonies.

Each Australian states enacted legislation based on the UK *Companies Act 1862* before and after federation 1901, until pressure in the 1960s for a uniform company legislation to be adopted.<sup>7</sup> Before 1960s, there was no uniformity in the legislation and the administration of company law, and this proved difficult for those corporations operating out of the jurisdiction in which they were incorporated.<sup>8</sup> The Commonwealth Government drafted a bill, which was to be passed as Companies Acts by each state except for Australian Capital Territory, Northern Territory and Territory of Papua and New Guinea.<sup>9</sup> The three territories were directly controlled by the Commonwealth administration in Canberra. Subsequently, the Commonwealth Government made ordinances for the three territories. The *Companies Ordinance 1963* came into effect on first July 1964 in the Territory of Papua and New Guinea.<sup>10</sup> The *Companies Ordinance 1963* was applied in Papua and New Guinea until Independence, 1975. As a result of the historical link there are a lot of similarities between company laws of Great Britain, Australia and PNG. The same is true for New Zealand (NZ).<sup>11</sup>

### **10.2.1 The Papua New Guinea Company and Corporate Governance Regime – Pre Independence**

PNG was colonized by three different countries; namely Great Britain, Germany and Australia. Britain and Australia colonized Papua, the southern part of PNG mainly for

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<sup>4</sup> *Salomon v Salomon and Co Ltd* [1897] AC 22.

<sup>5</sup> Gower, L. C. B., Davies, P. L. and Prentice, D. D., *Gower's Principles of Modern Company Law*, (6<sup>th</sup> edn., 1997) 44 – 46.

<sup>6</sup> Above n 1 at 42 - 43, paras. 2.140 and 2.150.

<sup>7</sup> *Ibid* at 43 – 44, para. 2.170.

<sup>8</sup> Ciro, T. and Symes, C., *Corporations Law: in Principle*, (8<sup>th</sup> edn., 2009) 3 – 4, para. 1.30.

<sup>9</sup> Ford, H. A. J., Ramsay, I. M. and Austin, R. P., *Ford's Principles of Corporations Law*, (9<sup>th</sup> edn., 1999) 43, para. 2.180.

<sup>10</sup> *Ibid* at 43, para. 2.180.

<sup>11</sup> Grantham, R. and Rickett, C. E. F., *Company and Securities Law: Commentary and Materials*, (2002) 33, para. 1.4; McDermott, J. R., *Understanding Company Law*, (2005) 3, para. 1.2, 1.3.

security reasons<sup>12</sup> and German colonized the northern part, New Guinea for economic reasons. Annexation effectively means that the territory is colonized; hence becomes part of the territory of the colonizer and its laws then apply.

#### **10.2.1.1 The Territory of Papua**

Papua was annexed by Britain in 1884.<sup>13</sup> The annexation was an act of state. It made it possible for British laws to apply. These laws include Acts of parliament and common law and equity. This made it possible for companies that were incorporated in Britain to operate in the territory. The administration of Papua was transferred to Australia in 1906 after five years of confederation in 1901. The Australian colonial administration made a serious attempt to provide for the corporate form, incorporation and operation of company and corporate governance framework. In 1912, the Lieutenant–Governor of Papua adopted the *Companies Ordinance 1912* (No.29 of 1912) which was based on the *Companies Act 1863* of Queensland. Company law from 1912 to 1926 was fragmented and there was need for consolidation. In 1926, Papua adopted a consolidated *Companies Ordinance 1912–1926*.<sup>14</sup>

Some years later under Australian colonial administration gold was discovered in Eddie Creek near Wau, Morobe Province. This attracted two of the largest companies, Bulolo Gold Mining and Dredging Ltd and New Guinea Goldfields Ltd to operate there. These companies were incorporated in Australia.<sup>15</sup> The New Guinea Goldfields Ltd was the biggest company operating in Wau and a major employer in the country. The hive of activity around the discovery of gold attracted many expatriates and locals who moved into the area and were employed. There were other smaller companies attracted by the gold mine that moved into Wau and Morobe Province, including Burns Philp & Company Ltd, which set up a trading store in

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<sup>12</sup> See Nelson, H., *Fighting for her Gates and Waterways: Changing Perceptions of New Guinea in Australian Defence*, (Discussion paper No. 3, 2005) 1. See the rest of the discussion in the paper.

<sup>13</sup> Moore, C., “Queensland’s Labour Trade and the Annexation of New Guinea in 1883,” in Latukefu, S., (ed.) *Papua New Guinea : a Century of Colonial Impact, 1884-1984*, (1989) 1.

<sup>14</sup> Deklin, A., “Company Law in Papua New Guinea,” in Tomasic, R., (ed.) *Company Law in East Asia*, (1999) 565 at 568 – 570.

<sup>15</sup> Waiko, J. D., *A Short History of Papua New Guinea*, (1993) 87.

Wau.<sup>16</sup> This illustrates that companies were operating in PNG long before Independence and that they contributed to the development of the territory and prepared it for Independence.

### **10.2.1.2 Territory of New Guinea**

New Guinea was under Germany's control. Its presence in the territory was predominantly for economic reasons; hence it did not leave any lasting legal legacy. The Germans first settled in New Guinea in 1883 and declared it a German territory in 1884.<sup>17</sup> The administration of New Guinea was handed to a conglomerate of German trading companies that consolidated as NGC and it was the first company operating in New Guinea from 1885 – 1899.<sup>18</sup> Although the company's operation was the biggest undertaken in New Guinea, many factors contributed to its downfall. Immediately after the downfall the German Imperial Government took over the failed enterprise.<sup>19</sup>

As stated, NGK was involved in commercial activities in New Guinea and at the same time it was the administrator and controlled German New Guinea on behalf of the Government of Germany. Being the administrator it determined, amongst other things, who went into the territory and activities that were to be undertaken in it. For example if missionaries were to come to New Guinea they had to be German speakers and from the German Missionary Society. In addition to their responsibility of spreading gospel they were to assist NGK to achieve its objectives through training of indigenous population in manual and other skills.<sup>20</sup>

NGC was the largest plantation firm in the Pacific. It grew crops like rubber, cacao, coffee, cotton, kapok, lemon grass, maize, taro, copra, palms and sisal. Of the 138,000 hectares that it had, 8288 was used for coconut, palms, rubber, cacao and sisal.

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<sup>16</sup> Sinclair, J., *Golden Gateway: Lae & the Province of Morobe*, (1997) ch 13, 105.

<sup>17</sup> Clay, B.J., *Unstable Images: Colonial Discourse on New Ireland, Papua New Guinea, 1875-1935*, (2005) 69.

<sup>18</sup> Ibid.

<sup>19</sup> Moore, C. and Kooyman, M., (eds.), *Australian Journal of Politics and History - A Papua New Guinea Political Chronicle 1967-1991*, (1998) Introduction XVI.

<sup>20</sup> Firth, S., *New Guinea under the Germans*, (1983) 136.

Eighty per cent of the whole of its plantings in New Guinea, including Madang and Finschhafen, was coconut. No wonder that by September 1914 copra export was increased to 6 million marks, making German New Guinea the leading copra producing country in the Pacific.<sup>21</sup>

NGC was not all that successful. Eventually it collapsed. Many reasons were given. One reason was the fall in the commodity price<sup>22</sup> whilst for others it was mismanagement.<sup>23</sup> And yet others look at the factors within the territory. Wrong crops were planted and they did not bring the needed revenue, thousands of labourers were not properly looked after or there was loss of control over the villagers.<sup>24</sup> These were reasons provided to justify the collapse of what otherwise appeared to be the biggest and successful company in the country. The collapse of NGK marked the end of the monopoly of one of the biggest companies in New Guinea.

### 10.2.1.3 Papua and New Guinea

Germany was defeated in World War One and it surrendered administration of New Guinea. It became a mandate territory under the League of Nations. Australia was given trusteeship of New Guinea in 1919. It set up its head quarters in Rabaul and adopted laws from Papua to be applied in New Guinea including the *Companies Ordinance 1912 – 1926*.<sup>25</sup> The company ordinances of both territories have the same content. In 1963, Papua and New Guinea adopted the *Companies Ordinance 1963* made by the Australian administration, which was applied in the two territories until Self-Government<sup>26</sup> in 1973.<sup>27</sup> Under Self-Government the two ordinances were merged into one, retitled *Companies Act 1973* and adopted under the PNG *Constitution* on 16 September 1975. The *Companies Act 1973* was applied until it

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<sup>21</sup> Ibid at 91.

<sup>22</sup> Firth, S., “The German Firms in the Pacific Islands, 1857 – 1914,” in Moses, J. and Kennedy, P.M., (eds.) *Germany in the Pacific and Far East, 1870 – 1914*, (1977).

<sup>23</sup> Above n 17 at 70.

<sup>24</sup> Above n 19, Introduction XVI at 66.

<sup>25</sup> Above n 14 at 569.

<sup>26</sup> See chapter nine, particularly footnote 59, which explains Self-Government.

<sup>27</sup> Ford, Ramsay and Austin, above n 9 at 43, para. 2.180.

was consolidated in 1982.<sup>28</sup> Finally, the *Companies Act 1997* was adopted from NZ law with some modifications, and is effective currently.

### 10.2.2 Company and Corporate Governance Regime – Post Independence

As noted in chapter three, corporate governance consists of rules, which are established to govern the affairs of a corporation. In terms of their binding order, Professor John Farrar classified corporate governance into three categories.<sup>29</sup> They are hard law, hybrid law and soft law. Hard law consists of legislation, and common law and equity. Hybrid law includes rules of Stock Exchange Listing Rules, and accounting and auditing standards, whilst soft law consists of codes of ethics, codes of good corporate governance and business ethics.

In order to understand the position of corporate governance rules in PNG it is important first to understand laws applicable in PNG. On 16 September 1975, PNG declared Independence and adopted a constitution. The *Constitution* is a supreme law in the country. Any other laws that are inconsistent with it are ineffective and invalid to the extent of that inconsistency.<sup>30</sup> Section 9 of the *Constitution* enlists all laws applicable in the country. It provides that the laws of PNG consist of:

- a. the PNG Constitution;
- b. the Organic Laws;
- c. the Acts of the Parliament;
- d. Emergency Regulations;
- e. the provincial laws;
- f. laws made under or adopted by or under PNG Constitution or any of those laws, including subordinate legislative enactments made under PNG *Constitution* or any of those laws; and
- g. the Underlying Law.

The Underlying Law consists of customary laws of PNG and the common law and equity of England.<sup>31</sup> In cases of inconsistency between common law and custom, the latter takes precedence.<sup>32</sup> The Underlying Law is firstly a “reserve law” in a sense that where there is absence or deficiencies in other laws it would be invoked to fill the

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<sup>28</sup> Above n 14 at 570.

<sup>29</sup> Farrar, J. H., *Corporate Governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) 3 – 4.

<sup>30</sup> *Constitution of PNG*, ss 10 and 11.

<sup>31</sup> *Constitution of PNG*, sch. 1.2.

<sup>32</sup> *Constitution of PNG*, sch. 2.2 (1).

deficiencies and in the process develop underlying law based on custom. The common law and equity adopted are those that are applied in the country immediately before Independence in 1975. Further, the Acts of parliament apply before Independence also became part of the laws of the country. This means any corporate governance principles adopted under common law and equity before Independence became part of the laws of the country. This includes also corporate governance principles adopted under any Act of parliament such as the *Companies Act 1912 - 1926*.

In PNG, corporate governance rules are provided in statutory laws, common law and equity, accounting and auditing standards and the constitution of a specific company. The significant statute is the *Companies Act 1997*, amongst other corporate governance legislations such as *Securities Act 1997*. It is not mandatory under the *Companies Act 1997* to have a company constitution, however if a company has a constitution it must register and file a copy with the Registrar of Companies at the Investment Promotion Authority. The rules that predominantly govern the internal affairs of a company include the *Company Act 1997* and the constitution of the company.

Case law or precedents are recognized as a source of laws in PNG. Two higher courts, namely the National and the Supreme Court, develop case law and they become binding on themselves and the lower courts. In developing case law the courts must take into account factors such as the National Goals and Directive Principles (NGDP) under Schedule 2.3 of the *Constitution*. Corporate governance rules developed by courts become binding on every person in the country.

#### **10.2.2.1 Companies Act 1997**

Corporations are either incorporated under *Companies Act* or created by a special Act

of Parliament.<sup>33</sup> The *Companies Act 1997*, along with company regulation, remains the more prominent legislation in the commercial field including related legislation such as *Securities Act 1997* and other commercial Acts of Parliament.<sup>34</sup> As indicated, the PNG *Companies Act 1997* was adopted from NZ and has the similar provisions to NZ's *Companies Act 1993*.

The important reasons for the adoption and establishment of *Companies Act 1997* were to facilitate economic development with company legislation that is easy to understand and a registration process that is not long and cumbersome.<sup>35</sup> Thus, unlike the *Companies Act* adopted in 1975, the 1997 Act does not make it mandatory to lodge the company's constitution and memorandum of association, and has removed the requirement of having a company secretary. The Act provides protection for shareholders and remedies when rights are violated and gives a prominent role to courts to effect remedies. Further, the Act defines the rights and duties of shareholders and directors.

The term "director" is given a broad definition. A director includes not only a person who is appointed to a position of a director,<sup>36</sup> but those persons who are: acting as directors, persons whose advice or instruction either a director or board is accustomed to act; persons who are required by the constitution to have powers that are normally exercised by the directors or board, or person who is acting under delegated power from the board.<sup>37</sup> A person who is acting in his or her professional capacity is not a director.<sup>38</sup> Hence, a receiver is not a director.<sup>39</sup> Shareholders, at the general meeting,

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<sup>33</sup> Special Act of parliament includes the following: *Business Group Incorporation Act 1974*, *Business Names Act 1963*, *Bodies Corporate (Joint Tenancy) Act 1951*, *Associations Incorporation Act 1966*, *Savings and Loan Societies Act 1961*, *Cooperative Societies Act 1982*, *Land Group Incorporation Act 1974*, *Partnership Act 1951* and *Investment Corporation Act 1971*.

<sup>34</sup> The commercial Acts include the following: *Bills of Exchange Act 1951*, *Insolvency Act 1951*, *Goods Act 1951*, *Investment Promotion Act 1992* and the *Hire-Purchase Act 1966*.

<sup>35</sup> Beven, A., "The New Papua New Guinea Companies Act 1997," in Institute of National Affairs (ed.) *The Companies Act 1997 – Proceeding of a Seminar held on 5<sup>th</sup> August 1997*, (1997) 2.

<sup>36</sup> *Companies Act 1997*, s 107(1) (a).

<sup>37</sup> See generally *Companies Act 1997*, s 107.

<sup>38</sup> *Companies Act 1997*, s 107(5).

<sup>39</sup> *Companies Act 1997*, s 107(2).

appoint directors by ordinary resolution.<sup>40</sup> In certain cases the court appoints them.<sup>41</sup> Likewise, a director is removed by ordinary resolution at the general meeting; however appointment and termination is subject to the constitution of the company.<sup>42</sup>

The board of directors is empowered to manage, direct or supervise the business and affairs of the company.<sup>43</sup> The *Companies Act* specifically uses the terms “managed”, “direction” or “supervision” implying that the board can either be a managing board or advisory board or both, depending on the size of the company and the stipulation under company’s constitution. Board members appoint one among them to be the chairperson of the board.<sup>44</sup> The board is responsible for the appointment of chief executive officer (CEO) and senior executives. The CEO and the management team are responsible for the day-to-day operation of the company. The power to manage is subject to review from time to time. The review mechanisms include preparation and submission of annual reports to shareholders prior to general meetings,<sup>45</sup> so that at the general meeting shareholders can question, discuss and comment on the management based on the report.

Duties of directors are explicitly provided under *Companies Act 1997*. The Act does not exclude the application of common law and equity. Therefore these laws on directors’ duties, and any other duties developed by courts by virtue of schedule 2.3 of the PNG *Constitution*, are still applicable. The *Companies Act* incorporates many director’s duties. These include the duty to:

- a. act in good faith and in what the director believes to be the best interest of the company;<sup>46</sup>
- b. exercise care, diligence and skill;<sup>47</sup>
- c. refrain from unauthorized use of company information;<sup>48</sup>

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<sup>40</sup> *Companies Act 1997*, s 131(2).

<sup>41</sup> *Companies Act 1997*, s 132.

<sup>42</sup> *Companies Act 1997*, s 134(1).

<sup>43</sup> *Companies Act 1997*, s 109(1).

<sup>44</sup> *Companies Act 1997*, sch 4.1 (1).

<sup>45</sup> *Companies Act 1997*, ss 209 and 210.

<sup>46</sup> *Companies Act 1997*, s 112.

<sup>47</sup> *Companies Act 1997*, s 115.

<sup>48</sup> *Companies Act 1997*, s 123.

- d. disclose interests in contract with the company;<sup>49</sup> and
- e. comply with the Companies Act and the Constitution.<sup>50</sup>

There are specific duties under the Act that directors owe directly to shareholders. These include, amongst others, the duty to supervise the share register, to disclose interests and disclose share dealings.<sup>51</sup> A shareholder can bring a personal action if there is a breach of these duties.<sup>52</sup>

The *Companies Act 1997*, in greater detail, provides for powers and functions of shareholders. Certain powers are automatically available to shareholders when they invest in a company. These powers include giving their approval for transaction that require unanimous agreement from them,<sup>53</sup> alteration of shareholders' rights,<sup>54</sup> and when company enters into major transactions.<sup>55</sup> Also, shareholders have right to apply to a higher court<sup>56</sup> for remedies. The application can be made on the basis that the affairs of the company are conducted in a manner that is oppressive, unfairly discriminatory or unfairly prejudicial to the person in his or her capacity as a shareholder or in any other capacity,<sup>57</sup> or apply to court for a derivative action.<sup>58</sup> Further, shareholders can apply to court for an order restraining a company or a director from engaging in conduct that would contravene the constitution or *Companies Act*.<sup>59</sup> Also, a shareholder has a right to inspect minutes and other formal documents.<sup>60</sup> Shareholders can make a formal written request for the information,<sup>61</sup> however if this fails they can obtain inspection by court order.<sup>62</sup>

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<sup>49</sup> *Companies Act 1997*, s 118.

<sup>50</sup> *Companies Act 1997*, s 114.

<sup>51</sup> See *Companies Act 1997*, ss 70, 118 and 126.

<sup>52</sup> *Companies Act 1997*, s 147 (1).

<sup>53</sup> *Companies Act 1997*, s 98.

<sup>54</sup> *Companies Act 1997*, s 98.

<sup>55</sup> *Companies Act 1997*, s 110.

<sup>56</sup> The higher court refers to the National Court and the Supreme Court of PNG.

<sup>57</sup> *Companies Act 1997*, s 152.

<sup>58</sup> *Companies Act 1997*, s 143.

<sup>59</sup> *Companies Act 1997*, s 142.

<sup>60</sup> *Companies Act 1997*, ss 216 – 218.

<sup>61</sup> *Companies Act 1997*, s 219.

<sup>62</sup> *Companies Act 1997*, s 220.

Most people in PNG do not understand the concept of the corporation and those who form companies do not fully grasp the concept of separate legal personality to differentiate between the assets of the company and personal assets. This leads to the abuse of company finances and properties. Consequently, many companies are usually declared insolvent and liquidated before they are fully established. The PNG Government under Self - Government<sup>63</sup> in 1973 realized that there were problems preventing 90 per cent of rural population undertaking commercial activities. Immediately prior to Independence, it enacted two pieces of legislation to give legal recognition to customary entities and enable them to be involved in business activities. It is important to give some consideration to these entities.

### **10.2.2.2 Customary Corporations**

Customary law is part of the laws of PNG.<sup>64</sup> Custom recognizes corporate entities such as clans and tribes. These customary entities own land. The members only have the right of use for different activities such as hunting and gardening. The Government came up with an innovative idea of enabling these traditional corporate entities to be involved in business activities by enacting the *Business Groups Incorporation Act 1974* (BGI Act) and the *Land Groups Incorporation Act 1974* (LGI Act) in giving effect to the Eight Point Plan (Eight Aims) of the Self-Government in 1974 to enable greater number of people to participate in the national economy.

The two Acts aimed at encouraging the people, especially 90 per cent of rural people living a subsistence way of life, to be involved in business activities using customary entities that they were already familiar with. The LGI Act was enacted to encourage local people to participate in the national economy by use of their land through incorporating land groups,<sup>65</sup> whereas the BGI Act enables customary groups to participate in general business activities not necessarily with the use of land. The BGI Act provides:

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<sup>63</sup> Above n 26.

<sup>64</sup> Custom is part of the Underlying Law adopted under s 9 of PNG's *Constitution*.

<sup>65</sup> *Land Groups Incorporation Act 1974*, s 1. Government owns around 3 per cent of land in PNG and the customary landowners own the rest. The Act is meant to enable people to use their land as an asset to participate in economic activities.

- a. greater participation by local people in the national economy by the establishment by them of group business and other economic enterprises;
- b. for the use of sound principles in the management of business;
- c. some formal structure of business groups for the basic protection of the members of business groups and persons dealing with those groups;
- d. for the use of simple rules for the regulation and control of business groups; and
- e. for the better and more effective settlement of certain disputes.<sup>66</sup>

Upon incorporation through the processes under the LGI Act and the BGI Act the incorporated land group and business group become corporations. This means that they have perpetual succession, can own and dispose of property, and can sue and be sued under their own names.<sup>67</sup> Customary corporations are only subject to customary laws, their own constitutions and the enabling Acts (i.e. LGI Act and BGI Act). Where there is dispute these laws are applied to resolve them by dispute settlement authorities.<sup>68</sup> The formal courts do not have jurisdiction over customary corporations unless it is stated otherwise.<sup>69</sup> An important point to note is that the LGI Act and the BGI Act provide means whereby groups that are already in existence in villages such as clans and tribes are given formal recognition through incorporation processes under the two pieces of legislation,<sup>70</sup> to use land in doing business or do other businesses not necessarily with use of land, hence custom is applied to resolve any disputes that arises between members in these corporations.

There is no clear corporate governance framework under the constitution or the enabling Acts. Custom is used in the appointment of the executives and the management of corporation. It is usually the leaders or elders of the incorporated clan or tribe that lead the customary corporations in accordance with custom.<sup>71</sup> Given the fluid nature of custom leaders manage a group's business and affairs in such a manner for self-interest using custom as justification. Lack of proper corporate governance rules and framework leaves customary corporations riddled with

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<sup>66</sup> *Business Groups Incorporation Act 1974*, s 1.

<sup>67</sup> *Land Groups Incorporation Act 1974*, s 11; *Business Groups incorporation Act 1974*, s 17.

<sup>68</sup> *Land Groups Incorporation Act 1974*, s 24; *Business Groups incorporation Act 1974*, s 43.

<sup>69</sup> *Land Groups Incorporation Act 1974*, s 23; *Business Groups incorporation Act 1974*, s 42.

<sup>70</sup> Kalinoe, L. K., "Incorporated Land Groups in Papua New Guinea," (2003 – 2004) 29, *Melanesian Law Journal*, 73 at 76.

<sup>71</sup> Custom is recognised under sch 2.1 of PNG *Constitution* but it must be those customs which are not repugnant to the general principles of humanity and which are not inconsistent with the constitutional laws or Acts of parliament. In order for the court to recognised custom it must first be pleaded as fact under ss 2 and 3 of *Customs Recognition Act 1963*.

mismanagement and misuse. As a result, there are high numbers of complaints.<sup>72</sup> The notion of establishing a customary corporation is noble; however the lack of clarity and certainty in the powers and functions of management was, and is, the cause of problems in these corporations, and will continue to be if these problems are not addressed.

### **10.3 CORPORATE GOVERNANCE – A NEW CONCEPT**

The term corporate governance is a new concept in PNG. It has never been discussed in literature or seen as an issue. Although, often there is public discussion of directors' misuse of company finances, insider dealings by company directors or collusion between government and SOE for the sale of the company assets, are all corporate governance issues; however these are never discussed from the perspective of corporate governance. Hence, there is little or no serious discussion on the matter to enable development of private and public sector corporate governance regimes. A number of reasons can be given for the lack of discussion, mainly the following:

- a. more than 85 per cent of the population lives a subsistence way of life in rural areas and the concept of company is still foreign to them;
- b. government controls much of the economy and the private economic sector is still at an infant stage; and
- c. PNG's financial market is still at a developing stage.

These reasons have made corporate governance take backstage, and it has not been considered seriously in PNG. In a transition economy like PNG it is important to understand corporate governance to improve laws to ensure good corporate governance practice in organizations, and this will contribute to attracting investment for PNG's private sector economy. PNG has a transition economy and government still controls the economy, making it difficult for private sector to expand in any major way.<sup>73</sup> Government participation in the PNG economy is justified in that it is to

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<sup>72</sup> See generally Kalinoe, L.K., "Incorporated Land Groups in Papua New Guinea," above n 70.

<sup>73</sup> For example, a private telecommunication company Digicel had to go through a court battle with Telikom, a public owned company to be given a license to operate in PNG. See Apec Digicel Opportunity Center, "Court clears air on Digicel License," < <http://www.apecdoc.org/node/6832>> at 25 September 2008.

fulfil the aspiration of the society enshrined in the NGDP. Its participation with the use of SOE creates serious corporate governance problems.

#### **10.4 CORPORATE GOVERNANCE AND STATE OWNED ENTERPRISE**

SOEs played a significant role in the social and economic development of PNG prior to Independence. Twenty years immediately before Independence the Australian colonial administration created state owned enterprises and used them as vehicles by which to provide goods and services to the people in the country. The Government, after Independence, retained many of them. Also, many private enterprises owned by foreigners operating in 1960s and 1970s came under the ownership of Government immediately before Independence when they left the country, as there was, at that time, an absence of a national capitalist class or national bourgeoisie to purchase, and privately own and control these enterprises.<sup>74</sup> Further, one of the significant reasons for Government control of public and private corporations after Independence was giving effect to one of its Eight Aims of 1974 of involving in the economy, which would bring desired development to the people.

After Independence in 1975, PNG economy continued to have weak markets. It had a formal cash sector and an informal subsistence sector, which created wide spread externalities. This inevitably led to SOE having broad objectives.<sup>75</sup> The broad objective is to make profits and provide fundamental social and economic needs of the society. In a developing economy SOE assumes the role of protecting and enhancing the infant economy and stimulating private sector economy and growth.<sup>76</sup> In light of this, public enterprise performs an important role in the socio-economic development of PNG. The role of SOE fundamentally depends on the complex inter-relationship between economic, social, political and ideological factors in a developing economy. In PNG, it is the combination of these interrelation and

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<sup>74</sup> Gupta, D. and Deklin, A., *Privatization in Papua New Guinea*, (Discussion paper No. 67, 1992) 4.

<sup>75</sup> Kalinoe, L., "Corporatisation and Privatization of State-Owned Enterprise in Papua New Guinea: A Socio-Legal Perspective from the Third World," (1996) 9(1), *Corporate and Business Law Journal*, 1 at 12 – 13.

<sup>76</sup> Trebilcock, M., "Public Enterprise in Papua New Guinea," in King, P., Lee, W. and Warakai, V., (eds.) *From Rhetoric to Reality?* (1985) 304 at 309.

National Goals and Directive Principles (NGDP) that provide the basis for government's continuous use of SOE.

The NGDP are provided for in the preamble of PNG *Constitution*, reflecting the aspiration of the society. They were formulated after a wide consultation with public leading to Independence on 16<sup>th</sup> September 1975. The NGDP were first adopted under Self-Government by then - Mr. Michael Somare as Eight Aims in the Government's 1974 Policy Document. The Eight Aims were adopted to help prepare the country for independence and also conceived as a socio-economic guideline for PNG's future.<sup>77</sup> The document generally provides for national self-reliance, equality of opportunity and equal distribution of benefits. The three of the Eight Aims for the purposes of this discussion are:

- a. A rapid increase in the proportion of the economy under the control of Papua New Guinean individuals and groups, and in the proportion of personal and property income that goes to Papua New Guineans;
- b. More equal distribution of economic benefits, including movement toward equalization of incomes among people and toward equalization of services among different areas of the country; and
- c. Government control and involvement in those sectors of the economy where control is necessary to achieve the desired kind of development.<sup>78</sup>

The Eight Aims were then adopted under the national *Constitution* of PNG as the NGDPs. The following are the five NGDPs.

- a. Integral human development - We declare our first goal to be for every person to be dynamically involved in the process of freeing himself or herself from every form of domination or oppression so that each man or woman will have the opportunity to develop as a whole person in relationship with others;
- b. Equality and participation - We declare our second goal to be for all citizens to have an equal opportunity to participate in, and benefit from, the development of our country;

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<sup>77</sup> Somare, M. T. and Australian Institute of International Affairs., *The Emerging Role of Papua New Guinea in World Affairs*, (1974) 6.

<sup>78</sup> National Planning Committee of Cabinet, *Strategies for Nationhood: Policies and Issues* (1974) X. See also King, P., Lee, W. and Warakai, V., "Editors' Introduction," in King, P., Lee, W. and Warakai, V., (eds.) *From Rhetoric to Reality: Papua New Guineas Eight Point Plan and National Goals after a Decade*, (1985) 1 at 1. See the history of the Eight Aims in Fitzpatrick, P., "The Making and Unmaking of the Eight Aims," in King, P., Lee, W. and Warakai, V., (eds.) *From Rhetoric to Reality: Papua New Guineas Eight Point Plan and National Goals after a Decade*, (1985) 22.

- c. National sovereignty and self-reliance - We declare our third goal to be for Papua New Guinea to be politically and economically independent, and our economy basically self-reliant;
- d. Natural resources and environment - We declare our fourth goal to be for Papua New Guinea's natural resources and environment to be conserved and used for the collective benefit of us all, and be replenished for the benefit of future generations; and
- e. Papua New Guinean ways - We declare our fifth goal to be to achieve development primarily through the use of Papua New Guinean forms of social, political and economic organization.<sup>79</sup>

The NGDPs are the national aims of the country that the Government and its agencies, and all persons, should use as guide in pursuing their various objectives. Although, the NGDPs are non-justiciable it is the duty of all governmental bodies to apply and give effect to them as far as lies within their powers.<sup>80</sup> These objectives have been adopted through many of the government policies, and through various enabling pieces of legislation that establishes SOE. The enabling legislation must clearly declare which NGDPs that the Act is giving effect to in establishing SOEs. For example, s 1 of *Electricity Commission (Privatization) Act 2002* provides that the Act is made taking the NGDPs into account.

Some SOEs were inherited from the colonial administration and are now owned and controlled by the Government. After Independence some activities of departments were corporatised, changing their organizational status: from department to statutory corporation; from part of a department to a government owned company; and from statutory corporation to government owned company, and the state maintains majority shareholding. The SOEs account for a large chunk of the machinery of Government and still maintain cultures, forms and spirits analogous to the public sector.

Corporatisation in PNG is seen generally as a process undertaken to ensure SOEs become efficient in the delivery of goods and services, and generate profit in the case of state companies. Enterprise autonomy is not a priority. The profit made is diverted to sustaining the activities of SOEs. During 1990s, the World Bank pressured the

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<sup>79</sup> The National Goals and Directive Principles are found in the preamble of the *Constitution of PNG*.

<sup>80</sup> See s 25 of PNG *Constitution*. The term non-justiciable is defined under sch. 1.7 of PNG *Constitution* as a matter that cannot be heard or determined by any courts or tribunals.

government to privatise some of the SOEs as one of the conditions for loans. PNG Banking Corporation was privatised and bought by the Bank of South Pacific. Others such as Telikom PNG Ltd, PNG Power Ltd and Eda Ranu were incorporated under the *Companies Act* with state having a 100 per cent shareholding through the “Independent Public Business Corporation of Papua New Guinea” (IPBC)<sup>81</sup>. SOEs are corporatised entities and they are either created by special legislation (statutory corporations) and/or incorporated under the *Companies Act 1997* or its predecessor (state companies). State companies are accountable to the IPBC and statutory corporations are accountable to responsible ministers. Ultimately, they are all accountable to parliament.

Other state institutions also ensure accountability in SOEs. Activities of SOEs are reviewed by the “Auditor General”<sup>82</sup> and “Public Accounts Committee”<sup>83</sup>. For purposes of *Public Finances (Management) Act 1995* (PFM Act) SOE is a public body.<sup>84</sup> PFM Act applies to those SOEs that have enabling Act that provides for the application of the Act except where provisions of PFM Act explicitly state that the Act applies to all public bodies such as SOE.<sup>85</sup> Government monitors the performance of SOE through a five-year corporate plan that they submit to it. SOE must submit a proposed work program,<sup>86</sup> and a performance and management plan from time to time setting out estimates of receipts and expenditure for the next financial year.<sup>87</sup> In addition, SOEs incorporated under the *Companies Act 1997* are required to comply with transparency and accountability requirements under that Act.

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<sup>81</sup> IPBC was established to manage and increase value of SOE so that they can be sold through privatisation. It also acts as a shareholder in trust for the state. IPBC replaced the Privatisation Commission that was established in 1997 to assist privatization of SOEs. See *Independent Public Business Corporation of Papua New Guinea Act 2002*.

<sup>82</sup> Section 8 of the *Audit Act 1989* provides that the auditor General shall inspect and audit the accounts of public bodies. SOEs are regarded as public bodies under section one of the *Audit Act 1989*. The issue of public body is further discussed in chapter 14.

<sup>83</sup> Public Accounts Committee is the constitutional office created under s 215 of PNG *Constitution* and its functions are provided under s 216. It has responsibility of examining public accounts, and control and transactions of moneys and property of the country and report to the parliament.

<sup>84</sup> *Public Finances (Management) Act 1995*, s 2.

<sup>85</sup> *Public Finances (Management) Act 1995*, s 48 (1) (4).

<sup>86</sup> *Public Finances (Management) Act 1995*, s 50.

<sup>87</sup> *Public Finances (Management) Act 1995*, s 49.

The Minister for Treasury performs an active role in SOEs. An SOE must submit a performance and management report, and financial statement of the previous year's report ending 31<sup>st</sup> December to the Minister for Treasury before 30 June every year.<sup>88</sup> The Minister must approve any contract involving payment or receipt of an amount or property of a value exceeding 100, 000 Kina.<sup>89</sup> Further, the Minister may direct the head of the Department of Treasury to carry out an investigation if he or she believes that SOE fails to implement the proposed work programme.<sup>90</sup> But Part V shows that Minister for Treasury does not deal with SOEs although PFM Act explicitly provide for the Minister's role in SOEs.

The roles and responsibilities of the board, management and Government in statutory corporations are provided under special Acts of Parliament, whereas in state companies they are provided under enabling Acts and/or *Companies Act 1997*. The roles and responsibilities of ministers/government are not clearly enunciated under some of the legislation. Even in other legislations that spell it out, the Government does not comply with statutory requirements. It is the similar state of affairs with directors, board and the management of SOE. Having different pieces of legislation dealing with the powers and functions of stakeholders in governance of SOEs, and being directed by government to execute other activities, is confusing and creates difficulties for management. The problem is exacerbated by appointing members of the board and management team who are political cronies, having no managerial knowledge or experience. These issues call for governance and accountability of SOEs to be improved.

## 10.5 CONCLUSION

Companies have been operating in PNG since annexation by Great Britain and Germany in the 19<sup>th</sup> century, and have assisted in developing PNG, preparing it for Independence. Under Australian colonial administration SOEs were created, independent of government and they provided essential goods and services. After

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<sup>88</sup> *Public Finances (Management) Act 1995*, s 63.

<sup>89</sup> *Public Finances (Management) Act 1995*, s 61.

<sup>90</sup> *Public Finances (Management) Act 1995*, s 64.

Independence the Government continued to utilize SOEs in accordance with the Eight Aims and the NGDP. Corporate forms adopted under company legislation are foreign to most people in PNG. To enable more people, especially the rural populace to participate in the national economy Government enacted two pieces of legislation, namely the LAGI Act and the BGI Act. However, without any specification of powers and functions of the executives and members, this has led to considerable corruption.

PNG has a developing economy and the Government controls much of it either through government departments, statutory corporations or state owned companies. The *Constitution* made it vital for government participation to ensure that the aspirations of people in NGDP are realized. However, ensuring productivity is equally important, as is accountability and transparency on the part of the Government, especially in SOEs, making discussion on corporate governance vital. Discussion of corporate governance is long overdue. These discussions are important for transitional economy like PNG's to assist with understanding problems and for the identification of issues that need development, to not only ensure accountability, transparency, efficiency and profitability but also to encourage foreign investment.

**PART V:**  
**CASE STUDIES**

# CHAPTER 11:

## METHODOLOGY IN DATA COLLECTION AND ANALYSIS

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### 11.1 INTRODUCTION

Human beings are continually struggling to comprehend the nature of phenomena presented by their environment. The means through which understanding of these phenomena is achieved is either through experience, reasoning, research or through a combination of one or more of them.<sup>1</sup> Research is a means often used in understanding these phenomena in the academic arena. Research is defined broadly as “generating knowledge about what you believe the world is”.<sup>2</sup> In *The Management Research Handbook*, Roger Bennett defines research as:

a systematic process of discovery, acquiring, and using knowledge. Put more formally, research is: a systematic, careful inquiry or examination to discover new information or relationships to expand/verify existing knowledge for some specified purpose.<sup>3</sup>

Research is a form of inquiry based on logic, reason and systematic investigation of evidence to answer questions or negate or affirm a proposition. There are four different approaches to research. In their book *Business Research Methods – A Managerial Approach* Veal and Ticehurst divide research approach into four paradigms:<sup>4</sup>

- a. Positivist – Critical/Interpretative;
- b. Qualitative – Quantitative;
- c. Inductive – Deductive; and
- d. Experimental – Non-experimental

First, the positivist paradigm approaches the subject of research objectively, detached from the researcher. The main aim of the inquiry is to provide description and explanation based on facts and observation. The interpretative paradigm views the world subjectively and the researcher is part of the research

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<sup>1</sup> Mouly, G.J., *Educational Research: The Art and Science of Investigation*, (1978) 6.

<sup>2</sup> Lee, N. and Lings, I., *Doing Business Research: a Guide to Theory and Practice*, (2008) 6.

<sup>3</sup> Bennett, R., “What is Management Research?” in Smith, N. C. and Dainty, P., (eds.) *The Management Research Handbook*, (1991) 67 at 68; see also Collis, J. and Hussey, R., *Business Research: A Practical Guide for Undergraduate and Postgraduate Students*, (2<sup>nd</sup> edn., 2003) 1.

<sup>4</sup> Veal, A. J. and Ticehurst, G. W., *Business Research Methods: a Managerial Approach*, (2<sup>nd</sup> edn., 2005) 24.

process. Second, quantitative research involves gathering and analysing numerical data to draw conclusion or test hypotheses. Often the research involves large numbers of cases and seeks to generalise to the whole population. On the other hand qualitative research does not involve numerical data, but involves a small number of cases and the findings are not generalised. Third, the deductive paradigm involves collection and analysis of data to confirm or negate a proposition or theory. Hence, the research starts with a theory and gathers information to confirm it. In inductive research the researcher interrogates data to find an explanation or come up with a hypothesis. Finally, experimental research occurs in an environment where researcher has control over variables, whereas non-experimental research occurs in the environment where the researcher has no control over the variables.<sup>5</sup>

This study is undertaken with a view to recording corporate governance practice in state owned enterprises (SOEs) in Papua New Guinea (PNG); therefore the empirical data are the responses of directors, chief executive officers, senior managers and consumers of SOEs, to discover the current corporate governance practice in SOEs. The appropriate approach in this circumstance is to adopt and apply research methods that provide flexibility and diversity in an area where the research has never been done before in PNG. Therefore the research paradigm undertaken is interpretive, qualitative, inductive and non-experimental so that this will enable the investigation of the real world in SOEs where more information is extracted to provide the position of corporate governance in SOEs in PNG. Given the fact that individual organizations (that is individual SOEs) are the focus of the research, the case study approach is considered suitable in the circumstances.

Empirical data forms an important component of this study, hence this chapter on methodology, which discusses the methods undertaken in collecting data and the underlying reason for their adoption. Further, it elucidates the rationale for the process involved in data analysis. The chapter therefore discusses the interpretative paradigm, which involves qualitative method, case study method and the inductive process of data collection and the processes involved in data collection and analysis. Then ethical processes and the validity and reliability issues in the research are discussed. Finally, the conclusion ensues.

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<sup>5</sup> Ibid at 29.

## 11.2 INTERPRETIVE RESEARCH

As stated above, the main objective of the research is to identify and document the corporate governance practice in selected SOEs in PNG. In doing so, an attempt is made to identify factors that affect good corporate governance practice in SOEs. In the light of the research objectives and the questions (see chapter 1) the research engaged current and the former directors and chief executive officers (CEOs), and current senior managers who are and have engaged with SOEs to gauge their knowledge, views and experiences on corporate governance. Further, the views of consumers of SOEs were obtained. This is because performance in corporate governance is reflected in the overall performance of SOEs and consumers are in better position to assess the quality and efficiency of services. The proper approach in such an inquiry is to apply interpretive research paradigm so that views of these different persons can be obtained. Further, this would enable subjects to be investigated in their natural settings.

Interpretive research is considered appropriate in this study as it allows the researcher to “study meaningful social action, not just external or observable behaviour of the people”.<sup>6</sup> By definition interpretive approach is “the systematic analysis of socially meaningful action through the direct detailed observation of people in natural settings in order to arrive at understandings and interpretations of how people create and maintain their social networks”.<sup>7</sup> Viewing interpretive research from an epistemological perspective, the inquiry takes a subjective approach to engage views and insights, which are created from human intuition and experiences, making the researcher a part of the research and yet maintaining objectivity so as to be “unaffected by and external to the interpretative process”.<sup>8</sup> In this research the participants mentioned above are made subjects of the study to obtain their views and experiences and to understand issues in corporate governance in SOEs from their perspective. In this sense, in interpretive research,

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<sup>6</sup> Neuman, W. L., *Social Research Methods: Qualitative and Quantitative Approaches*, (3<sup>rd</sup> edn., 1997) 69.

<sup>7</sup> Neuman, W. L., *Social Research Methods: Qualitative and Quantitative Approaches*, (6<sup>th</sup> edn., 2006) 88.

<sup>8</sup> Schwandt, T. A., “Three Epistemological Stances for Qualitative Inquiry – Interpretivism, Hermeneutics, and Social Constructionism,” in Denzin, N.K. and Lincoln, Y.S., (eds.) *The Landscape of Qualitative Research: Theories and Issues*, (2<sup>nd</sup> edn., 2003) 292 at 299 – 300.

unlike positivism, the researcher becomes part of the research process because of the researcher's role in understanding the circumstances and behaviour, and concurrently interpreting the information.<sup>9</sup> Interpretive research involves qualitative method, case study method and inductive process.

### 11.2.1 Qualitative Research

The qualitative research comes under the interpretative research paradigm.<sup>10</sup> Denzin and Lincoln define qualitative research as: “qualitative research involves an interpretative, naturalistic approach to the world. This means that qualitative researchers study things in their natural settings, attempting to make sense of, or interpret phenomena in terms of meaning people bring to them”.<sup>11</sup> Qualitative research begins from the premise that social reality is inherently associated with human beings and their social context.<sup>12</sup> The nature of the research enables a researcher to collect open-ended information from open - ended questions.<sup>13</sup> Bill Gillham outlines the rationale for qualitative method of research as follows:<sup>14</sup>

- a. To carry out an investigation where other methods – such as experiments – are either not practicable or not ethically justifiable.
- b. To investigate a situation where little is known about what is there or what is going on. More formal research may come later.
- c. To explore the complexities that are beyond the scope of more ‘controlled’ approaches.
- d. To ‘get under the skin’ of a group or organization to find out what really happens – the informal reality which can only be perceived from the inside.
- e. To view the case from the inside out: to see from the perspective of those involved.
- f. To carry out research into the processes leading to results (for example how reading standards were improved in a school) rather than into the ‘significance’ of the results themselves.

Points b, c, d, and e apply in this research. Qualitative research is suited for studies where “little is known” and there is a need to acquire information in order to learn more through document analysis or exploration of participants.<sup>15</sup> In the

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<sup>9</sup> Above n 4 at 24 – 25.

<sup>10</sup> Creswell, J.W., *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, (2<sup>nd</sup> edn., 2007) 39; Denzin, N.K. and Lincoln, Y.S., “Preface,” in Denzin, N.K. and Lincoln, Y.S., (eds.) *The SAGE Handbook of Qualitative Research*, (3<sup>rd</sup> edn., 2005) ix at xiv.

<sup>11</sup> Denzin, N.K. and Lincoln, Y.S., “The Discipline and Practice of Qualitative Research,” in Denzin, N.K. and Lincoln, Y.S., (eds.) *The SAGE Handbook of Qualitative Research*, (3<sup>rd</sup> edn., 2005) 1 at 3.

<sup>12</sup> Ibid.

<sup>13</sup> Creswell, J.W. and Plano C.V.L., *Designing and Conducting Mixed Methods Research*, (2007) 6.

<sup>14</sup> Gillham, B., *Case Study Research Methods*, (2000) 11.

<sup>15</sup> Creswell, J.W., *Educational Research: Planning, Conducting, and Evaluating Quantitative and Qualitative Research*, (2<sup>nd</sup> edn., 2005) 45.

context of this study I intend to examine and identify the corporate governance features and practices of five different SOEs through gauging the views of the directors, CEOs, senior managers and customers of SOEs. By adopting qualitative research I intend to gain a holistic worldview of the phenomena (that is corporate governance practice in these SOEs).<sup>16</sup> By holistic I mean that I study “a situation or thing in its entirety rather than identification of specific variables” and am not interested in hypothesis.<sup>17</sup>

In any qualitative research the researchers are part of, rather than separate from, the research problem that they investigate. Hence their work has a reciprocal impact on both them and the participants.<sup>18</sup> Therefore, as a researcher, I am part of the research collecting and interpreting of data from the perspective of the participants.<sup>19</sup> My involvement in the research is to collect and interpret data from the perspective of officers involved in corporate governance. The knowledge, experiences and views of participants is collected, analysed and interpreted from their social milieu.

### 11.2.2 Case Study

The case study is part of qualitative research and interpretative inquiry purposely used to unveil social phenomena.<sup>20</sup> The interpretative research paradigm adopts many different approaches in qualitative research for data collection. The qualitative data collection methods include narrative research, phenomenology, grounded theory, ethnography and case studies.<sup>21</sup> This research applies a case study method. Case study, as the name suggests, focuses solely on one case and that may include an individual, a group or an organization.<sup>22</sup> This may also include several cases. Case study is used in circumstances where the researcher

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<sup>16</sup> Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at 39.

<sup>17</sup> Lichtman, M., *Qualitative Research in Education: a User's Guide*, (2006) 11.

<sup>18</sup> Morrison, M., “What do we mean by educational research?” in Coleman, M. and Briggs, A.R.J., (eds.) *Research Methods in Educational Leadership and Management*, (2002) 1 at 18. Above n 17 at 12–13.

<sup>20</sup> Neuman, W. L., *Social Research Methods: Qualitative and Quantitative Approaches*, (3<sup>rd</sup> edn., 1997) 331 – 332; see also Punch, K., *Introduction to Social Research: Quantitative and Qualitative Approaches*, (2<sup>nd</sup> edn., 2005) 142 – 148.

<sup>21</sup> Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at ch 4; Baker, M.J., *Business and Management Research: How to Complete your Research Project Successfully*, (2003) ch 7.

<sup>22</sup> Above n 2 at 200 – 201.

“has little control over events, and when the focus is a contemporary phenomenon within some real-life context”.<sup>23</sup> In the context of this study corporate governance is a new area in PNG; particularly in SOEs. This makes it significant to engage the views of current and former directors and CEOs, senior managers and the customers of SOEs to understand corporate governance practice and the factors that affect good corporate governance in statutory corporations and state companies in PNG.

Case study is a research method rather than procedure for collecting data. That means that it is a comprehensive research strategy or methodology that covers design, data collection techniques and specific approaches to data analysis.<sup>24</sup> Case study mainly uses three strategies in data collection, namely, interviewing, observing and document analysis.<sup>25</sup> Clearly, the advantage in using the case study approach is the multiple strategies that can be used in order to examine a previously developed theory or to develop theories or propositions about phenomena after studying a social setting. The research involves interviews and document analysis to complement each other. Although case studies have often been categorised as qualitative, they can also use quantitative research tactics, particularly the employment of a mix of data collection methods.<sup>26</sup> In the context of this study I gauge the views and experiences of the participants, and include secondary quantitative data in the form of SOEs’ performance records in terms of profitability, from annual reports and the ratings of SOEs’ performance by customers in terms of efficiency of service delivery.

Case study enhances the research in that it focuses on first hand information to gain in-depth and rich information from a case. Gummesson succinctly states that a case study allows an in-depth and holistic understanding of multiple aspects of a phenomena, and interrelationship between different aspects.<sup>27</sup> This then provides the researcher with necessary and sufficient information to answer research

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<sup>23</sup> Yin, R.K., *Case Study Research: Design and Methods*, (3<sup>rd</sup> edn., 2003) 1.

<sup>24</sup> Denzin and Lincoln, “The Discipline and Practice of Qualitative Research,” above n 11 at 25; Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at 73; Stake does not see case study as method but choice of what to be studied. See Stake, R.E., “Qualitative Case Studies,” in Denzin, N.K. and Lincoln, Y.S., (eds.) *The SAGE Handbook of Qualitative Research*, (3<sup>rd</sup> edn., 2005) 443 at 443.

<sup>25</sup> Denzin and Lincoln, “The Discipline and Practice of Qualitative Research,” above n 11 at 25.

<sup>26</sup> Above n 2 at 200–201; see also Yin, R.K., *Case Study Research: Design and Methods*, (3<sup>rd</sup> edn., 2003) 14.

<sup>27</sup> Gummesson, E., *Qualitative Methods in Management Research*, (2<sup>nd</sup> edn., 2000) 86 -87.

questions or develop propositions. The conclusion therefore cannot be generalised and applied to other settings. In the context of this study case study examines the norms and practices in corporate governance and factors that affect good corporate governance particularly in each of the SOEs and generally in statutory corporations and state companies.

There are three types of case studies. Yin identified them as exploratory, descriptive and explanatory.<sup>28</sup> The types that are of relevance to this research are exploratory and explanatory case studies. The exploratory case study explores a case to gain in-depth knowledge and rich information. An explanatory case study examines and analyses how representative a case is by looking at similar cases, situations and contexts, rather than an individual case.<sup>29</sup> This can be done through “triangulation”<sup>30</sup> both within cases and between cases.<sup>31</sup> The exploratory case study answers the “what” question and explanatory case study answers the “why” and “how” questions.<sup>32</sup> In this research I intend to study five SOEs under the categories of statutory corporation and state company to gain in-depth knowledge of corporate governance in each SOEs. From this I wish to identify the similarities and differences in corporate governance practice in SOEs under statutory corporations and state companies and between statutory corporations and state companies.<sup>33</sup> In doing so I seek to discover the status of corporate governance in each SOEs to enable me to identify the factors that affect good corporate governance so that propositions can be made for improvement or further inquiry.

The literature review is a vital component of case study providing theoretical concepts relevant to conducting case studies. The discussion of theories and concepts through a literature review “is to place the case study in [or within the context of] an appropriate research literature [framework], so that lessons from the case study will more likely advance knowledge and understanding of a given

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<sup>28</sup> Yin, R.K., *Case Study Research: Design and Methods*, (1984) 17–19; See also above n 27 at 85; Cohen, L., Manion, L. and Morrison, K., *Research Methods in Education*, (6<sup>th</sup> edn., 2007) 254–255.

<sup>29</sup> Stake refers to this as collective case study. See Stake, R.E., *The Art of Case Study Research*, (1995) 3–4.

<sup>30</sup> Triangulation in research refers to the process in analysis of data to bring together data collected from different sources.

<sup>31</sup> Stake, R.E., *Multiple Case Study Analysis*, (2006) 33–38 and 77.

<sup>32</sup> Yin, R.K., *Case Study Research: Design and Methods*, (3<sup>rd</sup> edn., 2003) 5–7.

<sup>33</sup> This is using the comparative analysis method. See Glaser, B.G. and Strauss, A.L., *The Discovery of Grounded Theory: Strategies for Qualitative research*, (1999) 21; Yin, R.K., *Case Study Research: Design and Methods*, (2<sup>nd</sup> edn., 1994) 14.

topic,” and “to help define the unit of analysis...to identify the criteria for selecting and screening potential candidates for the cases to be studied, and to suggest the relevant variables of interest and therefore data to be collected as part of the case study”.<sup>34</sup> These choices will be hampered or limited without proper guidance from preliminary theoretical concepts. Hence, chapters 1 to 10 provide literature reviews and discussions of theoretical concepts. Theoretical concepts assist with defining research questions and guide any propositions for improvement (as discussed in chapters 14 and 15).

### 11.2.3 Inductive Process

Inductive research is typically associated with qualitative research.<sup>35</sup> It involves exploration of a subject to find more information as less is known about it.<sup>36</sup> This initially requires the collection of data, followed by analysis and theorisation or answering a question raised in the research. However, as stated above, in qualitative research literature reviews are important to demonstrate familiarisation of the subject and they assist with articulating the research issues.<sup>37</sup> This approach is frequent in case studies. In a case study “the researcher brings prior knowledge and understanding to their observations and so combines induction and deduction in selecting and interpreting information”<sup>38</sup> and prior knowledge is gained through literature review. This study applies a similar approach. A literature review was done, guided by agency theory to assist with familiarisation of the subject, that is corporate governance and this helps to refine the research questions.

## 11.3 DATA COLLECTION - METHODS

After selecting a research design, a data collection method has to be determined. In qualitative research, data collection involves ethnography/participant observation, qualitative interviewing, focus groups, language – based approaches to the collection of qualitative data (such as discourse and conversation analysis)

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<sup>34</sup> Yin, R.K., *Applications of Case Study Research*, (2<sup>nd</sup> edn., 2003) 3.

<sup>35</sup> Alvesson, M. and Deetz, S., *Doing Critical Management Research*, (2000) 1.

<sup>36</sup> Creswell, J.W., *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches*, (2<sup>nd</sup> edn., 2003) 30; See also above n 17 at 11 and 49.

<sup>37</sup> Baker, above n 21 at 168.

<sup>38</sup> Ibid.

and the collection and quantitative analysis of texts and documents.<sup>39</sup> Similarly, Lee and Lings discuss data collection in qualitative research as involving, amongst others, interviews, focus groups and documentary data.<sup>40</sup> For purposes of this research, the qualitative data collection method selected was interview and public document analysis.

### 11.3.1 Interviews

An interview is a “way of accessing people’s perceptions, meanings, definitions of situations and construction of realities”,<sup>41</sup> so that it provides “an authentic insight into people’s experiences”<sup>42</sup>. The interview is a formal and guided conversation involving the process of asking question and listening.<sup>43</sup> The interview enables the researcher to have face-to-face contact with the subjects and this would enable him or her to gain an insight into the personal views and experiences of the interviewees to obtain rich information on issues in corporate governance practice in SOEs. The rationale for the use of interviewing method is to gain access to people who can describe and analyse phenomena or a situation in their own words so that this “may provide access to the meanings that people attribute to their experiences and social world”.<sup>44</sup> The subjects, namely, the former and current directors and CEOs, senior managers and consumers of SOEs have special knowledge and experiences of issues being asked about and they are in a better position to answer questions.

There are different types of interviews method applied in qualitative research. They are categorised mainly as structured, semi - structured and unstructured interviews.<sup>45</sup> First, in structured interview, the respondent is asked pre-established

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<sup>39</sup> Bryman, A. and Bell, E., *Business Research Methods*, (2003) 281–282.

<sup>40</sup> Above n 2 at 217 - 227; Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at 129.

<sup>41</sup> Punch, above n 20 at 168.

<sup>42</sup> Silverman, D., *Interpreting Qualitative Data: Methods for Analysing Talk, Text and Interaction*, (2001) 87.

<sup>43</sup> Denzin, N.K. and Lincoln, Y.S., “Methods of Collecting and Analysing Empirical Materials,” in Denzin, N.K. and Lincoln, Y.S., (eds.) *The SAGE Handbook of Qualitative Research*, (3<sup>rd</sup> edn., 2005) 641 at 643.

<sup>44</sup> Miller, J. and Glassner, B., “The ‘Inside’ and the ‘Outside’ – Finding Realities in Interviews,” in Silverman, D., (ed.) *Qualitative Research: Theory, Method and Practice*, (2<sup>nd</sup> edn., 2004) 125 at 126.

<sup>45</sup> Fontana, A. and Frey, J.H., “The Interview – From Neutral Stance to Political Involvement,” in Denzin, N.K. and Lincoln, Y.S., (eds.) *The SAGE Handbook of Qualitative Research*, (3<sup>rd</sup> edn., 2005) 695 at 698.

questions which the respondent has already had time to review prior to the interview.<sup>46</sup> This interview provides limited flexibility and the researcher follows the set of questions in a sequential order. The role of the researcher is neutral, recording the answers delivered in a sequential order. Second, on the opposite end is the unstructured interview. This interview is non-standardised, open-ended and it enables the researcher to explore an issue in depth.<sup>47</sup> This type of interview usually occurs informally and the respondents are encouraged to “speak by using open questions and by asking them to clarify their statements.”<sup>48</sup> The respondent is comfortable and at ease when responding to questions. This interview enables the researcher the flexibility to probe in detail and extract rich information from the interviewee. The third type is the semi structured interview. This is the interview type applied in this research.

In semi-structured interview, the researcher uses the standard set of questions as an interview guide but also has an opportunity and flexibility of asking further related questions.<sup>49</sup> There are three reasons for using semi-structured interviews in this research. First, it allows the researcher to generally follow pre-established questions, and simultaneously provides clarity to the respondents as to the issues to be raised during interviews. Second, it provides opportunity and flexibility for the researcher to probe any issue that is relevant and important to the research. As Creswell explained that “probes are sub questions under each questions that the researcher asks to elicit more information. These probes vary from exploring the content in more depth (elaborating) to asking the interviewee to explain her or his answer in more detail (clarifying)”.<sup>50</sup> By probing, the researcher is able to conduct an exploratory discussion to get more information on an issue from the interviewee. This is where second question is asked to seek further description and clarification on issues raised with relation to first question.<sup>51</sup> And thirdly, semi-structured interview allows the respondents, who are people with vast knowledge and experience in the area of corporate governance to speak openly

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<sup>46</sup> Ibid at 701–703.

<sup>47</sup> Punch, above n 20 at 169–172.

<sup>48</sup> McMurray, A., Pace, R.W. and Scot, D., *Research: A commonsense Approach*, (2004) 200.

<sup>49</sup> Bryman, A. and Bell, E., *Business Research Methods*, (2003) 343.

<sup>50</sup> Creswell, *Educational Research: Planning, Conducting, and Evaluating Quantitative and Qualitative Research*, above n 15 at 596.

<sup>51</sup> Kvale, S., *Doing Interviews*, (2007) 65.

without restriction on issues raised with them. There are factors that may prejudice an ideal interview. Joseph Hair noted that:

When we conduct interviews there is always a risk the interview process itself will influence respondents. Perhaps the respondent comments are not entirely accurate. The inaccuracy maybe because of incomplete recall, a suppression of information because of social concerns or unwillingness to provide an accurate response to the question. There are some things people will simply not tell an interviewer.<sup>52</sup>

To avoid these risks, I ensured that prior to the interview the interviewees were given interview questions in order to refresh their memories and they were informed again of the nature of the study and privacy and confidentiality matters before the interviews. If there were signs of incomplete recall their memories were jogged by asking related questions. Where interviewees were unwilling to provide accurate information, it was noted and the same questions were posed to other respondents to answer. Answers given were then compared. The government appoints most directors and CEOs and they have tendency not to disclose information that would question the position of the government. Therefore, the former directors, CEOs and senior managers were included in the research, so that information that current directors and CEOs provide could be verified. The respondents were encouraged to provide written answers to the interview questions so that any answers they would not provide face-to-face could be obtained from written answers. This also enabled the participants to provide answers at their own convenience without being put under pressure, as is usually the case in interviews.

### **11.3.2 Documents**

In a case study the researcher can keep a journal diary and analyse public documents.<sup>53</sup> In the context of this research I kept a journal diary and collected, examined and analysed documents from individual SOEs. There are some documents that are categorised “confidential” that I had access to with the permission of chairpersons and CEOs. For example, I had access to the minutes of the board meetings, which were read at the office without being photocopied or taken out. I made copies of some public documents with the permission of the

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<sup>52</sup> Hair, J.F., Babin, B., Money, A.H. and Samouel, P., *Essentials of Business Research Methods*, (2003) 59.

<sup>53</sup> Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at 132-133.

chairpersons and the CEOs. The main documents that I copied were company constitutions, annual reports, annual returns and corporate plans.

## 11.4 DATA COLLECTION - PROCESSES

### 11.4.1 Sampling

Sampling is an important process in data collection. Sampling involves a selection process where subjects are chosen from which information can be collected.<sup>54</sup> It is important to consider the nature of the research before sampling, which is assisted by literature review. First, five SOEs were chosen for this research. Two of them are examples of statutory corporations and three are examples of state companies. This is a representative selection of cases.<sup>55</sup> The SOEs were chosen because they are the biggest SOEs in their category in PNG. More than one case was chosen because data from each can be compared and contrasted with others under their category and with others in another category. Second, choices have to be made about who to study in SOEs. This is called the selection of “cases within the cases” or mini-cases.<sup>56</sup> Given the fact that this is qualitative research involving case study methodology the researcher applied three types of non-probability sampling, which involved convenience sampling, snowball sampling and quota sampling.<sup>57</sup>

Convenience sampling is where selection is made due to accessibility of subjects to the researcher. In this case all current directors, CEOs and senior managers of selected SOEs are located in their head offices in Port Moresby and their accessibility and limited number made it convenient for me to conduct interviews with majority of them. Snowball sampling was also applied. This sampling tactic involves making contact with a small group of subjects for data collection and they in turn make contact with others. This is not random selection because the number in this case is imprecise. This sampling method was applied on former directors and CEOs. The addresses and locations of these subjects were not known after they left their jobs. Some are living in Port Moresby and others reside

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<sup>54</sup> Ghauri, P.N., *Research Methods in Business Studies: A Practical Guide*, (2<sup>nd</sup> edn., 2002) 112.

<sup>55</sup> Stake, “Qualitative Case Studies,” above n 24 at 450.

<sup>56</sup> Ibid at 451.

<sup>57</sup> Bryman, A. and Bell, E., *Business Research Methods*, (2003) 104 – 109.

in their respective provinces. The researcher went through the former and current directors and CEOs to locate others so as to involve them in the research. Quota sampling involves selection where sample is collected from “different categories, such as gender, ethnicity, age groups, socio-economic groups, and region of residence, and combination of these categories”.<sup>58</sup> This sampling method was applied to consumers of SOEs. Three major suburbs in Port Moresby were selected from which 30 residents from each suburb who were and/or are consumers of SOEs were randomly selected for interviews.

It is important to note that the study is about corporate governance in SOEs and selection of the participants in the research is to help with understanding of issues in corporate governance in SOEs, and also that any information they provide could also be verified against one another. Hence, different authorities in management hierarchy are selected including former directors and CEOs. The managers are important participants in this case study but consumers were also engaged so that their views on performance of SOEs can be obtained. This is because good corporate governance must ultimately be reflected in efficiency and quality of services experienced by consumers.

The total number of participants interviewed in each SOE differs. This depends on the number of current directors and senior managers of each SOEs and their accessibility and availability for interview. Their numbers are provided in chapter 12 and 13. Former directors and CEOs are difficult to locate. After locating them I had to assess their availability for interview. There were 90 customers of each SOE from three different suburbs and altogether 450 customers were interviewed. Thirty residents from each suburb in Port Moresby were selected. Although their views are not necessarily reflective of the views of the people in PNG, they provide some evidence of the performance of SOEs in terms of service delivery.<sup>59</sup> Their views are considered sufficient to assist in identifying whether corporate governance practice has an effect on the performance of SOEs.

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<sup>58</sup> Ibid at 107.

<sup>59</sup> I am aware of the fact that if services are rated poor in Port Moresby then that may generally be the same with other towns in PNG but worse in rural areas. But if services rated as good in Port Moresby, it may be bad or worse in rural areas.

Customer interviews were conducted with the assistance of three law students from the University of PNG. The students were paid allowances with funding from the Centre for Human Resources Development, University of PNG. I am grateful for their financial assistance.

#### **11.4.2 Issuing Questions for Interview**

Many participants are government appointees and they may be reluctant to discuss or divulge information face-to-face that may appear to be critical of the government. Interview questions were issued with a covering letter instructing participants to provide written answers when they came for their interview (see Appendices H, I and M). The interview guide questions allowed them to answer questions on their own at a time and place where they were motivated to do so. However, there are risks involved where the researcher is not sure whether the respondents have completed the questions on their own or whether they have asked for opinions from others.<sup>60</sup> I did not rely heavily on the written answers, but the answers provided in the interviews were compared against the written answers given by participants. The written answers were collected merely for comparative purposes.

#### **11.4.3 Conducting Interviews**

The interview in qualitative research is not a survey interview for discovery purposes but an active interview where “what”, “why”, and “how” questions are asked to obtain in-depth and rich information on a subject.<sup>61</sup> This research applied face-to-face and telephone interviews. Telephone interviews were conducted for those respondents who were unable to meet me in person or who lived out of Port Moresby where the research was conducted. With telephone interviews, I took notes and tried to remember everything stated in the conversation.<sup>62</sup> The disadvantage in telephone interview is the inaccessibility of interviewee to the information made available to the researcher for confirmation purposes.<sup>63</sup>

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<sup>60</sup> Above n 52 at 132.

<sup>61</sup> See Holstein, J.A. and Gubrium, J.F., “The Active Interview,” in Silverman, D., (ed.) *Qualitative Research: Theory, Method and Practice*, (2<sup>nd</sup> edn., 2004) 140.

<sup>62</sup> Above n 51 at 93.

<sup>63</sup> Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at 132-133.

All the interviews took place at the offices of the directors and CEOs. The interviews with former directors and CEOs were conducted at their current place of work or a place convenient to them. I rang secretaries of boards to make appointments with individual directors, and in the case of CEOs, I rang their secretaries. Others who did not want to meet arranged for a telephone interview. The arrangement for interview was made directly with former directors and CEOs, and customers of SOEs. Those former directors and CEOs who live out of Port Moresby were interviewed by phone. All the interviews were conducted in English based on the questions issued with the consent form submitted earlier (see Appendices K and L). Before the interview, I ensured that the consent form was signed and that the interviewee was aware of the nature of the study. Further, I requested and was granted verbal consent again from the interviewee before recording our conversation on audiotape. During the interview some participants were reluctant to answer detailed questions. In such circumstances I refrained from asking further questions. The interviews that were recorded on tape and on paper are kept in a secure place.

## 11.5 ETHICS

Ethical considerations are paramount in any research that involves human beings as subjects. As a student from the University of Waikato, I complied with ethical procedures under University's *Ethical Conduct in Human Research and Related Activities Regulations*<sup>64</sup> in conducting this research. First, I submitted an ethics application with the proposal to University of Waikato, School of Law and it was approved before I left for PNG on the field trip (see Appendix A). Second, along with the support letter from the supervisor (see Appendix B) a letter with the proposal and ethics approval was sent to the Centre for Human Resource Development, University of PNG for their support (see Appendix C). They assisted with funding and provided a letter of support (see Appendix D). Third, a letter (see Appendix E) was sent to the chairperson of the Independent Public Business Corporation (IPBC) for the consent of IPBC to conduct research in state companies (i.e. Telikom PNG Ltd, PNG Power Ltd and NCD Water & Sewerage

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<sup>64</sup> University of Waikato, *Ethical Conduct in Human Research and Related Activities Regulations*, (2008) < <http://calendar.waikato.ac.nz/assessment/ethicalConduct.html> > at 8 June 2009.

Ltd). The chairman of IPBC sent an internal memo to all board members and senior managers of state companies informing them of the nature of my study and asking for their co-operation and support in this research, and informed me to proceed with the research (see Appendix F). Similarly, the chairpersons of two statutory corporations (i.e. National Housing Corporation and National Broadcasting Corporation) sent an internal memo to all board members and senior managers after receiving my letters (see Appendix G).

I sent a letter and questions with the consent form to all directors and CEOs through the secretaries of the board (see Appendices H, K and M). I contacted the SOEs to ensure that the letters with their attachments had been received. Former directors and CEOs were contacted directly through letters and appointments were made for interview (see Appendix I). The consumers of SOEs were approached directly and the nature of the research was explained through a letter submitted to them (see Appendix J) and the letter was given for them to confirm the purpose of our studies. After they were given the opportunity to voluntarily sign the consent form we asked them several questions (see Appendix N). The data collection was done between April and September 2008.

#### **11.5.1 Written Consent and Access to Participants**

A letter was sent to the chairman of IPBC for state companies and chairpersons of each statutory corporation regarding the conduct of research in each SOE (see Appendices E and G). Then a letter was sent to individual respondents about their participation in the research and their written consent was received prior to the interviews (see Appendices K and L). Before the interviews, I explained the benefits and potential adverse effects of the information that would be provided and further advised that they could withdraw before or at any time during the interview. I was aware of the fact that I was dealing with many busy individuals and I made myself available at a time and place of their convenience.

### 11.5.2 Privacy of Participants

The researcher regards the right to privacy as important in this research. The right to privacy is a constitutional right provided under PNG *Constitution*.<sup>65</sup> If people's affairs are made public through the information that they provide they can be offended and/or suffer stress. Therefore privacy and confidentiality is paramount.<sup>66</sup> I made it absolutely clear in my letter to the participants that their permission would be sought where the disclosure was necessary. I was aware of the fact that most directors and CEOs are politically appointed and therefore would not want anything said against the government to be recorded. I was also aware that several participants were fearful that if some SOE issues were exposed to the public it would create a negative reaction, so they were unwilling to disclose the information.<sup>67</sup>

### 11.5.3 Confidentiality

The interviewee must have some trust in the researcher. Therefore on the first meeting for the interview I made it absolutely clear again reiterating, face-to-face the issue of privacy and confidentiality that I mentioned in the letter sent to them. This was done to enable the interviewee to feel at ease and comfortable, and able to disclose information that was asked of him or her. Further, I made it clear to the participants that any information provided by them would be kept confidential and not disclosed to anyone. As a qualitative researcher I was gauging people's views and experiences on a situation and "those whose lives and expressions are portrayed risk exposure and embarrassment, as well as loss of standing, employment, and self-esteem".<sup>68</sup> Their names are, and will only be, known to me, and any information they provided would be discussed using code names (see Appendix Q) to protect their identity.

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<sup>65</sup> See *Constitution of PNG*, s 55.

<sup>66</sup> Above n 4 at 68.

<sup>67</sup> Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at 139.

<sup>68</sup> Stake, above n 24 at 459.

#### **11.5.4 Confirmation of Information Collected**

It is important that information noted in interviews are from the interviewees and they must authenticate the information. After the interviews the notes and tape recordings were transcribed and sent to the interviewees for confirmation. I rang them individually for confirmation. Not many alterations were made to most of the transcripts. For customers, confirmations were made immediately after the interviews. Before all interviewees confirmed the information in the transcripts I made it absolutely clear that they should inform me clearly of anything contradictory to what they meant and how it should be said so that their words and intention could be noted.

#### **11.5.5 Papua New Guinea Cultural Views on Ethics**

PNG is culturally diverse, and the people have different traditions and ways of doing things. Similarly, organizations such as the SOEs have their own practices and norms that have to be observed. All participants in the research are from PNG; however few senior managers and the CEO of PNG Power are expatriates. Papua New Guineans live in a close-knit society and news spreads easily. Again the issue of confidentiality is very important in this research. Hence, I ensured that information disclosed was not revealed to anyone, not even my own close family members or research assistants.

In PNG, respect for one another and those above in the social hierarchy, such as elders and leaders, is an important custom. Even in SOEs there are hierarchical structures that have to be observed and respected. Nearly all senior managers and directors are Papua New Guineans and the customary practice of respect is also a norm in public organizations and institutions such as SOEs. Part of PNG culture is that one cannot enter a village or a clan without letting the elders and village leaders know about his/her presence. Before the issuance of letters and interview questions to the participants I formally informed the chairman of IPBC (which manages state companies) and chairpersons of statutory corporations that I would be interviewing their employees so that they would be expecting my presence. Those above the hierarchy were aware of my dealings with the directors and

senior managers. The culture of the society and the organization was observed in conducting this research.

## **11.6 RESPONSIBILITY OF A RESEARCHER**

From the commencement of data collection to the end of the interview, I ensured that ethical values were upheld at every stage. After the completion of every interview I assessed myself on how I would improve in approaching and talking to the participants, to make them feel comfortable and open in providing information. Douglas pointed out that:

Creative interviewing, as we see through out, involves the use of many strategies and tactics of interaction, largely based on an understanding of friendly feelings and intimacy, to optimize co operative, mutual disclosure and a creative search for mutual understanding.<sup>69</sup>

Before the interviews I introduced myself to the participants, told them about the purpose of interview and the nature of the study and asked them if they had any questions about the interview and the study.<sup>70</sup> I assessed the participants to ensure that friendly feelings were created and any tension was removed. Further, before the interview I explained the privacy and confidentiality matters and with their permission put on the audiotape recording before asking questions. During the interviews I smiled, and I maintained composure and curiosity. I listened attentively and took notes of important points raised but made eye contact at all times, apart from periodically looking at the tape recorder to ensure it was still running and recording.

## **11.7 METHODS IN DATA ANALYSIS**

The next process after collection of data is data analysis, which encompasses the “process of bringing order, structure and meaning to the mass of collected data”.<sup>71</sup> John Creswell describes the process as “preparing and organizing the data...for analysis, then reducing the data into themes through a process of coding and condensing the codes, and finally representing the data in figures, tables, or

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<sup>69</sup> Douglas was quoted in Holstein, J.A. and Gubrium, J.F., *The Active Interview*, (1995) 13.

<sup>70</sup> Above n 51 at 55.

<sup>71</sup> Quoting Marshall and Rossman in Ghauri, P.N. and Grronhaug, K., *Research Methods in Business Studies: a Practical Guide*, (3<sup>rd</sup> edn., 2005) 206.

discussion”<sup>72</sup> or to understand and gain insight from collected data.<sup>73</sup> Data analysis depends on whether research is quantitative or qualitative.<sup>74</sup> The data analysed is collected from semi-structured interviews and documents of the corporations.

### 11.7.1 Transcribing Data

In qualitative research the empirical data has to be transcribed. Transcription can be a tedious job and takes considerable time,<sup>75</sup> especially in situation where participants are communicating in languages other than English. Transcription is the “process of converting audiotape recording or field notes into text data”.<sup>76</sup> The information and intentions of participants can easily be distorted in the transcription process through words, writing and reinterpretation.<sup>77</sup> These problems were avoided as the means of communication during data collection was in English and were also recorded in English; hence there was no need for any translation. In this research all transcription was done while on the field trip in PNG to capture information while it was still fresh in the mind, and to be able to immediately refer the transcript to participants for confirmation. It also avoided amassing huge amounts of data. The data was analysed after it was transcribed.

### 11.7.2 Data Analysis

Data can be analysed in many different ways. In qualitative research it is through description, themes and layering and interrelating themes.<sup>78</sup> When the data is transcribed and organised into a format that is easy to analyse then the process of analysis takes place. The data analysis method used in this research is colour coding and thematic analysis. The data was organized into scripts and hand coded

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<sup>72</sup> Creswell, *Qualitative Inquiry & Research Design: Choosing among Five Approaches*, above n 10 at 148.

<sup>73</sup> Above n 71 at 206.

<sup>74</sup> Collis and Hussey, above n 3 at 252.

<sup>75</sup> Kowal, S. and O’Connell, D.C., “The Transcription of Conversations,” in Flick, U., Kardorff, E. and Steinke, I., (eds.) *A Companion to Qualitative Research*, (2004) 248 at 251; Bryman, A. and Bell, E., *Business Research Methods*, (2<sup>nd</sup> edn., 2007) 490.

<sup>76</sup> Creswell, *Educational Research: Planning, Conducting, and Evaluating Quantitative and Qualitative Research*, above n 15 at 233; Kowal and O’Connell, above n 75 at 248.

<sup>77</sup> Mishler, E.G., “Representing Discourse: The Rhetoric of Transcription,” (1991) 1, *Journal of Narrative and Life History*, 225 at 269; Cohen, Manion and Morrison, above n 28 at 367.

<sup>78</sup> Creswell, *Educational Research: Planning, Conducting, and Evaluating Quantitative and Qualitative Research*, above n 15 at 241–247; above n 51 at 101 – 109.

into different colours using a thematic coding analysis, in which common themes were coloured with the same colour (see Appendix O).

### 11.7.3 Thematic Coding Analysis

In thematic coding the researcher uses themes to analyse the qualitative data.<sup>79</sup> Information in the documents was analysed to identify common themes, and different coloured codes and notes were used for each emerging theme. First, the themes that appear in the script were highlighted with a highlighter and notes were put in the margins to re-emphasize the points raised in the script to assist with thematic categorisation. In the second phase, instead of examining the whole script the focus was on the coded themes to identify common themes. Then the final stage was looking through the data and previous coded themes and making contrasts and comparisons.<sup>80</sup> In this process different files and folders were created for the related codes, categories and themes for convenience and interpretative purposes.

## 11.8 VALIDITY AND RELIABILITY

Validity and reliability are means used in an empirical research to provide assurance of the research design, process, analysis and the conclusion reached. They can be referred to as measures used in providing quality assurance. Gay and Diehl define validity as “the degree to which a test measures what it is supposed to measure”<sup>81</sup> and “a research finding which accurately represents what is happening in the situation”<sup>82</sup>. In a qualitative research the researcher must validate findings. That means that the researcher applies different strategies to ensure accuracy and credibility of findings. There are different kinds of validity, amongst them, internal validity and external validity.<sup>83</sup> In internal validity I have used triangulation and “participants checking”.<sup>84</sup>

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<sup>79</sup> Creswell, *Educational Research: Planning, Conducting, and Evaluating Quantitative and Qualitative Research*, above n 15 at 243.

<sup>80</sup> Neuman, W.L., *Basics of Social Research: Qualitative and Quantitative Approaches*, (2<sup>nd</sup> edn., 2007) 330–332.

<sup>81</sup> Gay, L. R. and Diehl, P. L., *Research Methods for Business and Management*, (1992) 156.

<sup>82</sup> Collis and Hussey, above n 3 at 58.

<sup>83</sup> Cohen, Manion and Morrison, above n 28 at 135 - 137; see also above n 2 at 170 – 171.

<sup>84</sup> Creswell, *Educational Research: Planning, Conducting, and Evaluating Quantitative and Qualitative Research*, above n 15 at 252 – 253.

Triangulation is a means of ensuring validity.<sup>85</sup> In triangulation I firstly corroborated interview answers from current directors and CEOs with former directors and CEOs, and senior managers. Their answers are corroborated with the answers provided by consumers of SOEs on the performance of SOEs. Second, I corroborated evidence from observable field notes and interviews. And thirdly, evidence from two different method of data collection – that is from interviews and documentary sources were corroborated. In drawing information from these multiple sources, it is not only intended that the report presented is an accurate and credible account, but that it properly answers the research questions. Second in internal validity, applying the “participants checking” I showed the interview transcripts to each interviewee to be checked for accuracy, except those participants who lived out of Port Moresby, and who were interviewed by telephone.

Finally, external validity looks at the question of whether research findings can be generalised.<sup>86</sup> Given the nature of the research, that is case study, only five SOEs were the focus of the study and the findings cannot necessarily be generalised. However, other SOEs with similar features to the SOEs in the five case studies, and who have the Government or the IPBC as shareholder, and are covered by the same laws such as the IPBC Act and the *Companies Act 1997*, would find some aspects of this research relevant.

Reliability connotes consistency, dependability or trustworthiness. In the context of research reliability “is the degree to which a test consistently measures what it measures” winning confidence and trust that similar results would obtain using similar methodology.<sup>87</sup> It suffices to state that methods of data collection and analysis were clearly outlined in this chapter and this has been the process that I have been following from data collection to reporting the findings. In this process, I have identified my own biases, experiences, views and knowledge in corporate governance so that they are separated from the new lenses that I put on, looking at corporate governance solely from the perspective of the interview participants. I

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<sup>85</sup> Flick, U., “Triangulation in Qualitative Research,” in Flick, U., Kardorff, E. and Steinke, I., (eds.) *A Companion to Qualitative Research*, (2004) 178 at 178.

<sup>86</sup> Cohen, Manion and Morrison, above n 28 at 136–137.

<sup>87</sup> Above n 81 at 164.

have used audiotapes to capture highly detailed information of participants so that the report presented is reliable.<sup>88</sup>

## 11.9 CONCLUSION

One of the important components of the study is empirical data collection and analysis; hence this chapter discusses the theoretical framework and research methodology followed in extracting and analysing the data. The interpretive research paradigm was adopted in this research that includes, qualitative and case study methods and inductive process. The option of interpretative paradigm was adopted and used to study the participants in their natural settings in SOEs and to construe corporate governance from their perspective. From an ontological perspective corporate governance practice cannot be fully understood without understanding the rationale for certain processes, conduct and actions by posing “what”, “how” and “why” questions to gauge the views, experience and knowledge of the managers. This approach is relevant as this study is the first of its kind on corporate governance in PNG and particularly in SOEs. In addition, this approach would enable exploration and explanation of corporate governance to answer the research questions. The sources of data extractions were semi-structured interviews and documentary evidence. Ethical process, validity and reliability of the methodology are considered important, and discussed in this chapter to illustrate attempts taken in addressing them. Five SOEs are the subject of case studies and the findings in them are reported in chapters 12 and 13.

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<sup>88</sup> Perakyla, A., “Reliability and Validity in Research based on naturally occurring Social Interaction,” in Silverman, D., (ed.) *Qualitative Research: Theory, Method and Practice*, (2<sup>nd</sup> edn., 2004) 283 at 285.

## CHAPTER 12:

### INCIDENCES OF CORPORATE GOVERNANCE PRACTICE IN STATUTORY CORPORATIONS

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#### 12.1 INTRODUCTION

The National Housing Corporation (NHC) and the National Broadcasting Corporation (NBC) are the two largest statutory corporations in Papua New Guinea (PNG). As defined in chapter one, statutory corporations are state owned enterprises (SOEs) and established by Acts of parliament. Statutory corporations come under the responsibility of the Government and they can be funded through the Government's annual budgetary allocations. Unlike NBC, Government does not provide annual funding for NHC.

The NHC and the NBC have a controversial past. Both NHC and NBC have been the focus of considerable public attention since their inception for many reasons, including ministers' interference in governance, corrupt practices, and sacking of chief executive officers (CEOs) and directors. These incidents have become a norm. Interestingly, on my field trip between April and August 2008, the CEO of NHC was terminated and an acting appointment was made while awaiting court action which questioned the validity of the Government's action in terminating the CEO. Consequently, the acting CEO refused to answer questions or talk to me. The highlight of the field trip was while I was in the office of the former senior legal officer. Armed policemen forcefully entered the office, ordered the legal officer out and changed the locks to the office doors after removing all his personal belongings. Later I was informed that current management was dismissing the associates of the former CEO. Given these situations, it is important to understand corporate governance practice in statutory corporations. Furthermore, given their different legal framework, studying both NHC and NBC assisted in comparing and contrasting corporate governance frameworks and practice between them and with state companies in chapter 13.

The methodology of data collection is discussed in chapter 11. Questions that were asked relate to five themes. They were the definition of corporate

governance, ownership role of government, board and management, accountability and the objectives of SOEs. With regard to the last theme the annual reports were examined and the customers of the SOEs were interviewed to identify their views and experiences of the quality and efficiency of services provided by NHC and NBC. I now proceed to present the data provided by the participants.

## 12.2 PRESENTATION OF DATA

All information in this field survey was collected in Port Moresby. Arrangements were made for telephone interviews with senior managers, current and former directors and CEOs who live outside of Port Moresby or who did not want to meet me in person. I shall now proceed to present the data beginning with NHC.

### 12.3 CORPORATE GOVERNANCE PRACTICES IN NATIONAL HOUSING CORPORATION

NHC is established under the *National Housing Corporation Act 1990* (NHC Act).<sup>1</sup> It was established, amongst other things, to improve housing conditions and provide adequate and suitable housing for letting to eligible persons,<sup>2</sup> especially public servants. The head office is located in Port Moresby with branches located in each of the 19 provinces around the country. The majority of current directors and CEOs also reside in Port Moresby. Table 12.1 provides the number of current and former directors and CEOs who were issued with interview questions and were interviewed, including the senior managers.

Table 12.1 Number of Interview Participants in NHC

<b>Participants</b>	<b>Interview questions issued</b>	<b>Numbers that completed interview questions in writing</b>	<b>Numbers Interviewed</b>
Current Directors	8	6	5

<sup>1</sup> *National Housing Corporation Act 1990*, s 5.

<sup>2</sup> See others under s 25 of *National Housing Corporation Act 1990*.

Former Directors	5	4	4
Current CEO	1	0	0
Former CEOs	3	2	3
Senior Managers	4	2	4
<b>Total</b>	<b>21</b>	<b>14</b>	<b>16</b>

There is a total of eight current directors and all except two reside in Port Moresby. The director representing the churches lives in Tabubil, Western Province and the women’s representative lives in Alotau, Milne Bay Province. There was difficulty in locating former directors and CEOs; however I was able to find eight of them in Port Moresby through other directors. Five of them are former directors and three are former CEOs. All participants were interviewed face-to-face, except the director who lives in Alotau who was interviewed by telephone. The Acting CEO refused to answer interview questions or be interviewed.

### 12.3.1 Views on the Definition of Corporate Governance

Questions were asked about the definition of corporate governance to obtain the views and perceptions of the participants. The understanding of the concept of corporate governance is important because only through understanding of it can the directors and managers identify issues and problems that may appear in SOEs. From the data collected it is clear that directors and managers do not understand the definition of corporate governance. Their limited understanding depends on their prior acquaintance either through training or dealing with issues in corporate governance. The following answers were given when asked “what is corporate governance?”

I have heard it before. I think it is in my economic class at UPNG [University of PNG]. It is something to do with how a corporation is run (NHC - SM3).

It is something to do with directors in a company...oh yeah...as the name indicates...directors are responsible for governing the corporation (NHC - SM4)

It is a subject matter concerning the management of the company (NHC - SM1).

Most of these participants that explained corporate governance are senior managers. The definitions provided did not clearly explain the meaning of

corporate governance. Most directors stated having heard about it but did not know what it means. A few of the directors indicated not hearing about it. Those that explained corporate governance were expressing their own views. Most interviewees agreed that there is need for them to be educated on corporate governance and their duties and responsibilities.

### **12.3.2 The Role of the Government**

The Minister for the NHC is directly responsible for that entity. The board and CEO report directly to the Minister. Appointment of directors is made in compliance with the *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004* (RSA Act). The Minister for the NHC, in consultation with the Government submits a list of potential directors to the Public Service Commission (PSC). After recommendations from the PSC the responsible Minister appoints directors, except the *ex officio* members who become directors by virtue of their office. There are three *ex officio* members; namely the CEO, and the Heads of Department responsible for Treasury and for Lands and Physical Planning. If a director is to represent an interest group then the responsible Minister must also consult the group. Other directors appointed represent various interest groups in the society. For example, one of the directors represents private real estate interests and another represents the interests of women.

Nearly all participants who were interviewed stated that the responsible Minister does not comply with the procedures in making appointments. The following responses were received from the participants: “the Minister appoints directors without consulting anyone” (NHC – SM3); “I was directly appointed by the Minister and after being in the system, I realized that the Minister never follows the processes” (NHC – FD4). Procedures are put in place for the appointment of directors but they are never complied with.

Directors who were appointed have some form of association with the Government. Some current directors were reluctant to state their personal relationship with the Government, while others frankly described their relationship. For example, one of the directors was the advisor to the current party in Government during its election campaign. Another contested under the ruling

party in Government and being unsuccessful was subsequently appointed as a director after 2007 general elections. Some of the senior managers that were interviewed expressed the view that directorships were given to those persons as a reward for supporting the Government. One of the senior managers stated in the interview that “positions for a director and CEO are jobs for the boys” (NHC – SM2). The current chairman of the board is the CEO of PNG Agriculture Bank and a close ally of the current Government.

The Government also appoints the CEO of NHC. The Acting CEO refused to answer questions and have an interview with me but when I interviewed the directors, former CEOs and senior managers of NHC, they informed me about the appointment process for the CEO. This appointment process complies with the RSA Act. The board submits a list of names of potential CEOs after consultation with the PSC<sup>3</sup>, to the responsible Minister to be submitted to the Government for appointment. Two directors who were interviewed stated that they try to submit a list of people that can find favour with the Government and persons who can work in harmony with the Government. One of them stated that “we try to submit list that Government can accept. We do not want our list of nominee to be rejected by government” (NHC – FD2). There is a system put in place to select the CEO but the Government bypasses this process. When further asked how the Government bypasses the process, two instances were given. First, when the Government appoints a CEO outside of the list given contrary to the procedural requirement. And second, before deliberation over the names for CEO before the board, the Government submits the name of a person that it prefers for the job. The difference between the appointment of directors and of a CEO is that responsible Minister submits the names of potential directors to PSC and the board submits the names of potential CEOs to PSC. Ultimately, it is the responsible Minister and the Government that makes the appointment.

The Minister has the right of access to all information of the NHC. He can request any information from the board or the management. The Minister communicates directly with the CEO and can direct the CEO and the management to implement Government policies, unless a matter requires approval of the board. When asked why the Minister communicates directly with the management instead of the

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<sup>3</sup> Public Service Commission is established under s 190 of the *Constitution* of PNG.

board the majority of the interviewees indicated that members of the board are part-time and are not intimately connected with the issues in NHC, hence the Minister needs to deal directly with the CEO and the management. When asked whether the roles of the Minister are clear and understood by directors and managers, the majority indicated that they did not know the specific responsibilities. As one senior manager stated “the Minister’s relationship with us is not clear [or]... put in a document for us to see, that is why everyone here [in NHC] is required to follow his [the Minister’s] directions” (NHC – SM1).

### **12.3.3 The Board**

The board of NHC does not have board committees and only consists of non-executive directors. All directors are in full time employment with outside organizations. The directors, chairperson and CEO were not informed of their roles and responsibilities at the time of the appointment; however they generally understood that they were to give effect to the objectives of NHC and Government policies. As one former director stated “we were not told what we are required to do in the organization but we are expected to do our job as directors” (NHC – FD1). The board does not have a code of conduct.

Generally, a board’s principal role is to approve major transactions and it can sometimes order and direct management through board resolution on specific matters. Further, the board ensures that policy directives of the Government are implemented. The directors who were interviewed stated that their role on the board was to approve major transactions and ensure that management pursues the objectives and give effect to Government’s policies. Almost all directors did not have a knowledge, or if any, limited knowledge of affairs and business of the corporation. A former director stated that: “I do not know what the finance division does or legal division does. Since my time in office I have never spoken to persons in these divisions of NHC” (NHC – FD2)

The board does not review its own performance and its performance is not reported in the annual report. The CEO is the head of the management. The Government, rather than the board, reviews the role of the CEO and has the power to discipline the CEO through termination.

#### 12.3.4 Accountability

Since 1992, NHC has not had a corporate plan. However, it gives effect to objectives under NHC Act and implements Government policies. The revenues generated from rentals are diverted to sustaining its activities. NHC does not submit reports to the Department of Treasury. The reason given was that it does not get funding from the office of the Treasury or Government. One of the senior managers stated that: “Government does not fund us [NHC]. We were left out a long time ago and we try to survive with little money that we make. Why should we be reporting to them when we are not getting any money from them [the Government]?” (NHC – SM2). Further, the answer was “no” when senior managers and directors were asked about whether they deal with the Minister for Treasury.

The CEO deals directly with the responsible Minister. It is the CEO that submits the annual report to the responsible Minister with financial statement and auditor’s report. The annual reports are supposed to be presented in Parliament; however, the reports of NHC are never presented on the floor of the Parliament. One of the former directors stated that “the reports are presented but you hardly hear them presented on the floor of Parliament. They may be looked at by NEC or discussed in some ways in Parliament but that is not for me to say” (NHC – FD1). None of the information from the annual report, or any other information of the NHC is disclosed to the public. The annual report contains accounts report. Before it is submitted to Government the Auditor General must audit the accounts. The Auditor General is legally required to audit NHC’s account; however over the years private audit firms have been auditing accounts of the NHC. The Auditor General has the power to outsource auditing functions to private audit firms.

There is uncertainty over the question of whether the NHC is subject to the *Public Finances (Management) Act 1995* (PFM Act). Further, there was uncertainty over whether responsible Ministers, directors and CEOs can be investigated by the Ombudsman Commission. Some say only the Minister, while others stated that both the Minister and the directors can be investigated. Others did not have any idea. Similarly there was uncertainty and confusion over whether NHC can be

investigated by the Public Accounts Committee (PAC). Some stated that they can whilst others stated that they cannot.

In conclusion, it is clear from discussing issues of accountability that all participants generally agreed that NHC does not report to the Department of Treasury because of the Government's lack of funding, and does not have corporate plan. Further, there was uncertainty about the role of the PAC and the Ombudsmen Commission in relation to the NHC.

### **12.3.5 Objectives**

There was clearly a general agreement among the interviewees that the main objective of the NHC is community service; however where profits are made they are diverted to sustaining activities of the NHC. Ninety-eight per cent of 90 people that live in three main suburbs of Port Moresby and who are users or former users of NHC services, pointed out in interviews that the quality and efficiency of services provided by the NHC were poor, whilst two per cent were satisfied with the services. The NHC's annual reports for 2005, 2006 and 2007 show that the corporation did not make profits and in the three years and has not received funding from the Government.

## **12.4 CORPORATE GOVERNANCE PRACTICES IN NATIONAL BROADCASTING CORPORATION**

The NBC is established under the *Broadcasting Corporation Act 1973*.<sup>4</sup> Its role is to provide balanced, objective and impartial broadcasting services within and outside the country.<sup>5</sup> The NBC has, amongst other things, power to erect, maintain and operate transmitting and receiving stations and install and operate wired radio distribution services.<sup>6</sup> The NBC's head office is in Port Moresby. All data in this case study was collected in Port Moresby. Table 12.2 provides number of people that participated in the data collection.

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<sup>4</sup> *Broadcasting Corporation Act 1973*, s 3.

<sup>5</sup> *Broadcasting Corporation Act 1973*, s 6.

<sup>6</sup> *Broadcasting Corporation Act 1973*, s 6.

Table 12.2 Number of Interview Participants in NBC

<b>Directors/ Chief Executive Officer (CEO)</b>	<b>Interview questions issued</b>	<b>Number of interview questions answered</b>	<b>Numbers interviewed</b>
Current Directors	0	0	0
Former Directors	9	6	5
Current CEO	1	1	1
Former CEOs	4	4	4
Senior Managers	5	2	4
<b>Total</b>	<b>19</b>	<b>13</b>	<b>14</b>

The terms for the directors expired in January 2008 and were not renewed when I was in Port Moresby for data collection from April to September 2008. The legal officer of the NBC, who is also the board secretary, contacted the five former directors. They were issued with the interview questions, and the answered interview questions were collected before the interviews. The other four former directors whom I approached directly also live in Port Moresby. Two former directors and a senior manager were interviewed by telephone, whilst others were interviewed face-to-face.

#### **12.4.1 Views on the Definition of Corporate Governance**

The participants were asked to express their views on corporate governance. There were different views. Some senior managers expressed the view that they have come across corporate governance but did not know what it means. Others attempted to explain it. Most directors, especially those representing interest groups stated that they did not know the definition of corporate governance. An interesting answer was given by a former director, a lawyer by profession whose law firm does undertake corporate work. He stated that “corporate governance regards how the management administers NBC and how they are accountable for their conduct” (NBC – FD4). Some participants had come across the concept and understood what it meant whilst others had heard about it and could not define it. Further, others such as NBC – FD4 who dealt with issues relating to corporate

governance understood what it meant. A large majority of participants did not understand corporate governance although they had heard about it.

#### **12.4.2 The Role of the Government**

The Minister for Communication is responsible for NBC on behalf of the Government. The Government appoints and terminates the chairperson and the directors. Before the appointment, the Minister for Communications submits the names of potential directors to Cabinet to be endorsed and thereafter to the Head of State for the appointments. The directors are usually associated with the Government. The former chairman of the board was a candidate for parliament, and he did not get elected in 2002 general election under the ruling party in the current Government. As a private lawyer he also represented many Government members and ministers in court with their election petitions. It is the prerogative of the Government to appoint any person that it wishes to serve on the board, except the CEO and a nominee from the Department of Finance and Treasury who are *ex officio* members. In addition, the Government appoints and terminates the CEO.

When I was in Port Moresby on the field trip between April and September 2008, there was no operational board or legally appointed board. The vacancies existed for over eight months after the directors' contracts expired in January 2008. Senior managers stated that directors were not really needed. The responsible Minister communicates and deals directly with the CEO and therefore there is no need for them. One of the senior managers stated cynically that "directors come to board meetings to only receive their allowances" (NHC – SM2). It was agreed by all interviewees that the Minister for Communication deals with all operational and policy matters and may direct the management from time to time. Further, the Government through the responsible Minister has right of access to all information of the corporation.

#### **12.4.3 The Board**

The board consists of non-executive directors without board committees. All directors are part-time, fully engaged in employment with outside organizations.

The board can order and direct management through the board's resolutions, however much of what is done at meetings is approval of major transactions. The directors, chairperson and the CEO were not notified of their roles and responsibilities at the time of their appointment. They understood that they were to give effect to the objectives of NBC and policies of Government but did not understand their specific responsibilities in NBC. This was the exchange between a former director (NBC – FD3) and the researcher.

Researcher: What are your roles and responsibilities as a director?

Participant: Generally to attend board meetings and approve transactions.

Researcher: At the time of your appointment were you being told about your duties?

Participant: No, that has not happened.

Researcher: Were you aware of company documents that were provided for your duties?

Participant: Not that I am aware of...I have not come across any documents. I don't think having responsibilities written would make any difference...as you know...we are supposed to implement Government policies and objectives.

Further, directors, including the chairman do not have a code of conduct. The board does not review its own performance nor its performance reported in annual reports. The CEO is the executive head of NBC and a member of the board. The CEO deals directly with the board and the responsible Minister. The responsible Minister disciplines the board members and CEO through termination or other means such as suspension. The directors were also asked whether they know of the business of various divisions, and many indicated they did not have an intimate knowledge of, or had made an attempt to find out, what they do.

#### **12.4.4 Accountability**

The responsible Minister deals directly with the board and the CEO. The CEO submits annual report to the responsible Minister and the Department of Treasury after approval by board. NBC does not have corporate plan. It only implements policies of the Government and the NBC. The CEO reports directly to the responsible Minister. The Auditor General is legally required to audit the accounts of NBC. However, all the participants in this case study indicated that it outsources the auditing responsibility to private audit firms.

There was uncertainty and confusions among the participants in the case study over whether the PAC and the Ombudsmen Commission can investigate the NBC. Further, there was uncertainty over whether directors, CEO and responsible

Ministers can be investigated by the Ombudsman Commission. Some participants expressed the view that responsible Minister, directors and the CEO can be investigated by the Ombudsman Commission, while others were not sure and few indicated that that the Ombudsman Commission cannot investigate them. Certainly there is uncertainty amongst the interviewees about the role of the PAC and the Ombudsman Commission in the NBC. But it is generally agreed that Department of Treasury deals with the NBC with regard to financial matters. Further, participants agreed that issues with regard to the NBC are rarely discussed in Parliament.

#### **12.4.5 Objectives**

The main objective of the NBC is to provide broadcasting services to the community. It receives an annual budgetary allocation from the Government to perform its duties. Out of the 90 people that were interviewed about the efficiency and the quality of service provided by the NBC, 30 per cent were satisfied and 70 per cent rated the services as poor. Issues raised were of poor reception of programmes aired, boring programmes and the closing of NBC stations in more than half of the provinces so that people are unable to receive up-to-date provincial news.

#### **12.5 CONCLUSION**

The recurring themes that can be observed from these case studies can be summarized as follows:

1. Generally, the members of the board do not understand the concept of corporate governance. The interviewees that attempted to explain it have heard about it or dealt with issues in corporate governance.
2. The Minister of NHC and the Minister of NBC are responsible for the NHC and the NBC, respectively. The roles and responsibilities of these Ministers are provided under enabling legislation. The Ministers can be involved in both policy and operational matters of the SOEs. Further,

Government through the responsible Ministers can direct management to implement Government policies from time to time.

3. The Government has unfettered discretion and absolute power to appoint and terminate directors and CEOs.
4. The directors and CEOs were not informed of their roles and responsibilities at the time of appointment; however they agreed that they are appointed to implement Government policies and objectives of the corporations. Many of them are still uncertain about their specific responsibilities.
5. With regard to accountability it is clear from interviewing participants that Auditor General audits the accounts of the NHC and the NBC and can outsource to private audit firms.
6. Only the NBC submits annual reports to the Department of Treasury; the NHC does not.
7. There was uncertainty over whether the Ombudsmen Commission and PAC can investigate the NHC and the NBC.
8. The main objective of these SOEs is community service; however the quality and efficiency of services are poor.

Clearly, from above discussion it can be seen that Government has control over the two SOEs. People who have government connections are appointed as directors and CEOs, placing in important positions those who do not have supervisory or managerial knowledge and skills to manage the corporations. As stated by one of the senior managers, they are “job for the boys”. Hence there is no motivation to establish proper corporate governance mechanism or to improve on them. Like a government department the board and the management are at the whim of the Government. Lack of public scrutiny by PAC, the Ombudsman Commission or Treasury allows stakeholders in governance to pursue self-

interested activities. Lack of good governance and accountability in SOE is partly reflected in the quality and the efficiency of the service.

This chapter generally discusses corporate governance practice. Chapter 14, in addition, synthesizes and provides analysis of the different themes discussed in this chapter.

## CHAPTER 13:

### INCIDENCES OF CORPORATE GOVERNANCE PRACTICE IN STATE COMPANIES

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#### 13.1 INTRODUCTION

Chapter 12 discusses corporate governance practice in statutory corporations in Papua New Guinea (PNG). Similarly, this chapter discusses corporate governance practice in state owned enterprise (SOE), however with particular focus on state companies or public companies incorporated under the PNG *Companies Act 1997* or its predecessor. All state companies have one shareholder, namely the “Independent Public Business Corporation of Papua New Guinea” (IPBC)<sup>1</sup>. Sir Michael Somare’s Government established IPBC in 2002 to replace the Privatization Commission<sup>2</sup> established in 1999. The IPBC is established as a corporation to monitor the trust and the performance of the assets of the State and to dispose or sell these assets within the timetable and policy guidelines set out by the Government.<sup>3</sup> The Minister for SOEs oversees and supervises the performance of the IPBC and deals with state companies through the IPBC.

Three state companies selected to be studied were PNG Power Ltd (PNG Power), Telikom PNG Ltd (Telikom) and NCD Water & Sewerage Ltd (Eda Ranu). The same methodology discussed in chapter 11 was applied to these three case studies for the purposes of data collection and analysis. I shall now proceed to present the data.

#### 13.2 PRESENTATION OF DATA

The three state companies are involved in service-orientated activities. PNG Power and Telikom are two largest SOEs in PNG. Generally, they have monopoly over telecommunication service, and production and supply of electricity, respectively. On the other hand Eda Ranu’s realm of business activities is

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<sup>1</sup> IPBC was established under *Independent Public Business Corporation of Papua New Guinea Act 2002*.

<sup>2</sup> *Privatization Act 1999*.

<sup>3</sup> *Independent Public Business Corporation of Papua New Guinea Act 2002*, s 8.

restricted to Port Moresby and surrounding villages where it has a monopoly over the supply of water and sewerage services. I now proceed to present data under each of the SOEs starting with PNG Power, Telikom then followed by Eda Ranu.

### 13.3 CORPORATE GOVERNANCE PRACTICES IN PNG POWER LTD

The business undertakings of PNG Power used to be under the PNG Electricity Commission (PNGEC). PNGEC was established under the *Electricity Commission Act 1961* to build power stations and supply electricity around PNG. Under the *Electricity Commission (Privatization) Act 2002* the powers and functions were transferred from PNGEC to a successor company to be incorporated by Privatization Commission<sup>4</sup> under the *Companies Act 1997*, which would take ownership and control of assets and liabilities of PNGEC. PNG Power was incorporated under the *Companies Act* in 2003 taking full responsibility of powers and functions of PNGEC. PNG Power is the subject of this case study. Table 13.1 provides the number of current and former directors and CEOs, and senior managers of PNG Power who have participated in this case study.

Table 13.1 Number of Interview Participants in PNG Power Ltd

<b>Participants</b>	<b>Interview questions issued</b>	<b>Numbers that completed interview questions in writing</b>	<b>Numbers interviewed</b>
Current Directors	4	2	3
Former Directors	6	2	4
Current CEO	1	1	1
Former CEOs	3	2	2
Senior Managers	4	3	4
<b>Total</b>	<b>18</b>	<b>10</b>	<b>14</b>

<sup>4</sup> The Commission is established under the *Privatization Commission Act 1999*.

Board secretary of PNG Power assisted in distributing the interview questions to current directors and CEO. Written answers to questions were collected before the interview. It was difficult to find former directors and CEOs. I was able to find six former directors and three CEOs in Port Moresby. I had a telephone interview with one current director and two senior managers who were unable to meet me because of their busy schedules. Others were interviewed face-to-face.

### **13.3.1 Views on the Definition of Corporate Governance**

The majority of the participants attempted to define corporate governance. Nearly half of the directors including former directors stated that they had heard the definition but could not explain it. All senior managers including two expatriates fully explained the definition of corporate governance. One of them stated that corporate governance is “essentially to do with powers and functions of directors and managers in a company and how they are then accountable to higher authorities. In our [PNG Power’s] case it is IPBC and the Minister” (PNGP – SM2). Some who fully explained the definition of corporate governance have come across it in their work or through university study.

### **13.3.2 The Role of the Government**

IPBC is the only shareholder of PNG Power in trust for the State. The Minister for SOEs is responsible for PNG Power on behalf of the State and is supposed to deal with PNG Power through IPBC, but that is not the case in practice. Nearly all of the participants in this case study indicated that they do not understand the roles and responsibilities of the Minister for SOEs and IPBC but they only follow directions from them. The Minister is involved in all policy matters and some operational matters of PNG Power.

The Minister for SOEs appoints and terminates the members of the board who are supposed to be appointed on the basis of their expertise in various fields such as architecture or engineering. Many who are appointed directors are Government associates. One of the directors is a son of the Prime Minister. Former directors and senior managers told me that his appointment invited public criticism of conflict of interest and nepotism. The public saw that appointments made to these

key positions by the Government are to protect its interest and provide jobs for families and associates. The board tried to quell the public outcry by pointing out that the son was appointed on merit. The Minister also appoints and terminates the chairperson. The current chairman is a close associate of the Government. He explained openly about having provided financial support to the current Government leading up to its formation.

There were some disagreements over the method for appointing the CEO. These are some of the views that were expressed.

The CEO is appointed by the IPBC but the IPBC must consult the Government. Many people say it is the board that appoints but let me tell you the truth that IPBC appoints the CEO... Many people think that board appoints the CEO but it is not true (PNGP – FD1).

The Minister and IPBC appoint the CEO and the board makes the declaration of the appointment (PNGP – SM3).

IPBC is the shareholder and as a shareholder it appoints the CEO. The board is only a rubber stamp. Even if the board is given the power to appoint CEO the Minister and IPBC will still influence the appointment. This is why I am saying that IPBC and the Minister effectively appoint the CEO (PNGP – CD2).

From the different views expressed it is clear that the board appoints and terminates the CEO in consultation with the IPBC and the Minister. Any resolution by IPBC and the Minister of the person to CEO is final and the board must approve the decision by making declaration that that person is the CEO.

Further, the Minister and the IPBC are consulted on the objectives to be achieved under the corporate plan. The process involves the board of PNG Power, formulating the corporate plan and submitting to the IPBC, which endorses and can suggest changes to the plan in consultation with the Minister for SOEs. This is where the Minister can have a role in influencing the content of corporate plan to be in line with Government policies. The recommendation of the IPBC must be given effect under the plan. Furthermore, the IPBC and the Minister for SOEs can have access to all information of the company and deal directly with the CEO.

### **13.3.3 The Board**

The board consists of non-executive directors and a part time chairperson. Where necessary the board can appoint board committees to assist with its other extended

responsibilities. Directors were asked about whether they take time to find out about other divisions in the company. Two directors indicated making an attempt to find out about powers, functions and business of these various divisions.

The board has no code of conduct, does not review its own performance and does not report its performance in the annual report. The directors are not given written explanation of their responsibilities after their appointment; however they are advised to attend courses offered on corporate governance. Nearly all directors do not understand their general duties under the *Companies Act 1997*. They indicated that they are required to attend board meetings and deliberate on issues highlighted in the agenda that they receive before the meetings. Similarly, the chairperson indicated not having access to any document prescribing the roles of the chairperson but he understood clearly his responsibilities as a chairperson.

The CEO is the executive head of the company and is a member of the board. During the interview the current CEO stated that he generally understands his roles and responsibilities and his main role is to implement the objectives of PNG Power and the policies of the Government.

#### **13.3.4 Accountability**

The CEO reports directly to the board, which reports to the IPBC, which reports to the Government through the Minister for SOEs. Often the Minister for SOEs bypasses the board and the IPBC, and deals directly with the CEO and the management. One example given was when Government comes up with new policies, the Minister communicates directly with the management.

The board of PNG Power submits annual reports to the IPBC, and it tenders copies of the report to the Government when requested by the responsible Minister. All interviewees stated that according to their knowledge Parliament never discussed issues about PNG Power. Further, the board submits a copy of the report to the Registrar of Companies. But the Department of Treasury does not receive a copy of the report. The company does not disclose the report directly to the public, although the information is available for public inspection at the company's office in Port Moresby. There is no requirements for the contents of

the report, however it is generally required that board reports on the yearly operation of PNG Power.

The Auditor General audits the accounts of PNG Power; however it often outsources this to private audit firms. The reason for outsourcing is that the Office of the Auditor General does not have enough funds and auditors to audit PNG Power. All the participants were uncertain on whether PNG Power is subject to inspection by the Public Accounts Committee (PAC)<sup>5</sup>. Also, they were uncertain on whether Ombudsman Commission can investigate the Minister for SOEs, directors and CEO. This was a conversation between the researcher and a senior manager (PNGP – SM1) who has been working in the legal division of the company for over ten years.

Researcher: So you are saying that PAC and Ombudsman Commission cannot investigate PNG Power?

Interviewee: No...that is not what I am saying. What I am simply saying is that we are not sure after PNG Power was incorporated under the *Companies Act*. We [PNG Power] have become a private company. The Parliament must make it clear whether PAC and Ombudsman Commission can investigate PNG Power.

Some of the participants stated that only the chairperson and the Minister for SOEs are subject to investigation by Ombudsman Commission, others indicated that it is only the Minister, whilst others were uncertain about the matter. What is generally clear from the interviews is that the role of the Ombudsman Commission and the PAC in PNG Power is uncertain; hence this matter requires clarification by the legislature.

### 13.3.5 Objectives

The main objective of PNG Power is to be commercially viable and to make a profit. The Government subsidizes when it requires the company to embark on community service obligation. PNG Power is the only producer and supplier of electricity in PNG. Since corporatisation PNG Power has been making profit for the State. However, profitability is not reflected in the quality and efficiency of the service. Ninety-one per cent of 90 consumers interviewed stated that

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<sup>5</sup> It is established under s 215 of the PNG *Constitution* to inspect public accounts of PNG and report to parliament on any control of or transaction concerning public's monies or property. Also, see discussions in chapter seven.

efficiency and quality of services are poor while nine per cent were satisfied with the services.

### 13.4 CORPORATE GOVERNANCE PRACTICES IN TELIKOM PNG LTD

Telikom was established under the *Telikom PNG Limited Act 1996* and incorporated as a company under the *Companies Act* in 1997. In 1982 the business of telecommunication merged with postal services and they were governed under the *Post and Telecommunication Corporation Act 1982*.<sup>6</sup> The powers and functions were separated in 1996 under the *Post and Telecommunication Corporation (Corporatisation) Act 1996*. The regulatory powers and functions of the corporation with relation to telecommunications and radiocommunication were transferred to PANGTEL<sup>7</sup>; the powers and functions and business undertaking relating to postal services was transferred to Post PNG Ltd and powers and functions and business undertaking of the corporation with regard to telecommunication were transferred to Telikom. This case study focuses only on corporate governance practice in Telikom. Table 13.2 summarizes the number of current and former directors and CEOs, and senior managers of Telikom who were issued with questionnaires and were interviewed during my field trip to PNG between April and September 2008.

Table 13.2 Number of Interview Participants in Telikom PNG Ltd

<b>Participants</b>	<b>Interview questions Issued</b>	<b>Numbers that completed interview questions in writing</b>	<b>Numbers interviewed</b>
Current Directors	6	2	4
Former Directors	4	3	4
Current CEO	1	1	1
Former CEOs	2	1	1

<sup>6</sup> Post PNG Ltd, "Corporate profile," in *Post PNG Ltd*, < [http://www.postpng.com.pg/about\\_us.htm](http://www.postpng.com.pg/about_us.htm) > at 12 April 2010.

<sup>7</sup> PANGTEL stands for Papua New Guinea Radio-communications and Telecommunications Technical Authority. See Part IV of *Telecommunication Act 1996*.

Senior Managers	4	1	4
<b>Total</b>	<b>17</b>	<b>8</b>	<b>14</b>

There are six current directors of Telikom and four were interviewed. Like PNG Power, I found it difficult to locate former directors and CEOs in Port Moresby. Most of them have retired and are living in towns outside Port Moresby or in villages. I was able to locate four in Port Moresby and interviewed them. I interviewed one former CEO and two senior managers by telephone. Others were interviewed face-to-face.

#### **13.4.1 Views on the Definition of Corporate Governance**

Like PNG Power, views about the definition of corporate governance vary depending on prior knowledge. All senior managers interviewed attempted to explain the term. Generally, directors and CEOs had either heard about corporate governance and did not understand the concept, or had not heard about it and did not know what it is. Many of the interviewees did not understand the definition of corporate governance and did not provide an explanation.

#### **13.4.2 The Role of the Government**

IPBC is the only shareholder of Telikom in trust for the State. The Minister for SOEs and Minister for Communications are responsible for the company on behalf of the State. Telikom is indirectly subject to both as it is an SOE and also a communication company. The Ministers deal with the IPBC on matters regarding Telikom and the IPBC deals with the board. But the participants stated that the Ministers can deal directly with the board and management. For example, the Ministers can direct the board to implement Government policies without going through the IPBC. Directors that were interviewed were confused over the areas of responsibilities of the two Ministers. One of the former directors stated that “as a board we were required to implement any directions from the Ministers. We did not question whether direction they give is within their power” (T – FD4). Sometimes Telikom receives conflicting directions from the Ministers. Conflict arises when one directs the implementation of a policy without consulting the

other. Further, the directors and CEOs expressed disappointment over lack of clarity over the roles and responsibilities of IPBC.

All the participants agreed that the Government performs an influential role in Telikom. The responsible Ministers appoint and terminate directors, except a representative of IPBC who is an *ex officio* member of the board. The current representative on board of Telikom is the CEO of the IPBC who is also the CEO of the “Sana Arthur Berta (SBA) Ltd”; a company owned by family members of the current Prime Minister. The responsible Ministers also appoint and terminate the chairperson. The board is supposed to appoint CEO but Ministers and IPBC greatly influence the appointment. This is an exchange between former director (T – FD2) and the researcher.

Researcher: So...how is the appointment CEO done?

Interviewee: the Minister submits the name of who he likes to be a CEO...and the board just appoints the person that the Minister wants.

Researcher: How would you describe your role in the appointment?

Interviewee: We are like rubber stamps. It is really the Government, through the Minister that appoints the CEO.

The current management was careful in stating that the board appoints and terminates the CEO but in doing so it consults the Ministers and IPBC. Like PNG Power, it can be concluded that the board appoints the CEO in consultation with the Ministers. The responsible Ministers do influence the appointment.

Further, the Ministers have a role in the formulation of the corporate plan. After the board submits the plan to IPBC, IPBC endorses and recommends the plan in consultation with the responsible Ministers. This is where the Ministers can influence the content of the plan. The recommendations of IPBC have to be incorporated. All interviewees expressed the view that Government only involves in policy matters but in certain instances it can intervene in operational matters. Furthermore, the responsible Ministers and the IPBC have direct access to all information of Telikom.

### **13.4.3 The Board**

The board consists of non-executive directors, apart from the full time chairperson; and comprises of board committees. Most of these directors have full

time employment outside the company and spend less time getting to know the business and affairs of the company. The answer “no” was given when interviewees were asked whether directors spent time with senior managers to get to know what they are doing. Although directors ask questions about the company in meetings, this is insufficient to educate themselves about the business and affairs of the company.

Interview data shows that the participants are not aware of any documents that specifically provide for the roles and responsibilities of the directors or the board. There was confusion and the answer “no” was given when directors were asked whether they understood their general responsibilities under the *Companies Act 1997*. The board does not review its own performance, neither is its performance reported in the annual report. Further, the board has no code of conduct. The company secretary stated that he is working on a code of conduct that will be sent to the board for approval. A current and former chairperson stated that they are not aware of any documents prescribing their role but generally they preside over board meetings and ensure that the management implements the board’s resolutions, including the objectives of Telikom and government policies.

The CEO is not a member of the board. The CEO receives direction from the board and not the responsible Ministers or IPBC, however in certain cases for political expediency the responsible Ministers or the IPBC can direct the CEO to bypass the board and implement Government policies. The current CEO stated that the responsible Ministers deal with him directly to ensure that issues that are politically important are implemented, bypassing the IPBC. On occasions the board has reviewed the function of the CEO but at present there is no review mechanism. The CEO stated that his responsibility is to implement policies and the goals of the company and follow general duties under company constitution; however he is not aware of any documents that provide general guidelines on his responsibilities as a CEO.

#### **13.4.4 Accountability**

The CEO acts on behalf of the management and reports directly to the board, which deals with the IPBC, which then deals with the Government. The CEO, on

behalf of the management, submits an annual report to the board. The board submits a copy to the IPBC and another copy to the Registrar of Companies. The IPBC only submits the report to the Government upon request by responsible Ministers. Interviewees stated that they do not know whether these reports are tabled in Parliament, while others stated that they are not tabled in Parliament. Telikom does not submit its reports to the Department of Treasury.

Telikom does not disclose any company's information to the public, although the public can gain access to the reports through the Registrar of Companies. The Auditor General audits the accounts of PNG Power. In most cases the Auditor General outsources to private audit firms and performs a supervisory role.

There were uncertainties when participants were asked about whether the Ombudsman Commission can investigate responsible Ministers, directors and CEO. Some participants indicated that all directors apart from the CEO are subject to investigation by the Ombudsman Commission. Yet others indicated that it is only the chairperson and the CEO who are subject to investigations. Similarly, mixed reaction was given when participants were asked whether the Ministers can be investigated by the Ombudsman Commission in their dealings with Telikom. There were mixed responses also given to the question of whether PAC can investigate the accounts of Telikom. Some interviewees stated that PAC can investigate accounts of Telikom, some indicated that it cannot, whilst others were uncertain. Generally, there was uncertainty over the role of the Ombudsman Commission and PAC in Telikom.

#### **13.4.5 Objectives**

The main objective of Telikom is making profit in the process of providing telecommunication services. It does not receive funding from the Government hence Telikom has to make a profit to sustain its activities. If the Government would like Telikom to provide community services, it must subsidize costs. Within the last three years Telikom recorded profits. Seventy-six per cent of the 90 customers of Telikom that were interviewed regarded the quality and efficiency of the service as poor while 24 per cent were satisfied with the services. Towards the end of 2007, competition against Telikom was permitted. An English

company, Digicel was allowed to compete against Telikom in the mobile service industry. Services improved in this area of industry.

### 13.5 CORPORATE GOVERNANCE PRACTICES IN EDA RANU

The increase in population in the National Capital District (NCD) has stretched the water supply network beyond its limits. By 1990 the situation was deteriorating fast and getting worse. In 1993, a report of the Japanese International Cooperation Agency (JICA) stated that water supply network established by Australian Department of Housing and Construction between 1971 and 1973 was outdated and oversized. Many suburbs in Port Moresby were experiencing less water pressure or were experiencing a day or two without water. Following the report of JICA the Government corporatised the water and sewerage services in Port Moresby through enactment of *NCD Water Supply and Sewerage Act 1996* (NCD Act).<sup>8</sup> In compliance with NCD Act, NCD Water and Sewerage Pty Ltd was incorporated under the *Companies Act 1997*. Eda Ranu<sup>9</sup> is a trading name for NCD Water and Sewerage Pty Ltd. Since 1997 Eda Ranu has been supplying water and providing sewerage services to the residents of Port Moresby and surrounding villages. Table 13.3 provides the summary of the number of current and former directors and CEOs, and senior managers of Eda Ranu who answered the interview questions, and were interviewed during the field trip between April and September 2008.

Table 13.3 Number of Interview Participants in Eda Ranu

<b>Participants</b>	<b>Interview questions Issued</b>	<b>Numbers that completed interview questions in writing</b>	<b>Numbers interviewed</b>
Current Directors	6	3	5
Former Directors	5	3	3
Current CEOs	1	1	1

<sup>8</sup> Eda Ranu, "Our History," in *Eda Ranu*, <  
[http://www.edaranu.com.pg/index\\_files/ourcomp.htm](http://www.edaranu.com.pg/index_files/ourcomp.htm) > at 9 April 2010.

<sup>9</sup> Eda Ranu in 'Motu' dialect means 'our water'.

Former CEOs	3	3	2
Senior Managers	4	2	3
<b>Total</b>	<b>19</b>	<b>12</b>	<b>14</b>

Secretary of the board assisted with distributing interview questions to current directors and CEOs, and senior managers. A director, who is a landowner representative living in Kerekadi village in Sogeri Plateau outside Port Moresby, did not respond, and the other lived in Mendi and was difficult to reach. A former CEO who lives outside Port Moresby was interviewed by telephone, whilst the rest were interviewed face-to-face. Two former directors refused to have an interview.

### **13.5.1 Views on the Definition of Corporate Governance**

Generally all the participants had heard about corporate governance. Many of them did not understand what it means. Those that attempted to explain it are senior managers. Many of these senior managers have been working with the company for more than three years. The following are some of the views on the definition of corporate governance.

I heard about it [corporate governance] but to tell you what it is, I might be lying to you (ED – FD3).

People talk about corporate governance. I heard it...but I cannot explain it (ED – CD1).

Corporate governance is to do with the conduct of the managers in governing the corporation (ED – SM3).

The participants such as the senior managers who heard about corporate governance and deal with corporate issues explained it in their own words. Many of the directors have heard about it and cannot explain it. Clearly, explanation by participants depends on whether they have heard about corporate governance and dealt with issues surrounding it.

### **13.5.2 The Role of the Government**

IPBC is the major and sole shareholder of Eda Ranu. Minister for SOEs is responsible for Eda Ranu but is not a shareholder. The Minister was supposed to

deal with IPBC on matters regarding Eda Ranu. However, in practice the Minister bypasses the IPBC and communicates and deals directly with the chairperson and the CEO. The Minister appoints and terminates the chairperson and members of the board. On the other hand the CEO is appointed and terminated by the board. The board appoints the CEO but upon consultation with the Minister and IPBC. Many of the participants stated that the board complies with the direction of the Government in appointing the CEO.

Further, the Minister must be consulted by IPBC when the corporate plan is submitted for its endorsement by the board of Eda Ranu. Furthermore, the Minister can also have access to all information of the company, and can deal with both the policy matters and operation matters of the company. Most interviewees, including the senior managers stated that access to information was made possible by the close association the chairperson and the CEO have with the Government. One of the former directors stated bluntly that “the chairman and the CEO are the friends of the Government. Any information of Eda Ranu that Government asks, they provide” (ED – FD2). Usually the board of Eda Ranu submits reports to IPBC, which then submits reports to the Government. Many of these reports are not tabled in Parliament.

### **13.5.3 The Board**

The board consists only of non – executive directors but only the chairperson is a full time member of the board. Also, the board comprises of board committees. A representative of IPBC and the Department of Treasury serve as *ex officio* members on the board. The question was asked, why Eda Ranu has a director representing the Department of Treasury on the board. This was one of the many similar responses received from the participants: “our company [Eda Ranu] is occasionally funded by the Government and NCDC [National Capital District Commission] and that is why the Office of the Treasury is interested in how we spend the public monies” (ED – CD3).

The directors who were interviewed stated that they were not aware of their written roles and responsibility or understand their powers and functions under the *Companies Act* and the company constitution. When they were interviewed some

of the board members stated that they have not seen the *Companies Act* or the company constitution to understand their responsibilities. They understand their roles are to approve major transactions and ensure that management implements their resolutions and the objectives of Eda Ranu. The board and directors do not have a code of conduct. The board does not review its own performance or report its performance in the annual report. When the directors were first appointed they were not told of their roles and responsibilities nor were they trained after the appointment. Many of these directors lack intimate knowledge about the affairs and business of the company.

The CEO is the executive head of the organization and is not a member of the board. The board appoints the CEO in consultation with IPBC and the Minister. The CEO receives direction from the board, implements board's resolutions and reports to the board. The current CEO stated that he deals directly with the Minister for SOEs and his role is to give effect to the objectives of Eda Ranu.

#### **13.5.4 Accountability**

The CEO reports directly to the board of Eda Ranu. Eda Ranu submits the annual report through the board to IPBC and the Registrar of Companies. However, Eda Ranu does not disclose directly to the public, although information about the company is available at the office of Registrar of Companies. Private audit firm, appointed by the Auditor General, audits the accounts of Eda Ranu. Eda Ranu does not report to the Department of Treasury or Minister for Treasury. Given the mixed responses from the participants it was clear that there was confusion over whether Minister for SOEs, directors and CEO are subject to investigation by the Ombudsman Commission. Further, there was uncertainty over whether Eda Ranu is subject to investigation by PAC.

#### **13.5.5 Objectives**

The main objective of Eda Ranu after incorporation is making a profit through supply of water and disposal of sewerage in National Capital District. Corporatisation was intended to ensure that Eda Ranu provides an efficient and quality service. Since incorporation Eda Ranu has occasionally received

Government funding. Eighty-eight per cent of 90 residents of Port Moresby interviewed stated that the quality and the efficiency of services are poor and 12 per cent were satisfied with the services. Over the last three years Eda Ranu has recorded profits.

### **13.6 CONCLUSION**

The similarities that each of the state companies share that featured consistently and predominantly in this chapter can be summarized as follows:

- a. Few participants had not heard about corporate governance. Many that knew about it could not explain it. Some, mainly the senior managers attempted to explain corporate governance but their explanations were too vague and incomplete.
- b. IPBC is the main and sole shareholder of each of the state companies in trust for the State.
- c. The Minister for SOEs appoints and terminates the chairpersons and the directors.
- d. The CEO is appointed by board in consultation with the relevant Ministers and IPBC.
- e. The directors and CEOs understand generally that they are required to implement the objectives of the state companies but do not understand their specific roles and responsibilities under the *Companies Act* or the company constitutions.
- f. State companies do not have code of conduct for the board, directors and CEOs, and they are not notified of their responsibilities upon appointment or educated on their specific roles and responsibilities.
- g. Directors lack detail knowledge and understanding of the business and affairs of individual SOEs.

- h. The Auditor General is legally required to audit the accounts of the state companies; however the Auditor General outsources auditing of state companies to the private audit firms.
- i. There is confusion over whether the state companies are subject to inspection and investigation by PAC and whether relevant Ministers, directors and CEOs are subject to investigation by the Ombudsman Commission.
- j. State companies do not report to Department of Treasury and the Minister for Treasury.
- k. The main objective of the state companies is making profit, however where Government requires community services then it must subsidize costs. These companies have recorded profits since corporatisation, but the quality and efficiency of services are poor.

On the other hand the differences that featured consistently and predominantly among the three state companies are summarized as follows:

- a. The number of government ministers responsible for each SOE differs. Telikom has two responsible Ministers while PNG Power and Eda Ranu have one.
- b. Eda Ranu and Telikom have full-time chairpersons and PNG Power has a part-time one. Eda Ranu has representatives of IPBC and Department of Treasury on the board, Telikom PNG Ltd has only the representative of IPBC while PNG Power Ltd has no representative from the two institutions.
- c. Eda Ranu and Telikom have CEOs who are not the members of the board. In PNG Power CEO is a member of the board.

IPBC was established to manage the state companies and prepare them for privatization. In addition, IPBC was also given ownership responsibility; however there was no clear distinction between its role and the role of the relevant Ministers. This allows the relevant Ministers to deal directly with the board and management of state companies. Further, the data establish that there is a subjective approach in appointing and terminating directors without procedural compliance. Consequently, Government associates are appointed to the board. The Government's direct influence of state companies is also made possible by having Government associates on the board and management and having directors and CEOs who lack understanding and appreciation of their powers and functions. Furthermore, other major issues in state companies' are continuous ministerial interference and lack of accountability. The general public perception is that there is poor provision of services.

Like chapter 12, this chapter generally discusses corporate governance practice in state companies. Chapter 14, in addition, synthesizes different themes discussed in this chapter and provides analysis.

**PART VI:**  
**IMPLICATIONS AND CONCLUSIONS**

## CHAPTER 14:

# THE CONDITIONS OF CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA – A DEFECTIVE PARADIGM

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### 14.1 INTRODUCTION

This chapter discusses the findings of the interview data collected in chapters 12 and 13. Whilst these data are important *per se*, it is equally important that the legal position (that is the law) of corporate governance in each SOE is ascertained and addressed, and compared against the practice in individual SOEs. Then this is compared and contrasted against corporate governance systems in public sectors in New Zealand (NZ) and Australia as discussed in chapter 7. This chapter firstly examines the legal core of corporate governance in SOEs that are the subject of case studies. Second, the law and practice on corporate governance in SOEs is analyzed to establish the position of corporate governance in Papua New Guinea (PNG). Third, corporate governance in PNG is compared and contrasted against corporate governance in NZ and Australia. Fourthly, deficiencies in corporate governance in PNG are identified and discussed followed by relevant observations proffered by way of conclusion.

### 14.2 LEGAL CORE OF CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA

PNG does not have generic corporatisation legislation that covers all SOEs. They are either established under statutes or created under statutes and incorporated under the *Companies Act 1997*. These different statutes provide for accountability and governance of SOEs. This part examines the legal core of corporate governance framework in SOEs that are the subject of case studies in Part V. Under the

*Companies Act 1997*, the company's constitution is binding;<sup>1</sup> hence it is considered along with other legislation governing state companies.

#### **14.2.1 Statutory Corporation - National Housing Corporation**

The main legislation that governs the activities of the National Housing Corporation (NHC) is the *National Housing Corporation Act 1990* (NHC Act). It sets out the general powers and functions of NHC.<sup>2</sup> Under the Act, the Minister for NHC is responsible for the corporation and is greatly involved in its business and affairs. NHC must give effect to policies of the Government, directed by the Minister from time to time.<sup>3</sup> Most of these policies are geared towards building and maintaining houses for public servants. In this sense, the NHC acts as an agent of the Government to develop houses for its employees.<sup>4</sup> Interestingly, the Minister is involved in the affairs of the corporation to an extent that he/she determines payment for loss or damages to an affected person,<sup>5</sup> and gives the consent before funds for research with regard to housing are appropriated.<sup>6</sup> Furthermore, the Minister determines which bank the NHC should have an account with.<sup>7</sup> These are operational matters that should have been dealt with by the board of NHC.

The Government appoints the chairperson and sets their terms and conditions.<sup>8</sup> The directors are appointed in compliance with the *Regulatory Statutory Authorities (Appointment to Certain Office) Act 2004* (RSA Act). The Minister for NHC prepares and submits a list of candidates for directors' positions to the Public Service Commission (PSC) to be considered against the standard of "fit and proper person". The Minister makes the appointment after receiving the recommendation from PSC.

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<sup>1</sup> *Companies Act 1997*, s 32. Matters provided only in the Constitution and not the *Companies Act* are binding between the company and the shareholders, and between the shareholders. However, they are not binding on directors. Therefore the "constitution should not be used to confer rights on directors". See Beck, A. and Borrowdale, A., *Papua New Guinea Companies and Securities Law Guide*, (1999) 33.

<sup>2</sup> *National Housing Corporation Act 1990*, Part III.

<sup>3</sup> *National Housing Corporation Act 1990*, s 27.

<sup>4</sup> *National Housing Corporation Act 1990*, s 29.

<sup>5</sup> *National Housing Corporation Act 1990*, s 73. A person who is wronged by the corporation is an affected person for the purpose of s 73.

<sup>6</sup> *National Housing Corporation Act 1990*, s 63.

<sup>7</sup> *National Housing Corporation Act 1990*, s 23.

<sup>8</sup> *National Housing Corporation Act 1990*, ss 8 and 9.

For those directors who are required to represent an interest group, the Minister must consult the interest group before submitting the names to PSC.<sup>9</sup> Further, the chief executive officer (CEO) is appointed in accordance with the RSA Act.<sup>10</sup> The board submits names of three candidates to the responsible Minister for appointment.<sup>11</sup> Clearly, the Minister's powers are limited under the legislation. Also, the Minister on recommendation from the board may remove the CEO.<sup>12</sup> These procedures are in place in the legislation, but from the case studies, it appears that the Minister directly appoints and terminates directors and CEO without consulting the board, PSC or the interest groups.

The NHC Act does not provide for the powers and functions of the board, chairperson, directors and CEO. However, it does provide for the powers and functions of NHC. It can be concluded that performance of these officers can only be assessed against whether they have collectively exercised powers and performed functions of the NHC.

NHC is subject to Part III of the *Public Finance (Management) Act 1995* (PFM Act). That means the Auditor General can audit the accounts of NHC, and it must submit the management plan and annual report to the Department of Treasury. In practice, from Part V, this is not the case. The NHC does not submit the management plan or the annual report to the Department of Treasury, despite having custody over valuable assets of the State and coming under the control of the State's Minister. Also, the laws are not clear on whether the Ombudsman Commission can investigate responsible Ministers, directors, chairperson and the CEO or whether they are subject to the *Organic Law on the Duties and Responsibilities of Leadership* (Leadership Code). Similarly, the laws are silent on whether the Public Accounts Committee (PAC) can investigate NHC.<sup>13</sup>

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<sup>9</sup> *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004*, s 10.

<sup>10</sup> *National Housing Corporation Act 1990*, s 17; *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004*, s 4.

<sup>11</sup> *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004*, s 6.

<sup>12</sup> *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004*, ss 7 and 8.

<sup>13</sup> The powers and functions of Public Accounts Committee are provided under the *Constitution of PNG*, ss 215 and 216.

### 14.2.2 Statutory Corporation – National Broadcasting Corporation

The Minister for Communications is responsible for the National Broadcasting Corporation (NBC). The only official and legal document that provides for a corporate governance framework is the *Broadcasting Corporation Act 1973* (NBC Act), which also sets out the general powers of NBC.<sup>14</sup> Under the Act the responsible Minister advises NBC, on behalf of the Government on policies and priorities that it should pursue from time to time.<sup>15</sup> The Minister may direct NBC on what to broadcast and it has to report back to Parliament on whether the policies and directions given have been implemented. Further, the Minister may specify where to broadcast.<sup>16</sup> These are operational matters yet the responsible Minister deals with them.

The Government appoints and terminates the chairperson<sup>17</sup> and the CEO.<sup>18</sup> The directors are also appointed and removed by the Government, while the *ex officio* directors are nominated from their organization to be on the board of NBC.<sup>19</sup> It is interesting to note that, although NBC is a statutory corporation it is not subject to the RSA Act for the appointment of CEO and the directors. Unlike NHC, the Government makes direct appointments in NBC. The reason given by senior managers and directors in interviews is that the Government wants substantial control over what is to be disseminated to the public by having the capacity to control those in the management. The roles and responsibilities of the CEO<sup>20</sup> and chairperson<sup>21</sup> are specifically provided in the Act; however the roles of the board and the directors are not specified.

Section 27 of the NBC Act specifically provides that NBC is subject to Part III of the PFM Act. By virtue of Part III NBC must be audited by the Auditor General<sup>22</sup>, submit

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<sup>14</sup> *Broadcasting Corporations Act 1973*, s 11.

<sup>15</sup> *Broadcasting Corporations Act 1973*, s 7 (1).

<sup>16</sup> *Broadcasting Corporations Act 1973*, s 7 (2).

<sup>17</sup> *Broadcasting Corporations Act 1973*, ss 16 and 17.

<sup>18</sup> *Broadcasting Corporations Act 1973*, s 21B.

<sup>19</sup> *Broadcasting Corporations Act 1973*, ss 12 and 13.

<sup>20</sup> *Broadcasting Corporations Act 1973*, s 21B.

<sup>21</sup> *Broadcasting Corporations Act 1973*, s 20.

<sup>22</sup> *Constitution of PNG*, ss 213 and 214; *Audit Act 1989*.

its management plan and annual report to the Department of Treasury. The NBC Act is silent on whether responsible Ministers, directors, the chairperson and CEO are subject to the Leadership Code and hence can be investigated by the Ombudsman Commission. Similarly, it is not clear whether PAC can investigate NBC.

#### **14.2.3 State Company – NCD Water & Sewerage Ltd**

NCD Water & Sewerage Ltd (its trading name Eda Ranu is used hereafter) is incorporated under the *Companies Act 1997*, and obviously subject to that Act. It is also subject to the *NCD (Transfer of Assets, Etc.) Act 1995*, the PFM Act, the *Independent Public Business Corporation of PNG Act 2002* (IPBC Act) and of course the company constitution. The Independent Public Business Corporation of PNG (IPBC)<sup>23</sup> is the main and sole shareholder of Eda Ranu.

The responsible Minister appoints and terminates directors of Eda Ranu.<sup>24</sup> The Minister is defined under s 1 of the constitution as the Minister for Finance from time to time or such other Minister of State having the responsibility of the transfer act and the business of the company. This definition covers the Minister for SOEs; hence he or she can appoint and terminate directors. On the contrary, the IPBC Act provides for IPBC to appoint directors.<sup>25</sup> The question of who appoints the CEO is not clear under the constitution, however under the IPBC Act, IPBC appoints CEOs. Similarly, powers and functions of the chairperson and the board, but not the CEO, are provided under the constitution. The board is given a wider power to make decisions in the best interest of the company.<sup>26</sup> The board may delegate its powers to a committee in fulfillment of the purpose for which it was established.<sup>27</sup> Interestingly, Eda Ranu's operational jurisdiction is within National Capital District (NCD) and yet the municipal council, NCD Commission, has nothing to do with it.

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<sup>23</sup> The IPBC was established under the IPBC Act to act as a trustee shareholder and to manage state companies, increase their value and sell when they are ready for privatization.

<sup>24</sup> *Constitution of Eda Ranu*, s 110.

<sup>25</sup> *Independent Public Business Corporation of PNG Act 2002*, s 11 (2004 amendment).

<sup>26</sup> *Constitution of Eda Ranu*, s 134.

<sup>27</sup> *Constitution of Eda Ranu*, ss 126 and 127.

The company is required to appoint a private audit firm to audit the accounts of Eda Ranu in compliance with the *Companies Act*.<sup>28</sup> The constitution is silent on whether the Ombudsman Commission and PAC can inspect and investigate Eda Ranu and its management. On the other hand, the PFM Act only applies to borrowing of money from an outside source.<sup>29</sup>

#### 14.2.4 State Company – Telikom PNG Ltd

In 1996, telecommunication assets and activities of the State were transferred to Telikom PNG Ltd (Telikom) under the *PNG Power Limited Act 1996*. Telikom was incorporated under the *Companies Act 1997* with IPBC as a sole shareholder in trust for the State. The Act provides that the Telikom must fulfil its community service obligations, its general governmental obligations and its commercial obligation.<sup>30</sup> Telikom must perform its function consistent with general policies of Government notified to PANGTEL<sup>31</sup> by the Minister under s 6 of the *Telecommunication Act 1996*, and any direction given directly to Telikom.<sup>32</sup> The board of Telikom must prepare and submit to the Minister a corporate plan for three years.<sup>33</sup> In addition, it must perform its functions in a manner consistent with sound commercial practice.<sup>34</sup>

Shareholders appoint and terminate the appointment of chairperson and director(s).<sup>35</sup> Shareholders, in this case, refer to IPBC. The directors appoint CEO.<sup>36</sup> Under the IPBC Act, IPBC appoints directors and CEOs therefore appointment of CEO by directors under the constitution is inconsistent with the IPBC Act. Further, under Part IV the responsible Minister appoints directors, contrary to the IPBC Act. The constitution does not specifically provide for the powers and functions of board,

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<sup>28</sup> *Constitution of Eda Ranu*, s 171.

<sup>29</sup> *Constitution of Eda Ranu*, s 75.

<sup>30</sup> *Telikom PNG Limited Act 1996*, s 4.

<sup>31</sup> PANGTEL means “Papua New Guinea Radio-communications and Telecommunications Technical Authority.” PANGTEL is a statutory corporation established under *Telecommunication Act 1996*, and it only deals with technical matters (see *Telecommunication Act 1996*, s 32).

<sup>32</sup> *Telikom PNG Limited Act 1996*, s 6.

<sup>33</sup> *Telikom PNG Limited Act 1996*, s 10.

<sup>34</sup> *Telikom PNG Limited Act 1996*, s 7.

<sup>35</sup> *Constitution of Telikom PNG Ltd*, s 14.01.

<sup>36</sup> *Constitution of Telikom PNG Ltd*, s 18.01.

chairperson and CEOs but only powers of directors<sup>37</sup>. This means that the board only acts in situations where the constitution provides for the company to act. Also, Telikom is incorporated under the *Companies Act*, hence, the board and directors are subject to the powers and functions provided in the Act.

Section 30.02 of the constitution requires auditors to be appointed and removed in accordance with the *Companies Act*. Under the Act it is the company that appoints and removes auditors. This is in direct conflict with s 3 of the *Audit Act 1989*. There is no provision anywhere that states that Telikom and/or its management is to be subjected to the Leadership Code or PFM Act. There is also no provision that states that the Ombudsman Commission or PAC can inspect and investigate Telikom or that Auditor General should audit the accounts of Telikom.

#### **14.2.5 State Company - PNG Power Ltd**

PNG Power Ltd (PNG Power) is incorporated under the *Companies Act 1997*. IPBC is the only shareholder in trust for the State. PNG Power is subject to the *Companies Act*, the IPBC Act and the constitution of PNG Power.

The IPBC Act provides that IPBC appoints directors and CEOs. Under the constitution, company appoints and terminates directors at the annual general meeting after receiving the nominations of persons from shareholders.<sup>38</sup> In this case it is the shareholders that make the appointment. The only shareholder is IPBC. However, the Minister for SOEs appoints directors. Under the constitution board appoints the chairperson<sup>39</sup> and the CEO<sup>40</sup>. This is contrary to the practice under Part V where the Minister for SOEs appoints the chairperson and IPBC appoints the CEO. The appointment of CEO by IPBC is in compliance with the IPBC Act but contradicts the constitution of PNG Power. The powers and functions of the board<sup>41</sup> and the CEO<sup>42</sup> are specifically provided under the constitution.

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<sup>37</sup> *Constitution of Telikom PNG Ltd*, ss 17.01- 17.04.

<sup>38</sup> *Constitution of PNG Power Ltd*, s 16.10.

<sup>39</sup> *Constitution of PNG Power Ltd*, s 21.7.

<sup>40</sup> *Constitution of PNG Power Ltd*, s 19.2.

<sup>41</sup> *Constitution of PNG Power Ltd*, s 20.

<sup>42</sup> *Constitution of PNG Power Ltd*, s 19.4.

PNG Power is required to comply with reporting requirement under ss 179 and 215 of the *Companies Act*;<sup>43</sup> however its constitution is not clear on the appointment of a company auditor. In this case the company complies with the requirement of the *Companies Act*. That means the board appoints the auditor. The company's constitution and other related Act did not provide whether PNG Power is subject to the Leadership Code or the PFM Act. Further, there is no legislation that specifically provides whether the Ombudsman Commission and/or PAC can inspect and investigate PNG Power.

#### **14.2.6 Independent Public Business Corporation of Papua New Guinea**

It is important to also note that IPBC was established as a corporation to manage state companies and where necessary privatize them in accordance with policy guidelines and in consultation with the Responsible Minister.<sup>44</sup> The IPBC Act does not specify the role of the Government and Minister for SOEs, and state companies constitutions do not specifically provide for the role of IPBC. This creates confusion as to which authority the state companies should be dealing with and even more confusing is having a state company such as Telikom dealing with IPBC and two ministers - the Minister for SOEs and Minister for Communications. This indicates that the process of corporatisation was undertaken with alacrity. During the draft of the legislation no thought was given to other rules and gaps that needed to be filled.

In an amendment in 2003 to the IPBC Act Parliament vested in IPBC the power to appoint directors and CEOs. In explaining the rationale for the amendment in Parliament, the Prime Minister stated that “the Government amended the IPBC Act last year to give NEC full authority over decisions in sales and the appointment of directors, CEOs and consultants to IPBC and its vested entities. This is aimed at enhancing accountability and ensuring that the Government is in full control of the

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<sup>43</sup> *Constitution of PNG Power Ltd*, s 23.2.

<sup>44</sup> *Independent Public Business Corporation of Papua New Guinea Act 2002*, s 8.

policy approach and outcomes.”<sup>45</sup> The effect of the amendment is that the Government appoints directors and CEO of IPBC and makes policies and where necessary implements them. That means that it can involve itself directly with state companies in the implementation of the policies. Further, the effect of the amendment caused confusion and inconsistencies between the IPBC Act, the *Companies Act*, and the company constitutions, which have not been updated to meet the recent changes.

### **14.3 CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA**

The discussion in section 13.2 above, establishes the position of law in individual SOEs that are the subject of the case studies in Part V. The discussion in this part looks at the general position of corporate governance in statutory corporations and state companies by comparing corporate governance practice presented in Part V and law on corporate governance presented under section 13.4 in this chapter. From the data analysis five major themes emerged with their sub-themes. This part firstly discusses the understanding of the concept of corporate governance by directors and senior managers. Second, the explanation provided on the role of the Government. Third, role and composition of the board is discussed. Fourth, accountability in statutory corporation and state companies is discussed, and then followed by discussion of the objectives. Each of these themes is discussed under statutory corporations and state companies (except the theme on understanding of corporate governance), together with finding from literature reviews.

#### **14.3.1 Views on Corporate Governance**

Corporate governance is a new concept in PNG. The interview data shows that the interviewees have diverse views and understanding of corporate governance whilst others have no idea at all about what it is. The views and understanding depended on whether the participants were earlier introduced and exposed to the concept through

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<sup>45</sup> Somare, M., “Statement to Parliament on Privatization Policy,” (2003) in *Prime Minister of Papua New Guinea*, <  
<http://www.pm.gov.pg/pmsoffice/pmsoffice.nsf/pages/BFB46DA34BF5B5E64A256D6500169E94?OpenDocument> > at 14 October 2008.

training, during the course of their work or read or had heard about it. The diverse views are the result of different exposure to the concept.

**Familiarity with corporate governance.** Many of the interviewees who attempted to explain corporate governance were familiar with the concept. These persons were either senior managers who have been working in SOEs over many years, or educated at the university level or senior expatriate managers. Many of the explanations that were given did not fully explain corporate governance. For example, one director stated that corporate governance “is something to do with how a corporation is run” (NHC - SM3). The definition is too vague. Who and how corporations are governed is not explained and accountability to whom and for what is not clearly explained. Another interviewee stated that corporate governance is something to do with directors and managers (T – SM1). This does not explain corporate governance. Clearly, there is need for education on corporate governance. Only through education will directors and managers understand governance and accountability structure and processes.

**Unfamiliarity with corporate governance.** More than half of the interviewees had not heard of corporate governance. This group of people comprised the directors of statutory corporations. Many of them were directors representing interest groups and they lived in rural areas or had not been dealing with corporate governance issues. They also included few of the directors in state companies. Half of the interviewees had heard about corporate governance but could not explain it. One of the reasons for lack of understanding is that SOEs do not conduct training for directors and managers or conduct induction workshops. Many participants expressed disappointment over lack of these programmes.

**Need for education.** Nearly all participants agreed that there is need for education on corporate governance. They agreed that many problems that they have encountered relate to a lack of appreciation and understanding of what corporate governance is. A minority of the interviewees see no need as it is waste of time and money and they think that they essentially do what is required of them as directors and managers. There is greater need for education in corporate governance, particularly the general

fiduciary obligations of directors and managers and their specific responsibilities in individual SOEs.

### **14.3.2 Statutory Corporations**

#### **14.3.2.1 The Role of the Government**

Responsible Ministers, on behalf of the Government are hierarchically above the board and management of statutory corporations, and deal directly with the board and management. The following sub- themes emerged from the interview data.

**The role of responsible Minister.** The specific roles and responsibilities of responsible Ministers are provided under the NBC Act and the NHC Act. These do not restrict the Ministers to perform any other responsibilities that are deemed necessary or otherwise. The interviewee data indicated that Ministers intervene in all aspect of the activities of statutory corporations. The responsible Ministers can direct the management to open an account with a bank of his/her choice or direct the management on how to spend money. The data indicated that responsible Ministers see no limit to their responsibilities towards the corporations. The roles of these ministers are analogous to a responsible Minister of a government department. The impression given during the interview was that Ministers have no appreciation of corporations as having the status of “separate legal entity”.

**Involvement in policy and operational matters.** As stated above responsible Ministers deal directly with statutory corporations. The level of intervention in policy and operational matters of corporations involves directing and advising management on the type of policies to be implemented, and where and how to implement these policies. This is done to an extent that undermines managerial exercise of discretion. The case studies show that Ministers deal with operational matters without regard to the managers who are required to deal with these issues. As one letter to the editor puts it, “Minister seems to be running a one man show at NHC and innocent tenants

are being evicted without the consensus of the NHC officials”.<sup>46</sup> Eviction of tenants is not the responsibility of the Minister. Interview data also shows that responsible Ministers have no sense of distinction between policy matters and operational matters of corporations. Both the NBC Act and the NHC Act have allowed Ministers to involve in certain operational matters. This clouds the distinction between policy and operational matters. These license the Ministers to involve themselves in all activities of the corporations.

**Appointment and removal of directors and CEOs.** It is seen in chapter 12 that responsible Ministers appoint and remove CEOs directly without consulting bodies that they ought to consult required under the legislations. This enables responsible Ministers to appoint associates that Government prefers so as to advance their political agendas in the corporations. The Ministers, unfortunately, are not held to account for their actions. Directors and CEOs are terminated often, without any proper justification and compliance with procedures. This is clearly stated in *Paul Asakusa v Andrew Kumbakor*<sup>47</sup> where Justice Injia stated that “the Minister and the NEC had not followed the procedure prescribed by ss 8 & 9 of the *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004* [the RSA Act] in that the decision to suspend and appoint an acting CEO were not based on any recommendation of the board of NHC”. The case of Paul Asakusa is just one of the many instances where Government appoints a director or a CEO without complying with procedures. This explains directors and CEOs moving in and out without settling in their jobs. The consequence is that a CEO who is terminated after one year of a four-year term would be paid contractual entitlements for three years without meeting the full term. Taxpayers are made to pay exorbitant amounts for incompetence and ineffectiveness.

**Corporate Plans.** Statutory corporations do not have corporate plans but only give effect to government policies that are adopted as a management plan. Even though

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<sup>46</sup> Simboy, East Boroko, “NHC needs Overhaul,” (Port Moresby, 27<sup>th</sup> May 2009) in *Post Courier*, < <http://www.postcourier.com.pg/20090527/wehome.htm> > at 27 May 2009.

<sup>47</sup> For example *Paul Asakusa v Andrew Kumbakor, Minister for Housing & Others* [2009] PGNC 39; N3303 (10<sup>th</sup> April 2008) < <http://www3.pacii.org/pg/cases/PGNC/2008/39.html> > at 18 March 2009.

the enabling legislations (i.e. the NBC Act and the NHC Act) provide for their objectives, the management generally adopts government policies as their management plans. In addition responsible Minister can give directions to the management from time to time on policy matters. This allows the Minister to intervene in the affairs and business of corporations from time to time and not necessarily with regard to policy matters only.

**Access to information of corporation.** The Government through responsible Ministers has total access to all information of statutory corporations. They may request any information from time to time, including confidential information. The managements see it important for them to provide information to the Ministers and the Government so that they are updated about the progress of the corporations. Many of them feel that their primary obligation is to the Government. These views and the culture within statutory corporations have generally allowed Ministers to have total control of the corporations.

#### **14.3.2.2 The Board**

The boards that are supposed to ensure accountability in statutory corporations are indecisive and ineffective. Their only job is approving certain transactions undertaken by the management. This job is easily done by having CEOs walking into the Minister's office to have the transactions approved. The example that shows the insignificance of the board is when the terms of members of the board of NBC expired in early January 2008 and the Minister did not appoint new board members for over eight months. At the time of writing the new board was still not put in place. One senior manager summarized the view that they have of board members that; "directors come to board meetings to only receive their allowances" (NHC – SM2). The board is merely used as a "rubber stamp". If the board is to be effective then it has to be given other important responsibilities and these responsibilities must clearly be provided under corporations' charters or documents.

**Roles and responsibilities of directors.** The roles of stakeholders in governance of statutory corporations are not clear. The roles and responsibilities of the board,

chairperson, directors and CEO are not provided under the NHC Act, whereas in the NBC the roles of chairperson and CEO are provided. It is difficult for those officers whose roles are not provided to know how to conduct themselves. Consequently, corruption is rampant in statutory corporations. For example, in a case where police forcefully and unlawfully evicted a family from its home of 13 years, Justice Mark Sevua made the following observation; “allegations of serious corruption within the NHC is not a new issue, but is condoned and allowed to flourish with impunity by NHC management”.<sup>48</sup> This is serious, especially coming from a senior judge of over 20 years. The problem is exacerbated in appointing associates of the executive government with no experience and knowledge in governance, without following procedures enshrined in the enabling legislations or the RSA Act.

**Appointing and Monitoring CEOs.** Unlike state companies a board does not appoint CEOs in statutory corporations. The responsible Minister directly appoints the CEO in the NBC. This is in compliance with the NBC Act. The appointment of the CEO must comply with procedures under the RSA Act before the Government makes the appointment. From the interview data, these processes are never complied with. The Government either influences or directly appoints and removes CEOs. As a result, many of these matters appear before court for procedural irregularities. Lack of uniformity in the appointment and removal of CEOs in both NBC and NHC is clearly noticeable. Both are statutory corporations and require consistency and uniformity in the appointment and removal processes. Further, the Government must be made to comply with procedures for appointment and termination.

**Composition of the board.** Boards of statutory corporations consist entirely of non-executive directors including the chairperson, and there are no board committees. The fact that a board does virtually nothing means that there is really no need for board committees.

**Knowledge of the affairs and business of corporation.** Board members lack a detailed knowledge of the business and affairs of the corporations. All board

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<sup>48</sup> Arlo, J., “NHC, Police blasted for Unlawful Actions,” (Port Moresby, 28<sup>th</sup> May 2009) in *Post Courier*, < <http://www.postcourier.com.pg/20090528/thhome.htm> > at 28 May 2009.

members are in full time employment with other organizations and they do not have time to acquaint themselves with the information of the corporation. Many directors are appointed and removed at the whim of the Government and they do not have time to fully acquaint themselves with the information of the corporation. Also the only job that directors perform is the approval of strategic plans to be implemented by the management, therefore there is less need for them to know detailed information of the company. Directors are an important part of the corporation and they need to be informed about the affairs and business of the corporation.

#### **14.3.2.3 Accountability**

Accountability is totally weak in statutory corporations. The board that was supposed hold management accountability is weak and ineffective. The Minister is in fact performing the duties of the board. Lack of accountability can enable the Minister to divert the resources of the corporation to advance political interests or involve in self-interested activities.

**The role of Parliament.** Matters with regard to the NHC and the NBC are not discussed or given much attention at the national Parliament. The Parliament is not performing its democratic responsibilities. It is an important institution that acts on behalf of the people to hold responsible Ministers accountable. When Parliament is not performing its democratic obligations responsible Ministers are not accountable to any persons. Parliament must be activated to perform its parliamentary responsibilities.

**Confusion over the role of state institutions.** The interviews show confusion over the role of state institutions. It is clear the Auditor General audits the accounts of statutory corporations. The Department of Treasury receives annual reports from the NBC but not the NHC. The laws governing the NBC and the NHC are silent on whether the Ombudsman Commission and PAC can investigate the conduct of the NHC, the NBC, directors, chairpersons and CEOs. The interview data indicated that there was no past experience of their intervention. Half of the interview participants indicated that they do not know about whether these institutions can investigate the

corporations, while others stated that although they are not certain, investigation is essential. The roles of these state institutions must be clarified in relation to statutory corporations.

**Corporate plans and reports.** Both statutory corporations do not have a corporate plan. They implement government policies, and for the NHC resolutions of the management (endorsed by the board). Both the NHC and the NBC are subject to Part III of the PFM Act and are required to submit a management plan and annual reports to the Department of Treasury; however they do not submit their plan and reports. For the NHC, the reason given during the interview is that the Government does not fund the NHC. This reasoning is flawed because firstly the NHC uses State's assets to generate revenue and secondly, the NHC Act adopted Part III of the PMF Act and it is mandatory under ss 50 and 64 to submit a management plan and annual reports to the Department of Treasury, respectively. For the NBC, the reason given was that it only implements government policies. Justification for lack of management plan must not undermine the mandatory nature of ss 50 and 64. That means every statutory corporation must have a management plan, which must be submitted to the Treasury. Further, the NBC submits annual reports to the Government and the office of the Treasury, whereas the NHC submits only to the Government. Both corporations do not have standard content for annual reports. There is a need for consistency and clarity in who the report must be submitted to and about what is to be reported.

#### **14.3.2.4 Objectives**

Both the NHC and the NBC are required to implement government policies. NHC is not supported through budgetary allocations and as a result it undertakes some commercial activities to sustain itself. Although statutory corporations are required under Part III of the PFM Act to have a management plan, this requirement is not enforced by the Department of Treasury. Even if they do have plans they are unlikely to be implemented with constant involvement and directions by Ministers. From the case studies the public rates the services of the NHC and the NBC poor. That means that services provided by statutory corporations to the public are inefficient and of low quality.

### 14.3.3 State Companies

#### 14.3.3.1 The Role of the Government

The shareholders are owners of the company and they are provided with reserve powers under company legislation (chapters 4 and 10). There is an odd situation in state companies in PNG. IPBC is the main and only shareholder after enactment of the IPBC Act in 2002 and yet state companies deal directly with both IPBC and the relevant ministers. The following sub – themes emerged from the interviews.

**Uncertainty about the role of relevant ministers.** IPBC is the only shareholder in state companies. From the interview data it is clear that the Minister for SOEs was supposed to deal directly with IPBC and not state companies, but that is not the case. The Minister bypasses IPBC and deals directly with the board and the management. The main role of IPBC is managing state companies in such a way as to increase their value so that they can be sold in accordance with Government's policies on privatization. The roles of the responsible Ministers are not provided in the *Companies Act 1997*, the IPBC Act or other relevant statutes and yet they continue to involve in affairs and business of the companies. Other state companies deal only with the Minister for SOEs but Telikom in addition deals with the Minister for Communications whose role is also unclear. From the data it appears that ministers can intervene in all aspects of SOE activities. Directors in SOEs and the IPBC cannot challenge the intervention or directions as most of them are politically appointed. With lack of clarity about their role it is difficult to hold the relevant ministers to account.

**Involvement in policy and operational matters.** The Minister for SOEs is not a shareholder and yet is involved directly in the policy and operation matters of state companies. The Minister for SOEs is consulted in the drafting of the corporate plan and can intervene from time in giving policy directions. Further, the Minister is involved in operational matters. One of the examples provided in the data was the decision of PNG Power to renovate and extend the Power Station in Wewak, East

Sepik Province; but instead the Minister for SOEs gave direction for money to be utilized in building houses for government employees in Wewak (PNGP – SM3). It appears from the data that if it is politically convenient the relevant ministers can intervene in the operational matters of state companies. As stated above that the directors and CEOs are political appointees and cannot raise objections or challenge direction from the Minister.

**Appointment and removal of directors and CEOs.** From the case studies, the Minister for SOEs appoints and removes directors, and the chairperson.<sup>49</sup> During the case studies it was discovered that nearly all of the directors and CEOs have political affiliations. This establishes the fact that appointments are made to put persons with government affiliation in positions to assist in achieving political agendas or to pursue self-interests. For example appointments are made of persons who have associations with ruling parties so that whilst in the job they can accumulate enough financial resources to compete in the next elections.<sup>50</sup>

There are inconsistencies between different rules and regulations and the practice on the appointment and removal of directors and CEOs. IPBC is the only shareholder of state companies. By virtue of the *Companies Act 1997*, the IPBC is required to appoint and remove directors. This is not the case in practice. The IPBC Act also requires IPBC to appoint and remove directors and CEOs. PNG Power's constitution requires shareholders to appoint and remove directors except casual vacancies.<sup>51</sup> Shareholder in this case is IPBC and not the Minister for SOEs. Eda Ranu's constitution specifically provides that the Minister appoints the directors. The Minister complies with the constitution; however it is contrary to the IPBC Act and the *Companies Act 1997*. Telikom's constitution provides for shareholders to appoint the directors and the board to appoint the CEO. In practice, the Minister appoints the

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<sup>49</sup> For example, the Minister for SOE sacked all members of the board followed by public uproar and the Prime Minister ordered their reinstatement. See Radio New Zealand International, "PNG PM orders Reinstatement of Telikom Board," (13<sup>th</sup> December 2004) in *Radio New Zealand International*, < <http://www.rnzi.com/pages/news.php?op=getresults&offset=440&keywords=somare> > at 18 March 2009.

<sup>50</sup> See The National, "Bonga Payout a Subject of Dispute," (Port Moresby, 4<sup>th</sup> May 2007) in *The National*, < <http://www.thenational.com.pg/050407/nation4.htm> > at 18 March 2009.

<sup>51</sup> *Constitution of PNG Power Ltd*, ss 16.3 and 16.4.

directors and the CEO is appointed by the board on the recommendation of IPBC and the Minister for SOEs. The appointment by the Minister is contrary to the requirements of the IPBC Act and the *Companies Act*. Further, the constitution of Telikom does not say that the appointment of the CEO must be made on recommendation by IPBC and the Minister. Clearly, there are inconsistencies between practice, statutory requirements, and the constitution of the companies. They need to be streamlined so that there is consistency.

**Corporate plans.** The board of state companies consults IPBC and the Minister for SOEs in the formulation of corporate plan. The recommendation of the Minister and IPBC must be incorporated into a corporate plan. The Minister and IPBC have different objectives that they would like state companies to pursue. IPBC's incentive is to see companies maximize profit as a means to privatization. On the other hand the Minister's interests are to ensure that companies are involved in community service obligations. This can allow for two conflicting directions. However, given the fact that directors and CEOs in IPBC are political appointees they can be submissive to the demands of the Government. Therefore, the corporate plan would reflect the wishes of the Government. In addition, the fact from interview data shows that the responsible Minister can intervene and direct management of companies from time to time, allows room for Government to impose political agendas on companies or to connive with management to pursue self-interests. That means requirements under the corporate plan cannot necessarily be followed.

**Access to information of a corporation.** From the case studies responsible Ministers have right of access to all information of state companies on request. This is irrespective of whether it is information relating to policy or to operational matters. This is odd as the Minister is not a shareholder and there is no expressed provision in the role of the Minister with regard to accessing information and the type of information that the Minister should have access to.

### 14.3.3.2 The Board

State companies in PNG have one-tier board structure. The board represents the interests of shareholders and it must be accountable to them from time to time. Boards of state companies have divided accountability to both IPBC and relevant ministers. Powers that are traditionally given to boards of private companies, such as the power to appoint CEOs, are removed from them. Hence the board is generally weak and indecisive. The board is never used to consider anything substantive. Apart from appointing CEOs the board is only used as a rubber stamp.

**Roles and responsibilities of directors.** The general responsibilities of directors are provided under the *Companies Act*, which does not provide expressly for the powers and functions of the chairperson and CEO. Nearly all directors of state companies who were interviewed did not know their duties under the *Companies Act*. Some company constitutions did help in specifying their responsibilities whilst others did not. It is clear from the case studies that directors do not understand their roles and responsibilities, either because they do not have access to the documents or they are not specifically prescribed under the company constitutions. All corporations (that were the subject of case studies) did not have codes of conduct for the directors. At the time of the interview, the company secretary of Telikom was working on a code which will be sent to the board for endorsement. Generally directors and managers endeavour to achieve the objectives of the corporation without complying with standards of fiduciary duty and duty of care. Without clear knowledge of these responsibilities, it is difficult to assess whether their conduct, or following governmental directions, may be in breach of these duties.

**Appointing and monitoring CEOs.** Appointments of CEOs in state companies are usually made by the board. In doing so the board is provided with disciplining power to hold managers accountable to them. In state companies, the limited power that they have of making appointments is further reduced. The board only appoints CEOs on recommendation by IPBC and the relevant ministers. The power of appointment and termination is usurped by the Government and IPBC. Consequently, former directors expressed the view that they were reluctant to challenge any decisions of CEOs and

management. Also the board does not have the power to discipline the management. When a CEO is on good terms with the Government, the board would not challenge any of his or her decisions. Doing so would only be putting their positions in jeopardy. Further, both directors and CEOs are government associates and hence challenge and constructive criticism is limited or absent. Also many of the directors lack independence - have political affiliation. Therefore they cannot effectively monitor CEOs as they are also appointed by Government.

**Composition of the board.** Boards of state companies consist entirely of non-executive directors, except Telikom and Eda Ranu which have full time chairpersons. These chairpersons ensure that board agendas are prepared and that strategies approved by the board are implemented. The CEOs of Telikom and PNG Power (but not Eda Ranu) are members of the board. These state companies do not have executive directors. They are all state companies and yet composition of the board differs. There is need for consistency in board composition. Further, the boards of state companies have board committees. Two main committees are common in these SOEs. These main committees are the Audit and Risk Management Committees and Human Resource Committees. The interview data indicated that none of these committees look into issues regarding corporate governance. It was indicated in the case studies that all major issues are considered by the board and committees are not often used. Other matters which require more time are delegated to committees for their considerations. The impression given from the data is that board committees are ineffective and not often used.

**Knowledge of the affairs and business of corporation.** Nearly all directors of state companies work on a part-time basis. They are also on full time appointment with other organizations and are members of boards of other companies and SOEs. Given their divided commitments and time they would not be able to give much time and commitment to SOEs activities. The only time they have access to company information is at board meetings. Many of these directors generally lack intimate knowledge of the affairs and business of their companies and particularly lack technical knowledge of company businesses. In order to make decisions directors need to know all information about the companies.

### 14.3.3.3 Accountability

As stated above, boards that should monitor management are ineffective. It is only used as a rubber stamp to approve major transactions. The national Parliament that is supposed to ensure accountability is not interested in the affairs of SOEs. Furthermore, there is confusion over the role of state institutions that ought to monitor SOEs. This leaves SOEs as the backyard for Government and relevant ministers to manage as their private properties.

**The role of Parliament.** Boards of state companies submit annual reports to IPBC, which passes them onto the Government upon request. From the case studies the Government never discusses any issues with regard to state companies in Parliament. The views expressed by directors and managers are that they submit reports and what happens in Parliament is not their problem. When the issues of SOEs are not debated in Parliament the Minister is not held to account for his conduct in SOEs and for the activities of SOEs.

**Confusion over the role of state institutions.** The Auditor General audits the accounts of state companies. In all cases with regard to auditing the Auditor General outsources the auditing responsibilities to private audit firms. The board has no control over who should audit the company. Compliance with the *Companies Act* would mean that, a company, through its board, would appoint the auditor.<sup>52</sup> However, it is clear from the data that this is not the case. The requirement under PNG's *Constitution* and the *Audit Act 1989* is that the Auditor General must audit public bodies. Hence accounts of state companies are submitted to the Auditor General for auditing.

Further, from interview data there was a mixed response by interviewees and confusion over the roles of certain state institutions in relation to state companies. Many participants interviewed stated that they are not certain whether state

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<sup>52</sup> *Companies Act 1997*, s 190.

companies and their directors and CEOs are subject to investigation by the Ombudsman Commission. The confusion becomes obvious after the incorporation of these entities under the *Companies Act*. Few participants expressed views that the Ombudsman Commission can investigate SOEs but it has not been doing its job. Company documents and relevant legislation do not assist with expressed provision on whether companies are subject to the Office of the Ombudsman. With regard to PAC the answer “no” was given to the question of whether they are subject to investigation by PAC. Like the Ombudsman Commission’s involvement, statutes and company documents are not clear in stating whether companies are subject to investigation by PAC. The company secretaries for Telikom and PNG Power clearly indicated in the interviews that these matters need parliamentary clarification. If the Auditor General audits public bodies, PAC and the Ombudsman Commission were established to investigate public bodies. The logical conclusion would be that the Ombudsman Commission and PAC should investigate state companies. These issues will be discussed in chapter 15.

**Corporate plans and reports.** All state companies have a corporate plan that sets out their objectives and it is reviewed every three years. It is difficult to assess whether the companies are achieving their goals. The management does not have a clear strategy to achieve goals within six months or one year. With Government interference being a regular occurrence many of these objectives may not be achieved after three years. Further, state companies submit their annual reports to IPBC and the Registrar of Companies. Apart from the content requirement under the *Companies Act* there are no set standards for content reporting.

#### **14.3.3.4 Objectives**

The emphasis placed on state companies is to maximize profit. Unlike the two state companies that are the subject of these case studies, only the enabling Act of Telikom provides for a community service obligation. This means that for others they would only provide service for profit, unless relevant ministers compel them to provide community services. Government participation in SOEs is important to ensure these community service obligations are fulfilled. This makes it confusing for state

companies, because they have to deal directly with IPBC and responsible Ministers who have different objectives that they would like SOEs to pursue. State companies have made substantial profits in the last three years; however this is not reflected in the quality and efficiency of their services. This also poses the question of how much of the profits are being pushed back into the companies for community services. From the case studies the efficiency and quality of services are rated poor in all SOEs.

#### **14.3.4 Summary**

The main issues that consistently and prominently figure in corporate governance in statutory corporations and state companies are reviewed in sections 13.4 and 13.5, and are summarized as follows.

- a. There are inconsistencies between the laws and practice in SOEs.
- b. There is uncertainty over whether SOEs are subject to inspection and investigation by the Ombudsman Commission or PAC.
- c. There is a lack of parliamentary debate on matters regarding SOEs.
- d. Procedures are often not followed in appointing and removing directors and CEOs.

The issues that are highlighted specific to statutory corporations (i.e. NHC and NBC) are as follows.

- a. Both NHC and NBC do not have corporate plans. Generally, they implement government policies.
- b. NBC, but not NHC, submits an annual report to the Department of Treasury.
- c. The responsible Ministers are involved in the operational and policy matters of NHC and NBC and can direct the corporations from time-to-time with regard to policy and operation matters.

Some of the recurring themes that arise in state companies (i.e. PNG Power, Telikom and Eda Ranu) are as follows.

- a. There are inconsistencies between different rules and regulations that govern SOEs on corporate governance including company constitutions. Similarly, there are inconsistencies between the rules and the practice – this causes confusion.
- b. IPBC is the main and only shareholder of state companies but the responsible Minister for SOEs deals directly with SOEs in appointing directors and chairpersons, and directing state companies from time to time. Some of these actions are *ultra vires*.
- c. Telikom has two responsible Ministers, including the Minister for SOEs and the Minister for Communications whereas other state companies have only the Minister for SOEs.
- d. State companies submit their annual reports to IBPC rather than to the Department of Treasury or directly through Parliament.
- e. The roles of the responsible Ministers are not specified in any company documents.
- f. The Minister for SOEs and other responsible Ministers direct the board/management from time to time despite the fact that they are not shareholders.

Also, it is important to mention that the Government involves actively in all policy and operational matters in statutory corporation. It only involves in operational matters in state companies when it is politically convenient. All these identified issues relate to governance and accountability in SOEs. To identify the strength and weaknesses in any system it must be compared and contrasted against other systems. Hence, the discussion below identifies features of corporate governance in PNG that are different from NZ, Queensland and NSW as discussed in chapter seven.

#### **14.4 CORPORATE GOVERNANCE IN NEW ZEALAND, QUEENSLAND AND NEW SOUTH WALES COMPARED WITH CORPORATE GOVERNANCE IN PAPUA NEW GUINEA**

Corporate governance in NZ and Australian public sectors is discussed in chapter seven. It is clear from that discussion that relevant legislation has not distanced the Governments from SOEs. Further, it was concluded that SOEs would never replicate

the features of the private sector as long as the Government is a sole shareholder. It is useful to compare the PNG model with the NZ, Queensland and NSW models. PNG's model of corporate governance in public enterprise is similar in form to the models of NZ, Queensland and NSW but different in its substance. Their legislation provides simplicity, consistency and clarity with regard to the role of responsible Ministers, directors and CEOs, and also on the issue of accountability. The legislation also provide that SOEs should pursue both commercial and non-commercial obligations. There are major differences in governance and accountability between SOEs in PNG and those in NZ, Queensland and NSW.

NZ's *State-Owned Enterprises Act 1986* applies to all commercial SOEs in addition to specific Acts, the *Companies Act 1993* and company constitutions. Non-commercial SOEs are subject to the *Crown Entities Act (CE Act)* as are some of the non-commercial SOEs that are incorporated under the *Companies Act 1993*. SOEs in Queensland and NSW are subject to the *Government Owned Corporations Act 1993 (GOC Act)*, the *State Owned Corporations Act 1989 (SOC Act)* and the entity's own Acts, respectively. SOEs that are incorporated under the *Corporations Act 2001* are also subject to the GOC Act and the SOC Act. Unlike NZ, the GOC and SOC Acts cover both statutory corporations and state companies, and provide for the legal structure, governance and accountability of all SOEs. The enactment of respective NZ and Australian legislation is not an attempt to make "one size fit all" but to ensure that common elements shared in governance and accountabilities are fused and stressed to ensure clarity and consistency.

As highlighted above PNG lacks the generic legislation that governs SOEs. Statutory corporations are subject to their respective constituent laws and the PFM Act for accountability. State companies have specific Acts, *Companies Act 1997*, company constitutions and the IPBC Act. These different laws with different provisions on specific issues create inconsistencies and uncertainties; hence they contribute, to a certain extent, to the lack of accountability. PNG needs generic legislation similar to NZ, Queensland and NSW that must provide for statutory corporations and state companies and their governance and accountability.

### 14.4.1 The Government

There are many similarities and differences with regard to the role of government in public enterprises in the NZ, Australia and PNG public sectors. First, the relevant ministers in SOEs in NZ and Australia deal only with policy matters. They have a great influence with policy matters and strategic direction of SOEs. It is seen in chapter 7 that legislation provides for negotiations between the Ministers and the board in formulating agendas under the Statement of Corporate Intent (SCI), but it is clear that in the end shareholding ministers retain the prevailing right of objection and the power to impose their views on the final outcome. Similarly, shareholding ministers and responsible Ministers have the power to inform the board from time to time of government policy. This indicates that shareholders have ultimate power to determine the objectives that an SOE should pursue. Shareholders' direct intervention defeats the whole intention of having an autonomous board, separating politicians from management, making the intentions of corporatisation still an ideal.<sup>53</sup> Consequently, ministers deal only with policy matters.

Generally, in PNG the Government involves in both the policy and operational matters of SOEs. Laws governing statutory corporations provide for the responsible Ministers to be involved in policy and operational matters of the SOEs. For example, the Minister for Communications can direct NBC to open an account with a bank of his or her choice. Further, the data shows that relevant ministers can intervene any time on policy and operational matters of statutory corporations. In PNG statutory corporations are like a government department where a minister as political head can be involved in both the policy and operational matters of a department. Although legislation and other company documents are not clear on the role of relevant ministers in state companies, interview data shows they can also intervene in the policy and operational matters of state companies. Government must be made to deal with policy matters only in SOEs. The direct intervention of government in

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<sup>53</sup> Galvin, B., Victoria University of Wellington and Institute of Policy Studies, *Corporatisation and Privatisation: Completing the Revolution?*, (papers presented at a seminar held on 3 September 1987 in the Michael Fowler Centre, 1987) 3.

influencing policy implementation without related powers to do so creates the potential for corruption.

Second, there are two shareholding ministers in SOEs in NZ and Australia. They are the responsible Minister and the Minister for Finance. Shareholders in NSW are the Treasurer and a minister appointed by the State Premier. In addition, SOEs in NSW have a portfolio Minister. The potential for collusion is reduced in having two shareholding ministers, who can hold each other accountable and work together on a concerted understanding in the public interest. There is a potential problem in having two shareholding ministers. They may have different interests, priorities and views about how an SOE should be governed, the type of objectives to be pursued and the objectives that should be given priority. That means having two shareholding ministers can create a divided accountability.<sup>54</sup> Two ministers may have different views. For example, they may have different views about the goals that a SCI must have and how they should be pursued. Or conflict may arise given the fact that the Minister of Finance represents an electorate, the Government and Department of Finance - three institutions having different expectations from each other and their expectation for SOEs will also be different. Likewise, the responsible Minister represents different groups and his or her expectation of SOEs will be different from the first shareholding minister. In such circumstances the implementation of an SOE's objectives can be weakened due to the interplay of different interest of, not only shareholding ministers but also other governmental agencies.<sup>55</sup> Conversely having one shareholding minister can also allow the Minister to push agendas through without resistance or challenge.

PNG has a responsible Minister for individual statutory corporations and IPBC is the only shareholder of state companies. In addition, state companies have a sole responsible Minister, namely Minister for SOE, and in Telikom's case two responsible Ministers, including the Minister for Communications. The role of the Minister for SOEs is not outlined, however they are required to deal with IPBC on

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<sup>54</sup> Dixit, A. K., *The Making of Economic Policy: A Transaction-Cost Politics Perspective*, (1996) 51–52.

<sup>55</sup> Whincop, M. J., *Corporate Governance in Government Corporations* (2005) 66.

matters with regard to SOEs but this is not the case in practice. The concern in PNG is not conflict of interest among numbers of relevant ministers but allowing sole ministers to be involved in the affairs of SOEs. Statutory corporations must have two responsible Ministers and state companies must have autonomy. Any differences between the two responsible Ministers can be resolved in Cabinet. Any issues in SOEs that require the relevant minister's involvement must be specified.

Third, the governments in NZ and Australia appoint directors to SOEs. Governments may have political incentive in appointing directors to serve on the board. The power to appoint may ensure that appointed candidates are government associates so that government can influence them in order to use SOEs for political support or pursue other interests. The candidates can be appointed to the position of a director or CEO who share the same views as shareholding ministers or government. This means that the board and CEO will manage an SOE in such a manner that the shareholding ministers fulfil their wishes but do not directly mandate.<sup>56</sup> Where an SOE is managed in such a manner contrary to the wishes of shareholding ministers, they can issue credible threats.<sup>57</sup> There may be the threat of influencing appointment or termination, reduced-funding to an SOE or even regulation to reduce some of the powers of the management. Although criteria such as qualifications and experience are important factors for consideration in the appointment, they can be circumvented in SOEs. The ultimate discretion in the appointment and termination would see directors go in and out of power like a revolving door.<sup>58</sup>

Like NZ and Australia, the Government in PNG appoints directors to SOEs. From the case studies many directors and CEOs in PNG's public sector have no knowledge or experience in managing corporations. Almost all directors and CEOs are government associates, not to mention the fact that the appointment of directors in state companies is illegal as it is contrary to the *Companies Act 1997*. The Minister for SOEs is not a shareholder and yet continues to appoint directors. Many of the directors are political associates. The appointment of directors and CEOs to statutory

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<sup>56</sup> Ibid at 118.

<sup>57</sup> Dixit, A. K. and Nalebuff, B., *Thinking Strategically: The Competitive Edge in Business, Politics, and Everyday Life*, (1<sup>st</sup> edn., 1991) 124 – 126.

<sup>58</sup> Whincop, *Corporate Governance in Government Corporations*, above n 55 at 69.

corporations (not including NBC) is provided under RSA Act, however often the procedures are not complied with. Government needs to comply with legislative procedures in appointing directors and CEOs to statutory corporations. It must not be involved in the appointment or removal of directors or CEOs in state companies.

Fourth, the appointment of directors to SOEs in NZ and Australia is generally made on merit. But it must be admitted from the outset that appointments in SOEs are complex. Appointments in the private sector are based on managerial skills and experience. A director must have business and managerial skills and experience to ensure efficiency and profitability, to satisfy the requirement of successful business. However, in the public sector the board has to represent the ultimate residual claimants, the public. This requires directors to represent different interest groups such as employees and consumers. The group interest that a director represents obscures factors such as political affiliation. Interest groups would have a greater role in influencing the Government, and may easily pursue the Government to include their representative on the board, albeit having no specific investment interest or stake in the SOE. They bring different interests on board. Having a board that has different directors representing different interest has the potential to give rise to a conflict of interest.<sup>59</sup> The fact remains that as long as the Government makes appointments, they would be made to assuage special interest groups in return for political support or to repay political favours. Clearly, when other interests are pursued this easily leads to dissipation of the business aim of profit maximization.

In PNG interest groups have less impact on national politics (chapter 8). The Government directly appoints directors and most of them are political associates. These appointments are made to reward loyalty and support by appointing to positions in order to assist in advancing political and/or self-interests. It is advisable to have professional directors on SOEs as they are less threatened by termination than others, with future prospects for employment, having their reputation intact,<sup>60</sup> by ensuring the firm's performance standard are complied with. The down side is that

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<sup>59</sup> Ibid at 70.

<sup>60</sup> Ibid at 71.

they may have outside business interest that may conflict with the SOE's interests.<sup>61</sup> Directors must be appointed on merit. This requires standard criteria to be set out that are based on merit.

Fifth, in Queensland the boards of GOCs appoint CEOs with the approval of responsible Ministers. In contrast the NSW Government appoints CEOs of statutory SOCs with the recommendation of the board. In these cases the Government appoints or has an influence on the appointments. The important power of control through the appointment and removal of CEOs is shared with the Government. This can enable cohorts of government to be appointed to CEO positions. In a private corporation it is the board that appoints and terminates CEOs with minimal outside influence (although some shareholders influence the appointment of CEOs, especially in corporations where there is concentrated ownership in the form of institutional shareholders like in the UK and Australia). This is the approach taken by NZ where boards of SOEs appoint CEOs. In PNG, the Government appoints and terminates CEOs in statutory corporations. In state companies boards appoint CEOs on the recommendation from the Government and IPBC. The board's role is merely ceremonial. The important power to discipline management is taken away altogether from the board. Boards of SOEs must be given the exclusive power of appointing CEOs and senior managers.

Sixth, the processes involved in the appointment and termination of directors in statutory corporations and state companies in NZ and Australia are consistent and uniform. In PNG there are inconsistencies. In NBC the responsible Minister directly appoints directors and CEOs. In NHC procedures under the RSA Act have to be complied with, however in practice the Minister directly appoints directors and CEOs without consultation. The *Companies Act*, IPBC Act and company constitutions stated different things about the appointment of directors and CEOs. The process of appointment and termination in SOEs must be made consistent and uniform.

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<sup>61</sup> Duncan, I. and Bollard, A., *Corporatization and Privatization: Lessons from New Zealand*, (1992) 28.

Seventh, reporting to a parent department is no longer required in SOEs in NZ and Australia. The board is directly responsible to shareholders or responsible Ministers, but not the Department of Treasury when dealing with financial matters. This would ensure strict scrutiny by government; however not having an enabling system through a parent department may subject SOEs to direct political pressure. Originally parent departments would have acted as buffer zones to resist any political pressure.<sup>62</sup> This is true of SOEs in PNG. Statutory corporations, apart from NBC, are only accountable to responsible Ministers and not the Department of Treasury. The board and management are at the discretion of the responsible Ministers. Although IPBC is required to deal with state companies as a shareholder the Minister takes on its role and deals with state companies. This enables the relevant minister to deal with both policy and operational matters of SOEs. The relevant ministers must only deal with policy issues. This must be clearly specified.

Eighth, powers of shareholders in SOEs in NZ and Australia far outweigh the powers of shareholders in private corporations. Under *Companies Act 1993* and the *Corporations Act 2001* shareholders are only given the power to appoint and terminate directors, the right to receive annual reports and enforce their personal rights in court. Their roles are limited. However, shareholders in SOEs are given, amongst other things: power to influence the appointment of CEOs; power to formulate SCI; power to appoint and terminate directors; reserve power to intervene in directing management of government policies from time to time; and power to determine and declare dividends. These roles are prescribed in the legislation. Similarly, in PNG responsible Ministers of statutory corporations are provided with extensive powers but unlike Australia and NZ the powers and functions of Ministers are not clearly defined. There is lack of clarity and consistency of the roles and responsibilities of relevant ministers in practice and under various laws. Responsible Ministers are not shareholders in state companies but continue to deal with them. It is important that the powers and functions of relevant ministers dealing with SOEs are clearly specified.

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<sup>62</sup> Mascarenhas, R. C., *Public Enterprise in New Zealand*, (1982) 109.

And finally, it is highlighted in chapter 7 that the Government controls SOEs. Unlike the private sector, control of SOE does not necessarily mean responsible Ministers are directly accountable for all actions of SOEs. This is the biggest problem in PNG. The relevant ministers interfere in policy and operational matters and yet they are not held accountable for their actions by Parliament or by public scrutiny mechanisms such as the Ombudsman Commission. Even if they do, in the case of NZ and Australia, they may use “separate legal personality” argument so as not to answer questions in Parliament or they may regard any issues as commercially sensitive and not make public disclosure. Doctor Taylor summed up the possible behaviour of ministers as follows: “If it’s bad news its commercially sensitive, and I’ll refuse to answer, if it’s good news or trivial, it’s not sensitive, and I’ll take credit; if I am not sure which it is I’ll refer it to the corporation.”<sup>63</sup> Unlike a departmental enterprise where the department errs the Minister also errs and has to account for the wrong and cannot hide behind any curtains of excuses. The data in Part V indicated that relevant ministers in SOEs are not held to account in their dealing with SOEs. PNG Ministers must be made to account in their involvement with SOEs.

In conclusion it can be seen that Ministers’ powers far exceed their political power to become involved.<sup>64</sup> As McDonough noted that “the GOCs are little more than another manifestation of the state. They are very much agents and not independent entities with appropriate control over their own destiny”<sup>65</sup>. Consequently, there is little or no separation of ownership and control of SOEs in NZ, Queensland, NSW and PNG if the Berle and Means standards of control were to be applied (chapter 2). These standards of control, amongst others, include the appointment of management, formulation of a management plan and directing management from time to time.

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<sup>63</sup> Taylor G.D.S., “State-Owned Enterprises’ Accountability to Parliament,” (1987) 10, *The Capital Letter* (No.16) 1 (editorial).

<sup>64</sup> Above n 61 at 26 – 28; See general discussion in Aronson, M., “Ministerial Directions: The Battle of the Prerogatives,” (March 1995) 6(1), *Public Law Review*, 77.

<sup>65</sup> McDonough, D. D., “Corporate Governance and Government Owned Corporations in Queensland,” (1998) 10(1), *Bond Law Review*, 278 at 312.

### 14.4.2 The Board

The roles and responsibilities of directors, and CEOs in NZ, and Australia are clearly provided under SOE and company legislation. Directors in state companies are required to comply with fiduciary duties under *Companies Act 1993*<sup>66</sup> and the *Corporations Act 2001*<sup>67</sup>. Similarly, the directors of state companies in PNG are required to comply with fiduciary duties under the *Companies Act 1997*.<sup>68</sup> Fiduciary duty and duty of care must be performed in the best interest of the company. The application of these duties becomes complex in SOEs. The following issues can be raised about these duties.

- a. First, fiduciary duty is complicated in its application, especially where directors representing different interests constitute the boards of SOEs. When a director is faced with a conflicting situation, whose interest should take priority? For example, in a situation where the employee representative is made to vote on a response to an industrial action: is it breach of fiduciary duty not to vote in the interests of the company? What these issues raised is that fiduciary duty is difficult to enforce where there is no homogeneity of interest.<sup>69</sup> In addition, it becomes difficult in situations where management keeps much of the SOE's information without disclosure to verify whether directors discharge their fiduciary duties.<sup>70</sup>
- b. Second, like fiduciary duty, application of duty of care raises difficulties in SOEs. Some directors at the managerial level do not have business and managerial experience and skills. Other directors are appointed on a part-time basis. Should the duty of care be strictly applied to them? The dilemma faced is whether the standard of care applied would be that of a reasonable director or that of a person with director's skill, experience and knowledge. If the latter were to be the standard then it would be very low standard given the fact that

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<sup>66</sup> *Companies Act 1993*, ss 131 – 138.

<sup>67</sup> *Corporations Act 2001*, Chapter 2D, Part 2D.1.

<sup>68</sup> *Companies Act 1997*, ss 112 – 127.

<sup>69</sup> DeAngelo, H., "Competition and Unanimity," (1981) 71, *American Economic Review*, 18.

<sup>70</sup> Dixit, above n 54 at 50.

most directors do not have business and managerial experience. The consequence would be that many directors would escape liability based on the argument that their performance meets the standard of a reasonable person with their experience, skill and knowledge.

- c. And thirdly, s 131 of the *Companies Act 1993*, s 181 of *Corporations Act 2001* and s 112 of the *Companies Act 1997* provide that a director must act in good faith and in what he or she believes to be in the best in interest of the company, which creates tension with s 4 of the SOE Act, s 17 of the GOC Act and ss 8 and 20E of the SOC Act and generally for SOEs to involve in community service. The issue is whether it is in good faith and in the best interests of the company for SOEs to direct resources to meet community service obligations. There can be compromise by stating that good faith is subjective, therefore what matters is that the director believes in good faith that the act is in the best interest of the company. In other words “in the best interest of the company” means a director honestly believes that his or her actions promotes company’s objectives, hence in the best interest of the company and it does not necessarily mean profit maximization.<sup>71</sup> The issue needs clarification from the courts.

Generally, SOEs have multiple interests and it is difficult to hold directors accountable for their fiduciary duties. To minimize these problems laws in NZ and Australia have clearly provided for the roles and responsibilities of directors and set out objectives under SCI. Whether directors acted in the best interest of the company would be assessed by looking at whether they have complied with their duties and pursued the objectives of the corporations. There is a lack of clarity and consistency about the roles and responsibilities of directors in practice and under various laws in PNG. The data indicated that the majority of directors do not understand their roles and responsibilities under the *Companies Act*, company constitutions or specific SOE legislations. Hence the breach of fiduciary duty is rampant. The roles of directors and CEOs must be clarified, made consistent and accessible to them. Further, goals to be

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<sup>71</sup> Courts have never stated that “best interest” is profit maximisation. See McDermott, J., *Understanding Company Law*, (2005) 233 para. 8.2.5 (c).

achieved within six months or a year must be set out so that directors' performances are assessed against the achievement of those goals.

### **14.4.3 Accountability**

There are vast differences in how the SOEs, directors and CEOs are accountable in NZ, and Australia to PNG. First, SOEs in NZ and Australia are required to submit quarterly, annual and half-yearly reports to the Government and Department of Finance. In addition, their legislation clearly provide for the content of these reports. However, the public is not given access to these reports. Where reports are available, they are expensive. It is important for the public to be given such information so that they are informed of the performance of Ministers to determine whether they can be re-elected with their party in the next election. The argument of disclosure to the public is compelling given the fact also that the public like shareholders in the private sector are direct beneficiaries, although unlike private corporations they do not have the choice of selling shares in SOEs.

SOEs in PNG only submit annual reports; however there is no standard content which they have to report on. State companies submit reports to IPBC and not directly to Parliament. NBC submits annual reports to the responsible Minister and Department of Treasury, whereas NHC submits reports only to responsible Ministers. SOEs in PNG must also submit half-yearly reports, and legislation should clarify what must be reported and who the report should be submitted to. The public must also be informed about the activities of SOEs.

Second, in NZ and Australia the relationship of SOEs to other state institutions such as the Department of Treasury, the Ombudsman's Office and the Public Accounts Committee (PAC) is clearly provided in legislations or government documents. This matter is uncertain for state companies in PNG under specific Acts or company constitutions, and is not clearly stated in any government documents. Directors and CEOs who were interviewed during the case studies in Part V were uncertain on these matters. This provides a compelling case for the relationship of the Ombudsman

Commission, PAC and other public institutions that ensure accountability be clearly provided, including matters that they should address in SOEs.

Third, state companies in PNG have a corporate plan but not an SCI. Corporate plans are reviewable every three years, however there is no requirement for their standard content. Statutory corporations have no corporate plan. They only implement specific government policies. All SOEs in PNG need to have an SCI with clear specification of their content. SCIs must be reported in the half-yearly and annual reports and be reviewed once every year. An SCI is an intelligent creation adopted in NZ and Australia because it contributes largely to ensuring transparency and accountability; however certain issues can be raised about SCIs generally.

- a. Although SCIs provide clarity and certainty to aims to be achieved,<sup>72</sup> they are undermined when Ministers are allowed to intervene and inform management about public policies, including the political and social aims of the Government from time to time.<sup>73</sup> This is a loophole the Government can exploit to direct management for political reasons.
- b. The creation of broad objectives under an SCI can exhaust the limited resources of SOEs in their implementation; consequently many objectives may not be implemented or only partially implemented. Further, too much government interference can discourage enforcement.
- c. Although an SCI has clear and identifiable objectives, it only solves part of the problem. The fact that the interest of the public is not homogenous; SCIs will have broad commercial and non-commercial objectives. Broad objectives combined with distributional flexibility can provide opportunity for rent-seeking by interest groups, and political support by government.<sup>74</sup> Further, inclusion of social aims can cause confusion in apt trade-off between

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<sup>72</sup> Dixit, above n 54 at 49.

<sup>73</sup> For example see *Government Owned Corporations Act 1993*, ss 123 and 124.

<sup>74</sup> Whincop, J.M., "Another Side of Accountability: The Fiduciary Concept and Rent – Seeking in the Governance of Government Corporations," (2002) 25(2), *University of NSW Law Journal*, 379 at 383.

commercial and social objectives and that can lead to complications in decision-making, and provide excuses for poor performance. Having these problems because of broad objectives, SOEs will never match the efficiency standards of private enterprise, which has only one objective. Jeanette Johnston *et al* in her report noted:

The mixed objectives of public enterprise are in marked contrast with the traditional, single objective of private enterprise, that is, profit maximization, which provides [a] clear guide to decision-making, and a yard stick to measure results.<sup>75</sup>

- d. In drafting an SCI, to a certain extent, gives ownership of SCIs to the board, however as seen in chapter 7, legislation in NZ and Australia requires management of SOEs to operate in accordance with SCIs and directions from the shareholding ministers from time to time. This begs the question of whether the management of SOEs should be held to the highest standard under fiduciary duty. It is a misnomer to talk of SOE directors as fiduciaries when in fact they do not exercise discretion or utilize their business judgement acumen in managing SOE but are dictated to by the SCI and the shareholding ministers.
- e. An SCI is intended to be a contract; however it is contrary to the doctrine of contract to make it mandatory for the board to incorporate comments of the Minister and other modifications into the content of SCI. The parties to the agreement do not negotiate freely and on equal terms.<sup>76</sup>

In conclusion, it can be stated that, unlike private sector corporations, responsible Ministers perform a significant role in setting out the objectives to be achieved, and they intervene from time to time through policy directives. The clear consequence of

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<sup>75</sup> Johnston, J., Von Tunzelmann, A., New Zealand Planning Council and New Zealand State Services Commission, *The State in Business: Public Enterprise in New Zealand* (Planning paper No. 15, 1982) 10.

<sup>76</sup> For example, two SOEs in NSW, Australia Energy and Country Energy stated that an SCI is an agreement between a corporation and its shareholder. See Energy Australia, "Statement of Corporate Intent - 2008/09," (2008) in *Energy Australia*, < <http://www.energyaustralia.com.au/Common/About-us/Corporate-reports.aspx> > at 13 April 2009; Country Energy, "Statement of Corporate Intent – Year ending 30 June 2009," in *Country Energy*, < <http://www.countryenergy.com.au/wps/wcm/connect/CEL/CE/homepage/homepage> > at 2 November 2009.

this is that corporate plans and SCIs can be politicized. Also, being aware that ministers would scrutinize SCIs, boards would set out objectives that would favour the Government. The fact that ministers are allowed to modify SCIs<sup>77</sup> and involve in the whole negotiation and drafting process defeats the whole purpose of corporatisation, which is to create an independent board and separate its role from the Government. Despite some weaknesses, the SCI is one of the important devices in accountability that must be adopted in PNG.

#### **14.4.4 The Objectives**

Crown entities in NZ are mainly non-commercial entities and they are required to pursue mainly social and some commercial objectives. SOEs under the SOE Act are commercial entities. Their main focus is to be commercially successful. Although they are required to undertake community service obligations, these are subservient to commercial pursuit. In Queensland and NSW equal prominence is given to the business and social objectives of SOEs. In PNG, NBC only implements government policies. NHC implements government policies and some commercial undertakings. The objective of state companies, whether social or commercial, is not stated in their legislation with the exception of Telikom PNG under ss 4 and 5 of the *Telikom PNG Ltd Act 1996*. Case studies have indicated that quality and efficiency of services by SOEs are poor. Objectives of SOEs in PNG, whether commercial or non-commercial, must be clearly stated and equal importance must be placed on both.

#### **14.4.5 Summary**

Clearly, there is a vast difference in corporate governance arrangement in terms of substance, in NZ, Queensland and NSW on the one hand and PNG on the other. PNG needs to streamline the corporate governance framework in SOEs. This requires separating the Government from SOEs and clearly outlining the objectives of SOEs in legislation. Then there is a need to address fragmentation in SOEs, and improve the alignment of roles and responsibilities of different stakeholders in the governance of

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<sup>77</sup> The shareholding ministers have an unfettered discretion under s 120 of *Government Owned Corporations Act 1993* (Qld).

SOEs both in an SOE and between different SOEs of the same legal structure. In addition, there is a need to improve clarity in the relationship of SOEs with the relevant ministers and other government departments and institutions. These aims have been achieved successfully under the CE Act, SOE Act, GOC Act and SOC Act, which PNG needs to examine and adopt.

#### **14.5 THE SPECIFIC ISSUES IN CORPORATE GOVERNANCE AND THE WAY FORWARD**

A wide range of problems has already been identified. The solutions to these problems can be brought about through complete or partial privatization, or reforming the enterprises. The reform can either be external or internal. External reform includes improving the business environment, promoting competition and imposing strict budget constraints, whereas internal enterprise reform would include restructuring of the enterprise and introduce corporate governance reform. This study has been focusing on corporate governance. Recommendation of any solution would depend on the laws, political and socio-economic circumstances of PNG and the type of problems that are experienced by SOEs.

First, with respect to privatization, there is no dispute that it improves the efficiency of resource allocation and firm performance.<sup>78</sup> There are occasional instances where privatization fails. For example, privatization in Russia and the Czech Republic was described as failures.<sup>79</sup> Failures are mainly caused by a lack of blockholders<sup>80</sup> and protection of minority shareholders, which consequently provides the opportunity for managers to expropriate the assets of the companies.<sup>81</sup>

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<sup>78</sup> Megginson, W., Nash, R. and Randenborgh, M., "The Financial and operating Performance of newly Privatised Firms," (1994) 49, *The Journal of Finance*, 403; Megginson, W. and Netter, J., "From State to Market: A Survey of Empirical Studies on Privatisation," (2001) 39, *Journal of Economic Literature*, 321.

<sup>79</sup> Boycko, M., Shleifer, A. and Vishny, R., *Privatizing Russia*, (1995); Black, B., Kraakman, R. and Tarassova, A., "Russian Privatization and Corporate Governance: What went wrong?" (2000) 52, *Stanford Law Review*, 1731; Fox, M. B. and Heller, M. A., "Corporate Governance Lessons from Russian Enterprise Fiascoes," (2000) 75, *New York University Law Review*, 1720.

<sup>80</sup> "Blockholders" refers to shareholders who have a large amount of shares in a company.

<sup>81</sup> Shleifer, A. and Vishny, R., "A Survey of Corporate Governance," (1997) 52, *The Journal of Finance*, 737; Coffee, J. C., "The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications," (1999) 93, *Northwestern University Law Review*, 641; Glaeser, E., Johnson, S. and Shleifer, A., "Coase versus the Coasians," (2001) 116, *Quarterly Journal of Economics*, 853.

Although privatization is an ideal solution that works effectively in many jurisdictions such as NZ and appears to be an ideal solution for corporate governance problems in PNG, the prevailing social and economic circumstances of the country and the business environment do not permit it. The political situation is unstable and the country still faces many dilemmas of development (see chapters 8 and 9). The Government controls half of the country's weak economy and SOEs have a monopoly in the markets. After nearly 35 years of independence, 80 per cent of the population still live a subsistence way of life, with little or no income. The vast majorities of them do not have electricity, water supply or telecommunication services. Many of them are uninformed about the outside world. Government workers in rural townships are living in villages and others working in metropolitan areas are living in settlements at the periphery of towns and cities. The current housing allowance for a lawyer in Public Prosecutor's office is seven kina (K7.00), which cannot match a current fortnightly rental of K300.00.

If privatization were to be adopted, it would mean that private persons would have monopoly in the markets. And if profit maximization was to be the objective of private corporations they would avoid doing business in areas that would make them incur losses. This is usually the rural areas where more than 80 per cent of people live with little or no income. Monopolies have the tendency of increasing the price of goods and services without effective regulation. The consequence would be unequal distribution of goods and services contrary to the requirement of National Goals and Directive Principles of equal distribution of social and economic benefits to all people.<sup>82</sup> Alternatively, competition can also be introduced that can improve corporate governance. When corporations compete in the same market to sell their product to the same customers they tend to improve their corporate governance and that is reflected in efficiency and profitability. These are ideal topical issues for further research.

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<sup>82</sup> *Constitution of PNG*, Preamble, National Goal 2.

Second, corporate governance can be improved through internal reform of enterprises, either through mixed ownership in SOEs or change of corporate governance framework. Mixed ownership is where companies are jointly owned by the state as well as private persons. Boardman and Vining concluded in their study that SOEs and companies with mixed ownership tend to perform worse than privatized companies.<sup>83</sup> In terms of profitability mixed ownership is the same or at times worse than SOEs. Whether mixed ownership would improve corporate governance of SOEs in PNG is a matter that requires further research.

This study is focused on corporate governance and identifies its strength and weaknesses in SOEs in PNG. For the purposes of this discussion it is useful to discuss corporate governance under the following headings to point out specific problems generally highlighted in this chapter:

- a. allocation of control rights over SOEs between the responsible Ministers and the board of directors;
- b. accountability of those with control rights over SOEs; and
- c. mechanisms put in place to make SOEs more efficient and effective.

Firstly, the concept of control was discussed in chapter 2 and it is pointed out that to control means having the capacity to appoint and remove directors, to direct management from time to time and to determine the objectives of a corporation. From the above discussion on corporate governance in PNG and the discussion in Part V, responsible Ministers have these capacities. Consequently, responsible Ministers are in control of SOEs.

Secondly, one needs to look at the issue of how those who control are accountable for their conduct. In other words what are the mechanisms in place to ensure responsible Ministers are accountable. From the discussions in Part V and this chapter it is identified that there is lack of parliamentary debate on issues regarding SOEs. The Ombudsman Commission and PAC do not investigate SOEs. State companies and

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<sup>83</sup> Boardman, A. and Vining, A., "Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed, and State-Owned Enterprises," (April 1989) 32(1), *Journal of Law and Economics*, 1.

NHC are not subject to assessment by the Department of Treasury. This leaves the Auditor General as the only public institution that performs its statutory role of investigating the accounts of all SOEs. However, the Auditor General only audits the accounts of SOEs, leaving responsible Ministers completely immune to public scrutiny. They are like dictators, untouchable in their dealings with SOEs. This situation is unacceptable in a democracy. This is illustrated in state companies where the Minister for SOEs who is not a shareholder continues to illegally appoint directors. IPBC cannot do anything because directors and the CEO have government affiliation.<sup>84</sup> Who can hold the Minister accountable? No-one.

And thirdly, looking at the issue of efficiency and effectiveness, is largely considering whether management and SOEs have clear objectives. The roles and responsibilities of boards, chairpersons, directors and CEOs are not clear in some SOEs. Where they are provided these stakeholders do not understand their responsibilities. This makes it difficult for them to know what they are supposed to do. Statutory corporations do not have corporate plans, and they only give effect to government policies. State companies have corporate plans, which are formulated in consultation with IPBC and the Minister for SOEs. These plans are reviewed every three years. There is no set content, which the plan should have. State companies are silent on whether they are pursuing social or commercial objectives or both. Not knowing the objectives they are pursuing makes it difficult to hold them to account.

In conclusion discussion above shows that corporate governance problems in PNG's SOEs are the results of diverse and related causes. First, controlling shareholders and relevant ministers of SOEs have multiple interests, and their powers and functions are not clearly defined. They deal with the board and management that have no clear responsibilities or do not understand their responsibilities. Further, these shareholders and relevant ministers deal with SOEs that have no corporate plan (as in statutory corporations) or have corporate plans that have no standard format, and having the

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<sup>84</sup> Several directors of IPBC are failed politicians who contested under the ruling party in the government. The CEO is the managing director of the company owned by family members of the current Prime Minister. He is also the *ex officio* director in Eda Ranu and Telikom PNG Ltd. See Moutu, A., "Oligarchy, Defeatism and the Rule of Law," (24<sup>th</sup> November 2008) in *The Melanesia*, < <http://themelanesian.org/> > at 24 July 2009.

plans reviewed every three years. Furthermore, there is lack of accountability of all stakeholders responsible for governance of SOEs. These issues have contributed to problems in corporate governance in SOEs highlighted in chapter one, and they inevitably lead to inefficient and ineffective performance of SOEs. The suggested ways to address these are set out in chapter 15.

## **14.5 CONCLUSION**

This chapter establishes the fact that the Government in PNG predominantly controls SOEs without concomitantly being held accountable for its conduct. Consequently, control without accountability can drive a government to be involved with management in self-interested activities or to pursue other political agendas which are not in accordance with the corporate plan or policy directions, and managers can pursue self-interested activities. The control of corporations leads sometimes to interference in the operation of SOEs. Ministers' greater and active role in an SOE is further facilitated by a lack of clear provision on their roles and responsibilities, inconsistencies in the laws; lack of clarity and understanding in roles and responsibilities of the board, chairperson, directors and CEOs; ineffective role of the board; and confusion over whether public accountability mechanisms apply to responsible Ministers, directors and CEOs of SOEs.

Similarly, corporatisation in NZ and Australia has done little to separate the activities of SOEs from government but has provided greater transparency and accountability. Further, while the statutory framework for SOEs is not perfect as there is potential for political interference it does set out a clear framework to regulate the involvement of ministers through detailed legislation. This is not the case with PNG.

In PNG the problem lies in legislative defects and failure of Parliament and state institutions to monitor SOEs. The only state institution in PNG that performs its constitutional obligations is the Auditor General, but this office focuses only on financial accountability. The Auditor General has been outsourcing auditing responsibilities due to a lack of funding. The Auditor General alone cannot ensure proper accountability. Lack of public and proper internal accountability can enable a

responsible Minister to act in an irresponsible manner, and by so doing and by taking total control over SOEs, this creates an avenue for corrupt practices. This has led to inefficient deliveries of goods and services to the people (as highlighted in Part V). Given the problems in corporate governance the established framework needs to be reconsidered. Relevant corporate governance principles need to be identified and given effect to under a generic corporatisation legislation. Further, addressing the legislative shortfall is going to be the effective way, and given PNG's propensity to legal actions one can be assured that legislative change clarifying issues of governance and accountabilities in SOEs and particularly concerning the role of the responsible Minister would lead to legal actions. These issues are further discussed in chapter 15.

## **CHAPTER 15:**

# **CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA – DEVELOPING A NEW PARADIGM WHICH WORKS**

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### **15.1 INTRODUCTION**

State Owned Enterprises (SOEs) are vital for Papua New Guinea's (PNG's) developing economy and its people. Hence, there must be a change in perception of corporatisation in the country. Corporatisation must not be perceived as a means to an end (privatization), but having an important role to play within the corporate setting and PNG society as a whole. Hence there must be clear articulation of what is required in an SOE and importantly its corporate governance framework.

It is highlighted in chapter 3 that corporate governance principles adopted in a particular jurisdiction depends on ideologies that a particular state is pursuing or the political, legal, cultural and socio-economic circumstances of the country. Further, the principles adopted would also depend on whether an entity is in the public or the private sector. Thus, corporate governance enunciated by Cadbury Report (1992) in the UK is different from the King Report (2002) of South Africa and principles in the King Report are different from the Australian Stock Exchange, Corporate Governance Council's Corporate Governance Principles and Recommendations. After looking at political circumstance in chapter eight, the legal structure in chapter 10, cultural and socio-economic circumstances in chapter nine, corporate governance practices in Part V and the legal framework of individual SOEs in chapter 14, the step forward is to adopt a corporate governance framework that brings independence, transparency, responsibility, accountability and social responsibility.

First, in ensuring independence there must be a strong mechanism put in place to minimize and avoid potential conflict of interests between different stakeholders in governance so that each works within the confinement of their responsibilities and help contribute toward achieving the objectives of SOE. Second, in providing for

transparency an SOE must be able to make necessary information available to all officers so that an analysis is made for both financial and non-financial activities of the corporation. Third, there needs to be a system that is responsible for ensuring that officers are penalized for wrongful conduct. Fourth, accountability ensures officers must be held to account for their actions in a sense of being answerable for their conduct. In order to be held responsible and accountable clear roles and responsibilities of stakeholders in governance must be provided and where there is violation wrongdoers must be penalized accordingly or be answerable, respectively. And finally, under social responsibility, every SOE must have community service obligations as a component of their objectives. A well-managed SOE would be able to fulfil both commercial and non-commercial obligations. The discussion below puts in perspective how these corporate governance principles can be realized in SOEs in PNG.

This chapter moves a step further from the previous chapter and examines how a responsible Minister and management can be held accountable for their conduct. This is done by examining whether public accountability mechanisms can apply on management and responsible Ministers in their relationship with SOEs. Also, how responsible Ministers in state companies can be held to account under the *Companies Act 1997*. Hence, the aim is to highlight the external and internal accountability that would give effect to corporate governance principles, consequently give effect to the objectives and independence of SOEs. I shall begin by first discussing ministerial responsibility and the extent of its application followed by examination of the definition of public body. The discussion focuses on whether an SOE falls within the definitional ambit of a public body. This is followed thirdly by discussion of the external accountability mechanisms. In this segment external bodies established by the PNG *Constitution* and Acts of Parliament are looked at that can ensure accountability of ministers and managers. I also consider whether there is need for the establishment of any external accountability mechanisms. Fourth, I discuss how internal accountability mechanisms can be improved. Fifth, I discuss the possibility of having uniform legislation for SOEs in PNG and what that would entail. Finally, the conclusion provides general observations. I shall now begin the discussion with ministerial responsibility.

## 15.2 MINISTERIAL RESPONSIBILITY

In any democratic society responsibility to Parliament is important and necessary. The responsibility entails accountability, honesty and transparency. The ministerial responsibility is in essence the responsibility to Parliament. The Minister is responsible for all powers, functions and duties entrusted to him or her as a minister of the Government.<sup>1</sup> The doctrine of ministerial responsibility has two features; namely individual responsibility and collective responsibility of ministers to Parliament. The former is relevant for purposes of this chapter. This is where an individual minister is accountable to Parliament and the society in executing his or her responsibility on behalf of the Government. This responsibility extends to actions or inactions of officers of government departments in their official capacity. This means complaints about wrongs committed by a civil servant must be directed to the responsible Minister.<sup>2</sup> The doctrine is appropriately summarized as follows: “Each minister is responsible to Parliament for the conduct of his [or her] department. The act of every civil servant is by convention regarded as the act of his minister.”<sup>3</sup> Consequently, this creates reciprocity of duties whereby officers of department are responsible to the Minister in performance of their duties and the Minister is responsible for protecting and defending the officers.

The doctrine of ministerial responsibility is still relevant today, however its effectiveness is of concern as the Government becomes larger and more complex. The activities of the Government have increased and are now under control of non-departmental bodies. Notwithstanding, ministers are still responsible and accountable for their activities. Unlike a government department, the Minister is required to deal with non-governmental bodies only on matters with regard to policy. In some instances responsible Ministers may interfere in operational matters. The question of

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<sup>1</sup> Morrison, H., *Government and Parliament; a Survey from the Inside*, (3<sup>rd</sup> edn., 1964) 265- 266; See also Turpin, C., “Ministerial Responsibility,” in Jowell, J.L. and Oliver, D., (ed.) *The Changing Constitution*, (3<sup>rd</sup> edn., 1994) 109 at 130 – 133.

<sup>2</sup> Molan, M.T., *Constitutional Law: The Machinery of Government*, (3<sup>rd</sup> edn., 2001) 209 – 211.

<sup>3</sup> Quoted in Chew, S.K. and New Zealand Public Service Association – Research Division., *The Process of Privatisation in New Zealand : Implications for Ministerial Responsibility and the Continuing Role of the Government with respect to State-Owned Enterprises*, (1989) 5.

who is responsible and accountable for actions or omissions of the Minister or officers becomes uncertain. Herbert Morrison answered the question by stating that: “A minister is responsible to parliament for actions he [or she] may take with relation to a board, or action coming within his [or her] statutory powers which he [or she] has not taken.”<sup>4</sup> This limits the ministerial responsibility to only the conduct of the Minister and it does not extend to officers of the company. This may create potential for evasion, confusion and manipulation between administrative matters that management should deal with, and policy matters that the ministers should deal with in non-departmental bodies. The Minister may easily evade responsibility by stating that it is the responsibility of the board or management.

An SOE is an example of a non-departmental body. Unlike a government department, an SOE is a separate legal entity that is either created by statute or incorporated under *Companies Act* through the process of corporatisation. One of the aims of corporatisation is to separate the activities of an SOE from the Government; consequently narrowing ministerial responsibility and making the Minister only accountable for certain conduct of corporations.<sup>5</sup> For example, the Minister would be responsible only for policy matters, but not for the daily operational affairs and business of the corporation. In this sense ministerial responsibility is narrowed. It is discovered in Part V and chapter 13 that there is no clear provision for responsibility and accountability of ministers and management in SOEs in PNG, hence the extent of the application of ministerial responsibility is unclear.

It is important to distinguish between responsibility and accountability. They are inextricably connected and used interchangeably, however they have different meanings when used in the context of ministerial responsibility. Accountability connotes answerability whereas responsibility connotes blameworthiness. In distinguishing the two terms Sir Robin Butler argued that responsibility:

...implies personal involvement in an action or decision, in a sense that implies personal credit or blame for that action or decision...a Minister is accountable for all the actions and activities of his department, but not responsible for all the actions in the sense of being

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<sup>4</sup> Quoted in Woodhouse, D., “Ministerial Responsibility,” in Bogdanor, V., (ed.) *The British Constitution in the Twentieth Century*, (2003) 281 at 284.

<sup>5</sup> Above n 3 at 6.

blameworthy...a civil servant is not accountable to Parliament for his actions but is responsible for certain actions.<sup>6</sup>

The term accountability is used to refer to both responsibility and accountability throughout the thesis. The distinction is discussed here to highlight the fact that responsible Ministers are answerable not only for their conduct and the conduct of organization they are responsible for but can be penalized for their acts or omissions in appropriate circumstances. This is where the roles of the Ombudsman Commission and Public Accounts Committee (PAC) are important to ensure ministers and employees of SOEs are accountable and responsible for their conduct. The discussion below identifies mechanisms that ensure stakeholders in the governance of SOEs are held responsible and accountable. These include looking at external, public accountability mechanisms and internal accountability mechanisms, and how current establishments can be improved. Before looking at these issues it is important to identify whether an SOE is a public body.

### 15.3 PUBLIC BODY

Public functions began to increase when communities developed into welfare states. This resulted in governments delegating to entities outside of government departments the powers to perform public functions. Many private entities are now performing public functions and some of them operate under close ministerial or departmental control. There are different tests being used to determine whether an entity is a public body. First, Parliament may determine the definition of the term public body or may specifically stipulate in an Act of Parliament that an entity is an emanation of the State. For example, New Zealand's *State Sector Act 1988* expressly excludes SOE in defining "state service" as "all instruments of the Crown in respect of the Government of New Zealand" including Crown entities.<sup>7</sup> Similarly, the *Public Finance Act 1989* defines the Crown as including all ministers and their Departments and excludes SOEs and Crown entities.<sup>8</sup> In PNG, s 2 of the *Public Finances (Management) Act 1995* (PFM Act) provides that public body means:

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<sup>6</sup> Cited in above n 4 at 313.

<sup>7</sup> *State Sector Act 1988*, s 2 (NZ).

<sup>8</sup> *Public Finance Act 1989*, s 2 (NZ).

- a. a body, authority or instrumentality (corporate or unincorporate) established by or under an Act or a Constitutional Law; and
- b. a body, authority or instrumentality incorporated under the *Companies Act 1997* where and to the extent that – the constitution of that body provides; or an Act [other than PFM Act] provides, the *Public Finance (Management) Act 1995* shall apply to that body, authority or instrumentality other than the Auditor General.

Thus, any entity that is subject to the PFM Act or the Auditor General is a public body. The PFM Act is a public law and the Auditor General only audits the accounts of bodies that are funded by the State or that have control over the State's assets. The definition is inclusive, covering both statutory corporations and state companies. Further, schedule 1.2.2 of PNG's *Constitution* defines "governmental body" amongst other criteria as "a body set up by statute or administrative act for governmental or official purposes". The definition is restrictive. It does not cover state companies, which of course are incorporated under the *Companies Act* and not set up by statute, and does not involve strictly in governmental or official purposes. Where there is unclear specification under legislation, two tests under common law are applied to determine whether an entity is a public body. They are namely the "control test" and the "public functions test" (see chapter 5).

First, in the "control test" the nature and degree of control by government department and the responsible Minister is looked at to determine whether an entity is a "public body".<sup>9</sup> In order for an entity to be regarded as public body it must be largely controlled by the Minister or the government department.<sup>10</sup> That means that an entity that retains some independent discretion with limited ministerial control is not a

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<sup>9</sup> *Commissioner of Inland Revenue v Medical Council of NZ* [1997] 2 NZLR 297 at 327 – 328 (CA).

<sup>10</sup> See *Tamlin v Hannaford* [1950] 1 KB 18 (CA).

public body.<sup>11</sup> Control in this sense refers to *de jure* or legal control and not *de facto* or control that is in fact exercised.<sup>12</sup>

Applying the “control test” to PNG’s SOEs results in different outcomes. The legal responsibility of the Minister for SOEs in state companies is limited and in some of them, not mentioned at all. If the “control test” were to be applied then obviously state companies are not public bodies, even though in Part V the Minister appoints directors and he or she has greater influence on the management directly. The role of the Minister for SOEs is not stated in any documents of state companies; the Minister is not a shareholder and yet the Minister has *de facto* control in appointing directors and dealing directly with the management. In this case, applying the idea that control means legal control and not control that is in fact being exercised, excludes state companies as public bodies. In statutory corporations the Ministers’ responsibilities are clearly provided (see chapter 14). These responsibilities included intervening in the operational matters of SOEs. Sometimes, as discovered in Part V, Ministers exceed their responsibilities provided under the legislation. Hence, by applying the “control test” statutory corporations in PNG are considered public bodies.

The second common law test is the “public functions test” which, in essence, looks at whether an entity is exercising the public function or doing public works. Given the reality of the scope of the activities of modern government in “almost all aspects of commercial, industrial and developmental endeavour,”<sup>13</sup> and the use of private bodies in exercising governmental functions by virtue of statute, contract or franchise, the public function test must not be a conclusive test in itself.<sup>14</sup> The public function test must be considered with other determinants. For example, in PNG the Auditor General outsources auditing of some government institutions to private auditing firms. Although, the firm exercises a public function, it is not a public body as it is by nature a private firm, a large part of its work revolves around doing private work, and

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<sup>11</sup> See *Metropolitan Meat Industry Board v Sheedy* [1927] AC 899 (PC).

<sup>12</sup> *Bank voor Handel en Scheepvaart NV v Administrator of Hungarian Property* [1954] AC 584 at 617 (HL).

<sup>13</sup> *Bropho v Western Australia* (1990) 171 CLR 1 at 19 (HCA).

<sup>14</sup> Some cases indicate that the test is broad and vague, therefore accepted as problematic. For example see *Commissioner of Inland Revenue v Medical Council of NZ* [1997] 2 NZLR 297 at 326 – 327 (CA).

its management rather than the Government determines its strategic and operational direction. Therefore performing a public function does not necessarily prove that an entity is a public body. In circumstances where public function alone cannot determine whether an entity is a public body other factors have to be considered. Clearly, by applying the “public function test” all SOEs in PNG are public bodies. They implement government policies and relevant government ministers can direct them from time to time.

The PFM Act and PNG’s *Constitution* are the only statutory instruments in PNG that define “public body” and “governmental body,” respectively. The definition under the PFM Act is explicit that SOEs that are audited by the Auditor General or are subject to the PFM Act are “public bodies”. The Auditor General audits all SOEs in PNG therefore these SOEs come under the definition of “public body”. Further, the “control test” and “public purpose test” under common law are part of the Underlying Law of PNG and can be consulted and applied where there are deficiencies in the enacted laws.<sup>15</sup> It is clear after applying all these tests that SOEs are “public bodies”. This then poses the question of whether SOEs, as public bodies, are subject to external, public accountability mechanisms.

#### **15.4 EXTERNAL ACCOUNTABILITY MECHANISMS**

External accountability mechanisms ensure SOEs and various stakeholders involved in governance are held accountable for their conduct. These accountability mechanisms are provided under the PNG *Constitution* or Acts of Parliament. The discussion below considers whether SOEs are subject to them.

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<sup>15</sup> *Constitution of PNG*, ss 9 and 11.

## **15.4.1 The Constitution of Papua New Guinea**

### **15.4.1.1 Public Accounts Committee**

The PAC's role is to examine and report to the national Parliament on the public accounts, control of and transactions with or concerning public moneys and the property of the people of PNG.<sup>16</sup> The inspection and examination applies to any accounts, finance and property that are subject to inspection and audit by the Auditor General.<sup>17</sup> The Auditor General audits the accounts of all SOEs therefore PAC can investigate their accounts. Although, the Government does not fund state companies (i.e. PNG Power, Telikom and Eda Ranu) and the National Housing Corporation, they use state assets to generate revenues. These assets come under the "property" of the State and therefore PAC can investigate the accounts of all these SOEs. PAC's constitutional obligation with relation to SOEs is clear; however it is beyond comprehension to see the confusion over whether PAC can investigate SOEs in Part V. This means either PAC does not see its role extending to SOEs or feels reluctant to inspect their accounts given their corporate nature. The role of PAC in relation to SOEs must be specified clearly and made mandatory in a document that is accessible to members of the board and management, and other relevant authorities, including PAC.

### **15.4.1.2 Auditor General**

Case studies in Part V point out the fact that the Auditor General audits all SOEs in PNG. The purpose of the discussion in this part is to point out the legal basis for its role. Section 214 (1) of PNG's *Constitution* authorises the Auditor General to inspect, audit and report to Parliament on public accounts, control and transactions of public money and property of all arms of departments, agencies and instrumentalities of the national Government and all bodies set up by an Act of Parliament.<sup>18</sup> The Auditor General also audits and reports to Parliament any accounts, finances and property of

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<sup>16</sup> *Constitution of PNG*, s 216 (1).

<sup>17</sup> *Constitution of PNG*, s 216 (2).

<sup>18</sup> *Constitution of PNG*, s 214 (1).

an institution, insofar as that institution derived from public money or property of the public.<sup>19</sup> Section 8 (2) of the *Audit Act 1989* echoes s 214 of PNG's *Constitution* but uses the term all "public bodies". The Auditor General inspects, audits and reports to Parliament on accounts, records and financial transaction of all "public bodies". The definition of "public body" under s 2 of the PFM Act includes statutory corporations and state companies. In addition, all SOEs possess and use the State's property and the Government funds statutory corporations, therefore the Auditor General, as a public institution has the right to audit them. Before annual reports of "public bodies" are submitted to Parliament they must be audited by the Auditor General,<sup>20</sup> who can outsource auditing responsibilities to private audit firms.<sup>21</sup> Under Part V it is discovered that the Auditor General outsources all auditing responsibilities to private audit firms and merely performs a supervisory role. The current practice of the Auditor General should remain the same.

#### **15.4.1.3 Ombudsman Commission**

The Ombudsman Commission is one of the important institutions established under PNG's *Constitution* to ensure that public bodies and public office holders are held accountable for their conduct. Section 218 of the PNG *Constitution* provides that the purpose of the Ombudsman Commission is to help improve the work of governmental bodies and ensure that they are responsive to the needs of the people. The Commission also supervises the enforcement of the *Organic Law on the Duties and Responsibilities of Leadership* (Leadership Code). The Leadership Code complements the *Organic Law on the Ombudsman Commission* and provides for general duties and responsibilities of public bodies and public office holders that are provided under s 26 of the *Constitution*. The *Constitution*<sup>22</sup> and Leadership Code<sup>23</sup> give extensive power to the Ombudsman Commission to supervise the Leadership Code. Section 26 does not cover SOEs or directors and CEOs but only relevant ministers. Section 26(1)(a) of the *Constitution* explicitly provides that a minister is

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<sup>19</sup> *Constitution of PNG*, s 214 (3).

<sup>20</sup> *Public Finance (Management) Act 1995*, s 63(4).

<sup>21</sup> *Audit Act 1989*, s 4(1).

<sup>22</sup> *Constitution of PNG*, s 218.

<sup>23</sup> *Organic Law on the Duties and Responsibilities of Leadership*, s 17.

subject to the Leadership Code. If the relevant minister of SOEs, among other things, uses the office for personal benefit,<sup>24</sup> deals with the matter that he or she has personal interest in it,<sup>25</sup> asks, receives or obtains bribe<sup>26</sup> or misappropriates the funds of the State<sup>27</sup> in dealing with SOEs such a Minister would be subjected to investigation by the Ombudsman Commission.

SOEs (as public bodies), directors and CEOs are subject to investigation by the Ombudsman Commission not by virtue of the Leadership Code but under PNG's *Constitution*. Section 219(1) of the *Constitution* provides that the Ombudsman Commission can, on its own initiative or on complaint by an affected person, investigate the conduct of a governmental body or its employees, or a body established under statute. In addition, the Ombudsman Commission can investigate entities, which are mainly supported from public money, or entities that have the majority of their controlling authority appointed by the National Executive Council or the Government. A governmental body, as referred to under schedule 1.2.2 of the *Constitution* of PNG, applies to bodies set up by statute. This refers to statutory corporation. But s 219 (1) refers to "governmental body" or "body establish under statute" in the same sentence. This is a reference to two different entities. As defined above, a governmental body refers to a body set up by statute. It is suggested that "body established under statute" does not refer to "governmental body" but to state companies which are established under the *Companies Act*.

Further, the Government appoints directors and chief executive officers (CEO) in an SOE either directly or indirectly. The act of appointment qualifies under the statement "majority of controlling authority appointed by National Executive Council or government," making them subject to investigation by the Ombudsman Commission. These requirements enable not only statutory corporations but state companies to be subject to investigation by the Ombudsman Commission. Furthermore, SOEs are publicly owned and they also involve in community service obligations, therefore their role in the community and ownership justifies the Ombudsman Commission as a

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<sup>24</sup> *Organic Law on the Duties and Responsibilities of Leadership*, s 5.

<sup>25</sup> *Organic Law on the Duties and Responsibilities of Leadership*, s 6.

<sup>26</sup> *Organic Law on the Duties and Responsibilities of Leadership*, s 11.

<sup>27</sup> *Organic Law on the Duties and Responsibilities of Leadership*, s 13.

public institution to investigate any matters of public concern. This includes investigation of relevant ministers under Leadership Code, and directors and CEOs of SOEs by virtue of the *Constitution*.

After examining the PNG *Constitution* and the Leadership Code it is clear that the Ombudsman Commission can investigate relevant ministers, directors and CEOs. However, the lack of clear provision on the role of Ministers in SOEs makes it difficult for the Ombudsman Commission to perform its duty in holding them accountable. The problem is further exacerbated by the lack of clear demarcation between operational and policy matters and commercial and non-commercial matters in SOEs. The same problem applies with the investigation of directors and CEOs, where their roles and responsibilities are inconsistent and vague. Although, the *Companies Act* clearly provides for the duties of directors, the Ombudsman Commission would be reluctant to venture into the private sector arena. This calls for every SOE to have a corporate plan that provides for both commercial and non-commercial objectives. The Ombudsman Commission would only intervene to investigate a lack of implementation of non-commercial objectives that directly affect people.

People who lack government services or are recipients of inefficient and low quality service from government departments or institutions are “affected persons”. Section 219 of the *Constitution* provides for “affected persons” to lodge a complaint with the Ombudsman Commission. The following are specific situations in SOEs that can enable an affected person to lodge a complaint with the Commission.

- a. National Housing Corporation (NHC) – one of the important responsibilities of NHC is to provide houses for public servants. Many public servants who are entitled to a house from NHC are living in settlements and going to work. Also, current residents are living in NHC houses that are in bad condition. The pipes are leaking, the wood in the houses has eroded and sanitation is poor. People who are in these conditions are affected persons under s 219.

- b. National Broadcasting Corporation (NBC) – nearly half of the radio stations in the country have closed. The Government has not done anything about them. Some of them have been closed for four or five years. Radio stations provide people with access to information and provide venues where they can express themselves. Freedom of information is one of the important qualified rights in PNG, and entails the right to express one’s opinion and receive ideas and information.<sup>28</sup> The people in the provinces who do not have radio stations are affected persons under s 219.
- c. Eda Ranu – water is an essential commodity, however there are problems experienced with its supply. Some of these problems include “water cuts” for half a day or even a whole day, which affects business and households and the company’s response to plumbing maintenance, is very poor.<sup>29</sup> It takes days or even a week to do maintenance. Recently the water rates have increased dramatically without prior notification and reason(s) justifying the sudden increase. Many people who could not afford the high prices of water are involved in illegal water connections.<sup>30</sup> The persons who are affected by these situations come under s 219.
- d. Telikom – Telikom’s charges are the most expensive in the world.<sup>31</sup> Many people in rural townships, who are entitled to telecommunication services, have been waiting for 10 to 15 years, even though it is one of the stated objectives of Telikom to bring telecommunication service to the rural populace. And maintenance work takes weeks or even months to be done. People who are affected by these situations are affected persons under s 219.
- e. PNG Power – it has become a norm in towns and cities in PNG to continuously experience several power outages in a day. In Port Moresby

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<sup>28</sup> *Constitution of PNG*, s 46.

<sup>29</sup> For example, Victim of no water, “Eda Ranu Capability Questioned,” (Port Moresby, 22<sup>nd</sup> May 2009) in *The National*, < <http://www.thenational.com.pg/052209/letter6.php> > at 22 May 2009.

<sup>30</sup> Kenneth, G., “Eda Ranu clamps down on illegal connections,” (Port Moresby, 22<sup>nd</sup> July 2009) in *Post Courier*, < <http://www.postcourier.com.pg/20090722/news03.htm> > at 21 August 2010.

<sup>31</sup> Kolma, F.S., “A Mobile Service that is not Mobile,” (Port Moresby, 17<sup>th</sup> April 2007) in *The National*, < <http://www.thenational.com.pg/042307/column4.htm> > at 29 March 2009.

whole suburbs can be without power for a day. This affects business operations and household electric appliances. Compensation can be sought for the loss or damages caused as a result of power outages under s 19 of the *Electricity Supply (Government Power Stations) Act 1970*; however the provision has never been invoked. In one of the private surveys conducted to find out the reasons for the lack of investment in PNG, power outage is one of them.<sup>32</sup> Even a senior judge of the National and the Supreme Court, summoned the manager of PNG Power to explain continuous power outages.<sup>33</sup> People who are affected by electricity supply are affected persons under s 219.

As stated above s 218 of PNG's *Constitution* provides that the job of the Ombudsman Commission is to "help improve the work of governmental bodies and ensure that they are responsive to the needs of the people". This justifies the Ombudsman Commission to intervene in the matters outlined above, not only to improve the work of SOEs but also to ensure that they are responsive to the needs of the people. State companies are subject to the *Companies Act*, but where there is financial mismanagement; the Ombudsman Commission must initiate investigation into them, especially in circumstances where moneys earmarked for a public project in rural areas are misused. The relevant minister and the board must be held accountable in such circumstances. In Part V the users of SOEs' services have rated the efficiency and quality of services poorly. Lack of efficiency and effectiveness affects people personally.

In addition, persons who are affected by the activities of state companies can bring actions under entitled persons if the definition of entitled person is amended to include members of the public who are affected by their act or omissions (see discussions below). However, action through courts is expensive and it can take years for decisions. Hence, it is advisable to refer matters about SOEs to the Ombudsman Commission. Redress through the Commission is costless and after investigation, the

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<sup>32</sup> Manning, M., *Factors Contributing to the Lack of Investment in Papua New Guinea – A Private Sector Survey*, (Discussion paper No. 74, 1999) 11 and 19.

<sup>33</sup> Per, Z., "Judge Warns Power Boss over Blackout," (Port Moresby, 17<sup>th</sup> June 2009) in *The National*, < <http://www.thenational.com.pg/061709/nation3.php> > at 17 June 2009.

Commission can then advise the SOE to implement appropriate policy, or where there is violation of the Leadership Code or other laws, the Commission can refer responsible Ministers, directors or CEOs to the Public Prosecutor's Office for prosecutions.

#### **15.4.1.4 Right to Freedom of Information**

Section 51 of PNG's *Constitution* provides for every citizen to have the right of access to "official documents". Among the information that cannot be revealed, which is relevant for SOEs is commercial information. Particularly, s 51(1)(a) provides that citizens cannot have access to information on condition that the right to secrecy "is reasonably justifiable in a democratic society in respect of privileged or confidential commercial or financial information obtained from a person or body". That means that commercial or financial information that is obtained by an SOE from another person but not information that belongs to SOE. The information that belongs to an SOE is official information and is required under s 51 to be disclosed to the public. Further, commercial confidentiality in SOEs is a non-issue in PNG given the monopoly of economic activities. The public must demand the disclosure of annual reports of SOEs through national newspapers. This right can be enforced under s 57 of the PNG *Constitution*. State companies lodge their annual reports with the Registrar of Companies in Port Moresby, making some company information available for public accessibility; however over 90 per cent of people live out of Port Moresby and do not have access to the Company Office. The publication of reports in newspapers would enable these people to have access to the information. In doing so, the public is informed of the performance of the SOEs and can concurrently assess the performance of the responsible Minister and management and decide whether to re-elect the responsible Minister and his or her political party in the next general election.

#### **15.4.1.5 Parliament**

Parliament is the centre for accountability and it is through Parliament that SOEs are accountable to the people of PNG. As the guardian of public interest, Parliament

ensures, amongst other things, that policies of SOEs are consistent with government policies and that these objectives are implemented in an efficient and economic manner, and in accordance with the law.<sup>34</sup> To ensure accountability Parliament performs an “enabling role” and an “evaluative role”. In the former Parliament establishes SOEs through legislation that also sets out their structures and domains of activities. Parliament also has an opportunity to review the functioning of SOEs through general debates, debates on motions and during “question time” in Parliament.<sup>35</sup> Part V is clear that Parliament in PNG hardly performs its enabling role. Parliamentary sessions are unnecessarily adjourned,<sup>36</sup> and debates are not taken seriously and the number of questions asked has decreased since Independence in 1975 largely because the opposition is ineffective.<sup>37</sup> The only time questions on SOEs are raised is during “question time” or in the media, both of which are insufficient opportunities to thoroughly assess an SOE and its performance.

In its evaluative role, Parliament examines the annual reports submitted by SOEs to identify whether they have fulfilled the objectives set out for them to achieve.<sup>38</sup> Statutory corporations in PNG submit their reports to Parliament; however these are never presented in Parliament for discussion or debate. This defeats the whole purpose of submitting reports to Parliament. The boards of state companies submit reports to IPBC, which keeps all reports of state companies and submits them to Parliament when requested by the Minister for SOEs. IPBC is only a trustee shareholder. Its main role is to manage state companies, and prepare them for privatization through increasing their value. This role does not replace the role of Parliament, which is rightly the representative of the residual owners, the public. The public has the right to know how the SOEs are performing.

It is suggested that the submission of annual reports of SOEs must be made mandatory. This can be done through stipulation under a statute or by establishing a

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<sup>34</sup> Mascarenhas, R. C., *Public Enterprise in New Zealand*, (1982) 128.

<sup>35</sup> *Ibid* at 128–135.

<sup>36</sup> *Supreme Court Reference No. 4 of 1990* [1994] PNGLR 141; *Supreme Court Reference No. 3 of 1999: re Calling of Parliament* (unreported, 1999).

<sup>37</sup> Narokobi, M., “Parliamentary Reform for Good Governance,” in Sullivan, N., (ed.) *Governance Challenges for PNG and the Pacific Islands*, (2004) 108 at 114.

<sup>38</sup> Above n 34 at 35–37.

“Permanent Parliamentary Committee on SOEs” (PPCSOE) that would ensure that the reports are presented and assessed in Parliament. PPCSOE would not replicate the functions of PAC of examining accounts or examining matters raised by the Auditor General’s reports, but would perform other accountability roles that include: ensuring that annual reports are tabled in Parliament; that corporate plans are submitted and scrutinize by the relevant ministers; and that the relevant ministers are performing their responsibilities.

## **15.4.2 Acts of Parliament**

### **15.4.2.1 Department of Treasury**

Part III of the PFM Act provides for public bodies. It qualifies itself by stating firstly that it does not apply to public bodies, unless a law or constituent law provides specifically for its application with their exceptions and conditions. Second, if the provisions in Part III state that they apply to all public bodies notwithstanding contrary provision in any other laws then Part III applies.<sup>39</sup> The example of the first condition is where s 23 of the *National Housing Corporation Act 1990* provides that Part III applies to the corporation. This is where all provisions of Part III apply to the National Housing Corporation. The provisions that apply with regard to the second condition are examined below.

First, the department Head of Treasury may, at any time require chief executives of all public bodies to submit a performance and management plan of that public body.<sup>40</sup> Section 50 of the PFM Act only makes it optional for department heads to do so. This means he or she may or may not request the performance or management plan. It is suggested that the provision must be mandatory for the submission of a management plan and not at the request of the department head. Section 50 must be amended so it is made mandatory.

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<sup>39</sup> *Public Finance (Management) Act 1995*, s 48.

<sup>40</sup> *Public Finance (Management) Act 1995*, s 50.

Second, under s 63 of the PMF Act, all public bodies must prepare and submit two reports to the Minister for Treasury. The first is the performance and management report of its operation for the year, and second the following reports on investment: quarterly report on investment decisions; detailed report on investment and returns for the year; and a five year investment plan.<sup>41</sup> Failure to do so can result in the Minister penalising the public body by not releasing the annual grant appropriation and referring it to PAC for investigation.<sup>42</sup> Further, the Minister is entitled to initiate investigation if there is reason to believe that the public body may have failed to implement the management plan.<sup>43</sup> From the case studies in Part V none of the SOEs submit their performance and management report to the Department of Treasury. The explanation given during the interview is that, apart from the National Broadcasting Corporation, they do not receive their annual budgetary allocations from the Government. This is an inadequate and unconvincing explanation. SOEs have possession over the assets of the State and are generating revenue out of them. Surely, the people of PNG are interested in how they are being utilised. Therefore, the submission of a management report and an investment report must be made compulsory.

State companies and statutory corporations as public bodies are accountable to the Minister for Treasury and his/her Department. On the contrary, it was discovered in Part V that state companies and statutory corporations do not submit their annual reports or management plans to the Minister for Treasury and his or her Department. Despite this, these SOEs are not disciplined through referral to PAC. This illustrates the fact that either the Minister for Treasury or his or her Department fail to perform their statutory and supervisory duties or do not understand their responsibilities under the PFM Act or ignore performing their duties. They have an important responsibility to ensure that public monies are spent properly. The difficulty with the National Housing Corporation and the National Broadcasting Corporation is that they only implement government policies and do not have corporate plans. The job of the Minister and the Department of Treasury is to compel SOEs to produce corporate

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<sup>41</sup> *Public Finance (Management) Act 1995*, s 63(2).

<sup>42</sup> *Public Finance (Management) Act 1995*, s 63 (8).

<sup>43</sup> *Public Finance (Management) Act 1995*, s 64.

plans and ensure that public monies are spent according to the plans. The responsibilities of the Minister and Department of Treasury must be specified in a document that is accessible to SOEs and the Department of Treasury.

In addition, the Department of Treasury must establish a unit like “the Crown Ownership Monitoring Unit”<sup>44</sup> in New Zealand’s Treasury where administratively the unit will be linked to the Treasury, but have a specific function of assessing the performance of SOEs. The unit would deal solely with SOEs by requesting management plans, examining annual and financial reports and other company documents, and reporting to the relevant minister or “Independent Public Business Corporation of Papua New Guinea” (IPBC) on the performance of the relevant SOE.

#### **15.4.2.2 Independent Public Business Corporation of Papua New Guinea**

The development of IPBC in the aftermath of the Privatization Commission has caused problems because its roles have not been articulated. It was intended to replace the Privatization Commission which was established under the *Privatization Commission Act 1997*. Then, the Privatization Commission had only one responsibility under the Act, which was to value SOEs to identify whether they were ready for privatization. By virtue of the *Independent Public Business Corporation of PNG Act 2002*, IPBC assumes the responsibility of the Privatization Commission and is additionally entrusted with ownership of state companies and the responsibility of managing them. IPBC is made to be directly responsible to the Minister for SOEs; however the roles of responsible Minister with regard to IPBC and state companies are not stated in any documents. Without clear specification of roles, the Minister has a lot of room to manoeuvre and often bypasses IPBC and deals directly with SOEs. At times some of the Minister’s acts may be illegal. For example, the appointment of directors in state companies is contrary to IPBC Act and the *Companies Act 1997*. It is confusing for state companies to deal with both the Minister for SOEs and IPBC. Further, Telikom has to deal with two ministers

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<sup>44</sup> See The Treasury – NZ, “Crown Ownership Monitoring Unit,” (December 2009) in *The Treasury*, < <http://www.treasury.govt.nz/statesector/soes> > at 15 April 2010.

including the Minister for Communications. To resolve these impasses two approaches can be undertaken.

- a. Have the responsible Minister deal directly with state companies and have IPBC revert back to performing the role of the Privatization Commission.
- b. Revive the Privatization Commission and have it perform its previous role under the *Privatization Commission Act*, and have IPBC remain as a shareholder, performing all responsibilities of an owner. The Public Service Commission must make the appointment of directors and CEO of IPBC and the Government should be completely removed from dealing with state companies. The current situation is that the Minister for SOEs is not a shareholder or a director and yet continues to appoint directors in state companies thus violating the IPBC Act and the *Companies Act 1997*.

The second option would be a better alternative, as it will prevent the Government from interfering directly with the state companies. IPBC will then focus solely on its ownership responsibilities in appointing directors and chairpersons and other responsibilities under the *Companies Act 1997*. The Government is doing too many things with IPBC: it is replacing relevant ministers with IPBC as owner to create independence; it uses IPBC to value SOEs for privatization and also empower IPBC to manage state companies. Some of these responsibilities have to be removed from IPBC so that there is effective performance with single responsibility as a shareholder, which essentially means that its focus will not be on privatization.

#### **15.4.2.3 Deemed Directors**

Case studies in Part V highlighted that the Minister for SOEs provides advice, and directs the board and management to implement government policies or pursue other political agendas. In this role the responsible Minister or IPBC can be regarded as *de facto* controllers under section 107(1) (b) of the *Companies Act*. The provision refers to such a person in this capacity as:

- a. a person in accordance with whose directions or instructions a person referred to in section 107(1) may be required to act;

- b. a person in accordance with whose directions the board of the company may be required to act; and
- c. a person who exercises powers, which would fall to be exercised by the board.

Therefore, both responsible Ministers and IPBC providing advice and directions as *de facto* controllers are deemed to be directors and can be held responsible for their actions. However, as shareholders they may decide not to pursue action against themselves. This is where an “entitled person” (see discussion below) can take action against the responsible Ministers or IPBC. People who are affected by an act or omission of the company under the direction of the responsible Minister or IPBC can pursue actions against them in their capacity as deemed directors. For example, if a responsible Minister is known for directing PNG Power and in compliance with the company’s objective of rural electrification program, advises the company to install a generator in Wapenamanda in Enga Province and the company fails to do so, the people of Wapenamanda can sue the Minister as deemed director under s 148 or the company under s 150 of the *Companies Act* for failing to undertake actions that they are required to do. At the moment affected members of the public cannot sue. In order for them to take action, as suggested below, both provisions must provide for “entitled person”, whose definition is extended to include members of the public. Alternatively, they can report the inaction by PNG Power to the Ombudsman Commission. This is important as responsible Ministers are shareholders and it is unlikely for them to decide to take action against themselves. In state companies, IPBC is the shareholder. With government associates as CEO and directors on board, the management of IPBC would be reluctant to take action against the responsible Minister.

### **15.4.3 Other External Accountability Mechanisms**

After looking at PNG’s *Constitution* and Acts of Parliament it is clear that many issues about public accountability of SOEs are not certain or where there is certainty they are not given effect. The only public office that seems to be doing its job, as discovered from case studies is the Auditor General, who only ensures financial accountability, although accountability to the people of PNG is lacking. This provides an opportunity for stakeholders in governance to be involved in abuse, corrupt

practices and pursuance of self-interested activities. Apart from having uniform legislation (discussed below) the national Parliament needs to amend the definition of “entitled person” under s 2 of the *Companies Act* and establish a PPCSOE.

#### **15.4.3.1 Entitled Person**

SOEs that are established under the *Companies Act* are required to pursue objectives that are in the best interest of the company. Section 112 of PNG’s *Companies Act 1997* provides that directors are to act in good faith and in the best interests of the company. State companies must not only pursue commercial interests but also have to meet their community service obligations. Therefore, the best interests of the company are to achieve both objectives under the corporate plan. Members of the public who are affected by an SOE’s activities in fulfilling community service obligations must be able to hold the company and the management to account.

The public cannot pursue any actions against directors and the company under the *Companies Act 1997*. However this could be remedied by amending the definition of “entitled person”, and inserting the phrase “entitled person” into ss 148 and 150 of the *Companies Act 1997*. An “Entitled person in relation to a company, means a shareholder; and a person upon whom the constitution confers any of the rights and powers of a shareholder”.<sup>45</sup> There is a need to extend this to a person aggrieved by breach of the Act as is the case under s 1324 of the Australian *Corporations Act 2001*. The *Companies Act* provides that shareholders, former shareholders and “entitled persons” have the capacity to initiate legal actions under certain circumstances to hold a director or board to account if they engage in conduct which would contravene certain legislation or the constitution,<sup>46</sup> if they do not undertake actions which they are required to do,<sup>47</sup> or if the board is not acting in the best interests of the company,<sup>48</sup> or in a manner which is oppressive or unfairly prejudicial or discriminatory to a particular shareholder.<sup>49</sup> All of these provisions allow only a

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<sup>45</sup> *Companies Act 1997*, s 2.

<sup>46</sup> *Companies Act 1997*, s 142.

<sup>47</sup> *Companies Act 1997*, ss 148 and 150.

<sup>48</sup> *Companies Act 1997*, s 143.

<sup>49</sup> *Companies Act 1997*, s 152.

shareholder to initiate an action, but s 142 (injunction) and s 152 (prejudicial actions) enable an “entitled person” including a shareholder to initiate an action.

First, the extension of the definition of “entitled person” and its insertion under ss 143, 148 and 150 of the *Companies Act* would enable the public to apply to court to compel a director or the board to take certain actions with regard to non-commercial obligations that affect them. This would also enable the public as an “entitled person” to initiate proceedings under ss 142 and 152 of the *Companies Act*. Secondly, in acknowledging the reciprocal relationship that exists between state companies and the public and given the fact that community service is one of the two objectives of SOEs it is appropriate to extend the definition of an “entitled person” to include persons in society who are affected by the actions of the company. This would clearly include a local community or members of that community. However, to be reasonable it would need to be shown that the acts or omissions of SOEs in implementing a public policy have a direct impact on the lives of the people.

The amendment would ensure that state companies would be acting in the best interests of the public whose welfare and livelihood are affected by their actions. This recognizes the broad definition of corporate governance discussed in chapter three where managers are not only accountable to shareholders but to other stakeholders who are affected by the activities of SOEs. In chapter 14 it is pointed out that the Minister of SOEs breaches both the IPBC Act and the *Companies Act* in appointing directors. Unfortunately, board of IPBC and state companies cannot bring action as the members of the boards are cohorts of the Government and they would be reluctant to do so. This situation can enable an “entitled person” to bring a derivative action seeking the court’s declaration on the legality of the Minister’s actions under s 143 or an entitled person can bring an action seeking declaration through an “Originating Summons” in PNG’s National Court.<sup>50</sup>

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<sup>50</sup> Derivative action would allow the members of the public to bring an action on behalf of the company to get the company, directors and shareholders to do or not to do an act. This is important in SOEs where the directors and managers have close relationship and may be reluctant to initiate court actions against one another for acting contrary to the requirements of their duties. The amendment to the relevant provisions of the *Companies Act* can allow members of the public with vested interest to intervene in such circumstances.

An “entitled person” who brings an action against the company not only gives effect to implementing the objectives of the company but also ensures government policies are realized, which then indirectly gives effect to the National Goals and Directive Principles (NGDP) under PNG *Constitution* as all government policies generally reflect and amplify NGDP.<sup>51</sup> Further, s 55(1) of the *Constitution* recognizes equality for all; however it allows Parliament to enact laws to advance special benefit or welfare of the less advanced groups or residents of less advanced areas.<sup>52</sup> Policies of the Government usually reflect the principle of equality, consistent with s 55 and NGDP. It is submitted that amendment to “entitled person” is relevant and consistent with s 55 and NGDP to enable such people to advance their interests. This applies to those people in rural areas who have been waiting for the Government to provide them with electricity or telecommunication services for the last 35 years.

#### **15.4.3.2 Civil and Criminal Penalties**

In Australia, additional elements are inserted under civil penalty provisions to hold a person criminally responsible for contravention. Officers of companies who contravene ss 181, 182 and 183 of the *Corporations Act 2001* would be criminally liable if they acted improperly using their positions or information of the company recklessly or with intentional dishonesty. Also, they would commit an offence under s 184 of the *Corporations Act 2001* if they exercise duty of good faith with recklessness or with intentional dishonesty. The additional elements of recklessness and intentional dishonesty are added to these various civil penalty provisions to create criminal offences.<sup>53</sup> It is recommended that *Companies Act 1997* or a new generic corporatisation legislation should adopt Australia’s approach in criminalizing directors or officers of companies who intentionally compromise their duty of good faith. This would be seen not only as punitive but as a deterrent measure, to punish officers who violate their duty of good faith and would prevent future breaches.

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<sup>51</sup> *Constitution of PNG*, s 25.

<sup>52</sup> *Constitution of PNG*, s 55(2).

<sup>53</sup> There are other civil penalty provisions that have criminal consequences where there is violation under Australia’s *Corporations Act 2001*. For example, see ss 208, 209(3), 254L(3), 256D(4), 259F(3), 260D(3), 344 and 588G(3) of the Act. The commonality among these provisions is the element of dishonesty in them that creates criminal offence.

### 15.4.3.3 Permanent Parliamentary Committee on SOEs

The national Parliament has the power to establish permanent Parliamentary committees.<sup>54</sup> These committees are established to cover all major fields of the national Government's activities. In compliance with s 118 of PNG's *Constitution* Parliament must establish a PPCSOE by an Act of Parliament. The Act would provide for membership, jurisdictions, functions, powers and procedures of PPCSOE. Backbenchers and members of the opposition must constitute the membership of PPCSOE. The powers and functions of PPCSOE must be generally to review the policies and administration of SOEs. Its specific roles and responsibilities must include the following:

- a. Ensure that all annual reports of SOEs are submitted to the Ombudsman Commission, PAC, IPBC and Department of Treasury, published in one of the national newspapers and submitted to Government and must tabled in the national Parliament.
- b. Ensure every SOE has a corporate plan, which is reviewed annually.
- c. Ensure the Ombudsman Commission, PAC, the Auditor General and the Department of Treasury are performing their obligations of making certain that all participants in governance of SOEs are responsible and accountable in performing their duties.
- d. Ensure that responsible Ministers are performing their obligations as provided in legislation and company documents. If they are not performing their duties, PPCSOE should refer them to the Ombudsman Commission or PAC for investigations.

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<sup>54</sup> *Constitution of PNG*, s 118.

In addition, the PPCSOE must have the authority to call upon CEOs to answer for the efficiencies and the effectiveness of SOEs' operations. PPCSOE would be similar to PAC in a sense that like PAC it is a Parliamentary committee, but PAC has specific responsibilities to deal with financial matters including the power to investigate the accounts of all public bodies, inclusive of SOEs and governmental departments. PPCSOE would not deal with financial matters. Its area of responsibility would be confined to SOEs. The requirements of PPCSOE need to be clearly spelt out.

## **15.5 INTERNAL ACCOUNTABILITY MECHANISMS**

Internal and external accountability are equally important. Both have to operate together to ensure good corporate governance in an SOE. Sir Adrian Cadbury noted "...the actions which corporations take to improve their internal governance cannot make up for their deficiencies in their external framework, notably if an appropriate and enforceable legal system is lacking."<sup>55</sup> It is also true to say that the improvement in external framework cannot substitute for deficiencies in internal governance. In other words external accountability mechanisms, as discussed above, cannot be effective if the powers and functions of stakeholders in the governance of SOEs are not clearly specified. There has to be a clear standard whereby these stakeholders can be held to account. From Part V, there are many issues with the role of responsible Ministers, board, directors and CEOs that were identified and must be addressed to ensure good governance. These issues are discussed below.

### **15.5.1 Understanding Corporate Governance**

The conclusion reached from case studies is that participants were either not aware of the concept of corporate governance, or were unable to explain it. There is a greater need for SOEs to educate and provide training for their directors and managers on issues regarding corporate governance. Through this training they must be provided with general information about the public sector and the role of the Government;

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<sup>55</sup> Cadbury, A., "Foreword," in Claessens, S., *Corporate Governance and Development*, (March 2003), [page 7] < [http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus\\_1\\_CG\\_and\\_Development/\\$FILE/Focus\\_1\\_Corp\\_Governance\\_and\\_Development.pdf](http://www.ifc.org/ifcext/cgf.nsf/AttachmentsByTitle/Focus_1_CG_and_Development/$FILE/Focus_1_Corp_Governance_and_Development.pdf) > at 26 March 2009.

different legislation governing SOEs and the role of public institutions such as the Ombudsman Commission and PAC in relation to SOEs; information about their specific organization and its hierarchical structure; the powers, functions and procedures of the board and their own powers and functions, including fiduciary duty and duty of care, skill and diligence. Training must be made compulsory in each SOE.

### **15.5.2 The Role of the Government**

The legislation and SOEs' documents are silent on the powers and functions of responsible Ministers. This is the biggest hindrance to good corporate governance. Lack of clear expression of their roles and responsibilities has allowed the Ministers to interfere and control the management of SOEs who are confused about their own responsibilities and the responsibilities of the Ministers. Given their hierarchical status over management responsible Ministers can assume total control over the management without written explanation setting out the extent of their responsibilities. Having Ministers' roles specified would set the limit to how they should deal with SOEs and put management on notice as to the extent to which they can accept ministerial involvement. If there are two or more responsible Ministers, their powers and functions in relation to that SOE must be clearly specified.

In statutory corporations, the Government makes direct appointment of directors and CEOs, except in NHC where the Government appoints after compliance with the process under the *Regulatory Statutory Authorities (Appointment to Certain Offices) Act 2004* (RSA Act). Under the Act certain persons have to be consulted before appointment. In Part V, the Government does not comply with these requirements. On the other hand, although the *Broadcasting Corporation Act 1973* does not provide clearly for the appointment and removal directors and CEOs, the Government continues to appoint and terminate them. It is suggested that appointment and termination of directors in NHC and NBC must comply with processes under the RSA Act. In state companies, IPBC is supposed to appoint directors and CEOs, however, the Minister of SOEs is still responsible for the appointment of directors

contrary to the IPBC Act and the *Companies Act 1997*. The Minister's actions are in serious breach of the *Companies Act*.

Government appoints persons who have political affiliations with the parties in government. It is recommended that appointments should be made on merit. In circumstances where appointment is to be made on political affiliation candidates should demonstrate excellence in relevant skills and achievement and must demonstrate any significant political activity in the last five years. Where a statute requires a particular group or organization to appoint a delegate, the group should make the appointment according to merit-based criteria. The appointment and removal process must be set out in writing and must be open to public examination. In other words they must be transparent. The PPCSOE must scrutinize every appointment and removal made by the Government. It is suggested that for state companies IPBC should appoint directors and the board should appoint the CEO. In doing so, the Government is isolated from any direct dealings with state companies and only deals indirectly through IPBC.

In PNG, responsible Ministers often interfere in operational matters inaptly or unofficially and abdicate responsibility by classifying all failures as operational – this situation occurs because there is a lack of express provisions on the powers and functions of ministers to hold them responsible and accountable.<sup>56</sup> It is suggested that there must be a clear distinction between policy and operational matters. These must be clarified in the corporate plan. In conclusion the Government must be separated from SOEs.

### **15.5.3 The Board**

All board members who were interviewed and who answered the questions in Part V do not fully understand their governing roles and responsibilities. The lack of

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<sup>56</sup> For example, the responsible Minister for NHC, Andrew Kumbakor directed sales of the NHC building complex in Hohola, Port Moresby. He stated in Parliament, when questioned that it was a management decision and he had nothing to do with it. On interview during a case study, the former CEO at the time of the sales stated that the direction came from the Minister's office to sell NHC housing complex in Hohola and had nothing to do with his management at that time.

knowledge is the result of several causes including a lack of managerial knowledge and experience, lack of training or not having these responsibilities clearly provided in legislation, company constitutions or other documents of SOEs. To address these issues SOEs must have company charters that clearly set the powers and functions of the board. Having these duties provided in the document would provide a general guideline for the board to follow without making compliance compulsory so that the boards are still flexible and effective. One of the duties is for boards to appoint and terminate CEOs and senior managers. This duty must be made mandatory. This would ensure boards are effective and have the power to discipline management through appointment and termination. An important organ of the board is a board committee. These committees assist the board with workload. The committee must be provided with clear number, composition and procedure for reporting to the board. Apart from the committee, the board must have two executive directors. These directors must be in full time employment in SOEs.

Chairpersons of SOEs in PNG experience the same dilemma of confusion and uncertainty over their responsibilities. They have important responsibilities of promoting cohesive effectiveness and functioning of the board and in doing so play a pivotal role in creating a good relationship between the Government ministers and the board. In this case the responsible Minister, in principle, is supposed to deal directly with the chairperson and the board. However, responsible Ministers deal with CEOs directly in most cases, making the role of the chairman ineffective as a result. Legislation or company documents should clearly set out the powers and function of the chairperson. This would ensure that the relationship between the chairperson and board, and the chairperson and responsible Ministers are monitored. Also, the job of chairperson must be a full-time position.

CEOs of SOEs are basically the head of the management team and they perform administrative responsibilities. Their positions are hierarchically below the board and the responsible Ministers and for state companies, IPBC. However, in Part V, the roles and responsibilities of CEOs are not specified. The CEOs are generally required to provide leadership and strategic management in SOEs and in statutory corporations they are expected to provide policy advice to the responsible Ministers.

Unfortunately, these roles are not clearly identified; hence the leadership and strategic management roles of CEOs are poorly differentiated from those of the board. The CEO is at the top of the management team and his or her relationship with the board and the responsible Minister must be clearly articulated. For state companies, it is confusing for a CEO who has to deal with the board, IPBC and the Minister for SOEs. The responsibility of these stakeholders must be clearly articulated.

#### **15.5.4 Accountability**

Reporting is important in an SOE. All SOEs that are the subject of case studies in Part V indicated that they submit annual reports, however to whom the report is submitted and what is reported is important. It is suggested that the annual report should consist of corporate governance practices and the achievements of the organization. The corporate governance practice report, amongst other things, should consist of the structure and composition of the board, and the appointment and removal processes. Apart from submitting the report to Parliament and the company office for state companies, all SOEs must submit a copy of the report to the Department of Treasury and to one of the national newspapers in compliance with s 51 of PNG's *Constitution*.

Every SOE must have a corporate plan and submit their plan to responsible Ministers for approval before implementation and provide a copy to the Department of Treasury. State companies must submit their corporate plan to IPBC and the plan is to be approved by IPBC in consultation with Minister for SOEs. In addition to corporate plans, each SOE must have a "State of Corporate Intent" (SCI) like NZ and Australia, which sets out the objectives to be achieved half-yearly or annually. An SOE must be measured on the achievement of these objectives. Failure to achieve them must be reported and explained. It must be clearly stated that, apart from the end of each year when SCIs are reviewed, the Government must not intervene from time to time with policy directives of state companies. Hence, it must be mandatory for SCIs to be reviewed every year.

No SOE boards monitor and evaluate their own performance and that of individual board members in their official capacity. This is not a surprise given the fact that boards have no code of conduct. For state companies, directors are required to act in accordance with the *Companies Act 1997*, which requires them to comply with their fiduciary duties. That involves acting with integrity, care, skills and diligence and in the best interests of the company. However, most directors lack an understanding of these requirements. For statutory corporation there is no such requirement. It is suggested that all SOEs should have a code of conduct so that every board member has access to and can follow the code.

## **15.6 UNIFORM LEGISLATION**

Given the importance of corporate governance in SOEs in PNG, it is proper that corporate governance principles highlighted above are provided in generic legislation following the examples of New Zealand, Queensland and New South Wales. This would ensure simplicity, clarity, consistency and uniformity in the corporate governance framework. The legislation must, in general, provide mechanisms for creating SOEs and provide for both statutory and state companies. First, the legislation must, in detail, include the governance of each type of SOE including:

- a. the powers and functions of the Government and relevant ministers; and
- b. the powers and functions of the board, chairperson, directors and CEOs.

Secondly, and of equal importance is the provision for accountability of SOEs. Under accountability the legislation must state clearly:

- a. the role of the Ombudsman Commission, PAC and PPCSOE in SOEs;
- b. that SOEs must have a corporate plan and SCI and their content should be outlined in legislation. The relevant minister must have an input in the formulation of the corporate plan and SCI and the latter must be reviewed annually. In the annual report SOEs must state whether they have met their obligation under SCI.

- c. that the SOEs must submit annual and half-yearly reports. One of the matters to be reported must be corporate governance practice. The legislation must also state that the Government, Department of Treasury or the Auditor General may request any information from time to time.
- d. that annual and half-yearly reports must be presented in Parliament.
- e. that SOEs must present their reports in one of the national newspapers for the people of PNG, so as to meet the requirement under s 51 of PNG's *Constitution*; and
- f. the objectives of SOEs and the legislation must give equal prominence to commercial and community service obligations.<sup>57</sup>

It is recommended that the country should adopt generic corporatisation legislation similar to the *Government Owned Corporations Act 1993* (Qld) and the *State Owned Corporations Act 1989* (NSW) as discussed in chapter 7. The corporatisation legislation must adopt the above points and give effect to the corporate governance principles identified in the introduction of independence, transparency, responsibility, accountability and social responsibility.

## 15.7 CONCLUSION

This chapter has shown that SOEs in PNG are “public bodies” and are subject to the requirement under the PFM Act, subject to investigation by the Ombudsman Commission and PAC, and subject to audit by the Auditor General. Parliament also has an important responsibility to ensure accountability, although it lacks motivation in performing its duty in discussing and debating matters arising from the annual reports. Further, the requirement under the PFM Act is not met through submission of annual reports and corporate plans to the Department of Treasury. The Auditor General is left as the only effective external accountability mechanism. It only focuses on the accounts of SOEs to ensure accountability, however the Ombudsman Commission and PAC that were supposed to hold the responsible Ministers and management responsible for their actions or omissions are not performing their

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<sup>57</sup> Have similar provision to s 17 of the *Government Owned Corporations Act 1993* (Qld).

constitutional responsibilities. The effort to ensure proper accountability is not assisted in having inconsistencies in the legal framework and corporate governance practice and having roles and responsibilities of stakeholders in governance unspecified.

Steps forward are firstly to create a PPCSOE, which must ensure that SOEs meet all their legal responsibilities, one of which is to ensure that half-yearly and annual reports of SOEs are presented in Parliament, published in national newspapers, and submitted to the Department of Treasury. Second, entitled person under the *Companies Act* must be amended to include members of the public so that they can take action, especially in situations where non-compliance with community service obligations directly affects them. Third, create a criminal offence for intentional breach of duty of good faith. Finally, PNG must adopt generic corporatisation legislation that must provide for governance and accountability mechanisms, including the role of the Ombudsman Commission and PAC in SOEs and which will clearly specify the roles of relevant ministers, IPBC, board, directors and CEO in SOEs. In doing so the legislation would provide for internal and external accountability mechanisms, prevent relevant ministers from dealing directly with SOEs, or where the minister still assumes control, provide for ministerial responsibility to apply to SOEs so as to ensure that SOEs remain within the purview of public institutions such as PPCSOE, the Auditor General and the Ombudsmen Commission.

## **CHAPTER 16:**

## **CONCLUSION**

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### **16.1 INTRODUCTION**

Corporate governance has become a buzzword in the last 25 years. It has gained prominence due to separation of ownership and control (chapter 2). Corporate governance has become the talk of the governments, policy makers, organizations and international bodies such as OECD and the World Bank. Much of the literature on corporate governance is focused on private sector corporations, and literatures on public sector corporations is mainly focused on public sectors in developed or industrialised countries. Problems in corporate governance arise when managers administer corporations in a manner which is not promoting the interest of the owners. It is illegal and morally wrong, as fiduciaries to use corporations to pursue self-interest; in other words, to pursue interests that are not in the best interest of the corporation. Apart from pursuing the interests of shareholders corporations have relationships with other stakeholders such as creditors, customers, employees and suppliers whose interest must also be taken into account - not to mention communities that are affected by their activities.

In light of the different stakeholders in a company, and different interests that have to be taken into account, definitions of corporate governance differ. There is no single definition that is collectively accepted (chapter 3). The narrow definition only defines the interest and relationship of shareholders with the management whereas the broad definition encapsulates interest of the shareholders and other stakeholders, and their relationships with the management. Like Papua New Guinea (chapter 10), laws in New Zealand (NZ), Australia and the UK promote shareholders' interests and their short term interests (chapter 4). On the other hand German and Japanese models of corporate governance promote the interests of shareholders, and other stakeholders and their longer term interests (chapter 4). Given these situations definitional ambit of

corporate governance differs from one society to another and one organization to another to cater for the reality or the practice.

Unlike private sector corporations, the State is the sole shareholder in state owned enterprise (SOE) or has the controlling interest. The State is represented through government and other public bodies (chapter 5). Its role is not only restricted to regulation and policy-making but extends to welfarism. Public bodies are state agents that exercise and perform the delegated powers and functions of the Government. A state has multiple interests which are reflected in the broad objectives of SOEs that vary from commercial to non-commercial. Stakeholders in SOEs include members of the public, suppliers, customers and employees. In order to understand corporate governance in SOEs in a particular society, laws and practice need to be examined.

In the context of Papua New Guinea (PNG) the Government controls more than 50 per cent of the economy and uses SOEs to participate in it. Since Independence in 1975, SOEs have been increasingly facing problems in governance and accountability. Some corporate governance problems identified in PNG include situations where procedures are not complied with in appointing and terminating directors and chief executive officers (CEOs); directors and CEOs are involved in self-interested activities; appointment of political associates and family members as directors and managers which borders on nepotism, or the appointment of persons to management positions who do not have skill, knowledge or experience. These issues make the study of corporate governance in SOEs important. And yet there is no literature on corporate governance in SOEs to identify and address these issues.

In this research I have attempted as much as possible to fill the void in the literature, document empirical evidence on corporate governance in SOEs and specifically identify how relevant Ministers, directors and CEOs are held accountable in SOEs, and identify whether problems in corporate governance is one of the factors that contribute to the quality and efficiency of services.

## **16.2 CORPORATE GOVERNANCE IN PRIVATE AND PUBLIC SECTOR CORPORATIONS**

Chapter 3 discusses the narrow and broad definitions of corporate governance in the private sector. It is stated that the definition depends on the laws in a particular jurisdiction and/or practice in a particular organization and whether managers owe their obligation to shareholders only or shareholders and other stakeholders of the company. Corporate governance arises out of the agency theory; hence the theory is at the heart of it. In chapter 2 agency theory was discussed in connection with the doctrine of separation of ownership and control, which creates the agent and principal relationship. In such situations agents as humans would always attempt to pursue interests other than that of shareholders, hence different jurisdictions put in mechanisms in an attempt to align the interests of the owners and the managers. In the private sector the alignment of the two interests is done through external markets, and monitoring and bonding devices. There is an agency cost for aligning the two interests. Chapters 2 and 7 highlight that the external markets are costless in terms of agency cost. Chapter 4 looks specifically at corporate governance in NZ, Australia and other jurisdiction. Generally, Australia and NZ along with the UK have a system of self-regulation, sometimes called an outsider-based system of corporate governance. Their private sector corporations are subject to external markets. On the contrary the Japanese and German models have an insider system; hence external markets do not play a significant and effective role in disciplining managers. The insider system of corporate governance is based on majority/concentrated shareholding and stakeholders who perform important roles in corporations, particularly decision making at the board level. Therefore, the objectives are long-term viability of the company rather than short-term, and the company takes into account the interests of other stakeholders rather than just the shareholders.

The principles of corporate governance in the public sector are intended to replicate that of the private sector (chapter 6). In the public sector the State is the shareholder instead of private individuals as in private sector corporations. Chapter 5 discusses the role of the State and it is unequivocal from the discussion that the role of the State today is not restricted to military might, conquest of other territories, or strict

regulation, but extends to providing social and economic welfare for society. This makes the State depart from its traditional role, using different mechanisms such as SOEs to participate in regulation, policy, trade and other commercial and non-commercial activities.

As the State becomes more involved in these commercial and non-commercial activities through various institutions and organizations efficiency and profitability historically tend to suffer. This makes the statement that “one cannot serve two masters” become true. That means a government that pursues too many commercial and non-commercial objectives will be less efficient and effective compared with a government which focuses on one objective. Too many objectives would spread out resources, time and effort, hence efficiency would suffer. Further, government is the main and sole shareholder in SOEs. With multiple interests, a government can direct SOEs to be involved in a broad array of activities, whether commercial or community service or even self-interested activities if there are ineffective accountability mechanisms. Therefore, the corporatisation process was undertaken to separate state interests from the activities of SOEs. Corporatisation establishes a clear hierarchical structure, clear and defined objectives, defines the roles of stakeholders in governance, and provides effective accountability (chapter 6). As discussed in chapter 6 and highlighted in chapter 7 the corporatisation process in NZ, Queensland and New South Wales was aimed at separating state control from the activities of SOEs and making SOEs become more like private sector entities so that they operate in an efficient and/or profitable manner. However, it is seen in chapter 7 discussing “corporate governance in public sector” that the State generally controls SOEs. This is also true for Papua New Guinea.

The positive outcomes of corporatisation are the establishment of the legal framework of SOEs, and clear provisions on governance and accountability under the *State-Owned Enterprise Act 1986* (SOE Act) for commercial entities and the *Crown Entities Act 2004* (CE Act) for non-commercial entities in NZ, the *Government Owned Corporation Act 1993* (GOC Act) for Queensland and the *State Owned Corporation Act 1989* (SOC Act) for New South Wales (NSW). Further, the GOC

Act and SOC Act perform not only a regulative role but also a facilitative role in providing the corporatisation process.<sup>1</sup>

Chapter 7 concluded that corporatised entities would never achieve the efficiency and/or profitability similar to that of the private sector. However, SOEs must not be dismissed as a mere hybrid system created by a “nothing to do government” in order to have some form of control over the private sector and society generally. Jurisdictions that have similar models of governance to SOEs in the private sector have recorded success in terms of efficiency and profitability. For example, much of the corporate governance structure in SOEs reflects the German and Japanese models in private sector corporations as discussed in chapter 4. The commonalities with the German and Japanese models that are shared by SOEs in NZ and Australia are concentrated shareholding, stakeholder representation on boards and that the objectives of corporations not only focus on shareholders’ interests but on other stakeholders. It must also be noted that the success of corporations in these jurisdiction does not only depend on the type of model adopted but on other factors such as regulation, history, culture and business environment.

There are many differences in ensuring accountability and aligning the interest of shareholders with that of managers in private and public sector corporations. Chapter 2 pointed out three ways of aligning the interest of shareholders and managers. These are through bonding, monitoring and external markets. The common strategy in bonding is through pay for performance. The external markets include the managerial market, product market, share market and market for corporate control. As discussed in chapter 7, bonding and external markets do not apply in SOEs. Without the bonding device and external markets, SOEs rely on monitoring by government. It is noted in chapter 7 that there are problems associated with government monitoring of SOEs.

Like NZ and Australia, accountability in SOEs in PNG is not maintained through external markets or bonding. Government is required to perform an important role in

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<sup>1</sup> *Government Owned Corporation Act, 1993*, Chapter 2.

ensuring accountability through monitoring; however this becomes a major cause of problems in corporate governance. In order to adopt an appropriate model of corporate governance of a society one must take into account and consider the political and socio-economic circumstances, and the history, culture and prevailing ideologies of the society. PNG is connected to NZ and Australia in many respects.

Before Independence PNG was under Australian administration and most of the Australian - era laws were adopted immediately after Independence. Some of the laws such as the current *Companies Act 1997* and *Securities Act 1997* were adopted from NZ (chapter 10). PNG, NZ and Australia inherited the common law system from England and they all practice liberal democracy (chapter 8). These factors must also be balanced and guided by cultural influences, and the political and socio-economic circumstances of the country. PNG's culture is socialist oriented where sharing and caring for one another is a norm. This practice is reflected on a large scale at the national political level.

Most voters expect that these successful candidates will use political office to extract resources from the government and deliver them back to their supporters... to distribute the rewards of office to maintain support for the next election. ... Rent-seeking has flourished ... Political time horizons are short, with most parliamentarians lasting only a single term in office, so productive investments are curtailed as newly elected politicians focus their energies on short-term wealth distribution to shore up their supporter base rather than long-term wealth creation.<sup>2</sup>

When politicians cannot find enough resources to provide for their people and large group of supporters they become involved in corrupt practices. They put their associates into public bodies such as SOEs to reward their loyalty and to assist with their self-interested activities or to advance their political ambitions. This practice is wide spread from government departments to public bodies and other governmental agencies.

In chapter 8 I tried to show that politics has a greater influence in society and with weak state institutions corruption becomes systematic. This results in the country facing many dilemmas of development due to the inevitable consequence of corrupt practices (chapter 9). Chapters 12 and 13 recorded the primary data on corporate

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<sup>2</sup> Reilly, B., *Democracy and Diversity: Political Engineering in the Asia-Pacific*, (2007) 65 – 66.

governance, applying the data collection methodology discussed in chapter 11. The data uncovers many and varying problems in corporate governance in SOEs.

### **16.3 OUTCOMES OF THE STUDY**

The case studies presented in Part V document corporate governance practice and chapter 14 provides the legal framework. They are presented to answer three research questions posed in chapter 1. The main question is: what is the position of corporate governance in law and practice? Generally, the study reveals inconsistencies between the laws and practices of corporate governance, confusion and lack of understanding over roles and responsibilities of stakeholders in governance, and lack of accountability of different stakeholders in SOEs. Clearly, there is little or no separation between ownership and control. Three specific research questions were asked in chapter 1 to look at the position of corporate governance in PNG's SOEs.

First, how is the Government accountable for its involvement in SOEs? In the hierarchical structure of SOEs, management is accountable to the board and the board is accountable to the Government and IPBC with respect to state companies. In practice the relevant Ministers can at anytime intervene and interfere in the processes and activities of the board and management, and provide directions from time to time. The roles of relevant Ministers are specified in some SOEs and not others. The Ministers are not given legislative guidance on their involvement in SOEs. Where they are provided Ministers either act beyond or contrary to their legal duties. Further, often the relevant Ministers are not held accountable for their conduct in SOEs. Parliament rarely debates issues with regard to SOEs and it is not clear whether public institutions such as the Ombudsmen Commission can investigate the roles of relevant Ministers. The study shows, in answer to the question, that the Government is not accountable for its role in SOEs.

Second, how are directors and CEOs held accountable? Accountability of different stakeholders in governance of SOEs is also questionable. The roles and responsibilities of the board, chairperson, directors, and CEOs are provided in some SOEs and not others. Where they are provided these stakeholders do not understand

what they are. Some SOEs, mainly statutory corporations only implement government policies. There is no realistic yardstick to measure the performance of these SOEs in six months or one year. Others have corporate plans that are reviewed every three years. Thus, SOEs are not bound to achieve specific objectives in a short term. In such circumstances SOEs can do nothing and yet would not be held responsible for inaction. Further, SOEs except for the National Broadcasting Corporation (NBC), do not submit annual reports to the Department of Treasury. There is no requirement for specific information to be reported in SOEs apart from the general requirement under the *Companies Act*. And there is confusion over whether SOEs are subject to investigation by the Public Accounts Committee, or the Ombudsman Commission, or are answerable to the Department of Treasury, apart from the NBC, which submits annual reports to Treasury. From the case studies none of the public institutions have examined or investigated the SOEs. However, laws, namely the PNG *Constitution* and the *Public Finances (Management) Act 1995*, are very clear that SOEs are public bodies and therefore must be subjected to public scrutiny. With these weak internal and external accountability mechanisms directors and CEOs only have to please the relevant Ministers to maintain their jobs. Hence, directors and CEOs move in and out when there is a change of government.

The third question is whether corporate governance is a factor that affects the quality and efficiency of services. This question cannot be conclusively answered. On one hand, it is clear from the study that the main objectives of statutory corporations are to implement government policies - mainly non-commercial objectives, although profitability is also the important focus in some. The reason for establishing a statutory corporation is to create an autonomous entity that is separate from the Government so that there is efficiency in the production and delivery services. Chapters 12 shows that quality and efficiency of services by statutory corporations are generally rated poor. On the other hand, state companies are required to be efficient and profitable in pursuing both commercial and non-commercial objectives. State companies, except for Telikom PNG Ltd, do not expressly provide for community service obligations. From past reports state companies have generated substantial profits; however, chapter 13 shows that the quality and efficiency of their services are also rated poor. Being efficient does not mean that a company would be

profitable. That also means that in a monopoly a corporation can be inefficient and yet can achieve profitability. Lack of good corporate governance partly contributes to inefficiency and poor quality of services. There are other factors such as a lack of government funding and of resources in SOEs that may support and assist in causing these problems. These issues are not examined in this study.

#### **16.4 LIMITATIONS OF THE STUDY**

There are several limitations to this research that needs to be highlighted. First, my earlier objective was to engage the views of many former directors and CEOs. Most of them have retired or gained employment with organizations outside of Port Moresby. Without their address and contact numbers, I was unable to contact them. The reason for engaging this category of participants is that they are no longer employed with SOEs and would provide accurate information and express honest views on the issues. I was able to find some in Port Moresby who provided useful information for purposes of synthesising and analysis. Second, there is total lack of literature on corporate governance in PNG or if there is any then I am not aware of it. Much of the data collected is based on statutes, annual reports, annual returns, minutes of board meetings, corporate plans for state companies and data information through interviews. And thirdly, current directors and CEOs are politically appointed and many of them were reluctant to venture into politically sensitive discussions for fear of divulging information that may tarnish the reputation of the Government. Being aware of this limitation I have also engaged the senior managers.

#### **16.5 THE WAY FORWARD**

No single solution can resolve the number of issues in corporate governance which have been identified in this research. I have tried to provide a number of solutions in chapter 15 that may address each problem raised in chapters 12, 13 and 14. To effectively address these issues the laws and practice of corporate governance must be examined in totality. Chapter 14 discusses the position of corporate governance assessing both statutory provisions and the practices.

One of the glaring matters that surfaces in every case study is the role of the Government. The participants, especially former directors and CEOs repeatedly stated that there is too much Government interference and involvement in SOEs. By comparison relevant Ministers in NZ and Australia are used as effective monitoring mechanisms. In PNG relevant Ministers intervene in SOEs to advance political agendas or self-interest. Their roles as effective monitoring devices are substituted in pursuance of other agendas using SOEs. In such circumstances where a relevant Minister has conflicting agendas, what hope do SOEs have of achieving their aims of efficiency and/or profitability? Particularly, in a situation where the relevant Minister is the only monitoring instrument and connives with the board and management to pursue self-interests or allow management to pursue self-interests. The relevant Minister is assisted by associates of the Government sitting on the board and management to facilitate the achievement of these conflicting agendas to thrive. It seems that shareholders are less interested in an SOE achieving its objectives, and are using it to pursue other objectives. The lack of proper monitoring is also facilitated by the following factors: the roles and responsibilities of stakeholders in the governance of SOEs are not clearly specified, there is confusion over whether SOEs are subject to public institutions for accountability, state institutions are weak, and SOEs have multiple objectives that are not clearly specified.

Clearly, there are major issues with corporate governance. The overall framework of corporate governance needs to be re-examined and developed to address the current state of affairs. This requires major improvements in external and internal accountability mechanisms. Chapter 15 discusses different solutions to provide a way forward on how to monitor relevant Ministers, IPBC, directors and CEOs. Accountability as discussed in chapter 15 is about answerability and responsibility for illegal behaviour or wrongful acts. Clear external and internal accountability mechanisms would ensure that stakeholders in SOEs are answerable for their conduct and will be penalised accordingly if found guilty. The way forward is to look to NZ and Australia with whom PNG shares a common history, including the legal history, and ideologies.

Literature on corporate governance largely focuses on how to align the interests of the owners and the controllers in corporations (chapter 2). In SOEs it is the converse. The experience in NZ and Australia shows that their legislative framework has achieved the objectives of corporatisation; however government still maintains control of SOEs (chapters 6 and 7). These are two developed countries with stable political systems and vibrant state institutions, and they have a vigilant and investigative media that holds ministers accountable for their public duties. The system ensures that relevant Ministers are transparent and accountable. On the contrary PNG has an unstable and unpredictable political system, and weak state institutions. Hence, given such an environment, the Government must not control SOEs. The effort should be made to separate the activities of SOEs from the Government, create an autonomous board and empower it to monitor and discipline managers through appointment and termination. Further, clearly provide the roles and responsibilities of boards, directors and CEOs, and set out the objectives and the goals to be achieved every twelve months. The reporting process of each SOE must be established, including guidelines on what is to be reported. The roles of public institutions that are responsible for monitoring SOEs to ensure accountability must be clearly stated. In adopting these measures, there is a clear hierarchical structure, SOEs become independent from government and clear internal and external accountability mechanisms are established. These issues can properly be addressed in generic corporatisation legislation to ensure clarity, consistency and uniformity.

## **16.6 FURTHER RESEARCH**

First, it must be reemphasized and made absolutely clear before concluding that corporate governance in SOEs will never replicate corporate governance in the private sector. The latter will remain supreme unless SOEs are privatised. Whether PNG should be directed toward privatization is an issue that is beyond the scope of this study, however it would be an interesting research topic in the future, as to date, nothing substantive has been written on privatization in PNG. Second, future research should also look at whether the introduction of competition in product and factor markets would improve corporate governance in SOEs in PNG. Currently, SOEs that are the subject of these case studies have a monopoly over their markets. It would be

interesting to see whether competition would be feasible and could improve corporate governance. Third, future research should examine whether introducing different forms of ownership in SOEs, with the State maintaining 51 per cent interest, would improve corporate governance in SOEs. Finally, on a related issue, there is need for further research into corporate governance in the private sector. There is lack of substantive research like this on corporate governance in private sector corporations in PNG. These are some of the areas of research that can be pursued in the future.

## **16.7 CONCLUSION**

What this study shows is that a successful system of corporate governance derived from the private sector cannot adequately cope with the diversity and complexity of ownership and ownership interests and board compositions and functions at the public sector level. Further, an elegantly successful system of corporate governance in the public sector in one society cannot adequately cope with the diversity and complexity of ownership and ownership interests and the board and management compositions and functions in another society. In order to adopt an alternative system, there needs to be an understanding of corporate governance from the legal point of view and also from a practical standpoint to identify the strengths and weaknesses in a given sector. In addition, the process of selecting an alternative system must be guided by the ideologies, culture, political and socio-economic circumstances of the society. After looking at the legal position and practice on corporate governance, political and socio-economic circumstances and the national goals under PNG *Constitution*, it is clear that SOEs are important for PNG's developing economy and they can play an important role in developmental endeavours to achieve goals envisaged by the "National Goals and Directives Principles" in the national *Constitution*. At this juncture there is a need to separate activities of SOEs from the Government and provide for clear and consistent internal and external accountability mechanisms. Clarity and consistency can only be achieved through generic corporatisation legislation. The suggestions for improvement of corporate governance must not be seen as a final solution to bring an end to corporate governance woes but to minimize the effects of bad governance.

As Professor John Farrar stated:

Good corporate governance does not guarantee good performance but its absence usually indicates present or future problems.<sup>3</sup>

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<sup>3</sup> Farrar, J. H., *Corporate Governance: Theories, Principles and Practice*, (3<sup>rd</sup> edn., 2008) xxxix.

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Montevideo Convention on Rights and Duties of States 1933

# APPENDICES

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## Appendix A: Approval Letter from School of Law Ethics Committee – The University of Waikato

Waikato Law School  
*Te Wāhanga Ture*  
The University of Waikato  
Private Bag 3105  
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Telephone +64 7 838 4167  
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THE UNIVERSITY OF  
**WAIKATO**  
*Te Whare Wānanga o Waikato*

27 September 2007

Mr M Matui  
c/- School of Law  
University of Waikato  
Private Bag 3105  
HAMILTON

Dear Mange

I wish to advise that the School of Law Ethics Committee has approved your ethics application for the project "Developing a Corporate Governance Regime for State Owned Enterprise (SOE) in Papua New Guinea".

Should any changes from the existing application be made, you must stop the research and apply to the School of Law Ethics Committee for approval; and must not begin the research again until the necessary approval has been obtained.

We wish you well with your research project.

Yours sincerely

A handwritten signature in cursive script, appearing to read 'Claire Breen'.

Dr Claire Breen  
School of Law Ethics Committee

## Appendix B: Supporting Letter from the Chief Supervisor

Dean's Office  
The School of Law  
Te Wāhanga Ture  
The University of Waikato  
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THE UNIVERSITY OF  
**WAIKATO**  
*Te Whare Wānanga o Waikato*

8 April 2008

### TO WHOM IT MAY CONCERN

Dear Sir/Madam

It is my great pleasure to introduce to you one of our current PhD students from the University of Waikato, Mange John Matui. Mange will be in Papua New Guinea towards the end of March 2008 until August 2008 collecting data for his research project on corporate governance.

We would appreciate any assistance that you render to Mange with his PhD research. Please do not hesitate to contact me if you have any queries with regard to his PhD research programme.

Thank you for your time, consideration and assistance.

Yours faithfully

A handwritten signature in cursive script that reads 'John H Farrar'.

**Professor John H Farrar**  
**Dean**

JF:ns.students08

**Appendix C: Letter to the Director of the Centre for Human  
Resource Development – University of Papua New  
Guinea**

**Mange John Matui**

The School of Law  
The University of Waikato  
Private Bag 3105  
**Hamilton**  
New Zealand

Telephone: +64 7 838 4190  
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Website: [www.waikato.ac.nz/law](http://www.waikato.ac.nz/law)

**Dr. Bernard Minol**

The Director  
Centre for Human Resource Development  
University of Papua New Guinea  
P. O. Box 320  
**University**  
National Capital District  
Papua New Guinea

**27<sup>th</sup> March 2008**

Dear Dr. Minol,

**Re: CONDUCTING RESEARCH IN PAPUA NEW GUINEA**

As you are well aware from our previous communications that I have spent one year at the University of Waikato, and have written detailed “research proposal” which I have submitted with “ethics application form”. The research proposal and the ethics application have been approved (see attachment) and I will be leaving New Zealand for Papua New Guinea in April 2008. As a member of staff of University of Papua New Guinea I am required to inform your office about the nature of the study and how I am conducting the research in the country. Further, I am aware that I have to meet certain requirements to conduct research in Papua New Guinea.

I have met the ethics requirements of the University of Waikato. I need to be informed of any requirements that I need to meet to conduct research in the country before arrival as I have limited time, given five case studies that I have to conduct. I am planning on engaging three law students from University of Papua New Guinea to assist me with the research, and need financial assistance to engage these students. We will further discuss the issue of funding when I arrive in the country. I will also need a letter of support from your office and any other support that I may need from time to time while conducting research in Papua New Guinea.

The focus of the research is on corporate governance in state-owned enterprises in Papua New Guinea and I will be doing five case studies for six months, which includes conducting

interviews and document analysis. Professor John Farrar is my supervisor from the University of Waikato. He can be contacted on the following address.

**Professor John Farrar**  
Chief Supervisor  
School of Law  
The University of Waikato  
Private Bag 3105  
**Hamilton 3240**  
New Zealand  
Telephone: 64 7 856 2889  
Fax: 64 7 838 4417

I will contact you after receipt of this letter to discuss the above matters. You can also contact me on the above address.

Thank you for your time and consideration.

Yours sincerely,

.....  
**Mange John Matui**  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

## Appendix D: Supporting Letter from the Director of the Centre for Human Resource Development – University of PNG



THE UNIVERSITY OF PAPUA NEW GUINEA  
Centre for Human Resource Development

Office of the Director

22<sup>nd</sup> April 2008

### To Whom It May Concern

Dear Sir/Madam,

It is a great pleasure to introduce to you Mr. Mange Matui who is here in Port Moresby carrying out research from the University of Waikato, New Zealand.

Mr. Mange Matui is a Papua New Guinean and a lecturer in our School of Law at UPNG. In 2006 he won a New Zealand Aid Scholarship to study for his PhD degree at the Waikato University. Mr. Matui will be in PNG for the next six months to collect data and then return to Waikato to analyse and write his PhD dissertation. While he is Port Moresby he will be visiting various government, semi government institutions and others to collect information. He will explain the nature of his research to you when he visits you in your office.

The data that you and staff in your institution provide will be of great use to Mr. Matui in his studies in the first instance but will also be useful to the students of UPNG and the people of PNG in the long term.

I would like to encourage you to extend to Mr. Matui every assistance necessary so that he can collect the information he needs to complete his project.

May I thank you in advance for your assistance.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'B Minol'.

Bernard Minol  
Director  
Human Resource Development Unit  
University of Papua New Guinea

---

P. O Box 320, University, NCD, Papua New Guinea  
Ph: 3267140, 3267567 Fax: 3267187  
Email: [Minol.Bernard@uona.ac.pg](mailto:Minol.Bernard@uona.ac.pg)

## **Appendix E: Letter to the Chairperson of Independent Public Business Corporation of Papua New Guinea**

### **Mange John Matui**

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The University of Waikato  
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### **Hamilton**

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### **The Chairperson**

Independent Public Business Corporation of PNG  
P.O. Box 320

### **Port Moresby**

National Capital District

Papua New Guinea

Telephone: 675 321 2977

Facsimile: 675 321 2916

**24<sup>th</sup> April 2008**

Dear Sir/Madam,

### **Re: SEEKING CONSENT TO DO CASE STUDY RESEARCH IN STATE COMPANIES**

My name is Mange John Matui, a PhD student from the School of Law, University of Waikato, New Zealand. One of the requirements of my study is collecting empirical data on corporate governance practice in state owned enterprises. State-owned enterprises, particularly state companies, come under the control and management of the Independent Public Business Corporation of which you are the Chairperson. And it is selected as one of the case studies. This letter is written with the aim of seeking your permission to conduct research in Telikom Ltd, PNG Power Ltd and NCD Water and Sewerage Ltd (Eda Ranu). I also need your assistance in formally informing the management of the three state-owned enterprises of my presence in their offices in the coming weeks and to ask for their support and assistance.

The overall study is on corporate governance in SOEs. The thesis is entitled: DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR STATE-OWNED ENTERPRISE IN PAPUA NEW GUINEA. The aim of the study is to document corporate governance practice in SOEs in Papua New Guinea and identify factors that affect good corporate governance so that out of this research recommendations can be made for improvement in governance and accountability in state companies. State-owned enterprises perform an important role of providing goods and services to the people of Papua New Guinea and yet after 35 years of independence, one of state-owned enterprises' important aspects, corporate governance has never been examined and discussed. This is also generally true for corporate governance in the private sector. In my experience of teaching corporate law and business law at the University of Papua New Guinea corporate governance is never discussed although many issues in corporations relate to corporate governance. With your

assistance and support this research will document corporate governance in three state companies and provide recommendations on how to improve governance and accountability in them. The study can be used as a model for other state companies with similar structure and applying the same law as the three state companies.

I will be in the country for six months. During this time I will be collecting and transcribing the data. There will be two method of data collection used. First, in a semi-structured interview, the senior managers, directors and chief executive officers will be interviewed using semi-structured questions, which will be issued prior to the meeting. A letter will be sent to each of the participants explaining the nature of the research and seeking their permission to participate, and attached to the letter will be the consent form and “guideline questions”. As the name suggest, “guideline questions” will be used as a guide to inform the participants as to the type of questions that will be asked and the type of information required. The participants will also be asked to answer questions on paper and submit before the interview. The interview will take 40 minutes to one hour. Before the interview I will collect the signed consent form from the interviewees and any questions that are answered on paper before the interview. Second, documents such as annual reports and company constitution and other relevant documents pertaining to corporate governance will be collected, examined and analyzed during the course of the research. Before getting access to the documents I shall seek permission from the chairpersons, chief executive officers and the authorities who are in custody of the relevant documents. The objective in using the two methods of data collection is to collect an accurate account of corporate governance so that proper recommendations can be made for improvement.

As a researcher, I shall respect the norms and practices of individual organizations, the participants and the authorities. Also, confidentiality and privacy of the organizations and participants is paramount. The names of the participants will not be used in the report; instead code names will be used to protect their privacy. Each state company will be identified by name so that relevant laws can be discussed that relate to each of them and so that recommendation that will be made can be adopted by them. Given the fact also that state-owned enterprises are public entities, the people of Papua New Guinea and relevant government institutions would be interested in the report and want to know what can be done about corporate governance in these selected state-owned enterprises and other state-owned enterprises. After data collection, the notes from interviews and the audiotapes will be transcribed and the transcript will be submitted to participants for confirmation. The confirmation process will ensure accuracy of the data information and provide an opportunity for the participants to make changes to expressions that do not truly and clearly convey their intentions.

I can be contacted at the following address in Papua New Guinea:

**Centre for Human Resource Development**

P.O. Box 320

University

National capital District

Telephone: 326 7567

Facsimile: 326 7187

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

If you have any issues or queries, you may want to deal directly with my supervisor or the Post Graduate Office, University of Waikato, you can contact them at the following addresses:

**Professor John Farrar**  
Chief Supervisor  
School of Law  
The University of Waikato  
Private Bag 3105  
Hamilton 3240  
New Zealand  
Telephone: 64 7 856 2889  
Fax: 64 7 838 4417

**Postgraduate Studies Office**  
Student and Academic Services Division  
The University of Waikato  
Private Bag 3105  
Hamilton 3240  
New Zealand  
Telephone: 64 7 858 5194  
Fax: 64 7 838 4130

I have enclosed with this letter, a document of “guideline questions” for semi-structured interview, a letter from the Director of Centre for Human Resource Development – University of Papua New Guinea, a letter from my chief supervisor and an approval letter from the School of Law Ethics Committee for your information. I will contact you in the near future after receipt of this letter.

Thank you for your time and consideration.

Yours faithfully,

.....  
**Mange John Matui**  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

Attachments:

**Appendix F: Letter from the Chairman of Independent Public  
Business Corporation to the Chief Executive Officers of  
State Companies**



6 May 2008

Mr [REDACTED]  
General Manager  
Eda Ranu  
P O Box 1084  
WAIGANI  
National Capital District

Dear Mr [REDACTED]

**RE: ASSISTANCE TO MANGE JOHN MATUI WITH HIS RESEARCH ON  
CORPORATE GOVERNANCE**

May I take this opportunity to introduce Mange John Matui to you. Mange is a law lecturer, at the University of Papua New Guinea. He is currently studying at the University of Waikato, New Zealand. His research focus is on corporate governance, with particular emphasis on corporate governance in state-owned enterprise. He will be approaching you for assistance in answering questions through questionnaires. Please assist with this activity and any other help that he may need.

Thank you in advance for your time and assistance.

Yours sincerely



**SUMASY SINGIN, OBE**  
Chairman

## **Appendix G: Sample Letter to Chairpersons of Statutory Corporations**

### **Mange John Matui**

The School of Law  
The University of Waikato  
Private Bag 3105

### **Hamilton**

New Zealand

Telephone: +64 7 838 4190

Facsimile: +64 7 838 4171

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

Website: [www.waikato.ac.nz/law](http://www.waikato.ac.nz/law)

### **The Chairperson**

National Broadcasting Corporation  
P.O. Box 1359

### **Boroko**

National Capital District

Papua New Guinea

Telephone: 675 325 5233

Facsimile: 675 325 6296

**24<sup>th</sup> April 2008**

Dear Sir/Madam,

### **Re: SEEKING YOUR CONSENT TO DO CASE STUDY RESEARCH IN NATIONAL BROADCASTING CORPORATION**

My name is Mange John Matui, a PhD student from the School of Law, University of Waikato, New Zealand. One of the requirements of my study is collecting empirical data on corporate governance practice in state-owned enterprises. National Broadcasting Corporation is a state-owned enterprise (SOE), which comes under the category of statutory corporation and it is selected as one of the case studies. Since you are the chairperson of the National Broadcasting Corporation, this letter is written to you with an aim of seeking your permission to conduct research in the National Broadcasting Corporation. I also need your assistance to formally inform the management of my presence in their offices in the coming weeks and ask for their support and assistance.

The overall study is on corporate governance in SOEs. The thesis is entitled: DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR STATE-OWNED ENTERPRISE IN PAPUA NEW GUINEA. The aim of the study is to document corporate governance practice in SOEs in Papua New Guinea and identify factors that affect good corporate governance so that out of this research recommendations can be made for improvement in governance and accountability in the National Broadcasting Corporation. SOEs perform an important role of providing goods and services to the people of Papua New Guinea and yet after 35 years of independence, one of the SOE's important aspects, corporate governance has never been examined and discussed. This is also generally true for corporate governance in the private sector. In my experience teaching corporate law and business law at the University of Papua New Guinea corporate governance is never discussed although many issues in corporations relate to corporate governance. With your assistance and support this research will document corporate governance in National Broadcasting Corporation and recommendations on how to

improve governance and accountability in it. The study can be used as a model for other state companies with similar structure and applying the same law as National Broadcasting Corporation.

I will be in the country for six months. During this time I will be collecting and transcribing the data. There will be two method of data collection used. First, in semi-structured interview, the senior managers, directors and chief executive officers will be interviewed using semi-structured questions, which will be issued prior to the meeting. A letter will be sent to each of the participants explaining the nature of the research and seeking their permission to participate, and attached to the letter will be the consent form and “guideline questions”. As the name suggest, “guideline questions” will be used as a guide to inform the participants as to the type of questions that will be asked and the type of information required. The participants will also be asked to answer questions on paper and submit before the interview. The interview will take 40 minutes to one hour. Before the interview I will collect the signed consent form from the interviewees and any questions that are answered on paper before the interview. Second, documents such as annual reports and company constitution and other relevant documents pertaining to corporate governance will be collected, examined and analyzed during the course of the research. Before getting access to the documents I shall seek permission from the chairperson, chief executive officers and the authorities who are in custody of the relevant documents. The objective in using the two methods of data collection is to collect an accurate account of corporate governance so that proper recommendations can be made for improvement.

As a researcher, I shall respect the norms and practices of the organizations, participants and the authorities. Also confidentiality and privacy of the organization and participants is paramount. The names of the participants will not be used in the report; instead code names will be used to protect their privacy. The National Broadcasting Corporation will be identified by name so that relevant laws can be discussed that relate to it, and then recommendation that will be made can be adopted by the organization. Given the fact also that National Broadcasting Corporation is one of the public entities the people of Papua New Guinea and relevant government institutions would be interested in the report and want to know what can be done about corporate governance in the National Broadcasting Corporation and other SOEs that have similar structure and apply the same laws. After data collection, the notes from interviews and the audiotapes will be transcribed and the transcript will be submitted to participants for confirmation. The confirmation process will ensure accuracy of the data information and provide an opportunity for the participants to make changes to expressions that do not truly and clearly convey their intentions.

I can be contacted at the following address in Papua New Guinea:

**Centre for Human Resource Development**

P.O. Box 320

University

National capital District

Telephone: 326 7567

Facsimile: 326 7187

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

If you have any issues or queries, you may want to deal directly with my supervisor or the Post Graduate Office, University of Waikato, you can contact them at the following addresses:

**Professor John Farrar**  
Chief Supervisor

**Postgraduate Studies Office**  
Student and Academic Services Division

School of Law  
The University of Waikato  
Private Bag 3105  
**Hamilton 3240**  
New Zealand  
Telephone: 64 7 856 2889  
Fax: 64 7 838 4417

The University of Waikato  
Private Bag 3105  
**Hamilton 3240**  
New Zealand  
Telephone: 64 7 858 5194  
Fax: 64 7 838 4130

I have enclosed with this letter, a document of “guideline questions” for semi-structured interview, a letter from the director of Centre for Human Resource Development - University of Papua New Guinea, a letter from my chief supervisor and an approval letter from the School of Law Ethics Committee for your information. I will contact you in the near future after receipt of this letter to get your authorization in conducting the interview.

Thank you for your time and consideration.

Yours faithfully,

.....  
**Mange John Matui**  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

Attachments:

## **Appendix H: Sample Letter to Senior Managers, and current Directors and Chief Executive Officers of State Owned Enterprises**

**Mange John Matui**

The School of Law  
The University of Waikato  
Private Bag 3105  
Hamilton  
New Zealand  
Telephone: +64 7 838 4190  
Facsimile: +64 7 838 4171  
Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)  
Website: [www.waikato.ac.nz/law](http://www.waikato.ac.nz/law)

**Mr**.....

The Director  
Telikom Ltd  
P.O. Box 613

**Waigani**

National Capital District  
Papua New Guinea  
Telephone: 675 300 4813  
Facsimile: 675 325 0821

**7<sup>th</sup> May 2008**

Dear Sir/Madam

**Re: LETTER OF INVITATION TO PARTICIPATE IN THE RESEARCH ON CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES**

My name is Mange John Matui, a PhD student from the School of Law, University of Waikato, New Zealand. This is my second year of study at the University. One of the requirements of my study is collecting empirical data on corporate governance practice in state-owned enterprises. I have obtained permission from the chairman of Independent Business Corporation and he has advised me of sending an internal memo advising the management of Telikom PNG Ltd of the nature of my study and asked for your participation in this research. You are selected as one of the participants in this research to take part in an interview.

You may have already been aware that corporate governance is an area that has never been discussed in Papua New Guinea, particularly in state-owned enterprises. The world has witnessed collapse of large corporations around the world, largely in the USA and Europe. Next door, in Australia, our daily newspapers reported collapse of HIH because of poor governance or lack of accountability. Papua New Guinea also has many issues relating to directors, chief executive officers and the board but they were never discussed and analyzed from the perspective of corporate governance. Government in Papua New Guinea controls more than 50 per cent of the economy and state-owned enterprises perform vital role and in the frontline in the production and delivery of goods and services to the people of Papua New Guinea. The aim of this study is to document corporate governance practice in the selected state-owned enterprises and identify factors that affect good corporate governance. After

identifying these factors, recommendations can be made, and hopefully appropriate policies and legislations can be developed to address some of the issues. Further, given the fact that this is the first study with regard to corporate governance in Papua New Guinea the aim of this study is to spread the message about corporate governance and bring this message to the notice of management and the board of state owned-enterprises. Your participation will help towards understanding of corporate governance and its concomitant problems.

You will assist with the research in the following way. First, you will be interviewed face-to-face using the semi-structured interview method. In the process of interview you will firstly be issued with “guideline questions” to make you aware of the type of information that I will be discussing with you. You can also answer the questions on paper, and when you come for interview, hand over written answers to me. I will ask questions in line with the questions that are given to you and I will probe further on any related issues that you raise in the interview. The interview will take 40 minutes to one hour and it will be tape recorded. I will take some notes as we converse. Second, I will also be asking you about any documents relating to corporate governance that is under your custody or in the custody of any person within the organization or outside, which can assist with further understanding the issues. Before having access to these documents I will seek your permission or permission of anyone in authority. I hope that through the interview and analysis of the documents of the organization, I will document and report an accurate account of the status of corporate governance in your organization and suggest ways, based on the findings, on how to improve corporate governance in your organization and state-owned enterprises generally. This letter serves to seek your permission to conduct an interview with you at the time and place of your convenience.

Ethical virtues and rules are paramount in this research. The University of Waikato Human Resource Ethics Regulations (2005) is adhered to strictly in conducting this research. You and the organization that you work for will be respected in the conduct of the research. Your name will be treated as confidential and will not be disclosed under any circumstances. The research will take six months in Papua New Guinea. This time period provides me with an opportunity of transcribing the written note taken through the interview and the audiotape recording of our conversation and a copy of the transcript will be sent to you for confirmation. You will confirm the transcript for its accuracy and ensure that issues expressed in writing are your words and views. After the completion of the report a copy of the report will be sent to your organization.

I can be contacted at the following address in Papua New Guinea:

**Centre for Human Resource Development**

P.O. Box 320

University

National capital District

Telephone: 326 7567

Facsimile: 326 7187

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

If you have any issues or queries, you may want to deal directly with my supervisor or the Post Graduate Office, University of Waikato, you can contact them at the following addresses:

**Professor John Farrar**  
Chief Supervisor  
School of Law  
The University of Waikato

**Postgraduate Studies Office**  
Student and Academic Services Division  
The University of Waikato  
Private Bag 3105

Private Bag 3105  
Hamilton 3240  
New Zealand  
Telephone: 64 7 856 2889  
Fax: 64 7 838 4417

Hamilton 3240  
New Zealand  
Telephone: 64 7 858 5194  
Fax: 64 7 838 4130

I have enclosed with this letter, a document of “guideline questions” for semi-structured interview, a letter from the director of Centre for Human Resource Development - University of Papua New Guinea, a letter from my supervisor and an approval letter from the School of Law Ethics Committee for your information. I will contact you in the near future after receipt of this letter to schedule a time for interview.

Thank you for your time and consideration.

Yours faithfully,

.....  
**Mange John Matui**  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

Attachments:

## **Appendix I: Sample Letter to former Directors and Chief Executive Officers of State Owned Enterprises**

**Mange John Matui**

The School of Law  
The University of Waikato  
Private Bag 3105

**Hamilton**

New Zealand

Telephone: +64 7 838 4190

Facsimile: +64 7 838 4171

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

Website: [www.waikato.ac.nz/law](http://www.waikato.ac.nz/law)

**Mr**.....

The Former Director  
Telikom PNG Ltd  
P.O. Box 320

**Port Moresby**

National Capital District

Papua New Guinea

Telephone: 675 321 2977

Facsimile: 675 321 2916

**20<sup>th</sup> April 2008**

Dear Sir/Madam,

**Re: LETTER OF INVITATION TO PARTICIPATE IN THE RESEARCH ON  
CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES**

My name is Mange John Matui, a PhD student from the School of Law, University of Waikato, New Zealand. This is my second year of study at the University. One of the requirements of my study is collecting empirical data on corporate governance practice in state owned enterprises. You are one of the former directors of Telikom PNG Ltd selected as a participant in this research to take part in an interview.

You may have already been aware that corporate governance is an area that has never been discussed in Papua New Guinea, particularly the corporate governance in state-owned enterprises. The world has witnessed collapse of large corporations around the world, largely in the USA and Europe. Next door, in Australia, our daily newspapers reported collapse of HIH because of poor governance and a lack of accountability. Papua New Guinea also has many issues relating to directors, chief executive officers and the board but they are never discussed and analyzed from the perspective of corporate governance. Papua New Guinea Government controls more than 50 per cent of the economy and the Government uses state-owned enterprises at the frontline performing vital role in the production and delivery of goods and services to the people. The aim of this study is to document corporate governance practice in the selected state-owned enterprises and identify factors that affect good corporate governance. From the findings, recommendations will be made so that appropriate policies and legislations can be developed to address some of the issues. Further, given the fact that this is the first study with regard to corporate governance in Papua New Guinea, the aim is to spread the message about corporate governance and bring this message to the notice of the

management and the boards of state-owned enterprises. Your participation will help towards understanding of corporate governance and identification of its concomitant problems.

You will assist with the research in the following way. First, you will be interviewed face-to-face using semi-structured interview method. In this process of interview you will be issued with “guideline questions” to enable you to be aware of the type of information that I will be discussing with you. You can also answer the questions on paper and when you come for interview, hand over the written answers to me. I will ask questions in line with the “guideline questions” and will probe further on any related issues that are raised in the interview. The interview will take 40 minutes to one hour and it will be tape recorded. I will also take some notes as we converse. Second, I will be asking you about any documents relating to corporate governance that you may have or direct me to, which can assist with further understanding the issues. I hope that through the interview and analysis of documents of the organization, I will document and report an accurate account of corporate governance in Telikom PNG Ltd and suggest ways, based on the findings, on how to improve corporate governance in the organization and state-owned enterprises generally. This letter serves to seek your permission to conduct an interview with you at the time and place of your convenience.

Ethical virtues and rules are paramount in this research. The University of Waikato Human Resource Ethics Regulations (2005) is adhered to strictly in conducting this research. You and the organization that you have worked for will be respected in the conduct of this research. Your name will be treated as confidential and will not be disclosed under any circumstances. The research will take six months in Papua New Guinea. This period of time provides me with an opportunity of transcribing the written notes taken through the interview and the audiotape recording of our conversation, and a copy of the transcript will be sent to you for confirmation. You will confirm the transcript for its accuracy and ensure that issues expressed in writing are your words and views. After the completion of the report, a copy will be sent to your organization.

I can be contacted at the following address in Papua New Guinea:

**Centre for Human Resource Development**

P.O. Box 320

University

National capital District

Telephone: 326 7567

Facsimile: 326 7187

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

If you have any issues or queries, you may want to deal directly with my supervisor or the Post Graduate Office, University of Waikato, you can contact them at the following addresses:

**Professor John Farrar**

Chief Supervisor

School of Law

The University of Waikato

Private Bag 3105

Hamilton 3240

New Zealand

Telephone: 64 7 856 2889

Fax: 64 7 838 4417

**Postgraduate Studies Office**

Student and Academic Services Division

The University of Waikato

Private Bag 3105

Hamilton 3240

New Zealand

Telephone: 64 7 858 5194

Fax: 64 7 838 4130

I have enclosed with this letter, a document of “guideline questions” for semi-structured interview, a letter from the director of Centre for Human Resource Development - University of Papua New Guinea, a of my supervisor and an approval letter from the School of Law Ethics Committee for your information. I will contact you in the near future after receipt of this letter to schedule a time for interview.

Thank you for your time and consideration.

Yours faithfully,

.....  
**Mange John Matui**  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

Attachments:

## **Appendix J: Sample Letter to the Customers of State owned Enterprises**

**Mange John Matui**

The School of Law  
The University of Waikato  
Private Bag 3105

**Hamilton**

New Zealand

Telephone: +64 7 838 4190

Facsimile: +64 7 838 4171

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

Website: [www.waikato.ac.nz/law](http://www.waikato.ac.nz/law)

**Mr**.....

The Current/Former Customer of NHC

Gerehu Suburb

**Port Moresby**

National Capital District

Papua New Guinea

**20<sup>th</sup> April 2008**

Dear Sir/Madam,

**Re: LETTER OF INVITATION TO PARTICIPATE IN THE RESEARCH ON CORPORATE GOVERNANCE IN STATE OWNED ENTERPRISES**

My name is Mange John Matui, a PhD student from the School of Law, University of Waikato, New Zealand. This is my second year of study at the University. One of the requirements of my study is to collect empirical data on corporate governance practice in state-owned enterprises. The quality and efficiency of services that are provided by state-owned enterprises is an important component of this study. You are selected as one of the participants in this research to take part in an interview that will last five to ten minutes. You will be interviewed about the quality and efficiency of services that you experience as a customer of the National Housing Corporation.

Ethical virtues and rules are paramount in this research. The University of Waikato Human Resource Ethics Regulations (2005) are adhered to strictly in conducting this research. Your privacy will be respected in the conduct of the research. Your name will be treated as confidential and will not be disclosed under any circumstances. A code name will be used if any of your statements are quoted in the report. After the interview I will restate the information to you for confirmation.

I can be contacted at the following address in Papua New Guinea:

**Centre for Human Resource Development**

P.O. Box 320

University

National capital District

Telephone: 326 7567

Facsimile: 326 7187

Email: [mjm58@waikato.ac.nz](mailto:mjm58@waikato.ac.nz)

If you have any issues or queries, you may want to deal directly with my supervisor or the Post Graduate Office, University of Waikato, you can contact them at the following addresses:

**Professor John Farrar**  
Chief Supervisor  
School of Law  
The University of Waikato  
Private Bag 3105  
Hamilton 3240  
New Zealand  
Telephone: 64 7 856 2889  
Fax: 64 7 838 4417

**Postgraduate Studies Office**  
Student and Academic Services Division  
The University of Waikato  
Private Bag 3105  
Hamilton 3240  
New Zealand  
Telephone: 64 7 858 5194  
Fax: 64 7 838 4130

Thank you for your time, consideration and assistance.

Yours faithfully,

.....  
**Mange John Matui**  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

**Appendix K: Written Consent Form for Senior Managers, and  
former and current Directors and Chief Executive  
Officers of State Owned Enterprises**

**CONSENT FORM**

**Re: DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR  
STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA**

Put a tick (✓) to the box.

- a. I have read the letter given to me for this study in which the details and the nature of the study explained to me. My questions about the study have been answered to my satisfaction and I understand that I may ask further questions at any time.
  
- b. I also understand that I am free to withdraw from participating at any time or to decline to answer any particular question in the questionnaire or during the interview.
  
- c. I agree to provide information to the researchers on the understanding that it is completely confidential and my privacy is protected, unless my permission is given for the disclosure of my name.
  
- d. I wish to participate in this study under the conditions set out on the letter.

I (*state your full name*) ..... of (*state the name of the state owned enterprise*)..... and my (former or current\*) position with the state owned enterprise is (*state your position*) ..... and I have read and understood the information provided about the study in the letter and I agree to have an interview and have my conversation tape – recorded.

Signed: \_\_\_\_\_

Name: \_\_\_\_\_

Date: \_\_\_\_\_

---

\* Indicate whether you are a former or current director or chief executive officer. This does not apply to senior managers.

## Appendix L: Written Consent Form for Customers

### CONSENT FORM

**Re: DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA**

Put a tick (✓) to the box.

- a. I have read the letter given to me for this study in which the details and the nature of the study explained to me. My questions about the study have been answered to my satisfaction and I understand that I may ask further questions at any time.
- b. I also understand that I am free to withdraw from participating at any time or to decline to answer any particular question in the questionnaire or during the interview.
- c. I agree to provide information to the researchers on the understanding that it is completely confidential and my privacy is protected, unless my permission is given for the disclosure of my name.
- d. I wish to participate in this study under the conditions set out on the letter.

I (*state your full name*) ..... of (*state the suburb where you live*)..... and I (was or am\*) using the services of (*state the state owned enterprise*)..... and I have read and understood the information provided about the study in the letter and I agree to have an interview and provide information for this study.

Signed: \_\_\_\_\_

Name: \_\_\_\_\_

Date: \_\_\_\_\_

---

\* State whether you were or are currently using the services of the state owned enterprise.

## **Appendix M: Sample Semi-Structured Interview Questions for Current and Former Management**

### **QUESTIONS FOR CURRENT AND FORMER MANAGEMENT**

**Re: DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA**

#### **SECTION A: PERSONAL DETAILS**

1. Name:.....
2. Indicate whether you are a current or former Director/Chief Executive Officer or Senior Manger:.....
3. Interview Number:.....
4. State-owned Enterprise (Name):.....
5. Date of the Interview:.....
6. Time of the Interview:.....

#### **SECTION B: CORPORATE GOVERNANCE**

1. Have you heard of corporate governance?
2. How did you know about corporate governance?
3. Explain what you know about corporate governance?

#### **SECTION C: THE RESPONSIBLE MINISTER**

1. What are the roles and responsibilities of the relevant minister(s) for state owned enterprise?
2. What are the roles and responsibilities of Independent Public Business Corporation?
3. Who is the relevant Minister answerable to for his or her dealings with the state owned enterprise?
4. Can the relevant minister be penalised for his or her wrongful conduct dealing with the state owned enterprise?
5. Who penalises the relevant Minister for wrongful conduct in dealing with the state owned enterprise?
6. What information can state owned enterprise submit to the minister?

7. What information is the relevant minister allowed to have access to in the state owned enterprise?

**SECTION D: THE DIRECTORS**

1. Who appoints and removes directors?
2. What are the roles and responsibilities of a director?
3. Who is the director answerable to for his or her dealings with the state owned enterprise?
4. Who penalises the director for wrongful conduct in performing his or her roles and responsibilities?
5. What kinds of information must the directors receive from the corporation?

**SECTION E: THE BOARD**

1. Who makes up the board?
2. What are the roles and responsibilities of the Board?
3. What kind of information does board receive from the corporation?
4. How does the board receive information about the business and affairs of the company?
5. Who is the board answerable to?

**Chairperson**

6. Who appoints and removes the chairperson?
7. What are the roles and responsibilities of the chairperson?
6. Who is the chairperson answerable to?
8. Who penalises the chairperson for wrongful conduct in performing his or her roles and responsibilities?

**SECTION F: THE CHIEF EXECUTIVE OFFICER (CEO)**

1. Who appoints and removes the CEO?
2. What are the roles and responsibilities of CEO?
3. Who is the CEO answerable to for his or her dealings with the state owned enterprise?

4. Who penalises the CEO for wrongful conduct in performing his or her roles and responsibilities?

**SECTION G: GOVERNMENT DEPARTMENTS AND INSTITUTIONS**

1. Does Department of Treasury deal with the state-owned enterprise and if so then in what capacity?
2. Does the Ombudsman Commission deal with the state-owned enterprise and if so then in what capacity?
3. Does Auditor General deal with the state-owned enterprise and if so then in what capacity?
4. Does Public Accounts Committee deal with the state-owned enterprise and if so then in what capacity?
5. Do other government departments and institutions deal with state owned enterprise? (name them and their relations/dealings with the state owned enterprise)

**SECTION H: REPORTING**

1. How many reports does the state own enterprise provide in a year?
2. Who must the state owned enterprise provide the report(s) to?
3. Are there specific matters that the state owned enterprise must report on?

**SECTION I: OBJECTIVES**

1. Does the State-owned enterprise pursue;
  - a. Commercial obligations only?
  - b. Non-commercial obligations only?
  - c. Commercial and non – commercial obligations?
2. If one of the objectives of state owned enterprise is commercial, as it made profit in the last three years?
3. Does the state owned enterprise have a corporate plan?
4. How often is the corporate plan reviewed?

Thank you for your participation in this research.

Time the interview ends:.....

*The information provided in the interview will be transcribed and the script will be return to you for confirmation.*

**Mange John Matui**  
Interviewer  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

## Appendix N: Sample Interview questions for Customers

### QUESTIONS FOR CUSTOMERS

Re: **DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR STATE OWNED ENTERPRISES IN PAPUA NEW GUINEA**

#### **PART A: PERSONAL DETAILS**

1. Customer  
(Name):.....
2. State Owned Enterprise (Name):.....
3. Indicate whether you are a current or former User of the services:.....
4. Interview Number:.....
5. Location (Suburb):.....
6. Date of the Interview:.....
7. Starting time of the Interview:.....

#### **PART B: QUALITY AND EFFICIENCY OF SERVICES**

1. Are you using or have used the services of the state owned enterprise?  
Yes:  No:
2. Are you satisfied with the services provided by the state owned enterprise?  
Yes:  No:
3. How would you rate the efficiency and quality of the services provided by the state owned enterprise? (tick the box that you agree with)
  - a. Very Good
  - b. Good
  - c. Poor

Thank you for your participation in this research.

Time interview ends:.....

**Mange John Matui**

Interviewer

PhD Student

School of Law

The University of Waikato

New Zealand

# Appendix O: Sample Transcript, and Interview Protocol and Coding of the Interviews with former and current Management of State Owned Enterprises

## QUESTIONS FOR CURRENT AND FORMER MANAGEMENT

Re: **DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR STATE-OWNED ENTERPRISES IN PAPUA NEW GUINEA**

Name: [REDACTED]

Indicate whether you are a current or former Director/Chief Executive Officer or Senior Manger: Senior Manager

Interview Number: Number 2 (code name is PNGP – SM2)

State-Owned Enterprise (Name): PNG Power Ltd

Date of the Interview: Tuesday, 25 May 2010

Starting Time of the Interview: 2:30pm

### TRANSCRIPT

### THEMES FROM TRANSCRIPT

#### Corporate Governance

**Have you heard of corporate governance?**

Yea, occasionally I hear or come across the term corporate governance. PNG Power is a corporation and we deal with many issues with regard to corporation and corporate governance.

Sometimes hears about corporate governance

**Can you explain what you know about corporate governance?**

My limited understanding of corporate governance is that it is something to do with directors and managers, and how they go about administering the company. May be this does not explain properly what it means. I will have to find out to get back to you on this.

- Limited understanding  
- Explanation vague

**Tell me if you have been taught courses or attend workshops and seminars on corporate governance?**

No. I have been with PNG Power for nearly nine years, and speaking for myself personally, I have not been put through any training or workshops on corporate governance. As far as I know not even other directors and managers.

Managers/directors do not attend workshops and training on Corporate Governance

**Why PNG Power does not educate or teach you about corporate governance?**

I do not think this is the priority right now. PNG Power only provides training where it feels necessary and it is in the best interest of the company. I do not know what education in corporate governance would do for the company. If it has something to do with our responsibilities, I think PNG Power knows, on appointing us that we are capable of doing our job given our knowledge and experiences, and there is really no need for training.

Do not see the importance of corporate governance

**Do you think education or training on corporate governance important?**

Need for training

Yea...if that is something that will improve directors and managers in their performance then I agree with it.

### The Responsible Minister

**Can you tell me about the roles and responsibilities of the responsible Minister or relevant Minister(s) of PNG Power?**

Minister required to deal with IPBC only

The Minister of state owned enterprises deals with IPBC [Independent public business corporation of Papua New Guinea]. The responsibility of the Minister is specifically with relations to policy matters. When the Government makes policy the Minister informs them [IPBC] about the policy and it is the role of the IPBC to inform PNG Power about the policy and to some extent make sure that these policies are implemented.

**Explain whether it is correct to say from what you have stated that the Minister does not deal with PNG Power.**

In practice the minister deals directly with PNG Power

No...it is the opposite. The Minister does deal with PNG Power directly in matters like the appointment and termination of directors. And from time to time can directly influence the implementation of policies. In specific matters like these the Minister deals with PNG Power directly but mainly he deals with policy matters and directly with IPBC. Matters such as where an officer of PNG Power should work in PNG is not a matter that the Minister should deal with but sometimes we have Minister telling the management of PNG Power where an officer should work or where the money should be spent.

**Is the role of the Minister clearly specified in a sense of being written?**

That is something that I do not know. You have to ask the CEO and IPBC about that. But as far as I know I have not come across any documents in my nine years of service to this company that points out the role of the Minister. Many of us are confused about the specific responsibilities of the Minister. But because the Minister is above us we tend to just follow any directions and instructions given by him. Sometimes we disagree but he is the Minister and we have to do things he wants.

-Not certain  
-The minister's roles/duties not written

**What are the roles and responsibilities of Independent Public Business Corporation in dealing with PNG Power?**

As everyone knows IPBC is a shareholder of PNG Power. You may have known also that Government used to be a shareholder. But it is no longer the shareholder. That is why PNG Power was supposed to deal with IPBC and the IPBC is required to deal with the Minister and the Government. And IPBC's duty is supervising and managing PNG Power and making sure that we are making profit for the Government.

IPBC is the only shareholder of PNG Power

#### What do you mean when you said 'supposed to'?

Well, following the changes that have been made the Minister was not supposed to deal directly with PNG Power but in actual fact the Minister deals directly with PNG Power sometimes. In that sense we deal with both IPBC and the Minister.

The Minister deals directly with PNG Power

#### How do you feel dealing with both IPBC and the Minister?

To tell you the truth it can be confusing. The good thing is you do not deal with them on a daily basis. In one case we were told to fix power generator in Maprik by IPBC and plans were set and workers were about to be sent from Port Moresby to Wewak then we receive message from the Prime Minister's Department and the Minister to divert the money to connecting power to new residential houses in Wewak town. This is just one of the instances where we receive confusing directions.

Conflicting directions

Example

#### Whose directions does PNG Power follow when there are two different directions from the Minister and IPBC?

We tend to follow the Ministers directions. Before we follow the Ministers direction we have to advise IPBC on what we are doing with regard to their direction. In nearly all cases IPBC does not object to us complying with the Ministers directions. These cases do not come up often.

Ministers directions are always followed

#### Are relationship between IPBC and PNG Power clearly specified or written?

This is something I don't know. You might as well ask IPBC. But as far as I know there is no document that explains the relationship.

Relationship of IPBC and PNG power is not clear

#### Who is the Minister answerable to for his or her dealings with PNG Power?

The Minister is answerable to the Parliament. But I hardly hear debates about PNG Power in Parliament or the Minister is held to account for his dealing with PNG Power. I remember only once when Prime Ministers son...[name was given] was appointed as director and there was heated argument in Parliament between the Government and opposition after public uproar over the appointment.

The minister for SOE is not held to account by the parliament

#### Can the Minister or any relevant Minister be penalised for his or her wrongful conduct dealing with the PNG Power?

Yes, but I have not seen or heard the Minister being penalised. You see...the thing is, PNG Power deals with IPBC and not the Minister and that is why it is unlikely for the Minister to be penalised.

The minister is not accountable for his/her conduct.

**Who penalises the Minister who involves in wrongful conduct?**

Usually it is the Government that disciplines the Minister by removing him from ministerial portfolio. But that is unlikely and never happens. The discipline only happens when the Minister is not in the 'good books' of the Government, but not of misconduct in dealing with PNG Power.

Not penalised

**What information can state owned enterprise submit to the Minister?**

As I have said, we are directly responsible to IPBC and we only submit information such as annual reports to IPBC and not the Minister.

PNG power reports to IPBC

**Can the Minister be allowed access to the documents and information of PNG Power?**

Yes, the Minister can have access to any information.

The Minister has right of access to all information

**Can you explain why PNG Power allowed access of information to the Minister when it is only dealing directly with IPBC?**

I know ... I know...that does not make sense. I guess we can see it this way. PNG Power is a government institution and IPBC is a government institution and that enables the Minister to deal with both IPBC and PNG Power.

PNG Power is Govt institution, hence the Minister has right of access

**The Directors**

**Who appoints and removes directors?**

The directors are appointed and removed by the Minister for state owned enterprises. I do not know whether IPBC has any kind of input into the appointment or termination. Maybe it does. You have to find out from them. As far as I know it is the Minister that appoints them...and terminates them at anytime with or without any reasons.

The Minister appoints and terminates directors

**Do you have part-time or full-time directors?**

We have all part-time directors.

All non-executive directors

**Does that mean that these directors have full time employment outside?**

That is right. Most of these directors have full time employment outside and only come in for the board meetings. An example is our chairman. He is the owner of ...[name was given] and has to run his own company and also doing his job as chairman in here [PNG Power].

Directors only attend board meetings

**Do the directors come down and talk to managers and find out about what they do?**

Only two approach me this year. Not to find out specifically about what we are doing or general information about the nature of work we do but they ask specific question about what they were dealing with.

Directors do not spend enough time to know the business and affairs of PNG Power

**Would you agree when I say all directors are knowledgeable about the business of PNG Power?**

I disagree with that. If they do not spend time with us they would not know what we are doing. Most of them come in and go at the discretion of the Government and are not settled in their positions. They have not got enough time to know what we do.

Directors have limited knowledge about PNG power

#### **What are the roles and responsibilities of a director?**

The directors are mainly responsible for making strategic plans for the company. The management then implements the plans made by the directors through the board. Also one of their main duties is approving major transaction to be undertaken by us [PNG Power].

Directors make strategic decisions

#### **Can you tell me whether the responsibilities of directors are written in any documents?**

Their responsibilities are provided in PNG Power's Constitution. I used to have a copy but no longer have one. If I come across one I will give you a copy so that you can see it for yourself. The Constitution clearly provides for their duties.

Directors duties are provided in company constitution

#### **What about other documents such as PNG Companies Act?**

That is the law that I have not come across or have access to it for me to tell you what is in there. And I don't know whether they have responsibilities of a director. I am sorry to say this.

Does not know about roles of directors in companies Act

#### **You do not have to apologies. That is OK. Can you tell me who the director is answerable to for his or her dealings with PNG Power?**

The directors are members of the board and they are answerable to the board and because the Minister appoints them they are answerable to the Minister. I don't know about IPBC. The IPBC is the shareholder of this company and I guess they are also answerable to IPBC.

Directors are accountable to the board and the Minister and not IPBC

#### **Who penalises the director for wrongful conduct in performing his/her roles and responsibilities?**

The Minister penalises them. This is done through termination of their appointment. Usually it is the board or IPBC that makes the recommendation to the Minister for termination. You see...the directors are on part time and you can hardly find any wrong committed by them.

IPBC only makes recommendation for disciplining the directors

#### **What are the circumstances that may call for termination of directors?**

A director does not have to do anything wrong to be terminated. The Minister has the power to terminate a director any time from the position. Even the whole board members can be terminated by the Minister if the Minister's directives are not approved at the board level. Most of our directors are terminated through this process. For individual directors, there has to be gross misconduct on their part.

The minister terminates director with or without reasons

#### **The Board**

### What are the powers and functions of the board?

The functions of the board are provided in the Constitution of PNG Power. Get a copy and you will see them. They mainly approve major transactions and make policy decisions for the management to implement. Also any directions that come from the Government has to be approved by the board. As you can see that it is like steering wheel of a car that determines which direction the company should go.

Makes policy decisions and Approves major transactions

### Who is the board answerable to?

The board members are directors and the Minister appoints them and that is why they are answerable to the Minister and the Government. And also IPBC is the shareholder and therefore they are answerable to IPBC.

Board is accountable to IPBC and the Minister

### Why is the board answerable to the Minister when it is not a shareholder?

That is a good question because that is something that I do not understand either. My only guess is that PNG Power is still seen as the company of the Government and that is why it wants to have direct influence.

No certain of why the Minister deals with the Board

### Chairman

#### Is the chairperson a full – time position?

No, it is a part time position.

Chairman is part-time

#### Who appoints and removes the chairperson?

The Minister appoints and removes chairperson just like the directors.

The Minister appoints/terminates the Chairman

#### What are the roles and responsibilities of the chairperson?

The chairman mainly presides over meetings. In this role he liaise with the CEO to ensure that agendas of the meetings a prepared before the meetings.

#### Who is the chairperson answerable to?

The chairperson is answerable to the Minister because the Minister appoints him to that position.

The chairman is accountable to the Minister

#### Who penalises the chairman for wrongful conduct in performing his roles and responsibilities?

Again, as I have said ... the Minister disciplines the chairman, just like the directors. Disciplining is done through termination.

The Minister disciplines the Chairman

### The Chief Executive Officer (CEO)

#### Who appoints and removes the CEO?

It is confusing with the appointment of CEO. Everyone says it is the board but in fact it is the Government and IPBC that appoint the CEO. The board appoints a CEO from the recommendation of the Minister and IPBC. I have been working here for nine years and I can tell you

Board appoints the CEO from the recommendation of IPBC and the Minister

that board has never independently make decision in the appointment of a CEO.

**Why do you think the board should have exclusive power to appoint a CEO?**

Well...you see the Minister and IPBC seem to be doing many things in the company. As far as I am concern, I think they are outsiders, and we are running a company here. Some of these important decisions like appointment should be given to the board. That is only my opinion.

Board should have executive power to appoint CEO

**Can you explain to me what are the roles and responsibilities of the CEO?**

The CEO is the linkman between the board and the management. He is the head of the management team in PNG Power. He makes sure that managers are informed about the decisions of the board and ensures that the managers implement the directions.

CEO is the executive head of management

**Who is the CEO answerable to for his or her dealings with the PNG Power?**

The CEO is answerable to the board and IPBC.

CEO accountable to IPBC and the board

**Who penalises the CEO for wrongful conduct in performing his or her roles and responsibilities?**

The only penalty is through termination. IPBC terminates the CEO. Before IPBC terminates the board has to make recommendation for the termination.

IPBC terminates CEO and not the board

**Government Departments and Institutions**

**Does Department of Treasury deal with the PNG Power and if so then in what capacity?**

You see, PNG Power is a company. Don't forget that. That is why it does not have anything to do with Treasury Department. Previously when it was not a company it deals with the Treasury. But now its status has changed and it is now an independent body. And also, PNG power does not receive government funding to justify Treasury Department to look into its account.

PNG Power does not deal with Dept of Treasury

**Does the Ombudsman Commission deal with the PNG Power and if so then in what capacity?**

This matter has not been clarified since PNG power became a company. I think the legislature should look into this matter and clarify the role of the Ombudsman Commission. My view is that only the directors are subject to investigation by Ombudsman Commission.

Not certain of the role of Ombudsman Commission in PNG Power

**Why is it only the directors that are subject to investigation by Ombudsman Commission?**

The Minister and the Government appoint the directors. That is why, in my view, Ombudsman Commission can investigate them. That has not happened and nothing is clearly expressed about this matter but I am only expressing my view.

Not certain whether Ombudsman can investigate directors

**Does Auditor General deal with PNG Power and if so then in what capacity?**

Auditor General audits the accounts of PNG Power. We do not have any choice about that. It is a requirement that PNG Power should be audited by them.

\*G audits the accounts of PNG power

**Do other government departments and institutions deal with PNG Power?**

No we do not deal with any government institutions except Auditor General.

Does not deal with other Govt institutions

### Reporting

**How many company reports does PNG Power provide in a year?**

We only submit annual report towards the end of the year. During the course of the year the Minister or IPBC may want report on specific matters that we submit.

Submits only the annual reports

**Who do you submit the annual report to?**

We submit a copy to IPBC and a copy to the Registrar of Companies. IPBC is the shareholder and that is why we submit to IPBC and Registrar of Companies because PNG Power is a company.

Submits reports to IPBC and the Registrar of companies

**Do you submit a report at all to the Minister and the Government?**

No. We only submit report to IPBC. And if the Minister needs the report then he requests a copy from IPBC.

Does not submit reports to Govt

**Are there specific matters that the PNG Power must report on?**

We provide auditors reports and financial statements and the summary of the PNG Powers operation in a year.

**Are you required by law or company constitution to include these specific matters?**

I think every company have to provide those matters in their annual reports. I do not think we are compelled to include certain matters in our report. We can put anything that we want to.

PNG Power is not compel to provide certain information in the report.

### Objectives

**Does PNG Power pursue commercial obligations only, non-commercial obligations only or commercial and non – commercial obligations?**

PNG power pursues commercial and non-commercial obligations. Our main priority is to be profitable in any ventures that we undertake in the process of supplying electricity to the people. At times the government may require us to produce or supply electricity to certain areas and people that is not included in our plan. In this case they have to make some contributions for us to provide the services.

PNG power has commercial and non-commercial obligations

**What particular areas are you specifically referring to?**

I am referring especially to the rural areas.

**You said that PNG Power pursues commercial objectives. As it made profit in the last three years?**

Yes. We always make profit since PNG Power became a company and even before that. Every year we write fat cheque dividends to the Government. You can see that in our annual reports.

Made profit in the last 3 years

**Does PNG Power have a corporate plan?**

Yes, we [PNG Power] have a corporate plan.

png power has corporate plan

**How often is the corporate plan reviewed?**

It is reviewed after every three years. The next review will be early next year. The board can also at any time review the corporate plan to see what is achieved and what is not.

Corporate plan reviewed every 3 years

**Who decides on the objectives to be included in the corporate plan?**

First the board and the management come up with the draft corporate plan and it has to be sent to IPBC for approval.

Management drafts corporate plan

**In approving does IPBC make any changes?**

Yes, they do suggest changes in consultation with the Minister and the board has to incorporate those changes.

png power must incorporate changes made by the minister and IPBC

*The information provided in the interview will be transcribed and the script will be return to you for confirmation.*

**Thank you for your participation in this research.**

Time the interview ends: 3.32pm

**Mange John Matui**

Interviewer  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

## Appendix P: Sample Transcript and Coding for Interviews with Customers of State Owned Enterprises

### QUESTIONS FOR CUSTOMERS

Re: DEVELOPING A NATIONAL CORPORATE GOVERNANCE REGIME FOR STATE-OWNED ENTERPRISES IN PAPUA NEW GUINEA

#### PART A: PERSONAL DETAILS

1. Customer (Name): Mr [REDACTED]
2. Indicate whether you are a current or former User of the services of National Housing Commission: Current User
3. Interview Number: Number 8 (Code name is NHC – C8)
4. Location (Suburb): Gerehu (Stage 2)
5. State-owned Enterprise (Name): National Housing Corporation
6. Date of the Interview: Tuesday, [REDACTED]
7. Starting time of the Interview: 9.01am

#### PART B: QUALITY AND EFFICIENCY OF SERVICES

1. Are you using or have used the services of the National Housing Corporation?  
Yes:  No:
2. Are you satisfied with the services provided by the National Housing Corporation?  
Yes:  No:
3. How would you rate the efficiency and quality of services provided by the National Housing Corporation? (tick the box that you agree with)
  - a. Very Good
  - b. Good
  - c. Poor

Thank you for your participation in this research.

Time interview ends: 9.12am

**Mange John Matui**  
Interviewer  
PhD Student  
School of Law  
The University of Waikato  
New Zealand

## Appendix Q: An explanation of the Codes used in the Research and the Reports

State-Owned Enterprises	Current directors; Current Chief Executive Officers	Former Directors; Former Chief Executive officers	Senior Mangers	Customers of State-Owned Enterprises
National Housing Corporation (NHC)	NHC – CD1 NHC - CCEO	NHC – FD1 NHC – FCEO1	NHC – SM1	NHC – C1
National Broadcasting Corporation (NBC)	NBC – CD1 NBC - CCEO	NBC – FD1 NBC – FCEO1	NBC – SM1	NBC – C1
PNG Power Ltd (PNGP)	PNGP – CD1 PNGP - CCEO	PNGP – FD PNGP – FCEO1	PNGP – SM1	PNGP – C1
Telikom PNG Ltd (T)	T – CD1 T - CCEO	T – FD1 T – FCEO1	T – SM1	T – C1
Eda Ranu (ER)	ER – CD1 ER - CCEO	ER – FD1 ER – FCEO1	ER – SM1	ER – C1

Eda Ranu is the trading name for NCD Water & Sewerage Ltd. The trading name is used throughout the thesis, hence Eda Ranu is used in coding.

### Coding reference for state owned enterprises

1. NHC refers to National Housing Corporation
2. NBC refers to National Broadcasting Corporation
3. PNGP refers to PNG Power Ltd
4. T refers to Telikom PNG Ltd
5. ER refers to Eda Ranu

Note that state owned enterprises have been identified by their name rather than code name in the thesis. This is for the purpose of discussing the relevant laws that apply to them.

### Coding reference of the participants

1. CD refers to current directors
2. CCEO refers to current chief executive officer
3. FD refers to former director
4. FCEO refers to former chief executive officer

5. SM refers to senior managers
6. C refers to customers

Notice in the table that numbers are used after the initials. For example, NHC – CD1 represents the first current director in National Housing Corporation. The second director interviewed has NHC – CD2 as the code name. The code name T – FCEO1 means that the first former chief executive officer of Telikom PNG Ltd. The second former chief executive officer of Telikom PNG Ltd has the code name T – FCEO2. The current chief executive officer has the reference CCEO. For example ER – CCEO means current chief executive officer of Eda Ranu. They do not have numbers because there is only one current chief executive officer in each state-owned enterprise. Customers have the code name beginning with the SOE's initials followed by C and a number. For example, the first customer interviewed in NBC has the code name NBC – C1 and the last customer in the NBC interviewed has the code name NBC – C90. Thirty customers from each of the three suburbs in Port Moresby were selected for each state-owned enterprise. Altogether there were 90 customers for each state-own enterprise.

The thesis has used some direct quotes made by the participants. The quotes are represented by the relevant code names. For example the code name PNGP – SM3 beside a quote represents a quote stated by the senior manager three in PNG Power Ltd.

## **Appendix R: The OECD Principles of Corporate Governance<sup>1</sup>** (Revised Text, April 2004)

### **I. Ensuring the Basis for an Effective Corporate Governance Framework**

*The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.*

- A.** The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.
- B.** The legal and regulatory requirements that affect corporate governance practices in a jurisdiction should be consistent with the rule of law, transparent and enforceable.
- C.** The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served.
- D.** Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

### **II. The Rights of Shareholders and Key Ownership Functions**

*The corporate governance framework should protect and facilitate the exercise of shareholders' rights.*

- A.** Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.
- B.** Shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.
- C.** Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings:
  - 1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
  - 2. Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.
  - 3. Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated. Shareholders should be able to make their views known on the remuneration policy for board members and

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<sup>1</sup> OECD, *OECD Principles of Corporate Governance*, (revised edition, 2004) [Preamble] <  
<http://www.oecd.org/dataoecd/32/18/31557724.pdf> > at 15 July 2010

- key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.
4. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.
- D.** Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.
- E.** Markets for corporate control should be allowed to function in an efficient and transparent manner.
1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.
  2. Anti-take-over devices should not be used to shield management and the board from accountability.
- F.** The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.
1. Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.
  2. Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.
- G.** Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

### **III. The Equitable Treatment of Shareholders**

*The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.*

- A.** All shareholders of the same series of a class should be treated equally.
1. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.
  2. Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.
  3. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.
  4. Impediments to cross border voting should be eliminated.
  5. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.
- B.** Insider trading and abusive self-dealing should be prohibited.
- C.** Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

## **IV. The Role of Stakeholders in Corporate Governance**

*The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.*

- A.** The rights of stakeholders that are established by law or through mutual agreements are to be respected.
- B.** Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.
- C.** Performance-enhancing mechanisms for employee participation should be permitted to develop.
- D.** Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.
- E.** Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.
- F.** The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

## **V. Disclosure and Transparency**

*The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.*

- A.** Disclosure should include, but not be limited to, material information on:
  - 1. The financial and operating results of the company.
  - 2. Company objectives.
  - 3. Major share ownership and voting rights.
  - 4. Remuneration policy for members of the board and key executives, and information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.
  - 5. Related party transactions.
  - 6. Foreseeable risk factors.
  - 7. Issues regarding employees and other stakeholders.
  - 8. Governance structures and policies, in particular, the content of any corporate governance code or policy and the process by which it is implemented.
- B.** Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure.
- C.** An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.
- D.** External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.
- E.** Channels for disseminating information should provide for equal, timely and cost efficient access to relevant information by users.
- F.** The corporate governance framework should be complemented by an effective approach that addresses and promotes the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest that might compromise the integrity of their analysis or advice.

## **VI. The Responsibilities of the Board**

*The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.*

- A.** Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.
- B.** Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.
- C.** The board should apply high ethical standards. It should take into account the interests of stakeholders.
- D.** The board should fulfil certain key functions, including:
  - 1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
  - 2. Monitoring the effectiveness of the company's governance practices and making changes as needed.
  - 3. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
  - 4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders.
  - 5. Ensuring a formal and transparent board nomination and election process.
  - 6. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
  - 7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.
  - 8. Overseeing the process of disclosure and communications.
- E.** The board should be able to exercise objective independent judgement on corporate affairs.
  - 1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.
  - 2. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.
  - 3. Board members should be able to commit themselves effectively to their responsibilities.
- F.** In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

## **Appendix S: OECD Guidelines on Corporate Governance of State-Owned Enterprises (2005)<sup>1</sup>**

### **I. Ensuring an Effective Legal and Regulatory Framework for State-Owned Enterprises**

*The legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions. The framework should build on, and be fully compatible with, the OECD Principles of Corporate Governance.*

- A. There should be 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.
- B. Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate. Their legal form should allow creditors to press their claims and to initiate insolvency procedures.
- C. Any obligations and responsibilities that an SOE is required to undertake in terms of public services beyond the generally accepted norm should be clearly mandated by laws or regulations. Such obligations and responsibilities should also be disclosed to the general public and related costs should be covered in a transparent manner.
- D. SOEs should not be exempt from the application of general laws and regulations. Stakeholders, including competitors, should have access to efficient redress and an even-handed ruling when they consider that their rights have been violated.
- E. The legal and regulatory framework should allow sufficient flexibility for adjustments in the capital structure of SOEs when this is necessary for achieving company objectives.
- F. SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.

### **II. The State Acting as an Owner**

*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.*

- A. 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.
- B. 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.
- C. The state should let SOE boards exercise their responsibilities and respect their independence.
- D. 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.

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<sup>1</sup> OECD, *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, (2005) in OECD, < [http://www.oecd.org/document/33/0,3343,en\\_2649\\_34847\\_34046561\\_1\\_1\\_1\\_37439,00&&en-USS\\_01DBC.html](http://www.oecd.org/document/33/0,3343,en_2649_34847_34046561_1_1_1_37439,00&&en-USS_01DBC.html) > at 15 July 2010

- E.** 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.
- F.** The state as an active owner should exercise its ownership rights according to the legal structure of each company. Its prime responsibilities include:
  1. Being represented at the general shareholders meetings and voting the state shares.
  2. Establishing well structured and transparent board nomination processes in fully or majority owned SOEs, and actively participating in the nomination of all SOEs' boards.
  3. Setting up reporting systems allowing regular monitoring and assessment of SOE performance.
  4. When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.
  5. Ensuring that remuneration schemes for SOE board members foster the long term interest of the company and can attract and motivate qualified professionals.

### **III. Equitable Treatment of Shareholders**

*The state and state-owned enterprises should recognise the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable treatment and equal access to corporate information.*

- A.** The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equitably.
- B.** SOEs should observe a high degree of transparency towards all shareholders.
- C.** SOEs should develop an active policy of communication and consultation with all shareholders.
- D.** The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions such as board election.

### **IV. Relations with Stakeholders**

*The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders.*

- A.** Governments, the co-ordinating or ownership entity and SOEs themselves should recognise and respect stakeholders' rights established by law or through mutual agreements, and refer to the OECD Principles of Corporate Governance in this regard.
- B.** Listed or large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.
- C.** The board of SOEs should be required to develop, implement and communicate compliance programmes for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.

### **V. Transparency and Disclosure**

*State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.*

- A. The co-ordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs.
- B. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.
- C. SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures does not substitute for an independent external audit.
- D. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. Large or listed SOEs should disclose financial and non-financial information according to high quality internationally recognised standards.
- E. SOEs should disclose material information on all matters described in the OECD Principles of Corporate Governance and in addition focus on areas of significant concern for the state as an owner and the general public. Examples of such information include:
  1. A clear statement to the public of the company objectives and their fulfilment.
  2. The ownership and voting structure of the company.
  3. Any material risk factors and measures taken to manage such risks.
  4. Any financial assistance, including guarantees, received from the state and commitments made on behalf of the SOE.
  5. Any material transactions with related entities.

## **VI. The Responsibilities of the Boards of State-Owned Enterprises**

*The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.*

- A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.
- B. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.
- C. The boards of SOEs should be composed so that they can exercise objective and independent judgement. Good practice calls for the Chair to be separate from the CEO.
- D. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.
- E. When necessary, SOE boards should set up specialised committees to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration.
- F. SOE boards should carry out an annual evaluation to appraise their performance.

# Appendix T: Corporate Governance Guidelines for Government Owned Corporations (February 2009)<sup>1</sup>

## Corporate Governance Principles

### Principle 1: Foundations of management and oversight

#### *Recommendations*

- The board should have a formal statement or board charter which clearly defines the roles and responsibilities of the board and individual directors and the matters which are delegated to management. This also applies to any committees established by the board.
- A board handbook should be available to facilitate board operations and induction and self-evaluation processes.
- Appropriate induction processes should be developed for new members in relation to their board and committee functions and for senior executives to allow them to participate fully and actively in management decision-making at the earliest opportunity.
- A register of committees and their functions should be maintained.
- The process for performance evaluation of the chief executive officer and senior executives should be disclosed.

#### *Commentary*

Clear definition of the roles and responsibilities of the board and management will assist the board to effectively perform the role required by section 88 of the GOC Act (Role of board). It will enable the board to provide strategic guidance for the GOC and effective oversight of management. It will also enhance the accountability of the board and management to the GOC and the shareholding Ministers.

The members of the board and any committees established by the board should also be clearly aware of their roles and responsibilities and fully understand the GOC's business and corporate expectations.

#### *Reporting*

A summary of the formal statement or board charter should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section. The corporate governance section of the annual report should disclose whether a performance evaluation for the chief executive officer and senior executives has taken place in the reporting period and how it was conducted.

### Principle 2: Structure the board to add value

#### *Recommendations*

- A majority of the board should be independent directors.
- The board should develop and implement a plan for identifying, assessing and enhancing directors' competencies.
- Disclose the process for performance evaluation of the board, committees and individual directors.

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<sup>1</sup> Queensland Government, Office of Government Owned Corporation., "Corporate Governance Guidelines for Government Owned Corporation," (February 2009) in *Queensland Government*, < <http://www.ogoc.qld.gov.au/goc-policies/index.shtml> > at 17 July 2010

- The board and committees regularly review their information needs (quality, quantity and timeliness) to ensure the information they receive is appropriate for the effective discharge of their duties.
- Develop and implement appropriate, formal self-evaluation processes for the board and committees.

### *Commentary*

GOC directors are appointed by the Governor in Council under the GOC Act. In this regard the board does not play a formal role in setting the composition or size of the board. All GOC directors appointed by the Governor in Council are non-executive directors.

The board should continue to regularly assess the ongoing independence of each director and the board generally to ensure that they continue to exercise unfettered and independent judgement. The board must ensure that the interests of the shareholding Ministers and the public are properly protected and that individual vested interests do not have the opportunity to influence decision making against the interests of the GOC as a whole.

For GOCs the issue of independence is most relevant in situations where directors are a material supplier or customer of the GOC or its subsidiaries, or have a material contractual relationship with the GOC or its subsidiaries other than as a director. However, assessment of the independence of a director, including materiality thresholds, is ultimately a matter for the board to determine. The key issue is whether the director's independent judgement is impaired by the material relationship. The board should be able to explain to shareholding Ministers its reasoning in relation to the determination of independence, including disclosure of specific relationships and detailed discussion of how materiality (or immateriality) is determined.

GOC boards should have arrangements in place for determining materiality thresholds and for assessing a director's independence in light of interests disclosed by them.

GOC directors should be equipped with the knowledge and information they need to discharge their responsibilities effectively. Individual and collective performance should be reviewed at regular periods not exceeding two years. Board evaluations should be carried out under the responsibility of the chair and according to best practice. The evaluation should address whether the objectives of the board or committee are being met in a cost effective manner. The board should have access to continuing education and training to maintain, update and enhance their skills, knowledge and experience.

In general, the chair should continuously monitor the performance of individual directors, the board and committees.

Internal reporting frameworks should be sufficiently comprehensive to support the monitoring and review functions of the board and committees.

Given the appointment of new directors of GOCs is undertaken by the Governor in Council, a nomination committee (Recommendation 2.4 of the ASX Principles) is not considered necessary as most of the functions of such a committee are not vested in the board. However, the board should still continually assess the skills of the board and develop strategies to enhance them where appropriate, having regard to the nature of the GOC's business. GOC boards should also make shareholding Ministers aware of skills shortages that have been identified and are encouraged to provide nominees with the necessary skills to address such shortages.

### ***Reporting***

The corporate governance section of the annual report should disclose:

- the skills, experience and expertise relevant to the position of director held by each director in office at the date of the report;
- the names of the directors considered by the board to be independent and the GOC's materiality thresholds;
- a statement as to whether there is a procedure agreed by the board to take independent professional advice at the expense of the GOC;
- the term of office held by each director in office at the date of the report, including the date the director was first appointed; and
- whether a performance evaluation for the board has taken place in the reporting period and how it was conducted.

A description of the process for performance evaluation of the board, committees and individual directors should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section.

Whenever a performance evaluation of the board is conducted, the GOC should provide a written report to shareholding Ministers of the results of the evaluation. This report should also cover how the GOC has rated its compliance with the broader GOC policy framework.

## **Principle 3: Promote ethical and responsible decision-making**

### ***Recommendations***

- Establish and disclose a code of conduct outlining the practices necessary to maintain confidence in the company's integrity and to guide compliance with legal and other obligations to stakeholders.
- Establish and disclose the policy for trading in securities by directors, officers and employees.
- Establish the code of conduct in line with the best practice guide provided in Appendix A.

### ***Commentary***

GOC boards and senior executives must observe the highest standards of ethical behaviour. The GOC should clarify the standards of ethical behaviour required and monitor and enforce observance of those standards.

GOCs have a number of stakeholders in addition to their shareholders to which they owe legal and other obligations. These include employees, clients and customers and the community as a whole. It is important for GOCs to demonstrate their commitment to appropriate corporate practices that recognise these interests and to corporate social responsibility in general.

This may be implemented through a code of conduct or appropriate alternative means such as policy and procedures documents. The code of conduct should deal with ethical matters as well as legal compliance. The code should reflect the significant public responsibility and high standards of conduct that GOCs should have as publicly owned enterprises.

The code of conduct could be a separate code for directors and executives or included as part of the corporate code of conduct.

The code should provide guidance as to the practices necessary to maintain confidence in the GOC's integrity, and the responsibility and accountability of individuals for reporting and

investigating reports of unethical practices. The code should give clear guidance as to the expected conduct of directors, senior executives and employees and must give consideration to the elements of the best practice guide as per Appendix A. It is also considered to be good practice for the code to be developed with the participation of employees and stakeholders. It should be fully supported and implemented by the board and senior executives.

In drafting the code, GOCs should have regard to the suggestions in the ASX Principles and the recommendations of the Auditor-General. In this regard, the Auditor-General recommends that:

- codes of conduct are enhanced by the incorporation of examples and scenarios to assist in ethical decision-making; and
- ☐ the operations of boards are enhanced by the development of specific codes of conduct for directors addressing matters such as potential conflicts of interest and confidentiality.

The *Managing Conflicts of Interest in the Public Sector – Guidelines and Toolkit* jointly issued by the Crime and Misconduct Commission (Qld) and Independent Commission Against Corruption (NSW) should also be considered in the development of the code of conduct where it relates to conflicts of interest policies.

Although the *Public Sector Ethics Act 1995* does not apply to GOCs, the principles set out in that Act may be relevant.

The code should also include or make reference to guidance on procurement processes and contain a system for ensuring compliance and for enabling employees to alert management of misconduct. This should be consistent with, but not necessarily limited to, the requirements of the *Corporations Act 2001* (Cth).

These matters might also be dealt with in other documents, such as policies or compliance programs. In that case, it may be appropriate for the code of conduct to make reference to those documents.

A trading policy, including the application of restricted share trading registers (if used), should be established where directors, officers or employees of the GOC may in the course of their duties have access to inside information about any securities or where trading in securities may create a conflict of interest. This policy would supplement any legal duties which apply to directors, officers and employees in relation to use of information.

### ***Reporting***

The code of conduct and trading policy, or a summary of their provisions, should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section and communicated to employees as part of the induction process and on an ongoing basis. GOCs should also consider making advisers, consultants and contractors aware of the GOC's expectations as set out in the code of conduct.

## **Principle 4: Safeguard integrity in financial reporting**

### ***Recommendations***

- The board should establish an audit committee.
- The chief executive officer and the chief financial officer (or equivalent) state in writing that the financial reports present a true and fair view and are in accordance with accounting standards.

### ***Commentary***

An independent audit committee is a key element of good corporate governance. It should have at least three members who are all financially literate, with at least one member having relevant qualifications and experience (i.e. should be a qualified accountant or other finance professional with experience of financial and accounting matters). Some members of the committee should have an understanding of the industry in which the GOC operates. The chair of the committee should not be the chair of the board. As referred to in Principle 1, the committee should have a clearly defined charter setting out the roles and responsibilities of the committee and its members.

GOCs should have structures in place to ensure the faithful and factual representation of its financial position. Although under the *Corporations Act 2001* (Cth) the statement referred to above is only required to be made in respect of listed entities, it is recommended for GOCs as it encourages management accountability.

### ***Reporting***

The corporate governance section of the annual report should disclose:

- details of the names and qualifications of those appointed to the audit committee, or those who perform the functions of an audit committee; and
- the number of meetings held by the audit committee and the names of the attendees.

The audit committee charter should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section.

## **Principle 5: Make timely and balanced disclosures**

### ***Recommendation***

- Establish written policies and procedures to ensure compliance with disclosure requirements (including those in the GOC Act) and generally ensure the accountability of senior management for that compliance.

### ***Commentary***

Section 122 of the GOC Act requires GOCs to keep shareholding Ministers reasonably informed about the operations, financial performance and financial position of the GOC and its subsidiaries. This requirement has a similar rationale to the continuous disclosure obligations which apply to listed companies under the ASX Listing Rules. GOCs also have a number of specific disclosure obligations imposed on them by the GOC Act, relevant policies and other legislation.

As well as their legal obligations, GOCs are generally accountable to their shareholding Ministers who are in turn accountable to Parliament. It is important that shareholding Ministers have sufficient information about GOCs to fulfil this obligation. GOCs should therefore ensure that the shareholding Ministers have access to material information concerning the GOC, including the operations, financial performance, financial position and governance of the GOC and its subsidiaries. GOCs should adopt a broad approach to disclosure, which may go beyond the disclosures strictly required by law. In this respect, the GOC's code of conduct (refer to Principle 3) must ensure that shareholding Ministers receive timely and complete advice of potential and actual breaches of the code of conduct and securities trading policies by GOC board members, chief and senior executives and where material, GOC employees.

GOCs should also adequately disclose material risk factors and any material changes in the GOC's risk profile. This requires the establishment of sound internal risk management systems as referred to in Principle 7.

### ***Reporting***

A summary of the policies and procedures to ensure compliance with disclosure requirements should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section.

GOCs must regularly assess the information needs of stakeholders to ensure that their needs continue to be met by the GOC's public disclosures.

## **Principle 6: Respect the rights of shareholders**

### ***Recommendation***

- Design and disclose a communication strategy to promote effective communication with shareholding Ministers.

### ***Commentary***

Shareholding Ministers have a general right to obtain information from GOCs about their operations by virtue of the accountability of the GOC to the government, Parliament and the public via the Ministers.<sup>2</sup> GOCs should respect the rights of shareholding Ministers and their representatives, having regard to the requirements of responsible government, and facilitate the effective exercise of those rights. They should communicate effectively and actively consult with the shareholding Ministers and give them ready access to balanced and understandable information about the GOC and corporate proposals. GOCs should not only comply with existing legal and regulatory requirements but also go beyond them where relevant in order to build credibility and confidence.

In general it is expected that the shareholding Ministers will communicate with the chair of the GOC, both on a formal and informal basis. The chief executive officer and other officers and employees should communicate with the Office of Government Owned Corporations or representatives of shareholder departments. The GOC should work cooperatively with the Office of Government Owned Corporations and shareholder departments to ensure that the shareholding Ministers can be briefed in a timely manner.

### ***Reporting***

A description of the arrangements the GOC has to promote communication with shareholding Ministers should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section.

## **Principle 7: Recognise and manage risk**

### ***Recommendations***

- Establish policies on risk management and oversight.
- Require management to design and implement a risk management and internal control system to manage the GOC's material business risks.
- Ensure the integration and alignment of the risk management system with corporate and operational objectives.

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<sup>2</sup> *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1 at 88 – 89 per Finn J.

- Ensure clear communication throughout the GOC of the board and senior management's position on risk.
- Ensure a common risk management terminology across the GOC.
- Ensure risk management is undertaken as part of normal business practice and not as a separate task at set times.
- Ensure information systems for reporting on risk are integrated to enable aggregation and reporting at a corporate level.
- Undertake a risk assessment to identify any high-risk fraud areas and develop strategies to mitigate any significant fraud risks.
- Implement policies and procedures which include:
  - employee responsibilities in relation to fraud prevention and identification;
  - responsibility for fraud investigation once a fraud has been identified;
  - processes for reporting on fraud related matters to management;
  - reporting and recording processes to be followed to record allegations of fraud;
  - requirements for employee training to be conducted on fraud prevention and identification; and
  - a reference to the GOC's code of conduct for ethical behaviour.
- Implement a fraud control plan for ongoing monitoring and coordination of fraud control activities, which identifies fraud risk, incorporates control strategies, action plans and a timetable for implementation, and sets out responsibilities and accountabilities for fraud control at all levels of the GOC.
- Management reports to the board as to the effectiveness of the GOC's management of its material business risks, allowing the board to assess the effectiveness of the implementation of the company's risk management and internal control systems annually.
- The chief executive officer and the chief financial officer (or equivalent) state to the board that the statement given under the recommendations applying to Principle 4 is founded on a sound system of risk management and internal compliance and control which implements board policies; and the risk management and control system is operating efficiently and effectively in all material respects.

### *Commentary*

It is important that GOCs should have a sound system of risk oversight and management and internal control. The system should be designed to identify, assess, monitor and manage risk, and inform shareholding Ministers of material changes to the GOC's risk profile.

The policies should clearly set out the roles and responsibilities of the board, committees, management and, if applicable, internal audit in relation to risk management.

Risk management and internal control systems should be implemented by senior management and incorporate planning for business continuity and disaster recovery. The systems should deal with significant business risks which are relevant to the GOC, which may include risks such as trading, financial (as addressed in the Code of Practice for GOCs' Financial Arrangements), security, public liability and workplace health and safety risks.

GOCs should also give consideration to the establishment of an internal audit function which will bring a systematic and disciplined approach to improve risk management, financial control and governance procedures. The establishment of a risk management committee may also be appropriate.

Internal auditors should ensure that procedures are adequately implemented and be able to guarantee the quality of information disclosed by the GOC. Consultation between internal auditors and the Auditor-General as external auditor should be encouraged.

In relation to systems for fraud and corruption control, the Crime and Misconduct Commission has produced *Fraud and Corruption Control: Guidelines for best practice*. Although GOCs are not subject to the jurisdiction of the CMC, this provides a useful guide as to the elements of such a system.

### ***Reporting***

A description of the GOC's risk management policy and internal compliance and control systems should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section.

The corporate governance section of the annual report should also disclose that the GOC's management has reported to the board as to the effectiveness of the GOC's management of its material business risks.

## **Principle 8: Remunerate fairly and responsibly**

### ***Recommendations***

- GOCs should disclose their remuneration policies to show the broad structure and objectives of the policies and the link between remuneration of the chief executive officer and senior executives and corporate performance.
- The board should establish a remuneration committee.

### ***Commentary***

Remuneration is an important issue for GOCs. As a result of the public ownership of GOCs, public accountability and transparency is required in relation to remuneration policies.

When setting remuneration for chief executive officer and senior executives, GOCs should aim to ensure a balance between public accountability and transparency and the GOCs' need to attract and retain high calibre employees from competitive labour markets. The remuneration arrangements for chief and senior executives are set in accordance with Government approved principles, having regard to specific key criteria or standards.

GOCs are also required to have a remuneration policy endorsed by shareholding Ministers which should include:

- the principles used to determine the nature and amount of remuneration including the broad structure and objectives of the GOC's remuneration policy; and
- details of how the principles establish a link or relationship between remuneration paid and the performance of the GOC.

In accordance with Principle 1, the remuneration committee should have a formal charter which sets out the roles and responsibilities of committee members.

### ***Reporting***

The corporate governance section of the annual report<sup>3</sup> should include the following information:

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<sup>3</sup> To the extent that this information is already disclosed in the financial statements in accordance with AASB 124, that information can be incorporated in the corporate governance section by cross reference.

- disclosure of the GOC's remuneration policies;
- the names of the members of the remuneration committee and their attendance at meetings of the committee.
- The charter of the remuneration committee should be made publicly available, preferably on the GOC's website in a clearly marked corporate governance section.

# Appendix U: ASX Corporate Governance Principles and Recommendations<sup>1</sup>

2<sup>nd</sup> Edition

ASX Corporate Governance Council

## Principle 1: Lay solid foundations for management and oversight

Companies should establish and disclose the respective roles and responsibilities of board and management.

The company's framework should be designed to:

- enable the board to provide strategic guidance for the company and effective oversight of management
- clarify the respective roles and responsibilities of board members and senior executives in order to facilitate board and senior executives' accountability to both the company and its shareholders<sup>2</sup>
- ensure a balance of authority so that no single individual has unfettered powers.

### Recommendation 1.1:

Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.

### Commentary

#### Role of the board and management

Boards should adopt a formal statement of matters reserved to them or a formal board charter that details their functions and responsibilities. There should be a formal statement of the areas of authority delegated to senior executives.

The nature of matters reserved to the board and delegated to senior executives will depend on the size, complexity and ownership structure of the company, and will be influenced by its tradition and corporate culture, and by the skills of directors and senior executives.

Disclosing the division of responsibility assists those affected by corporate decisions to better understand the respective accountabilities and contributions of the board and senior executives.

That understanding can be further enhanced if the disclosure includes an explanation of the balance of responsibility between the chair, the lead independent director, if any, and the chief executive officer, or equivalent.

The division of responsibility may vary with the evolution of the company. Regular review of the balance of responsibilities may be appropriate to ensure that the division of functions remains appropriate to the needs of the company.

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<sup>1</sup> ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations*, (2<sup>nd</sup> edn., August 2007) in ASX < [http://www.asx.com.au/about/corporate\\_governance/reviced\\_corporate\\_governance\\_principles\\_recommendations.htm](http://www.asx.com.au/about/corporate_governance/reviced_corporate_governance_principles_recommendations.htm) > at 18 July 2010

<sup>2</sup> Senior executives refers to the senior management team as distinct from the board, being those who have the opportunity to materially influence the integrity, strategy and operation of the company and its financial performance.

### **Responsibilities of the board**

Usually the board will be responsible for:

- overseeing the company, including its control and accountability systems
- appointing and removing the chief executive officer, or equivalent
- where appropriate, ratifying the appointment and the removal of senior executives
- providing input into and final approval of management's development of corporate strategy and performance objectives
- reviewing, ratifying and monitoring systems of risk management and internal control, codes of conduct, and legal compliance
- monitoring senior executives' performance and implementation of strategy
- ensuring appropriate resources are available to senior executives
- approving and monitoring the progress of major capital expenditure, capital management, and acquisitions and divestitures
- approving and monitoring financial and other reporting.

### **Allocation of individual responsibilities**

It is also appropriate that directors clearly understand corporate expectations of them. To that end, formal letters upon appointment for directors setting out the key terms and conditions relative to that appointment are useful.

Suggestions for the contents of the letter are contained in Box 1.1.

#### **Box 1.1 Content of a director's letter upon appointment**

Companies may find it useful to consider the following matters when drafting directors' letters upon appointment:

- term of appointment
- time commitment envisaged
- powers and duties of directors
- any special duties or arrangements attaching to the position
- circumstances in which an office of director becomes vacant
- expectations regarding involvement with committee work
- remuneration, including superannuation and expenses
- requirement to disclose directors' interests and any matters which affect the director's independence
- fellow directors
- trading policy governing dealings in securities (including any share qualifications) and related financial instruments by directors, including notification requirements
- induction training and continuing education arrangements
- board policy on access to independent professional advice
- indemnity and insurance arrangements
- confidentiality and rights of access to corporate information
- a copy of the constitution
- organisational chart of management structure.

Similarly, senior executives including the chief executive officer, or equivalent, and the chief financial officer, or equivalent, should have a formal job description and letter of appointment describing their term of office, duties, rights and responsibilities, and entitlements on termination. Box 8.1 (Principle 8) provides further commentary on the matter of termination entitlements.

**Recommendation 1.2:**

Companies should disclose the process for evaluating the performance of senior executives.

**Commentary**

The performance of senior executives should be reviewed regularly against appropriate measures.

**Induction**

Induction procedures should be in place to allow new senior executives to participate fully and actively in management decision-making at the earliest opportunity.

To be effective, new senior executives need to have a good deal of knowledge about the company and the industry within which it operates. An induction program should be available to enable senior executives to gain an understanding of:

- the company's financial position, strategies, operations and risk management policies
- the respective rights, duties, responsibilities and roles of the board and senior executives.

**Recommendation 1.3:**

Companies should provide the information indicated in the Guide to reporting on Principle 1.

**Guide to reporting on Principle 1**

The following material should be included in the corporate governance statement in the annual report:

- an explanation of any departure from Recommendations 1.1, 1.2 or 1.3
- whether a performance evaluation for senior executives has taken place in the reporting period and whether it was in accordance with the process disclosed.

A statement of matters reserved for the board, or the board charter or the statement of areas of delegated authority to senior executives should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section.

**Application of Principle 1 in relation to trusts and externally managed entities**

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

A trust should clarify the relationship between the responsible entity and the parent company where relevant, and articulate the relevant roles and responsibilities of the board and management of the responsible entity.

Trusts should also have regard to the responsibilities of external directors and the compliance committee under Part 5C.5 of the Corporations Act.

**Principle 2: Structure the board to add value**

Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties

An effective board is one that facilitates the effective discharge of the duties imposed by law on the directors and adds value in a way that is appropriate to the particular company's circumstances. The board should be structured in such a way that it:

- has a proper understanding of, and competence to deal with, the current and emerging issues of the business
- exercises independent judgement
- encourages enhanced performance of the company
- can effectively review and challenge the performance of management.

Ultimately the directors are elected by the shareholders. However, the board and its delegates play an important role in the selection of candidates for shareholder vote.

**Recommendation 2.1:**

A majority of the board should be independent directors.<sup>3</sup>

**Commentary**

**Independent decision-making**

All directors – whether independent or not – should bring an independent judgement to bear on board decisions.

To facilitate this, there should be a procedure agreed by the board for directors to have access in appropriate circumstances to independent professional advice at the company’s expense.

Non-executive directors should consider the benefits of conferring regularly without management present, including at scheduled sessions.<sup>4</sup> Their discussions can be facilitated by the chair or lead independent director, if any.

**Independent directors**

An independent director is a non-executive director who is not a member of management and who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of their judgement. Relationships which may affect independent status are set out in Box 2.1.

Directors considered by the board to be independent should be identified as such in the corporate governance statement in the annual report. The board should state its reasons if it considers a director to be independent, notwithstanding the existence of relationships listed in Box 2.1, and the corporate governance statement should disclose the existence of any such relationships. In this context, it is important for the board to consider materiality thresholds from the perspective of both the company and its directors, and to disclose these.<sup>5</sup>

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<sup>3</sup> A series of relationships affecting independent status are set out in Box 2.1.

<sup>4</sup> At times it may be appropriate for the independent directors to meet without other directors present.

<sup>5</sup> For example, a board may decide that affiliation with a business which accounts for, say, less than X% of the company’s revenue is, as a category, immaterial for the purpose of determining independence. If the company discloses the standard it follows and makes a general statement that the relevant director meets that standard, investors are better informed about the board’s reasoning

**Box 2.1: Relationships affecting independent status<sup>6</sup>**

When determining the independent status of a director the board should consider whether the director:

1. is a substantial shareholder of the company or an officer of, or otherwise associated directly with, a substantial shareholder of the company<sup>7</sup>
2. is employed, or has previously been employed in an executive capacity by the company or another group member, and there has not been a period of at least three years between ceasing such employment and serving on the board
3. has within the last three years been a principal of a material professional adviser or a material consultant to the company or another group member, or an employee materially associated with the service provided
4. is a material supplier or customer of the company or other group member, or an officer of or otherwise associated directly or indirectly with a material supplier or customer
5. has a material contractual relationship with the company or another group member other than as a director.

Family ties and cross-directorships may be relevant in considering interests and relationships which may affect independence, and should be disclosed by directors to the board.

**Regular assessments**

The board should regularly assess whether each non-executive director is independent. Each non-executive director should provide to the board all information that may be relevant to this assessment. If a director's independent status changes, this should be disclosed and explained in a timely manner to the market.

**Recommendation 2.2:**

The chair should be an independent director.

**Commentary****Role of chair**

The chair is responsible for leadership of the board and for the efficient organisation and conduct of the board's functioning.

The chair should facilitate the effective contribution of all directors and promote constructive and respectful relations between directors and between board and management.

Where the chair is not an independent director, it may be beneficial to consider the appointment of a lead independent director.

The role of chair is demanding, requiring a significant time commitment. The chair's other positions should not be such that they are likely to hinder effective performance in the role.

**Recommendation 2.3:**

The roles of chair and chief executive officer should not be exercised by the same individual.

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<sup>6</sup> The relationships affecting independent status in Box 2.1 are adapted from the definition of independence given by *Corporate Governance, A Guide for Fund Managers and Corporations – Blue Book*, Investment and Financial Services Association, 2004 at [www.ifsa.com.au](http://www.ifsa.com.au).

<sup>7</sup> For this purpose a "substantial shareholder" is a person with a substantial holding as defined in section 9 of the Corporations Act.

### **Commentary**

There should be a clear division of responsibility at the head of the company.

The division of responsibilities between the chair and the chief executive officer should be agreed by the board and set out in a statement of position or authority.

The chief executive officer should not go on to become chair of the same company. A former chief executive officer will not qualify as an “independent” director unless there has been a period of at least three years between ceasing employment with the company and serving on the board.

### **Recommendation 2.4:**

The board should establish a nomination committee.

### **Commentary**

#### **Purpose of the nomination committee**

A board nomination committee is an efficient mechanism for examination of the selection and appointment practices of the company.

Ultimate responsibility for these practices, however, rests with the full board, whether or not a separate nomination committee exists.

For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without a nomination committee should have board processes in place which raise the issues that would otherwise be considered by the nomination committee.

#### **Charter**

The nomination committee should have a charter that clearly sets out its roles and responsibilities, composition, structure, membership requirements and the procedures for inviting non-committee members to attend meetings.

The terms of reference of the nomination committee should allow it to have access to adequate internal and external resources, including access to advice from external consultants or specialists.

#### **Composition of nomination committee**

The nomination committee should be structured so that it:

- consists of a majority of independent directors
- is chaired by an independent director
- has at least three members.

#### **Responsibilities**

Responsibilities of the committee should include recommendations to the board about:

- the necessary and desirable competencies of directors
- review of board succession plans
- the development of a process for evaluation of the performance of the board, its committees and directors
- the appointment and re-election of directors.

## **Selection and appointment process and re-election of directors**

A formal and transparent procedure for the selection, appointment and re-appointment of directors to the board helps promote investor understanding and confidence in that process. Important issues to be considered as part of the process include:

- *Director competencies* – In order to be able to discharge its mandate effectively the board should comprise directors possessing an appropriate range of skills and expertise. The nomination committee should consider implementing a plan for identifying, assessing and enhancing director competencies.

An evaluation of the range of skills, experience and expertise on the board is important when considering new candidates for nomination or appointment. Such an evaluation enables identification of the particular skills that will best increase board effectiveness.

- *Board renewal* – Board renewal is critical to performance, and directors should be conscious of the duration of each director's tenure in succession planning.

The nomination committee should consider whether succession plans are in place to maintain an appropriate balance of skills, experience and expertise on the board.

- *Composition and commitment of the board* – The board should be of a size and composition that is conducive to making appropriate decisions. The board should be large enough to incorporate a variety of perspectives and skills, and to represent the best interests of the company as a whole rather than of individual shareholders or interest groups. It should not, however, be so large that effective decision-making is hindered.

Individual board members should devote the necessary time to the tasks entrusted to them. All directors should consider the number and nature of their directorships and calls on their time from other commitments.

In support of their candidature for directorship or re-election, non-executive directors should provide the nomination committee with details of other commitments and an indication of time involved. Prior to appointment or being submitted for re-election non-executive directors should specifically acknowledge to the company that they will have sufficient time to meet what is expected of them.

The nomination committee should regularly review the time required from a non-executive director, and whether directors are meeting that requirement. Non-executive directors should inform the chair and the chair of the nomination committee before accepting any new appointments as directors.

- *Election of directors* – The names of candidates submitted for election as directors should be accompanied by the following information to enable shareholders to make an informed decision on their election:
  - biographical details, including competencies and qualifications and information sufficient to enable an assessment of the independence of the candidate
  - details of relationships between:
    - the candidate and the company, and
    - the candidate and directors of the company

- directorships held<sup>8</sup>
- particulars of other positions which involve significant time commitments
- the term of office currently served by any directors subject to re-election
- any other particulars required by law.<sup>9</sup>

Non-executive directors should be appointed for specific terms subject to re-election and to the ASX Listing Rule and Corporations Act provisions concerning removal of a director. Re-appointment of directors should not be automatic.

**Recommendation 2.5:**

Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.

**Commentary**

The performance of the board should be reviewed regularly against appropriate measures.

**Induction and education**

Induction procedures should be in place to allow new directors to participate fully and actively in board decision-making at the earliest opportunity.

To be effective, new directors need to have a good deal of knowledge about the company and the industry within which it operates. An induction program should be available to enable new directors to gain an understanding of:

- the company’s financial, strategic, operational and risk management position
- the rights, duties and responsibilities of the Directors
- the roles and responsibilities of senior Executives
- the role of board committees.

Directors should have access to continuing education to update and enhance their skills and knowledge.

**Access to information**

The board should be provided with the information it needs to discharge its responsibilities effectively.

Senior executives should supply the board with information in a form and timeframe, and of a quality that enables the board to discharge its duties effectively. Directors are entitled to request additional information where they consider such information necessary to make informed decisions.

**The board and the company secretary**

The company secretary plays an important role in supporting the effectiveness of the board by monitoring that board policy and procedures are followed, and coordinating the timely completion and despatch of board agenda and briefing material.

It is important that all directors have access to the company secretary. The appointment and removal of the company secretary should be a matter for decision by the board as a whole.

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<sup>8</sup> These are directorships required to be disclosed by law, and any other directorships relevant to an assessment of independence.

<sup>9</sup> The *Guidelines for notices of meeting* at [www.asx.com.au](http://www.asx.com.au) are designed to assist communication with shareholders and contain guidance on framing resolutions for the election of directors.

The company secretary should be accountable to the board, through the chair, on all governance matters.

**Recommendation 2.6:**

Companies should provide the information indicated in the Guide to reporting on Principle 2.

**Guide to reporting on Principle 2**

The following material should be included in the corporate governance statement in the annual report:

- the skills, experience and expertise relevant to the position of director held by each director in office at the date of the annual report
- the names of the directors considered by the board to constitute independent directors and the company's materiality thresholds
- the existence of any of the relationships listed in Box 2.1 and an explanation of why the board considers a director to be
- independent, notwithstanding the existence of those relationships
- a statement as to whether there is a procedure agreed by the board for directors to take independent professional advice at the expense of the company
- the period of office held by each director in office at the date of the annual report
- the names of members of the nomination committee and their attendance at meetings of the committee, or where a company does not have a nomination committee, how the functions of a nomination committee are carried out
- whether a performance evaluation for the board, its committees and directors has taken place in the reporting period and whether it was in accordance with the process disclosed
- an explanation of any departures from Recommendations 2.1, 2.2, 2.3, 2.4, 2.5 or 2.6.

The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- a description of the procedure for the selection and appointment of new directors and the re-election of incumbent directors
- the charter of the nomination committee or a summary of the role, rights, responsibilities and membership requirements for that committee
- the board's policy for the nomination and appointment of directors.

**Application of Principle 2 in relation to trusts and externally managed entities**

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

There may be technical conflict in implementing the Recommendations that a director be independent and that the chair be an independent director or a lead independent director, where the manager or responsible entity is a wholly-owned subsidiary of a parent company such as a fund manager and all the directors are employees of the parent. This should be discussed and clarified in any explanation of departure from the Recommendations included in the corporate governance statement in the annual report.

**Principle 3: Promote ethical and responsible decision-making**

Companies should actively promote ethical and responsible decision-making

To make ethical and responsible decisions, companies should not only comply with their legal obligations, but should also consider the reasonable expectations of their stakeholders

including: shareholders, employees, customers, suppliers, creditors, consumers and the broader community in which they operate. It is a matter for the board to consider and assess what is appropriate in each company's circumstances. It is important for companies to demonstrate their commitment to appropriate corporate practices and decision making.

Companies should:

- clarify the standards of ethical behaviour required of the board, senior executives and all employees and encourage the observance of those standards
- comply with their legal obligations and have regard to the reasonable expectations of their stakeholders
- publish the policy concerning the issue of board and employee trading in company securities and in associated products, including products which operate to limit the economic risk of those securities.

### **Recommendation 3.1:**

Companies should establish a code of conduct and disclose the code or a summary of the code as to:

- the practices necessary to maintain confidence in the company's integrity
- the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders
- the responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

## **Commentary**

### **Purpose of a code of conduct**

Good corporate governance ultimately requires people of integrity. Personal integrity cannot be regulated. However, investor confidence can be enhanced if the company clearly articulates acceptable practices for directors, senior executives and employees.

The board has a responsibility to set the ethical tone and standards of the company. Senior executives have a responsibility to implement practices consistent with those standards. Company codes of conduct which state the values and policies of the company can assist the board and senior executives in this task and complement the company's risk management practices.

### **Application of a code of conduct**

Companies should formulate policies on appropriate behaviour of directors, senior executives and employees. Companies should encourage the integration of these policies into company-wide management practices. A code of conduct supported by appropriate training and monitoring of compliance with the code are effective ways to guide the behaviour of directors, senior executives and employees and demonstrate the commitment of the company to ethical practices. Companies should ensure that training on the code of conduct is updated on a regular basis.

Companies should consider making advisers, consultants and contractors aware of the company's expectations as set out in the code of conduct.

It is not necessary for companies to establish a separate code for directors and senior executives. Depending on the nature and size of the company's operations, the code of conduct for directors and senior executives may stand alone or be part of the corporate code of conduct.

Suggestions for the content of a code of conduct are set out in Box 3.1.

**Box 3.1: Suggestions for the content of a code of conduct**

Companies may find it useful to consider the following matters when formulating a code of conduct:

1. Give a clear commitment by the board and senior executives to the code of conduct. This is often linked to statements about the aspirations or objectives of the company, its core values, and its views about the expectations of shareholders, employees, customers, suppliers, creditors, consumers and the broader community.
2. Detail the company's responsibilities to shareholders and the financial community generally. This might include reference to the company's commitment to delivering shareholder value and how it will do this, and the company's approach to accounting policies and practices, and disclosure.
3. Specify the company's responsibilities to shareholders, employees, customers, suppliers, creditors, consumers and the broader community. This might include reference to standards of product quality or service, commitments to fair value, fair dealing and fair trading, and the safety of goods produced.
4. Describe the company's approach to the community. This might include environmental protection policies, support for community activities, and donation or sponsorship policies.
5. Articulate the company's responsibilities to the individual. This might include the company's privacy policy, and its policy on the use of privileged or confidential information.
6. Outline the company's employment practices. This might include reference to occupational health and safety, employment opportunity practices, special entitlements above the statutory minimum, employee security trading policies, training and further education support policies, practices on drug and alcohol usage and policies on outside employment.
7. Describe the company's approach to business courtesies, bribes, facilitation payments, inducements and commissions. This might include how the company regulates the giving and accepting of business courtesies and facilitation payments, and prevents the offering and acceptance of bribes, inducements and commissions and the misuse of company assets and resources.
8. State the measures the company follows to promote active compliance with legislation wherever it operates. This might include stating whether the company's policy is to comply with Australian or local legal requirements regarding employment practices, responsibilities to the community and responsibilities to the individual, particularly if the host country follows materially different standards than those prescribed by Australian law or international protocols.
9. Specify how the company handles actual or potential conflicts of interest. This might include reference to how the company manages situations where the interest of a private individual interferes or appears to interfere with the interests of the company as a whole, and how the company prevents directors, senior executives and employees from taking improper advantage of property, information or position, or opportunities arising from these, for personal gain or to compete with the company.
10. Identify measures the company follows to encourage the reporting of unlawful or unethical behaviour and to actively promote ethical behaviour. This might include reference to how the company protects those, such as whistleblowers, who report violations in good faith, and its processes for dealing with such reports.<sup>10</sup>

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<sup>10</sup> For guidance on the provision of a whistleblowing service, see Australian Standard on *Whistleblowing Protection Programs for Entities* (AS 8004).

11. Describe the means by which the company monitors and ensures compliance with its code.

**Recommendation 3.2:**

Companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy.

**Commentary**

Public confidence in the company can be eroded if there is insufficient understanding about the company's policies governing trading by "potential insiders". The law prohibits insider trading, and the Corporations Act and the ASX Listing Rules require disclosure of any trading undertaken by directors or their related entities in the company's securities.<sup>11</sup>

For the purpose of this policy a "potential insider" is a person likely to possess inside information and includes the directors, the chief executive officer, or equivalent, the chief financial officer, or equivalent, staff members who are involved in material transactions concerning the company, and any other member of staff who is likely to be in the possession of inside information.

"Inside information" means information concerning a company's financial position, strategy or operations and any other information which a reasonable person might consider, if it were made public, would be likely to have a material impact on a decision to buy or sell a company's securities.<sup>12</sup>

Where companies establish a trading policy, they should also introduce appropriate compliance standards and procedures to ensure that the policy is properly implemented. There should also be an internal review mechanism to assess compliance and effectiveness. This review may involve an internal audit function.

Suggestions for the content of a trading policy are set out in Box 3.2.

**Box 3.2: Suggestions for the content of a trading policy**

Companies may find it useful to consider the following matters when formulating a trading policy:

1. Clearly identify the directors, officers, employees or group of employees who are restricted from trading ("designated officers").<sup>13</sup>
2. Identify and raise awareness about the prohibitions under the law and the requirements of the policy. This should include an awareness that it is inappropriate for the designated officer to procure others to trade when the designated officer is precluded from trading, and an awareness of the need to enforce confidentiality against external advisers.
3. Require designated officers to provide notification to an appropriate senior member of the company, for example, in the case of directors, to the chair, of intended trading, including entering into transactions or arrangements which operate to limit the economic risk of their security holdings in the company. No prior notification is needed

<sup>11</sup> See ASX Listing Rule 3.19A regarding disclosure by the company of directors' notifiable interests within five business days. Companies should note that as at July 2007 the Government proposes amending section 205G of the Corporations Act regarding disclosure by directors of their notifiable interests. The proposed amendment would reduce the timeframe for disclosure from 14 days to two days. There is also a proposal to remove the Listing Rule.

<sup>12</sup> Companies should be aware of the relevant provisions of the *Corporations Act*.

<sup>13</sup> Anyone coming into possession of inside information has obligations to comply with the law relating to insider trading.

for participation in dividend reinvestment plans and other corporate actions open to all shareholders.<sup>14</sup>

4. Require subsequent confirmation of the trading that has occurred.
5. Identify whether trading windows or black-outs are used and if so, details of their application.
6. Specify whether there is any discretion to permit trading by designated officers in specific circumstances, for example, financial hardship, details of such circumstances, and the basis upon which discretion is applied.
7. Specify whether the company prohibits designated officers from trading in financial products issued or created over the company's securities by third parties, or trading in associated products.
8. Specify that the company prohibits designated officers from entering into transactions in associated products which operate to limit the economic risk of security holdings in the company over unvested entitlements.
9. Specify whether the policy applies to the securities of other companies of which the designated officer has inside knowledge because of their position in the company.

Where a company makes any representations about the alignment of a director's or senior executive's interests, the company should take into account the extent to which that director or senior executive has an economic interest in the relevant securities.<sup>15</sup>

### **Recommendation 3.3:**

Companies should provide the information indicated in the Guide to reporting on Principle 3.

### **Guide to reporting on Principle 3**

An explanation of any departure from Recommendations 3.1, 3.2 or 3.3 should be included in the corporate governance statement in the annual report.

The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- any applicable code of conduct or a summary
- the trading policy or a summary.

### **Application of Principle 3 in relation to trusts and externally managed entities**

References to "directors" and "employees" of a company should be applied as references to directors and employees of the responsible entity, and the relevant trading is in securities of the trust and to equivalent roles in respect of other externally managed entities. The trading policy should refer to the securities or units of the listed entity.

## **Principle 4: Safeguard integrity in financial reporting**

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting

This requires companies to put in place a structure of review and authorisation designed to ensure the truthful and factual presentation of the company's financial position. The structure would include, for example:

- review and consideration of the financial statements by the audit committee

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<sup>14</sup> The recommended disclosure is of the designated officer's effective exposure under their security holdings as a result of these transactions or arrangements.

<sup>15</sup> This will prevent the company making misleading representations about alignment of interests.

- a process to ensure the independence and competence of the company's external auditors.

Such a structure does not diminish the ultimate responsibility of the board to ensure the integrity of the company's financial reporting.

**Recommendation 4.1:**

The board should establish an audit committee.

**Commentary**

**Purpose of the audit committee**

A board audit committee is an efficient mechanism for focusing on issues relevant to the integrity of the company's financial reporting.

Ultimate responsibility for the integrity of a company's financial reporting rests with the full board, whether or not a separate audit committee exists.<sup>16</sup>

For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without an audit committee should have board processes in place which raise the issues that would otherwise be considered by the audit committee. If there is no audit committee, it is particularly important that companies disclose how their alternative approach assures the integrity of the financial statements of the company and the independence of the external auditor, and why an audit committee is not considered appropriate.

**Importance of the audit committee**

The existence of an independent audit committee is recognised internationally as an important feature of good corporate governance.

ASX Listing Rule 12.7 requires that an entity included in the S&P All Ordinaries Index at the beginning of its financial year have an audit committee during that year. If an entity is in the top 300 of that Index it must follow the Recommendations below on the composition, operation and responsibilities of the audit committee.<sup>17</sup>

**Recommendation 4.2:**

The audit committee should be structured so that it:

- consists only of non-executive directors
- consists of a majority of independent directors<sup>18</sup>
- is chaired by an independent chair, who is not chair of the board
- has at least three members.

**Commentary**

**Composition of the audit committee**

The audit committee should be of sufficient size, independence and technical expertise to discharge its mandate effectively.

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<sup>16</sup> It is desirable that all members of the board be financially literate.

<sup>17</sup> See note 2.

<sup>18</sup> For further guidance on the concept of an independent director, refer to Box 2.1 and to Recommendation 2.1.

### **Importance of independence**

The ability of the audit committee to exercise independent judgement is vital. International practice is moving towards an audit committee comprised of only independent directors.<sup>19</sup>

### **Technical expertise**

The audit committee should include members who are all financially literate (that is, be able to read and understand financial statements); at least one member should have relevant qualifications and experience (that is, should be a qualified accountant or other finance professional with experience of financial and accounting matters); and some members should have an understanding of the industry in which the entity operates.

### **Recommendation 4.3:**

The audit committee should have a formal charter.

### **Commentary**

#### **Charter**

The charter should clearly set out the audit committee's role and responsibilities, composition, structure and membership requirements and the procedures for inviting non-committee members to attend meetings.

The audit committee should be given the necessary power and resources to meet its charter. This will include rights of access to management, rights to seek explanations and additional information and access to auditors, internal and external, without management present.

#### **Responsibilities**

The audit committee should review the integrity of the company's financial reporting and oversee the independence of the external auditors.

#### **Meetings**

The audit committee should meet often enough to undertake its role effectively. The audit committee should keep minutes of its meetings and these should ordinarily be included in the papers for the next full board meeting after each audit committee meeting.

#### **Reporting**

The audit committee should report to the board.

The report should contain all matters relevant to the committee's role and responsibilities, including:

- assessment of whether external reporting is consistent with committee members' information and knowledge and is adequate for shareholder needs
- assessment of the management processes supporting external reporting
- procedures for the selection and appointment of the external auditor and for the rotation of external audit engagement partners
- recommendations for the appointment or, if necessary, the removal of the external auditor
- assessment of the performance and independence of the external auditors. Where the external auditor provides non audit services, the report should state whether the audit

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<sup>19</sup> For example, IFSA adopts this position, see *Corporate Governance, A Guide for Fund Managers and Corporations – Blue Book*, Investment and Financial Services Association, 2004 at [www.ifsa.com.au](http://www.ifsa.com.au).

committee is satisfied that provision of those services has not compromised the auditor's independence

- assessment of the performance and objectivity of the internal audit function
- the results of the committee's review of risk management and internal control systems. Principle 7 provides further guidance on this matter
- recommendations for the appointment or, if necessary, the dismissal of the head of internal audit .

#### **Recommendation 4.4:**

Companies should provide the information indicated in the Guide to reporting on Principle 4.

#### **Guide to reporting on Principle 4**

The following material should be included in the corporate governance statement in the annual report:

- the names and qualifications of those appointed to the audit committee and their attendance at meetings of the committee, or, where a company does not have an audit committee, how the functions of an audit committee are carried out
- the number of meetings of the audit committee
- explanation of any departures from Recommendations 4.1, 4.2, 4.3 or 4.4.

The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- the audit committee charter
- information on procedures for the selection and appointment of the external auditor, and for the rotation of external audit engagement partners.

#### **Application of Principle 4 in relation to trusts and externally managed entities**

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

It is recognised that for a trust to convene an audit committee as required by the Recommendations, and to convene a compliance committee as may be required by the law, may create an overlap and an administrative burden – the two committees will serve substantively similar purposes. Trusts that are required under the law to convene a compliance committee may wish to consider using the compliance committee to also serve the function of the audit committee, with any necessary adaptations in accordance with the Recommendations.

### **Principle 5: Make timely and balanced disclosure**

Companies should promote timely and balanced disclosure of all material matters concerning the company.

Companies should put in place mechanisms designed to ensure compliance with the ASX Listing Rule requirements such that:

- all investors have equal and timely access to material information concerning the company – including its financial position, performance, ownership and governance
- company announcements are factual and presented in a clear and balanced way. "Balance" requires disclosure of both positive and negative information.

**Recommendation 5.1:**

Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.

**Commentary**

There should be vetting and authorisation processes designed to ensure that company announcements:

- are made in a timely manner
- are factual
- do not omit material information
- are expressed in a clear and objective manner that allows investors to assess the impact of the information when making investment decisions.

Suggestions for the content of these policies are set out in Box 5.1.

**Box 5.1: Continuous disclosure policies**

Companies may find it useful to consider the following matters when formulating continuous disclosure policies:

- the type of information that needs to be disclosed
- internal notification and decision-making concerning the disclosure obligation
- the roles and responsibilities of directors, officers and employees of the company in the disclosure context; in particular, who has primary responsibility for ensuring that the company complies with its disclosure obligations and who is primarily responsible for deciding what information will be disclosed
- promoting understanding of compliance
- monitoring compliance
- measures for seeking to avoid the emergence of a false market in the company's securities
- safeguarding confidentiality of corporate information to avoid premature disclosure
- media contact and comment
- external communications such as analyst briefings and responses to shareholder questions.

**Commentary on financial results**

Companies should include commentary on their financial results to enhance the clarity and balance of reporting. This commentary should include information needed by an investor to make an informed assessment of the entity's activities and results.

ASX Listing Rule 4.10.17 requires a company's annual report to include a review of operations and activities. Although not specifying the contents of that report, the rule endorses the Group of 100 publication, *Guide to Review of Operations and Financial Condition*, which is reproduced in ASX Guidance Note 10 – Review of Operations and Activities.

**Eliminating surprise**

Shareholders' concerns about executive payments are often exacerbated by a lack of information concerning core entitlements when they are agreed. This can be alleviated if, for example, the nature of the termination entitlements of the chief executive officer, or

equivalent, is disclosed to the market at the time they are agreed as well as at the time the actual payment is settled.<sup>20</sup>

**Recommendation 5.2:**

Companies should provide the information indicated in the Guide to reporting on Principle 5.

**Guide to reporting on Principle 5**

An explanation of any departures from Recommendations 5.1 or 5.2 should be included in the corporate governance statement in the annual report. The policies or a summary of those policies designed to guide compliance with Listing Rule disclosure requirements should be made publicly available, ideally by posting them to the company's website in a clearly marked corporate governance section.

**Principle 6: Respect the rights of shareholders**

Companies should respect the rights of shareholders and facilitate the effective exercise of those rights.

Companies should empower their shareholders by:

- communicating effectively with them
- giving them ready access to balanced and understandable information about the company and corporate proposals
- making it easy for them to participate in general meetings.

**Recommendation 6.1:**

Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.

**Commentary**

Publishing the company's policy on shareholder communication will help investors understand how to obtain access to relevant information about the company and its corporate proposals.

**Electronic communication**

Companies should consider how best to take advantage wherever practicable of new technologies that provide:

- opportunities for more effective communications with shareholders
- improved access for shareholders unable to be physically present at meetings.

See Box 6.1 for suggestions on how to improve shareholder participation and enhance market awareness through electronic means.

**Meetings**

Companies should consider how to use general meetings effectively to communicate with shareholders and allow reasonable opportunity for informed shareholder participation.

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<sup>20</sup> Companies should note that entering into employment agreements with senior executives, or obligations under those agreements falling due, may trigger a continuous disclosure obligation under Listing Rule 3.1. See Companies Update 1 May 2003 *Continuous Disclosure and Chief Executive Officer Remuneration* at [www.asx.com.au](http://www.asx.com.au).

The ASX Corporate Governance Council has developed guidelines for improving shareholder participation through the design and content of notices and through the conduct of the meeting itself.<sup>21</sup>

### **Communication with beneficial owners**

Companies may wish to consider allowing beneficial owners to choose to receive shareholder materials directly, for example, by electronic means.

### **Website**

All companies should have a website and are encouraged to communicate with shareholders via electronic methods. If a company does not have a website it must make relevant information available to shareholders by other means, for example, a company may provide the information on request by email, facsimile or post.

#### **Box 6.1: Using electronic communications effectively**

Companies should use their websites to complement the official release of material information to the market. This will enable broader access to company information by investors and stakeholders. Measures companies may consider include:

- placing all relevant announcements made to the market, and related information (for example, information provided to analysts or media during briefings), on the company website after they have been released to ASX
- webcasting or teleconferencing analyst or media briefings and general meetings, or posting a transcript or summary of the transcript to the website
- placing the full text of notices of meeting and explanatory material on the website – see Guideline 12 in the *Guidelines for notices of meeting* at [www.asx.com.au](http://www.asx.com.au)
- providing information about the last three years' press releases or announcements plus at least three years of financial data on the website
- providing information updates to investors by email.

### **Recommendation 6.2:**

Companies should provide the information indicated in the Guide to reporting on Principle 6.

### **Guide to reporting on Principle 6**

An explanation of any departure from Recommendations 6.1 or 6.2 should be included in the corporate governance statement in the annual report. The company should describe how it will communicate with its shareholders publicly, ideally by posting this information on the company's website in a clearly marked corporate governance section.

### **Application of Principle 6 in relation to trusts and externally managed entities**

The annual general meeting is the central forum by which companies can effectively communicate with shareholders, provide them with access to information about the company and corporate proposals, and enable their participation in decision-making. The Corporations Act does not, however, require trusts to hold annual general meetings, although they may do so. Trusts should consider the range of means by which they may achieve the same ends, including the possibility of convening general meetings.

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<sup>21</sup> Guidelines for improving shareholder participation through the design and content of notices and the conduct of the meeting itself are at [www.asx.com.au](http://www.asx.com.au). They are guidelines only and not reporting requirements.

Listed entities that are not required to comply with section 250RA of the Corporations Act should consider the range of means by which they may achieve the same ends.<sup>22</sup> This applies not only to trusts and externally managed entities but also to entities such as foreign incorporated entities. Any such entity should include in its annual report a statement disclosing the extent to which it has achieved the aims of the provisions of section 250RA during the reporting period and give reasons for not doing so.

## **Principle 7: Recognise and manage risk**

Companies should establish a sound system of risk oversight and management and internal control.<sup>23</sup>

Risk management is the culture, processes and structures that are directed towards taking advantage of potential opportunities while managing potential adverse effects.<sup>24</sup>

Risk management should be designed to:

- identify, assess, monitor and manage risk
- identify material changes to the company's risk profile.<sup>25</sup>

Risk management can enhance the environment for identifying and capitalising on opportunities to create value and protect established value.

The company should address risks that could have a material impact on its business (material business risks), as identified by the company's risk management system. The board should regularly review and approve the risk management and oversight policies.

### **Recommendation 7.1:**

Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.<sup>26</sup>

### **Commentary**

Each company will need to determine the material business risks it faces. When establishing and implementing its approach to risk management a company should consider all material business risks. These risks may include but are not limited to: operational, environmental, sustainability, compliance, strategic, ethical conduct, reputation or brand, technological, product or service quality, human capital, financial reporting and market-related risks.<sup>27</sup>

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<sup>22</sup> Section 250RA [Auditor required to attend listed company' AGM] of the Corporations Act makes it an offence for the lead auditor not to attend a listed company's AGM, or arrange to be represented by a suitably qualified member of the audit team who is in a position to answer questions about the audit.

<sup>23</sup> For the purposes of Principle 7 a reference to a "company" will also include references to a "subsidiary" and an "associate" as defined in AASB 128 *Investments in Associates*.

<sup>24</sup> There is a range of guidance available on risk management. Frameworks for risk management include the Australian/ New Zealand *Standard for Risk Management – ANZ 4360* at [www.standards.org.au](http://www.standards.org.au) and COSO *Enterprise Risk Management – Integrated Framework*, published by the Committee of Sponsoring Organisations of the Treadway Commission at [www.coso.org](http://www.coso.org).

<sup>25</sup> Companies should be aware of their obligations under section 299A of the Corporations Act [Annual directors' report – Additional requirement for listed public companies].

<sup>26</sup> The ASX Corporate Governance Council has issued *Supplementary Guidance to Principle 7* which is at [www.asx.com.au](http://www.asx.com.au).

<sup>27</sup> Financial reporting risk is the risk of a material error in the financial statements.

The board is responsible for reviewing the company's policies on risk oversight and management and satisfying itself that management has developed and implemented a sound system of risk management and internal control.<sup>28</sup>

### **Risk management policies**

Risk management policies should reflect the company's risk profile and should clearly describe all elements of the risk management and internal control system and any internal audit function.

When developing risk management policies the company should take into account its legal obligations.<sup>29</sup> A company should also consider the reasonable expectations of its stakeholders. Stakeholders can include: shareholders, employees, customers, suppliers, creditors, consumers and the broader community in which the company operates.

Failure to consider the reasonable expectations of stakeholders can threaten a company's reputation and the success of its business operations. Effective risk management involves considering factors which bear upon the company's continued good standing with its stakeholders.

A company's risk management policies should clearly describe the roles and accountabilities of the board, audit committee, or other appropriate board committee, management and any internal audit function.

### **Recommendation 7.2:**

The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks.

### **Commentary**

#### **Risk management and internal control system**

Internal controls are an important element of risk management. Management should design, implement and review the company's risk management and internal control system.

As part of its oversight for the risk management and internal control system, the board should review the effectiveness of the implementation of that system at least annually. The board retains responsibility for assessing the effectiveness of the company's systems for management of material business risks. It may be appropriate in the company's circumstances for the board to make additional enquiries and to request assurances regarding the management of material business risks.

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<sup>28</sup> There is a range of guidance available on internal control. Frameworks for internal control include the COSO *Internal Control Integrated Framework* at [www.coso.org](http://www.coso.org). Additional guidance is available through the Institute of Chartered Accountants in England and Wales – *Internal Control, Guidance for Directors on the Combined Code* at [ww.icaew.co.uk](http://ww.icaew.co.uk) and Australian/New Zealand Standard for Compliance – ANZ 3806 at [www.standards.org.au](http://www.standards.org.au).

<sup>29</sup> Legal obligations include but are not limited to requirements dealing with trade practices and fair dealing laws, environmental law, privacy law, employment law, occupational health and safety and equal employment and opportunity laws.

### **Internal audit function**

An internal audit function will generally carry out the analysis and independent appraisal of the adequacy and effectiveness of the company's risk management and internal control system. A company should therefore consider having an internal audit function.<sup>30</sup> An alternative mechanism may be used to achieve the same outcome depending on the company's size and complexity and the types of risk involved.

The internal audit function should be independent of the external auditor. The internal audit function and the audit committee should have direct access to each other and should have all necessary access to management and the right to seek information and explanations.

### **Risk management committee**

A board committee is an efficient mechanism for focusing the company on appropriate risk oversight, risk management and internal control. The appropriate committee may be the audit committee, a risk management committee or another relevant committee.

Ultimate responsibility for risk oversight and risk management rests with the full board, whether or not a separate risk management committee exists.

For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without a risk management committee should have board processes in place which raise the issues that would otherwise be considered by a risk management committee.

### **Recommendation 7.3:**

The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.

### **Commentary**

Unlike Recommendation 7.2, this Recommendation only addresses financial reporting risks directly because the Corporations Act requires a declaration in relation to a listed entity's financial statements by the chief executive officer and/or the chief financial officer.<sup>31</sup>

The integrity of the company's financial reporting depends upon the existence of a sound system of risk oversight and management and internal control. The requirement to provide this assurance encourages management accountability in this area.

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<sup>30</sup> Guidance on the internal audit function is found in the Technical Information and Guidance section at [www.iaa.org.au](http://www.iaa.org.au).

<sup>31</sup> Section 295A [Declaration in relation to listed entity's financial statements by chief executive officer and chief financial officer] in Part 2M – Financial Reporting of the Corporations Act. The directors' declaration under s295(4) can now only be made once the directors have received a declaration from the CEO and CFO, or equivalents that: (a) the financial records have been properly maintained, (b) the financial statements comply with accounting standards and (c) the financial statements and notes give a true and fair view. Any company not required to comply with section 295A of the Corporations Act should consider the range of means by which it may achieve the same ends and should include in its annual report a statement disclosing the extent to which it has achieved the aims of the provisions of section 295A during the reporting period and provide reasons for not doing so.

The assurance under this Recommendation forms part of the process by which the board determines the effectiveness of its risk management and internal control systems in relation to financial reporting risks.<sup>32</sup>

**Recommendation 7.4:**

Companies should provide the information indicated in the Guide to reporting on Principle 7.

**Guide to reporting on Principle 7**

The following material should be included in the corporate governance statement in the annual report:

- explanation of any departures from Recommendations 7.1, 7.2 7.3 or 7.4
- whether the board has received the report from management under Recommendation 7.2
- whether the board has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) under Recommendation 7.3.

The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- a summary of the company's policies on risk oversight and management of material business risks.

**Application of Principle 7 in relation to trusts and externally managed entities**

References to "board" and "directors" should be applied as references to the board and directors of the responsible entity of the trust and to equivalent roles in respect of other externally managed entities.

**Principle 8: Remunerate fairly and responsibly**

Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear.

The awarding of remuneration is a key area of focus for investors. When setting the level and structure of remuneration, a company needs to balance its desire to attract and retain senior executives and directors against its interest in not paying excessive remuneration. It is important that there be a clear relationship between performance and remuneration, and that the policy underlying executive remuneration be understood by investors.<sup>33</sup>

**Recommendation 8.1:**

The board should establish a remuneration committee.

**Commentary**

**Purpose of the remuneration committee**

A board remuneration committee is an efficient mechanism for focusing the company on appropriate remuneration policies.

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<sup>32</sup> The G100 has published guidance to assist companies to meet their obligations under Principle 7 in *Principle 7 – Guide to Compliance with ASX Principle 7 – Recognise and Manage Risk* at [www.groupof100.com.au](http://www.groupof100.com.au).

<sup>33</sup> Note the requirements relating to disclosure of remuneration policy and details in Section 300A of the Corporations Act.

Ultimate responsibility for a company's remuneration policy rests with the full board, whether or not a separate remuneration committee exists.

For smaller boards, the same efficiencies may not be derived from a formal committee structure. Companies without a remuneration committee should have board processes in place which raise the issues that would otherwise be considered by the remuneration committee.

### **Charter**

The remuneration committee should have a charter that clearly sets out its role and responsibilities, composition, structure and membership requirements and the procedures for non-committee members to attend meetings.

The terms of reference of the remuneration committee should allow it to have access to adequate internal and external resources, including access to advice from external consultants or specialists.

### **Composition of remuneration committee**

The remuneration committee should be structured so that it:

- consists of a majority of independent directors
- is chaired by an independent director
- has at least three members.

### **Responsibilities of the remuneration committee**

The responsibilities of the remuneration committee should include a review of and recommendation to the board on:

- the company's remuneration, recruitment, retention and termination policies and procedures for senior executives
- senior executives' remuneration and incentives
- superannuation arrangements
- the remuneration framework for directors.<sup>34</sup>

### **Remuneration policy**

The company should design its remuneration policy in such a way that it:

- motivates senior executives to pursue the long-term growth and success of the company
- demonstrates a clear relationship between senior executives' performance and remuneration.

The remuneration committee may seek input from individuals on remuneration policies, but no individual should be directly involved in deciding their own remuneration.

The remuneration committee should ensure that the board is provided with sufficient information to ensure informed decision-making.

### **Recommendation 8.2:**

Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.

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<sup>34</sup> The remuneration framework for directors is often addressed by the nomination committee rather than the remuneration committee.

## Commentary

Executive directors' and senior executives' remuneration packages should involve a balance between fixed and incentive pay, reflecting short and long-term performance objectives appropriate to the company's circumstances and goals.

The Corporations Act requires companies to make detailed disclosure of executive remuneration policies in their remuneration reports which are subject to an advisory vote by shareholders. Under the Listing Rules and the Corporations Act companies are not generally required to obtain shareholder approval for equity-based incentive plans for senior executives who are not directors.

However, companies may find it useful to submit to shareholders proposed equity-based incentive plans which will involve the issue of new shares to senior executives prior to implementing them. This communication is directed at providing the board with a timely assurance that a plan is reasonable.<sup>35</sup> Companies may also consider reporting to shareholders on whether equity-based remuneration payments involving the issue of new shares to senior executives are made pursuant to plans approved by shareholders.

Guidelines on an appropriate framework for determining executive directors' and senior executives' remuneration packages are contained in Box 8.1.

### **Box 8.1: Guidelines for executive remuneration packages**

Most executive remuneration packages will involve a balance between fixed and incentive pay.<sup>36</sup> Companies may find it useful to consider the following components in formulating packages:

1. Fixed remuneration. This should be reasonable and fair, taking into account the company's legal and industrial obligations and labour market conditions, and should be relative to the scale of business. It should reflect core performance requirements and expectations.
2. Performance-based remuneration. Performance-based remuneration linked to clearly specified performance targets can be an effective tool in promoting the interests of the company and shareholders. Incentive schemes should be designed around appropriate performance benchmarks that measure relative performance and provide rewards for materially improved company performance.
3. Equity-based remuneration. Appropriately designed equity-based remuneration, including stock options, can be an effective form of remuneration when linked to performance objectives or hurdles. Equity-based remuneration has limitations and can contribute to 'short-termism' on the part of senior executives. Accordingly, it is important to design appropriate schemes. The terms of such schemes should clearly prohibit entering into transactions or arrangements which limit the economic risk of participating in unvested entitlements under these schemes.<sup>37</sup> The exercise of any entitlements under these schemes should be timed to coincide with any trading

<sup>35</sup> Under Section 211 of the Corporations Act benefits that are "reasonable remuneration" are an exception to the requirement for member approval for financial benefits to related parties under Section 208 of the Act.

<sup>36</sup> Companies should note that entering into employment agreements with senior executives, or obligations under those agreements falling due, may trigger a continuous disclosure obligation under Listing Rule 3.1. See Companies Update 1 May 2003 *Continuous Disclosure and Chief Executive Officer Remuneration* at [www.asx.com.au](http://www.asx.com.au).

<sup>37</sup> Where a company makes any representations about the alignment of a senior executive's interests, the company should take into account the extent of that senior executive's alignment of interest based on any disclosure under the company trading policy.

windows under any trading policy established by the company.

4. Termination payments. Termination payments, if any, for chief executive officers should be agreed in advance, including detailed provisions in case of early termination. There should be no payment for removal for misconduct. Agreements should clearly articulate performance expectations. Companies should consider the consequences of an appointment not working out, and the costs and other impacts of early termination.

Box 8.2 contains guidelines for appropriate practice in non-executive director remuneration.

**Box 8.2: Guidelines for non-executive director remuneration**

Companies may find it useful to consider the following when considering non-executive director remuneration:

1. Non-executive directors should normally be remunerated by way of fees, in the form of cash, non-cash benefits, superannuation contributions or salary sacrifice into equity; they should not normally participate in schemes designed for the remuneration of executives.
2. Non-executive directors should not receive options or bonus payments.
3. Non-executive directors should not be provided with retirement benefits other than superannuation.

**Recommendation 8.3:**

Companies should provide the information indicated in the Guide to reporting on Principle 8.

**Guide to reporting on Principle 8**

The following material or a clear cross-reference to the location of the material should be included in the corporate governance statement in the annual report:

- the names of the members of the remuneration committee and their attendance at meetings of the committee, or where a company does not have a remuneration committee, how the functions of a remuneration committee are carried out
- the existence and terms of any schemes for retirement benefits, other than superannuation, for non-executive directors
- an explanation of any departures from Recommendations 8.1, 8.2 or 8.3.

The following material should be made publicly available, ideally by posting it to the company's website in a clearly marked corporate governance section:

- the charter of the remuneration committee or a summary of the role, rights, responsibilities and membership requirements for that committee
- a summary of the company's policy on prohibiting entering into transactions in associated products which limit the economic risk of participating in unvested entitlements under any equity-based remuneration schemes.

**Application of Principle 8 in relation to trusts and externally managed entities**

Under the Corporations Act, remuneration and indemnity for costs and expenses of the responsible entity is required to be disclosed in a trust's constitution. This may overlap to an extent with the Recommendations and should be taken into account by trusts.

Externally managed entities should disclose a summary of any management agreement terms relating to management fees or the equivalent, including performance fees, including a clear cross-reference to the location of this material.

Listed entities that are not required to comply with section 300A of the Corporations Act or AASB 124 *Related Party Disclosures* should consider the range of means by which they may

achieve the same ends and should provide a clear cross-reference to the location of this material.<sup>38</sup>

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<sup>38</sup> Section 300A [Annual Directors' Report – Specific information to be provided by listed companies – particularly Disclosure of remuneration policy and details] and AASB 124 *Related Party Disclosures*.

# Appendix V: The UK Corporate Governance Code (The Combined Code – 2010)<sup>1</sup>

## Code of Best Practice

### SECTION A: LEADERSHIP

#### A.1 The Role of the Board

##### Main Principle

Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

##### Supporting Principles

The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

All directors must act in what they consider to be the best interests of the company, consistent with their statutory duties.<sup>2</sup>

##### Code Provisions

- A.1.1 The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision. The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.
- A.1.2 The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees.<sup>3</sup> It should also set out the number of meetings of the board and its committees and individual attendance by directors.
- A.1.3 The company should arrange appropriate insurance cover in respect of legal action against its directors.

#### A.2 Division of Responsibilities

##### Main Principle

There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.

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<sup>1</sup> Financial Reporting Council, "The UK Corporate Governance Code," (June 2010) in Financial Reporting Council, < <http://www.frc.org.uk/corporate/reviewCombined.cfm> > at 15 July 2010  
<sup>2</sup> For directors of UK incorporated companies, these duties are set out in the sections 170 to 177 of the Companies Act 2006.  
<sup>3</sup> Provisions A.1.1 and A.1.2 overlap with FSA Rule DTR 7.2.7 R; Provision A.1.2 also overlaps with DTR 7.1.5 R (see Schedule B).

## **Code Provision**

A.2.1 The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.

## **A.3 The Chairman**

### **Main Principle**

The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.

### **Supporting Principle**

The chairman is responsible for setting the board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues. The chairman should also promote a culture of openness and debate by facilitating the effective contribution of nonexecutive directors in particular and ensuring constructive relations between executive and non-executive directors.

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. The chairman should ensure effective communication with shareholders.

## **Code Provision**

A.3.1 The chairman should on appointment meet the independence criteria set out in B.1.1 below. A chief executive should not go on to be chairman of the same company. If, exceptionally, a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reasons to shareholders at the time of the appointment and in the next annual report.<sup>4</sup>

## **A.4 Non-executive Directors**

### **Main Principle**

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

### **Supporting Principle**

Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors, and in succession planning.

## **Code Provisions**

A.4.1 The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary. The senior independent

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<sup>4</sup> Compliance or otherwise with this provision need only be reported for the year in which the appointment is made.

director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate.

A.4.2 The chairman should hold meetings with the non-executive directors without the executives present. Led by the senior independent director, the non-executive directors should meet without the chairman present at least annually to appraise the chairman's performance and on such other occasions as are deemed appropriate.

A.4.3 Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes. On resignation, a nonexecutive director should provide a written statement to the chairman, for circulation to the board, if they have any such concerns.

## **SECTION B: EFFECTIVENESS**

### **B.1 The Composition of the Board**

#### **Main Principle**

The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.

#### **Supporting Principles**

The board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy.

The board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.

The value of ensuring that committee membership is refreshed and that undue reliance is not placed on particular individuals should be taken into account in deciding chairmanship and membership of committees.

No one other than the committee chairman and members is entitled to be present at a meeting of the nomination, audit or remuneration committee, but others may attend at the invitation of the committee.

#### **Code Provisions**

B.1.1 The board should identify in the annual report each non-executive director it considers to be independent.<sup>5</sup> The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has been an employee of the company or group within the last five years;

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<sup>5</sup> A.3.1 states that the chairman should, on appointment, meet the independence criteria set out in this provision, but thereafter the test of independence is not appropriate in relation to the chairman.

- has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme;
- has close family ties with any of the company's advisers, directors or senior employees;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- represents a significant shareholder; or
- has served on the board for more than nine years from the date of their first election.

B.1.2 Except for smaller companies,<sup>6</sup> at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. A smaller company should have at least two independent non-executive directors.

## **B.2 Appointments to the Board**

### **Main Principle**

There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.

### **Supporting Principles**

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender.

The board should satisfy itself that plans are in place for orderly succession for appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.

### **Code Provisions**

- B.2.1 There should be a nomination committee which should lead the process for board appointments and make recommendations to the board. A majority of members of the nomination committee should be independent non-executive directors. The chairman or an independent non-executive director should chair the committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship. The nomination committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.<sup>7</sup>
- B.2.2 The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.
- B.2.3 Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six

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<sup>6</sup> A smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year.

<sup>7</sup> The requirement to make the information available would be met by including the information on a website that is maintained by or on behalf of the company.

years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.

B.2.4 A separate section of the annual report should describe the work of the nomination committee<sup>8</sup>, including the process it has used in relation to board appointments. An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.

## **B.3 Commitment**

### **Main Principle**

All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.

### **Code Provisions**

B.3.1 For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises. A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and their impact explained in the next annual report.

B.3.2 The terms and conditions of appointment of non-executive directors should be made available for inspection.<sup>9</sup> The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them. Their other significant commitments should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.

B.3.3 The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.

## **B.4 Development**

### **Main Principle**

All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.

### **Supporting Principles**

The chairman should ensure that the directors continually update their skills and the knowledge and familiarity with the company required to fulfil their role both on the board and on board committees. The company should provide the necessary resources for developing and updating its directors' knowledge and capabilities.

To function effectively, all directors need appropriate knowledge of the company and access to its operations and staff.

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<sup>8</sup> This provision overlaps with FSA Rule DTR 7.2.7 R (see Schedule B).

<sup>9</sup> The terms and conditions of appointment of non-executive directors should be made available for inspection by any person at the company's registered office during normal business hours and at the AGM (for 15 minutes prior to the meeting and during the meeting).

## **Code Provisions**

- B.4.1 The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders.
- B.4.2 The chairman should regularly review and agree with each director their training and development needs.

## **B.5 Information and Support**

### **Main Principle**

The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.

### **Supporting Principles**

The chairman is responsible for ensuring that the directors receive accurate, timely and clear information. Management has an obligation to provide such information but directors should seek clarification or amplification where necessary.

Under the direction of the chairman, the company secretary's responsibilities include ensuring good information flows within the board and its committees and between senior management and nonexecutive directors, as well as facilitating induction and assisting with professional development as required.

The company secretary should be responsible for advising the board through the chairman on all governance matters.

## **Code Provisions**

- B.5.1 The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties.
- B.5.2 All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with. Both the appointment and removal of the company secretary should be a matter for the board as a whole.

## **B.6 Evaluation**

### **Main Principle**

The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.

### **Supporting Principles**

The chairman should act on the results of the performance evaluation by recognising the strengths and addressing the weaknesses of the board and, where appropriate, proposing new members be appointed to the board or seeking the resignation of directors.

Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).

## **Code Provisions**

- B.6.1 The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.
- B.6.2 Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. A statement should be made available of whether an external facilitator has any other connection with the company.<sup>10</sup>
- B.6.3 The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the chairman, taking into account the views of executive directors.

## **B.7 Re-election**

### **Main Principle**

All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

### **Code Provisions**

- B.7.1 All directors of FTSE 350 companies should be subject to annual election by shareholders. All other directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years. Nonexecutive directors who have served longer than nine years should be subject to annual re-election. The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.
- B.7.2 The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role.

## **SECTION C: ACCOUNTABILITY**

### **C.1 Financial and Business Reporting**

#### **Main Principle**

The board should present a balanced and understandable assessment of the company's position and prospects.

#### **Supporting Principle**

The board's responsibility to present a balanced and understandable assessment extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements.

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<sup>10</sup> See footnote 7

## **Code Provisions**

- C.1.1 The directors should explain in the annual report their responsibility for preparing the annual report and accounts, and there should be a statement by the auditor about their reporting responsibilities<sup>11</sup>.
- C.1.2 The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company<sup>12</sup>.
- C.1.3 The directors should report in annual and half-yearly financial statements that the business is a going concern, with supporting assumptions or qualifications as necessary<sup>13</sup>.

## **C.2 Risk Management and Internal Control<sup>14</sup>**

### **Main Principle**

The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

### **Code Provision**

- C.2.1 The board should, at least annually, conduct a review of the effectiveness of the company's risk management and internal control systems and should report to shareholders that they have done so.<sup>15</sup> The review should cover all material controls, including financial, operational and compliance controls.

## **C.3 Audit Committee and Auditors<sup>16</sup>**

### **Main Principle**

The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor.

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<sup>11</sup> The requirement may be met by the disclosures about the audit scope and the responsibilities of the auditor included, or referred to, in the auditor's report pursuant to the requirements in paragraph 16 of ISA (UK and Ireland) 700, "The Auditor's Report on Financial Statements". Copies are available at: <http://www.frc.org.uk/apb/publications/pub2102.html>.

<sup>12</sup> It would be desirable if the explanation were located in the same part of the annual report as the Business Review required by Section 417 of the Companies Act 2006. Guidance as to the matters that should be considered in an explanation of a business model is provided in paragraphs 30 to 32 of the Accounting Standard Board's Reporting Statement: Operating And Financial Review. Copies are available at: <http://www.frc.org.uk/asb/publications/documents.cfm?cat=7>.

<sup>13</sup> 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009' suggests means of applying this part of the Code. Copies are available at: [www.frc.org.uk/corporate/goingconcern.cfm](http://www.frc.org.uk/corporate/goingconcern.cfm).

<sup>14</sup> The Turnbull guidance suggests means of applying this part of the Code. Copies are available at [www.frc.org.uk/corporate/internalcontrol.cfm](http://www.frc.org.uk/corporate/internalcontrol.cfm).

<sup>15</sup> In addition FSA Rule DTR 7.2.5 R requires companies to describe the main features of the internal control and risk management systems in relation to the financial reporting process.

<sup>16</sup> The FRC Guidance on Audit Committees suggests means of applying this part of the Code. Copies are available at: <http://www.frc.org.uk/corporate/auditcommittees.cfm>.

## Code Provisions

- C.3.1 The board should establish an audit committee of at least three, or in the case of smaller companies<sup>17</sup> two, independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience<sup>18</sup>.
- C.3.2 The main role and responsibilities of the audit committee should be set out in written terms of reference<sup>19</sup> and should include:
- to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;
  - to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;
  - to monitor and review the effectiveness of the company's internal audit function;
  - to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
  - to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
  - to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm, and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.
- C.3.3 The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available<sup>20</sup>. A separate section of the annual report should describe the work of the committee in discharging those responsibilities<sup>21</sup>.
- C.3.4 The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.
- C.3.5 The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.
- C.3.6 The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditor. If the board does not accept the audit committee's recommendation, it should include in the annual

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<sup>17</sup> See footnote 6

<sup>18</sup> This provision overlaps with FSA Rule DTR 7.1.1 R (see Schedule B).

<sup>19</sup> This provision overlaps with FSA Rules DTR 7.1.3 R (see Schedule C).

<sup>20</sup> See footnote 7

<sup>21</sup> This provision overlaps with FSA Rules DTR 7.1.5 R and 7.2.7 R (see Schedule B).

report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.

C.3.7 The annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded.

## **SECTION D: REMUNERATION**

### **D.1 The Level and Components of Remuneration**

#### **Main Principle**

Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

#### **Supporting Principle**

The performance-related elements of executive directors' remuneration should be stretching and designed to promote the long-term success of the company.

The remuneration committee should judge where to position their company relative to other companies. But they should use such comparisons with caution in view of the risk of an upward ratchet of remuneration levels with no corresponding improvement in performance.

They should also be sensitive to pay and employment conditions elsewhere in the group, especially when determining annual salary increases.

#### **Code Provisions**

D.1.1 In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code.

D.1.2 Where a company releases an executive director to serve as a nonexecutive director elsewhere, the remuneration report<sup>22</sup> should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.

D.1.3 Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for nonexecutive directors should not include share options or other performance-related elements. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board. Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in provision B.1.1).

D.1.4 The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. The aim should be to avoid rewarding poor performance. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.

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<sup>22</sup> As required for UK incorporated companies under the *Large and Medium-Sized Companies and Groups (Accounts and Reports) Regulations 2008*.

D.1.5 Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.

## **D.2 Procedure**

### **Main Principle**

There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

### **Supporting Principles**

The remuneration committee should consult the chairman and/or chief executive about their proposals relating to the remuneration of other executive directors. The remuneration committee should also be responsible for appointing any consultants in respect of executive director remuneration. Where executive directors or senior management are involved in advising or supporting the remuneration committee, care should be taken to recognise and avoid conflicts of interest.

The chairman of the board should ensure that the company maintains contact as required with its principal shareholders about remuneration.

### **Code Provisions**

- D.2.1 The board should establish a remuneration committee of at least three, or in the case of smaller companies<sup>23</sup> two, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman. The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.<sup>24</sup> Where remuneration consultants are appointed, a statement should be made available<sup>25</sup> of whether they have any other connection with the company.
- D.2.2 The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments. The committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of ‘senior management’ for this purpose should be determined by the board but should normally include the first layer of management below board level.
- D.2.3 The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.
- D.2.4 Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules<sup>26</sup>) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.

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<sup>23</sup> See footnote 6

<sup>24</sup> This provision overlaps with FSA Rule DTR 7.2.7 R (see Schedule B).

<sup>25</sup> See footnote 7

<sup>26</sup> Listing Rules LR 9.4; available at <http://fsahandbook.info/FSA/html/handbook/LR/9/4>.

## **SECTION E: RELATIONS WITH SHAREHOLDERS**

### **E.1 Dialogue with Shareholders**

#### **Main Principle**

There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place<sup>27</sup>.

#### **Supporting Principles**

Whilst recognising that most shareholder contact is with the chief executive and finance director, the chairman should ensure that all directors are made aware of their major shareholders' issues and concerns.

The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient.

#### **Code Provisions**

- E.1.1 The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.
- E.1.2 The board should state in the annual report the steps they have taken to ensure that the members of the board, and, in particular, the nonexecutive directors, develop an understanding of the views of major shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.

### **E.2 Constructive Use of the AGM**

#### **Main Principle**

The board should use the AGM to communicate with investors and to encourage their participation.

#### **Code Provisions**

- E.2.1 At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should, in particular, propose a resolution at the AGM relating to the report and accounts. For each resolution, proxy appointment forms should provide shareholders with the option to direct their proxy to vote either for or against the resolution or to withhold their vote. The proxy form and any announcement of the results of a vote should make it clear that a 'vote withheld' is not a vote in law and will not be counted in the calculation of the proportion of the votes for and against the resolution.

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<sup>27</sup> Nothing in these principles or provisions should be taken to override the general requirements of law to treat shareholders equally in access to information.

E.2.2 The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. For each resolution, where a vote has been taken on a show of hands, the company should ensure that the following information is given at the meeting and made available as soon as reasonably practicable on a website which is maintained by or on behalf of the company:

- the number of shares in respect of which proxy appointments have been validly made;
- the number of votes for the resolution;
- the number of votes against the resolution; and
- the number of shares in respect of which the vote was directed to be withheld.

E.2.3 The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.

E.2.4 The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.

# Appendix W: Corporate Governance in New Zealand Principles and Guidelines<sup>1</sup>

## Principles for Corporate Governance

- Directors should observe and foster high ethical standards.
- There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively.
- The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility.
- The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs.
- The remuneration of directors and executives should be transparent, fair, and reasonable.
- The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.
- The board should ensure the quality and independence of the external audit process.
- The board should foster constructive relationships with shareholders that encourage them to engage with the entity.
- The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose.

## Principles and Guidelines

### 1. Ethical Standards

#### Principle

Directors should observe and foster high ethical standards.

#### Guidelines

- 1.1 The board of every entity should adopt a written code of ethics for the entity that sets out explicit expectations for ethical decision making and personal behaviour in respect of:
- conflicts of interest, including any circumstances where a director may participate in board discussion and voting on matters in which he or she has a personal interest;
  - proper use of an entity's property and/or information; including safeguards against insider trading in the entity's securities;
  - fair dealing with customers, clients, employees, suppliers, competitors, and other stakeholders;
  - giving and receiving gifts, facilitation payments, and bribes;
  - compliance with laws and regulations; and
  - reporting of unethical decision making and/or behaviour.
- 1.2 Every code of ethics should include measures for dealing with breaches of the code.
- 1.3 Every entity should communicate its code of ethics to its employees and provide employee training. Whistle blowing procedures should be provided.
- 1.4 Every board should have a system to implement and review the entity's code of ethics. The board should monitor adherence to the code and hold directors, executives, and other personnel accountable for unethical behaviour.

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<sup>1</sup> Securities Commission, NZ., *Corporate Governance in New Zealand, Principles and Guidelines – A Handbook for Directors, Executives, and Advisers*, (16<sup>th</sup> March 2004) < <http://www.sec-com.govt.nz/publications/list.shtml> > at 18 July 2010.

- 1.5 Every entity should publish its code of ethics. Annual reports should include information about the steps taken to implement the code and monitor compliance, including as appropriate any serious instances of unethical behaviour and the action taken.

## **2. Board composition and performance**

### **Principle**

There should be a balance of independence, skills, knowledge, experience, and perspectives among directors so that the board works effectively.

### **Guidelines**

- 2.1. Every issuer's board should have an appropriate balance of executive and non-executive directors, and should include directors who meet formal criteria for "independent directors".
- 2.2. All directors should, except as permitted by law and disclosed to shareholders, act in the best interests of the entity, ahead of other interests.
- 2.3. Every board should have a formal charter that sets out the responsibilities and roles of the board and directors, including any formal delegations to management.
- 2.4. The chairperson should be formally responsible for fostering a constructive governance culture and applying appropriate governance principles among directors and with management.
- 2.5. The chairperson of a publicly owned entity should be independent. No director of a publicly owned entity should simultaneously hold the roles of board chairperson and chief executive (or equivalent). Only in exceptional circumstances should the chief executive go on to become the chairperson.
- 2.6. Directors should be selected and appointed through rigorous, formal processes designed to give the board a range of relevant skills and experience.
- 2.7. Directors should be selected and appointed only when the board is satisfied that they will commit the time needed to be fully effective in their role.
- 2.8. The board should set out in writing its specific expectations of non-executive directors (including those who are independent).
- 2.9. The board should allocate time and resources to encouraging directors to acquire and retain a sound understanding of their responsibilities, and this should include appropriate induction training for new appointees.
- 2.10. The board should have rigorous, formal processes for evaluating its performance, along with that of board committees and individual directors. The chairperson should be responsible to lead these processes.
- 2.11. Annual reports of all entities should include information about each director, identify which directors are independent, and include information on the board's appointment, training and evaluation processes.

## **3. Board Committees**

### **Principle**

The board should use committees where this would enhance its effectiveness in key areas while retaining board responsibility.

### **Guidelines**

- 3.1 Every board committee should have a clear, formal charter that sets out its role and delegated responsibilities while safeguarding the ultimate decision making authority of the board as a whole.
- 3.2 Where issuers have board committees, the charter and membership of each should be published for investors.

- 3.3 Proceedings of committees should be reported back to the board to allow other directors to question committee members.
- 3.4 Each publicly owned company should establish an audit committee of the board with responsibilities to: recommend the appointment of external auditors; to oversee all aspects of the entity-audit firm relationship; and to promote integrity in financial reporting. The audit committee should comprise:
- all non-executive directors, a majority of whom are independent;
  - at least one director who is a chartered accountant or has another recognised form of financial expertise; and
  - a chairperson who is independent and who is not the chairperson of the board.

## **4. Reporting and Disclosure**

### **Principle**

The board should demand integrity both in financial reporting and in the timeliness and balance of disclosures on entity affairs.

### **Guidelines**

- 4.1 All boards should have a rigorous process for assuring directors of the quality and integrity of entity financial reports including their relevance, reliability, comparability, and timeliness.
- 4.2 Annual reports of all entities should, in addition to all information required by law, include sufficient meaningful information to enable investors and stakeholders to be well informed on the affairs of the entity.
- 4.3 All issuers should have an effective system of internal control for reliable financial reporting.
- 4.4 The chief executive, the chief financial officer (or equivalent officers), and at least one other director of publicly owned entities should certify in the published financial reports that these comply with generally accepted accounting standards and present a true and fair view of the financial affairs of the entity.
- 4.5 Each listed entity should have a clear and robust internal process for compliance with the continuous disclosure regime, which should include board examination of continuous disclosure issues at each board meeting.
- 4.6 Every entity should make its code of ethics, board committee charters and other standing documents important to corporate governance readily available to interested investors and stakeholders.
- 4.7 Boards of issuers should report annually to investors on how the entity is implementing the Principles and explain any significant departure from guidelines supporting each Principle.

## **5. Remuneration**

### **Principle**

The remuneration of directors and executives should be transparent, fair, and reasonable.

### **Guidelines**

- 5.1 The board should have a clear policy for setting remuneration of executives (including executive directors) and non-executive directors at levels that are fair and reasonable in a competitive market for the skills, knowledge and experience required by the entity.
- 5.2 Publicly owned entities should disclose their remuneration policy in annual reports.
- 5.3 Executive (including executive director) remuneration should be clearly differentiated from non-executive director remuneration.

- 5.4 Executive (including executive director) remuneration packages should include an element that is dependent on entity and individual performance.
- 5.5 No non-executive director should receive a retirement payment unless eligibility for such payment has been agreed by shareholders and publicly disclosed during his or her term of board service.

## **6. Risk Management**

### **Principle**

The board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks.

### **Guidelines**

- 6.1 The board should require the entity to operate rigorous processes for risk management and internal control.
- 6.2 The board should receive regular reports on the operation of risk management and internal control processes.
- 6.3 Boards of issuers should report annually to investors and stakeholders on risk identification and management and on relevant internal controls.

## **7. Auditors**

### **Principle**

The board should ensure the quality and independence of the external audit process.

### **Guidelines**

- 7.1 The board should inform itself fully on the responsibilities of external auditors and be rigorous in its selection of auditors on professional merit.
- 7.2 The board should satisfy itself that there is no relationship between the auditor and the entity or any related person that could compromise the independence of the auditor, and should require confirmation of this from the auditor.
- 7.3 The board should facilitate full and frank dialogue among its audit committee, the external auditors, and management.
- 7.4 No issuer's audit should be led by the same audit partner for more than five consecutive years (i.e. lead and engagement audit partners should be rotated from the engagement after a maximum of five years).
- 7.5 Boards of issuers should report annually to shareholders and stakeholders on the amount of fees paid to the auditors, and should differentiate between fees for audit and fees for individually identified non-audit work (i.e., separating each category of non-audit work undertaken by the auditors, and disclosing the fees payable for this).
- 7.6 Boards of issuers should explain in the annual report what non-audit work was undertaken and why this did not compromise auditor independence.

## **8. Shareholder Relations**

### **Principle**

The board should foster constructive relationships with shareholders that encourage them to engage with the entity.

**Guidelines**

- 8.1 Publicly owned entities should have clear published policies for shareholder relations and regularly review practices, aiming to clearly communicate the goals, strategies and performance of the entity.
- 8.2 Publicly owned entities should maintain an up-to-date website, providing:
- a comprehensive description of its business and structure;
  - a commentary on goals, strategies and performance; and
  - key corporate governance documents;
  - all information released to the stock exchange (for listed entities), including reports to shareholders.
- 8.3 Publicly owned entities should encourage shareholders to take part in annual and special meetings by holding these in locations and at times that are convenient to shareholders.
- 8.4 The board should facilitate questioning of external auditors by shareholders during the annual meeting.

**9. Stakeholder Interests****Principle**

The board should respect the interests of stakeholders within the context of the entity's ownership type and its fundamental purpose.

**Guidelines**

- 9.1 The board should have clear policies for the entity's relationships with significant stakeholders, bearing in mind distinctions between public, private and Crown ownership.
- 9.2 The board should regularly assess compliance with these policies to ensure that conduct towards stakeholders complies with the code of ethics and the law and is within broadly accepted social, environmental, and ethical norms, generally subject to the interests of shareholders.
- 9.3 Public sector entities should report annually to inform the public of their activities and performance, including on how they have served the interests of their stakeholders.