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The Theory and Practice of the State Model of Corporate Governance

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***Abstract*—**A theoretical framework for corporate governance is needed to bridge the gap between the corporate governance of private companies and State-Owned Enterprises (SOEs). The two dominant models, being shareholder and stakeholder, do not always address the specific requirements and challenges posed by 'hybrid' companies; namely, previously national bodies that have been privatised while the government retains significant control or holds a majority of shares. Thus, an exploratory theoretical study is needed to identify how 'hybrid' companies should be defined and why the state model should be acknowledged since it is the less conspicuous model in comparison with the shareholder and stakeholder models. This research focuses on the state model of corporate governance to understand the complex ownership, control pattern, goals, and corporate governance of these hybrid companies. The significance of this research lies in the fact that there is a limited available publication on the state model. This research argues for the state model, which proceeds from an understanding of the institutionally embedded characteristics of hybrid companies, where the government as a shareholder, is either a majority of the total shares, or has been granted power based on the rule of law; the company bylaws.

***Keywords*—**Corporate governance, control, shareholders, state model.

I. Introduction

THE global economy today captures different dynamism by the role of the government as a shareholder in different giant evolving companies, which should be subject to more in-depth investigation. To start, there is an increasing presence of SOEs in the global economy [2], [7], [8]. Many have shifted from being national bodies to listed companies, against the backdrop of a transition to a market economy since the 1980s [15], [25]. These companies can be classified as modern stated-controlled companies [13].

Saudi Arabia, China, Brazil and other countries have created efficient state capitalism [16]. Such capitalism in the economy has spanned to companies such as Equinor and Petrobras, TCLCE, NBCL and Aramco where these companies are hybrid.

The purpose of hybrid companies represents a balance between wealth creation and public good improvement as most of them have a strategic objective [9], [14], [28], which range from employment stability, infrastructure creation [12], or market regulation [28]. Before transitioning into hybrid companies, the economic, political and social goals of SOEs establish their centrality in generating public welfare [17], [10].

Having observed the bylaws of these hybrid companies, the argument is that these companies are run by the state model of corporate governance. The main literature about the corporate governance of state models defines it as a model that empowers the government to maintain and retain control over the company's decisions despite going public [3], [13].

This model is opposed to a free-market economy where government intervention is minimal to property protection [25]. This cannot be neatly separated from laissez-faire, which means freedom from regulation where government intervention is kept to minimum [24]. Whatever the desirability or undesirability of such political and economic ideology, the state model is axiomatic not grounded there. Thus, it is less likely to be accepted by radical adherents of economic liberalism due to the inherent power and control to the government in this model of corporate governance. This model is less likely to disappear any time soon. Therefore, the broad objective of this research is to provide a better understanding of the state model, irrespective of its desirability or undesirability.

A. Research Objectives

The main reason for conducting this research is because there is a clear gap between corporate governance theories in one side, and soft laws represented by recommendations and guidelines by the Organization for Economic Cooperation and Development (OECD) and the World Bank alongside the industry practice in another side. As such, the main objective of this study is closing this gap by suggesting a synthesis of different corporate governance theories that may adequately explain the state model. This study also intends to:

1) Expand literature that refutes the dichotomous view of companies being either a full SOE or privately owned company [3].
2) Provide a theoretical framework to understand the state model and to briefly demonstrate how existing corporate governance theories have not explained or predicted this model that governs evolving companies such as hybrid companies.
3) Identify the power tools granted to the government as a shareholder as well as the risks associated with the state model.
4) Put forward an argument for why the state model should be acknowledged.

B. Research Questions

This research investigates the following key questions:

1) How hybrid companies and the state model are introduced?
2) To what extent does existing corporate governance theories

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explain the state model?

3) To what extent the state model should be acknowledged?

C. Methodology

The methodology of this study is qualitative. It is possible to use qualitative research for exploratory, explanatory, and descriptive research. This study investigates the state model by analysing existing literature, and by observing different case studies that support this study to be exploratory.

The case-study method, researcher observation and documentary analysis are all methods in qualitative legal research where a combination of such methods is likely to answer this study's questions most effectively.

II. Literature Review on Hybrid Companies

Metaphorically speaking, an apple cannot be placed on the shelf of oranges. This mis-categorization applies to SOEs that have been corporatized on publicly listed exchanges, while the government remains an equity shareholder that controls the company's decisions. These companies should not be viewed in white and black terms. Gupta's work suggested that these companies that the government owns partially also have elements of private ownership [15]. His work is entirely relevant because it is one of the very few articles that does not look at SOEs with a dichotomous view, as either being an SOE or privately owned [6], [15]. To illustrate, companies are not either SOEs or private companies because this classification does not explain the real world [6]. This dichotomous view neglects the multitude of variations in terms if state involvement [6].

A new hybrid form of companies exists [6], [11] represented by an admixture of state ownership and private ownership [6], [20], [22]. Furthermore, these hybrid companies can take different forms of the state model, including blackholder model and public-private partnerships incorporating elements from government and market logics [22]. Given this recognition of hybrid companies, it is important, ex ante, to have a clearer understanding of its corporate governance and how the state model is rooted to existing corporate governance theories, which is what the next section will offer.

III. A Theoretical Framework to Understand the State Model

A. The State Model

The state model asserts a strong and direct role of the government in the company to provide some assurance that private companies would serve the public interest [16]. The most influential exposition of the state-model was Andrew Shenfield in his book 'Capitalism' in 1967.

The state model of corporate governance is a model where the government plays a strong direct role in the decision making of a company [16]. There is a good definition that this research would like to borrow form the Chinese literature to clarify the state model, which is as follows. Using the state ownership to design corporate governance rules where although power is allocated to shareholders, power is ultimately resided to the government [27]. Nevertheless, the state model is recognised in soft law as both the OECD and the World Bank appreciate this model albeit not overtly. The state model is aligned with OECD principles on the corporate governance of SOEs that were issued in 2015, in which such principles have interestingly recognised that any company with any degree of government ownership should be considered as a SOE.

The World Bank emphasises that the government can exercise control either when it is the sole shareholder or the majority shareholder. [30] The government also exercises control over the company by appointing the board of directors for example [30]. In companies where the state owns minority shares, the state may exercise control through shareholder agreements or special legal provisions such as through a gold share structure. [30]

B. A Search for a Theory that Explains the State Model

This research contends that neither of the shareholder nor the stakeholder models of corporate governance adequately address the nature and goals of hybrid companies. The shareholder model is the result of the contractarian theory that suggests that shareholders are the principals in whose interests the company should exclusively be run [19]. Thus, accountability should be exclusively held to all shareholders [19]. As such, this model points to a narrow view of corporate governance to ensure that managers follow the interests of all shareholders equally [5], [18].

Conversely, contrarianism without shareholder maximization advances the stakeholder model of corporate governance [12]. Its basic contention is that a company should be managed not only for the benefits of shareholders but also directly in the interests of all 'stakeholder' groups including, without limitations, categories such as employees and suppliers [19]. This results in a broader view of corporate governance which is related to the wider society [18].

In light of the above gap in the literature, this research argues that neither of these models fits hybrid companies where the government is either a blockholder or a controlling shareholder. Having said that, however, the existence of the government is not in itself an adequate justification for the state model of corporate governance to apply. There will be some SOEs companies that have become listed while the government does not control. Consequently, this means such companies may adopt the shareholder or stakeholder or an emerging model, in which exploring this is left for future research.

Given the above identified gap by this research, the argument is that the state model of corporate governance that governs hybrid companies needs a synthesis of different theories for us to understand such governance. To start, the theory of the firm is the first synthesis since it advocates the argument that corporate governance should protect the interest of the company [19], [13]. This goal is what should justify the power to the government as a shareholder in hybrid companies.

The interest of the company should come first since hybrid companies are partially, at least, owned by the general public, they should generate value to the government and the people. This duty is put up because hybrid companies are required to be accountable to the general public [1]. Therefore, the theory of the firm can partially explain the governance of hybrid companies.

The second point of synthesis within the theory-building for the corporate governance of hybrid companies is path dependency theory. This theory advances that the current corporate governance of a company is a relic of its governance in the past [21]. Thus, this theory explains the persistence and governance inertia of companies and institutions which could also be applied to the rationale behind why hybrid companies are run by the state model.

Overall, while there is no one corporate governance theory that addresses the state model, different synthesis of corporate governance theories may explain how hybrid companies are run and governed. Nevertheless, how these companies operate in reality and in boardrooms may be different and such operation explains much more that theories hypothesize, which is what the next section will offer.

IV. Power and Potential Risks in the State Model

By reading the bylaws of different hybrid companies that have been mentioned earlier in this research, the analysis is that the government as a shareholder has different tools of power. These tools include the government being a blockholder or being a controlling shareholder who holds gold shares or dual class structures, or being both. These different tools of power do not only show varieties of authority but most importantly different versions of the state model(s).

The government can be granted based on the bylaws which means it has been granted authority [16]. Those structures that allow a shareholder to maintain and retain power over the company decisions can be described as a lock on control [4], which is known on the literature as a shareholder-unfriendly governance structure [23].

The extensive amount of power could be seen as a risk to investors who may be sceptical about power abuse because the government tends to be demonised [29]. The Petroquisa case is well-suited to explain the risk of power abuse. This company is a subsidiary of Petrobras. It is the most prominent lawsuit involving a state-controlled enterprise in Brazil concerned alleged abuse in asset sales by Petrobras Quimica SA Petroquisa, during the country's large scale privatization programme [23]. Petrobras, as the controlling shareholder of Petroquisa, approved the sale of almost all of Petroquisa's holding in exchange for only US$1,000 in cash and more than (US$940) million in Moedas Podres which is the Brazilian currency [23]. Thus, minority shareholders complained of expropriation following the asset sales, claiming that Petrobras, as the controlling shareholder of Petroquisa, acted in an abusive fashion in approving the sale which privileged the interest of the federal government over the interest of the company and its minority shareholders [23].

A further risk is that these companies might be used as de facto weapons. China dispute with Japan over islands claimed by both countries is the evidence to support such possible risk. Many companies withheld deliveries and shipments of rare earth metals which are critical in the production of modern technologies to Japanese buyers [16]. While the Chinese government denied that state firms were withholding these deliveries to Japan [16], it was hard to prove they were withholding [16]. As the dispute heated up once more toward the end of 2012, Chinese state firms appeared to have been encouraged to stop buying Japanese products if possible [16].

V. Balancing the Debate

The state model is not the only governance model that grants extra power to shareholders that is based on the rule of law. Such power is different than how power in companies is distributed; which is based on the number of shares possessed by a shareholder. The Silicon Valley in the US is a good illustrative case study [26]. This is because many of these companies issue a class structure that empowers certain shareholders. Take for example, the Dual Class Shares structure (DCS) that gives the holders of such class multiple voting rights [25]. The DCS is not widely exercised because the principle is that each shareholder has a single vote that is exercised at general meetings of shareholders [25]. This is classically referred to as 'one share, one vote' [14].

The New York Times; a newspaper company, is a prominent example of a company that even after going public [16], [18], the company shares have been structured to empower the founders with extra the right to control [16]. Google has used dual classes of shares to allow their founders to maintain control of the company after going public [16], [18].

Mark Zuckerberg and other investors of Facebook retained a class of stock to which was attached ten votes per share [20], [25]. On the other hand, public investors were only offered one share one vote stock [25]. LinkedIn had listed with a similar structure and Groupon followed with an even more extreme voting variance [4], [25]. The founders of the latter company retained shares to which were attached 150 votes each [25].

Therefore, hybrid companies which are run by the state model should not be criticized based upon their corporate governance model being opposite of the free-market model that may still be popular in liaise fair economies. But rather they should be criticized based on two grounds: first, they should be criticized if governments with certain political ideologies compromise the company's interest. Second, they should be criticized if the corporate governance goals are not focused on growth and maximising the company's portfolio. From this perspective, the pursuit of economic growth and the company portfolio should be the primary if not the sole objectives of these companies.

VI. Conclusion

Hybrid companies have public goals while simultaneously carrying out economic activities, which makes these companies unique. While these companies are governed in a way that gives the government as a shareholder great power and control, with greater power comes more responsibility and accountability.

More analysis to the state model of these companies contributes to the existing corporate governance scholarship by analysing a different set of legal and economic corporate governance mechanisms, hitherto largely ignored in the literature.

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