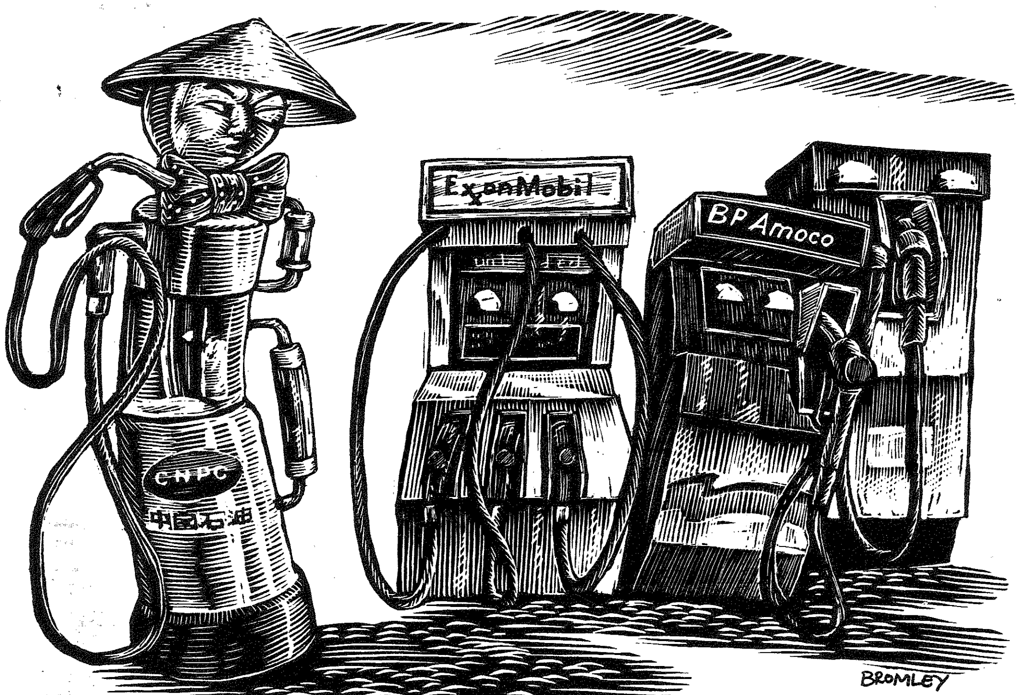
MANAGEMENT PETROCHINA

Western wiles to woo the market

Managers at China's largest oil producer will have compensation linked to performance if the state-owned company's US listing goes ahead, says **Ho Swee Lin**



An unusual ceremony was held in Beijing last month. After decades of service, about 60 senior managers and heads of operations at PetroChina, a Chinese state-owned enterprise, signed a new management contract. It was a solemn moment as they accepted a document demanding an unprecedented degree of commitment from them.

The managers were given new performance targets set by PetroChina's top executives. In return, the company promised rewards that would increase their compensation twentyfold, with 75 per cent of the overall compensation as bonuses based on performance.

PetroChina, the main division of China National Petroleum Corporation (CNPC), the country's largest oil producer, has in the past eight months tried to shed its image as a typical Chinese state-owned company. This has mainly been in preparation for a listing on Wall Street and Hong Kong in early April.

It has has required a significant change in attitude within the company, which is more accustomed to meeting production targets under 50 years of China's command economy. A wholly state-owned company, PetroChina will offer a 10 per cent stake to international investors. CNPC will retain a 90 per cent stake, which will leave it majority-owned by the Chinese government.

Top salary: Ma Fucai

The IPO is also part of the Chinese government's wider plan to reform the country's highly inefficient, unprofitable state industries and an experimental foray into international capital markets. China's efforts to join the World Trade Organisation have brought home the urgency of reform as it prepares to open its domestic markets and to embrace international competition.

CNPC plans to trim its 1.55m workforce by two-thirds, leaving only 480,000 employees on PetroChina's payroll. PetroChina holds all CNPC's domestic assets, while the parent company retains all domestic non-operational assets and overseas ventures.

By adopting western measures, such as the new management pay scheme, PetroChina hopes to impress potential investors in its forthcoming initial public offering, as it did an audience of fund managers in Hong Kong yesterday when it began its two-week international roadshow.

The company has also hired an impressive team of international companies as advisers to educate its executives on western-style management. If it succeeds, it will clear the way for other Chinese state-owned enterprises to tap the international market for funds.

Other companies waiting to list overseas include Baoshan Iron and Steel, a unit of one of China's largest steel producers; China Petrochemical Corporation (Sinopec), China's second-largest oil company; and CNOOC, the main vehicle of China National Offshore Oil Corporation, China's third-largest oil company.

"If we want to go to other countries to ask investors to put money in our hands, we will have to do our utmost to understand their needs and meet their demands," said Huang Yan, 59, PetroChina's vice-chairman and president, at the contract-signing ceremony. "We must discard our old ways of doing things."

However, in spite of its makeover PetroChina retains many of its old ways. Questions are being asked about whether the company, which is one of the five biggest oil producers in the world, can indeed be like BP Amoco, Royal Dutch/Shell or Exxon Mobil.

"PetroChina is like a diplomat's son – the new management scheme is an allowance to enable him to attend school where he can learn more about the outside world," said one western fund manager. "But he is chauffeur-driven to and from school every day and has a butler to attend to him at all times. That is not what I would call proper education."

But PetroChina, the Chinese government and thousands of advisers, including consultancy firm McKinsey, audit firm PwC, seven law firms and lead underwriters Goldman Sachs and China International Capital Corporation obviously think the new management scheme is a selling-point. Under the scheme, some 300 top executives can look forward to a staggering twentyfold jump in their annual compensation. The company hopes this will motivate management to strive for better performance.

With the exception of the board, the targets for all managers are set by the top 10 executives. Performance targets and compensation for top employees will in turn be stipulated by a supposedly independent committee. However, the committee so far comprises Tung Chee-chen, younger brother of Tung Chee-hwa, Hong Kong's chief executive, and Wu Jinglian, an influential Chinese economist who serves as adviser to Zhu Rongji, the Chinese premier, who are not considered impartial outsiders. Even if Franco Bernabe, the former head of Italy's ENI, were appointed as a non-executive director, as has been widely reported, there would be only three outsiders in the company.

"Investors have to ask some really hard questions about the credibility and accountability of the so-called independent directors," said Stephen Diamond, a law professor at Santa Clara University in the US. "They should be extremely cynical about the minimal corporate governance protection [that PetroChina has]."

Of the executives entitled to the management incentive scheme, the highest-paid – presumably Ma Fucai, 54, the company's chairman – will receive an annual compensation of Rmb500,000 ($60,000) while the lowest-paid will receive Rmb200,000, including cash, bonuses and stock options.

The highest compensation currently in PetroChina is believed to be about Rmb84,000, so some of the company's executives will be among the highest-paid in the country, exceeding even the pay packets of most Chinese government leaders.

Doubts have also been cast upon the independence of the company's management and its freedom to make business decisions. Once part of China's ministry of petroleum, PetroChina has always been run by the state. It was widely reported last year that the company's decision to build a natural gas pipeline from Qinghai province in west China to Lanzhou city was in response to Zhu Rongji's comments after his visit to the city that Lanzhou badly needed to use cleaner fuel to solve its pollution problem.

But PetroChina is not alone in performing "favours" for the government. Last year, Sinopec was asked to pay a ridiculously high price to buy China National Star Petroleum, a debt-ridden ethylene plant in Guangzhou. Analysts – and even the company – say such practices will continue. This means that shareholders' interests could be severely compromised if PetroChina continued to undertake unprofitable or ill-advised projects simply to comply with state policy or to please government officials.

'Investors have to ask some hard questions about the credibility and accountability of the so-called independent directors'

"One of my biggest concerns is whether the management is a free agent," said a director at a European fund management house. "PetroChina still operates in a highly regulated environment and constant interference by government bodies in the company's operations will make it a risky investment."

There are concerns, too, about some of PetroChina's "old habits". Company executives have always behaved like government officials. Mr Ma is still being addressed as "Minister Ma" by employees, business associates and even bankers. The company is also renowned for its bully tactics – dictating terms to customers and hardly ever negotiating deals on a commercial basis.

PetroChina may be a separate entity that owns only domestic assets, but many observers view it as being one with CNPC. Mr Ma is both PetroChina's chairman and president of CNPC.

Bill Patterson, a director at the American Federation of Labor and Congress of Industrial Organisations, a union body, says such considerations could lead to US pension funds boycotting PetroChina's IPO. TIAA-CREF, the world's largest pension system, with $280bn in assets under management, and the California Public Employees Retirement System (Calpers), which manages $170bn in assets, both said last week that they did not plan to invest in PetroChina.

"What investors don't want to do is to be passive minority partners with the Chinese government, which has such [a] poor track record," said Prof Diamond. "It is not the size of the offering or the pricing of the transaction that really matters."

The sensitivity of these issues had prompted PetroChina's bankers to delay a public filing of the company's listing application. Much depends on the management's ability to assuage these concerns during the international roadshow this week.

The company's executives, meanwhile, will have to wait and see whether the listing that will give them their massive pay rises