

THE CHANGING FACE OF CORPORATE GOVERNANCE

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Corporate governance is the system by which companies, and like organisations, are controlled. It involves the members (shareholders) as well as directors and management, with the relationships between these groups being of fundamental importance. Shareholders form companies by pooling part of their savings in a common endeavour. They elect a board of directors, and delegate most of the powers of ownership to them, to direct and be responsible for the management of the company. However, since these powers are delegated to the board as a whole, it can act only when it meets, and it is physically impossible for it to manage the company in an operational sense. Thus the board must hire management, and delegate a large part of its powers to it. It follows that management is accountable to the board and the board is accountable to the shareholders. It is because these accountabilities are not well-understood, and even less well-observed, that failures in governance occur.

This article draws heavily on my personal experience in many boardrooms: I joined my first board in 1972 and have since served on over thirty, in the public, private and not-for-profit sectors. I have been an executive director, a managing director and, on some dozen occasions, chairman of the board. My views have also been influenced by a number of other experiences. Between 1985 and 1990, as Chairman of the National Companies and Securities Commission, I was the chief regulator of the corporate sector; between 1990 and 1996, I was Chairman of the Working Group on Corporate Practices and Conduct which produced the first standards on corporate governance in Australia; since 1990, I have acted as a consultant to a wide range of individual corporate and other boards, and have taught many groups of current and aspiring directors. I have had the benefit of many scores of discussions with company chairmen and directors about their problems and their successes, and altogether I have discussed the matters covered in the article with well over five hundred groups of directors. Close contact, over several years, with the Australian Shareholders' Association and various institutional investors have provided me with an insight into the shareholders' perspective. The experience of chairing a number of audit committees, and other contacts with the accounting profession, have also been

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helpful in shaping my views. Against this background, in the few cases in which I have been forced to choose between my own experience and the conclusions in academic writings I have preferred the former.

In this article I trace the development of corporate governance over the last two decades. The article highlights first the importance of good governance, then describes the emergence of the concept of corporate governance. It considers the major influences on changing governance practices, and assesses recent innovations in governance and their impact. The current situation is examined and certain outstanding governance issues highlighted. The article concludes with a comment on the progress towards better governance.

I WHY IS GOOD GOVERNANCE IMPORTANT?

Good governance is desirable and important for two reasons.

First, in a well-governed company, the risks of fraud and corporate collapse are reduced, and there are mechanisms which reduce the likelihood of company controllers enriching themselves at the expense of investors. Considerable evidence has emerged in the hearings of the HIH Royal Commission, and from the court cases involving One.Tel and Harris Scarfe, that governance practices in those companies were poor and accountability lax.¹ Of course neither good governance, nor anything else, can provide a guarantee of the preservation and enhancement of investments. At the same time, some badly governed companies do succeed, but most of the companies that do collapse turn out to have been poorly governed. Similarly, where corporate controllers have enriched themselves directly, or through their private companies, an absence of accountability can usually be observed. Bond Corporation and Rothwells may be mentioned as examples.

The importance of investor protection has increased with the enormous surge in share ownership, and the growing dependence of ageing populations on savings, which are largely invested on the share market. The 1986 survey of share ownership conducted by the Australian Stock Exchange showed 9.2 per cent of adult Australians holding shares (directly and indirectly)² and the equivalent survey in 2000 showed that the figure had risen to 54 per cent.³ Most people can expect a prolonged period in retirement in which their standard of living will depend in large part on the success of their investments on the stock market. Unfortunately the development of understanding has not kept pace with the growth of share ownership so that the complexity of the legislation and of the investment markets, taken with the ignorance of most investors, renders millions very vulnerable.

1 See, eg. Andrew Bristow and John Cannings, 'Directors' and Officers' Responsibilities' in John D Adams et al, *Collapse Incorporated: Tales, Safeguards and Responsibilities of Corporate Australia* (2001) 225.

2 Australian Associated Stock Exchanges, *Australian Shareownership 1986* (1986) 1.

3 Australian Stock Exchange, *2000 Australian Shareownership Study* (2000) 4, <<http://www.asx.com.au/about/pdf/ShareownershipSurvey2000.pdf>> at 22 July 2002.

Good governance is desirable and important for a second reason: it can increase the creation of wealth by improving the performance of honestly managed and financially sound companies. Perhaps the most clear cut evidence of this is found in the surveys conducted by Wilshire Associates of USA on behalf of the Californian Public Employees Superannuation Fund ('CalPERS'). CalPERS is one of the largest institutional investors in the world, with US\$151 billion under management. It is one of the most proactive investors globally and for many years has published its own standards of corporate governance⁴ against which it assesses the performance of the companies in which it invests. It proclaims that shareholders should act like owners and it takes an interventionist role in companies which it believes to be poorly governed. It pioneered the practice of publishing an annual hit list of underperforming companies — one that the Australian Shareholders' Association ('ASA') has adopted — and it brings substantial pressure to bear on the laggards to be more accountable and to improve their governance. The Wilshire studies were designed to measure the effects of this intervention. They cover 42 companies which had been targeted by CalPERS and show that, on average, their share prices lagged behind the Standard and Poors 500 Index by 66 per cent in the five years before the CalPERS intervention and then outperformed the Index by 52.5 per cent in the five years after it.⁵

Remarkable improvements in performance have also been demonstrated in a smaller number of companies with which Lens, another activist shareholder in the United States, has been involved. Lens typically buys a much larger proportion of the shares, in a smaller number of companies, than CalPERS. It seeks to identify companies with substantial unexploited potential and poor governance practices and then buys sufficient shares to give it a major influence with the board. It makes its profit by selling out after the effects of its intervention have become apparent to the market.

A more general indication of the correlation between good governance and good performance was provided by a 1997 survey conducted by *Business Week*, which analysed the performance of the companies controlled by the 25 best and 25 worst boards in the US.⁶ *Business Week* recognised that there is no simple measure of a good board or good governance so they surveyed 295 large pension funds and money managers, and other recognised governance specialists. Marks were awarded under several headings which were grouped under shareholder accountability, board quality and board independence. The best and the worst companies were selected on the basis of the votes of those polled and the marks awarded. None of the 25 companies with the best boards scored less than 7 out of 10 for performance, and 19 of them scored 8.5 or better. Of the 25 companies with the worst boards, 22 scored 3 or less out of 10 for performance.

4 California Public Employees' Retirement System (CalPERS), *Corporate Governance: Core Principles and Guidelines* (1998).

5 Steven L Nesbitt, 'Long-Term Rewards From Shareholder Activism: A Study of the "CalPERS Effect"' (1994) 6 *Journal of Applied Corporate Finance* 75; Steven L Nesbitt, *The 'CalPERS Effect': A Corporate Governance Update* (1995).

6 This discussion is based on Henry Bosch, *Shareholders' Rights* (2001) 168.

None of this provides conclusive proof that good governance produces good performance, but repeated surveys of institutional investors by the consultants McKinsey & Company demonstrate the perceived value of good governance. In the survey of the year 2000 it was found that over 80 per cent of institutional shareholders are prepared to pay a higher price for the shares of companies which they consider to be well-governed; and the premium which the average institutional investor was prepared to pay for a company which was considered to be well-governed, all other things being equal, was found to range from 18 per cent in the United Kingdom to 27 per cent in Indonesia.⁷

II THE DEVELOPMENT OF CORPORATE GOVERNANCE

Before the crash of 1987, the term 'corporate governance' was rarely used in Australia and few people gave much thought to the concepts now covered by it. Shareholders were essentially passive. The ASA had well under 500 members, its activities were limited, and its influence was negligible. Institutional shareholders paid almost no attention to the way that companies were governed and, if they were dissatisfied with one of their investments, they took the 'Wall Street Walk' and sold their shares. In my judgment the greatest single failure of corporate governance in those times was the failure of shareholders to act like owners.

Nevertheless, I observed that a high proportion of the boards of the large, well-established, listed companies took their duties and responsibilities seriously, without giving a great deal of detailed thought to the formal procedures and mechanisms which are now considered important. Since they wished to abide by the law and were conscious of their own (and their company's) reputation, they behaved honestly and in what they believed to be a correct and appropriate manner. At the same time, as the events of the mid 1980s showed, it was possible for ambitious men to build substantial financial empires without regard to such matters. Some were merely reckless, others were unscrupulous, and a few have been proved to have been dishonest, but the damage which they caused to investors, and to the reputation of the Australian capital markets, was considerable. It was in reaction to the consequences of their actions that the concept of corporate governance gained wider recognition in Australia, and the debate about it began to catch up with what was being developed in the northern hemisphere.

The collapses of major companies, and the revelations about the behaviour of their controllers, seriously undermined the confidence of domestic investors and made it more difficult and more expensive to raise capital overseas. In response, the leading business organisations, headed by the Business Council, the Australian Stock Exchange, the Australian Institute of Company Directors ('AICD') and the professional accounting bodies, formed a Working Group to

7 Paul Coombes and Mark Watson, 'Three Surveys on Corporate Governance' [2000] *The McKinsey Quarterly*, Number 4, 74, 76.

develop the first Australian standards of good governance. Drafts were exposed for public comment and the outcome was the publication, in 1991, of *Corporate Practices and Conduct*⁸ which set out, for the first time, principles and guidelines for the structure of boards and the conduct of directors. Towards the end of the drafting process the Australian Investment Managers Group, the first organisation to represent institutional shareholders in Australia, joined the Working Group and published a statement that its members would 'give preference in their investment decisions to those corporations which comply with the principles in the paper'.⁹ It was proposed that all public companies should state in their annual reports that they supported and had adhered to the principles set out in the booklet, and about half of the major companies did so.

The first edition of *Corporate Practices and Conduct* was followed, in the UK, in December 1992, by the Cadbury report¹⁰ and then by a number of other codes of conduct and statements of good practice in Australia and several other countries.¹¹ Two further editions of *Corporate Practices and Conduct* were published, in 1993 and 1995, to take account of developments in thinking about governance, particularly in the US and the UK.

Following the publication of the Code of Best Practice included in the Cadbury report, the London Stock Exchange amended its listing rules to require all listed companies to publish a statement, in each annual report, covering their adherence to the Code,¹² and in 1995 the Australian Stock Exchange followed with a similar listing rule which came into force on 1 July 1996.¹³ From that date all listed companies were required to make a statement in each annual report about their corporate governance practices, and a great deal of information started to become available about such matters as the procedures boards had in place for nominating directors, the terms and conditions of their appointment and retirement, the approach to identifying and managing business risks, the relations with the auditors and the board's committee structure. Many of the largest and best companies started to make disclosure statements in 1995, before the listing rule came into force, and a wide variety of practices was revealed.

The new listing rule led to considerable changes in board structure and procedure. The corporate governance statements not only allowed companies to compare practices and to become aware more easily of better ways of doing

8 Working Group on Corporate Practices and Conduct (chaired by Henry Bosch), *Corporate Practices and Conduct* (1991).

9 Ibid 1.

10 Sir Adrian Cadbury (chair), *Report of the Committee on the Financial Aspects of Corporate Governance — The Code of Best Practice* (1992).

11 See, eg, American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations* (1992); Sir Richard Greenbury (chair), *Directors' Remuneration: Report of a Study Group Chaired by Sir Richard Greenbury* (1995); Toronto Stock Exchange Committee on Corporate Governance in Canada, 'Where Were the Directors?' *Guidelines for Improved Corporate Governance in Canada* (1994).

12 This requirement is now set out in Financial Services Authority, *The Listing Rules* (2002) Rule 12.43A.

13 Australian Stock Exchange, Listing Rule 4.10. See also Australian Stock Exchange, Guidance Note 9, *Disclosure of Corporate Governance Practices: Listing Rule 4.10* (2001).

things, but it provided shareholders with a more effective means of exerting pressure for changes in governance.

III INFLUENCES BEHIND THE CHANGES IN GOVERNANCE

Fund managers have exerted a significant influence in the changes to date. The Australian Investment Managers Group developed quickly: it appointed a full time manager in 1993 and changed its name to the Australian Investment Managers Association. It lobbied Parliament for legislation to require disclosure along the lines adopted in London and it played an important role in influencing the Australian Stock Exchange to introduce the new listing rule noted above. In 1995, it published the 'Blue Book',¹⁴ which was similar to, though somewhat more proscriptive than, the principles in *Corporate Practices and Conduct*.¹⁵ Considerable pressure was exerted on listed companies to conform with the principles in the Blue Book and it became apparent that the easiest, quickest and cheapest way in which a company could raise its share price was to conform with the principles. Considerable changes in governance practices became apparent from a comparison of the annual company statements in the years after 1995 and there was a great deal of convergence. The managed funds' most spectacular success was the boardroom revolution at Coles Myer following the Yannon transaction, but there were many less public interventions which made the boards of listed companies more conscious of the wishes of their shareholders.

Individual shareholders were also beginning to play a strong and constructive role by the middle of the 1990s. Membership of the ASA rose from under 500 in 1990 to over 2000 in 1995, and is over 7000 in 2002. A growing full-time staff was added to the efforts of an increasing number of active volunteers. On a number of occasions the ASA has embarrassed boards by leading shareholder revolts at annual general meetings ('AGMs'), which compelled chairmen to call polls, and far more frequently it has forced the consideration of issues on which boards would have preferred to remain silent. As well as public interventions, the ASA's regular magazine, *Equity*, reports a much larger number of governance issues which have been raised privately with companies, many of which have led to change in corporate behaviour. Two measures of effectiveness are worth noting: over 170 corporate members have joined the ASA, presumably to be able to keep a watch on its activities, and so many companies seek private meetings with the ASA before their AGMs that many approaches have to be declined. It is not suggested that individual shareholders have been as influential as the institutions, but taken together, there are encouraging signs that individual Australian shareholders have begun to act like owners and are exerting considerable influence on governance practices.

14 Australian Investment Managers Association, *Corporate Governance: A Guide for Investment Managers and a Statement of Recommended Corporate Practice* (1995).

15 Working Group on Corporate Practices and Conduct, above n 8.

Another potential influence on governance was the remarkable spate of new legislation arising from the crash of 1987, and the revelations which flowed out of it. The *Corporations Act 1989* (Cth) was a significant legislative undertaking and since it was passed there has been a long series of amending Acts.¹⁶ Important changes have been made to the law governing disclosure¹⁷ and related party transactions¹⁸ which have made a real difference; there has been much attention paid to the business judgment rule;¹⁹ and the frequent changes in the law have served to raise its visibility. However, the intense parliamentary activity in this area seems to have had less practical effect on the way Australian companies are governed than the rise of shareholder activism.

At the same time, since 1987, there has been much new legislation outside the corporations law arena which has imposed additional duties on companies and directors in areas such as health and safety, the environment, consumer protection and trade practices. This has probably had a greater practical effect than the changing corporations legislation. There are now so many specific and detailed requirements, and the penalties for breaching them are so severe, that in many companies a considerable amount of board time is spent on compliance with the law rather than company performance. It is perceived that the responsibilities of directors have become very complex and diverse and there have been many complaints that boards are now unable to focus on serving their shareholders properly because of the attention which has to be paid to compliance. While some of the complaints have been rather exaggerated, to some extent there is a real conflict in the pressures on directors. However, the focus on compliance has led boards to pay more attention to internal control, and to developing new ways of making management more accountable. To that extent, it has made a constructive contribution to the development of better governance systems.

While the new legislation in the corporations law area has had less practical effect than many might like to think, there can be no doubt about the impact of court decisions. Mr Max Eise's personal liability for \$97 million in the *National Safety Council case*²⁰ still resonates in boardrooms, and several other cases involving insolvency, such as Mrs Morley's case,²¹ have increased the consciousness of directors' responsibilities. Outside the insolvency area the courts have given directors less real reason to fear, but the *AWA case*²² created a great deal of attention and the energy with which the AICD argued for the business judgment rule shows that there is a widespread feeling that directors are at risk.

16 These include the *Corporations Legislation Amendment Act 1991* (Cth); *Corporate Law Reform Act 1994* (Cth); *Company Law Review Act 1998* (Cth); *Corporate Law Economic Reform Program Act 1999* (Cth).

17 *Corporate Law Reform Act 1994* (Cth) sch 1.

18 *Corporate Law Economic Reform Program Act 1999* (Cth) sch 1.

19 *Corporations Act 2001* (Cth) s 180(2).

20 *Commonwealth Bank of Australia v Friedrich* (1991) 5 ACSR 115.

21 *Morley v Statewide Tobacco Services Ltd* [1993] 1 VR 423.

22 *Daniels v Anderson* (1995) 37 NSWLR 438.

Regulatory pressures have also played a significant part in changing attitudes in the boardroom. The streamlining made possible by the centralised Commonwealth system, and later by the Wallis reforms,²³ efficiencies stemming from the introduction of computers, greater resources, and greater powers, increased the effectiveness of the Australian Securities Commission and later the Australian Securities and Investments Commission. Although there were signs of toothlessness, particularly in the Yannon case,²⁴ the corporate watchdog has played a considerable and constructive role in improving governance practices. The power to take action to ban directors, and the more recent readiness to use it against such prominent figures as Adler,²⁵ Williams²⁶ and Whitlam,²⁷ has been particularly effective in raising awareness that times have changed. It should also be noted that other regulatory bodies, particularly the Australian Competition & Consumer Commission, have contributed substantially to making directors more aware of their responsibilities, and in some cases, have blown a cold breath of fear through boardrooms.

Alongside the influence of the shareholders, new legislation, court decisions and the regulators, there has been a growth of peer pressure among directors themselves. The active participation of the Business Council (representing the largest companies) and the AICD was essential in developing the first governance principles set out in *Corporate Practices and Conduct*. That participation sprang from a recognition that the ability of Australian companies to raise capital, and the price at which they can do so, depends at least in part on their reputation, which in turn requires standards of governance at least comparable to those overseas. Since 1990, the business community has paid close attention to the governance debate, particularly in the US and the UK. The AICD and other business bodies have been active in raising governance standards, and many boards have made considerable efforts to improve their practices, often with the assistance of a growing band of consultants specialising in the governance area.

IV CHANGES IN GOVERNANCE PRACTICE

There have been many changes in the way that companies are controlled since serious thinking about corporate governance began less than two decades ago. Essentially these have focused on making management more accountable to boards and making boards more accountable to shareholders. It will be argued later in this article that the process is far from complete but nevertheless, remarkable progress has been made.

23 These stemmed from the recommendations made in Stan Wallis, *Financial System Inquiry* (1997).

24 See Australian Securities and Investments Commission, 'Yannon Matter Concludes' (Press Release 00/004, 6 January 2000), <<http://www.asic.gov.au>> at 22 July 2002.

25 *Re HIH Insurance Ltd (in prov liq) and HIH Casualty & General Insurance Ltd (in prov liq)*; *Australian Securities & Investments Commission v Adler* (2002) 41 ACSR 72.

26 *Ibid.*

27 *Australian Securities & Investments Commission v Whitlam (No 2)* (2002) 42 ACSR 407.

As a starting point it is worth recalling the extent of management dominance in the 1960s and 1970s which was taken to its greatest extent in the US. In 1970 Professor Mace of Harvard University conducted an extensive series of interviews with company presidents and directors. The situation he found was summed up by one vice chairman who said:

The old concept that the stockholders elect the board, and the board selects the management, is a fiction. It just doesn't apply to today's large corporations. The board does not select the management, the management selects the board.²⁸

In 1989 these observations were reinforced by a second Harvard professor, Jay Lorsch. He noted substantial changes since 1970 but quoted one director as saying:

the CEO influences the composition of the board first, and sets the tone of what's considered on the agenda, what information is available, how issues are dealt with in committee or by the full board, and who is put on which committee. The CEO can ... have a lot of influence on the way a board functions.²⁹

Management in Australia rarely, if ever, became quite so dominant, perhaps because most of the larger Australian companies started as overseas subsidiaries of British firms, but in my observation, even in the 1980s most boards of larger companies left most things to management. The dominance of management in the large entrepreneurial companies such as Bond Corporation, Rothwells and Spedley revealed weakness and inattention in their boardrooms.

A Recent Innovations

Life in most boardrooms is now very different; in most companies new structures have been adopted and new practices have become accepted. The innovations set out below are, in my judgment, the most important. It is not suggested that there were no companies doing some of these things before 1990, and it is certainly not the case that all companies do all of them now, but their acceptance has grown rapidly in the last decade and they continue to be extended and refined. Of course, there are such large differences between companies in size, ownership structure, complexity, traditions and personalities that there is no single right way of governing well. It may well be inappropriate for any single company to use all of the new techniques at the same time; however, they all contribute to better governance.

- It is now generally accepted that the board must perform certain functions, and that it is prudent for them to be set out in writing so that both directors and management know their respective responsibilities. This is sometimes done in a formal board charter, but it may involve other documents such as a 'statement of matters reserved for the board'.
- In order to ensure that the board actually performs the tasks it has reserved for itself, and that adequate time is allocated to the most important of them,

28 Myles L Mace, *Directors: Myth and Reality* (1971) 65.

29 Jay W Lorsch, *Pawns or Potentates: The Reality of America's Corporate Boards* (1989) 82.

it is accepted as good practice that there should be a procedure for setting meeting agendas. This may involve an annual agenda for the board.

- In 1980, board committees were rare in Australia, but they are now common. They have been found to increase the efficiency with which boards carry out detailed tasks, such as those related to audit and risk management, and they make it much easier to deal with sensitive matters such as remuneration and selection in confidence. Nearly all large listed companies now use audit, remuneration and nomination committees. It has become accepted practice that board committees are given written charters which set out their duties, responsibilities and the limits to their authority, as well as the arrangements by which they report to the full board.
- Formal reviews of performance are becoming well-established. Annual reviews of the CEO have been general for some years but reviews of the performance of the board as a whole, and reviews of individual directors, are becoming more common. Some companies have also begun to carry out reviews of the performance of the chairman and of board committees.
- Some boards have begun to hold elections (or re-elections) of the chairman each year.
- It has become common for boards to discuss and agree a set of rules or guidelines for the conduct of directors. These are likely to include such matters as conflicts of interest, access of directors to independent external advice at the company's expense, questions by directors to executives other than the CEO, confidentiality, loyalty to the board's decisions, the handling of dissent, methods of raising matters of concern and introducing items to the agenda, attendance at meetings, board papers, directors' benefits, board harmony and common purpose, and sometimes the expectations of the chairman and the authority delegated by the board. These matters are sometimes covered in a board charter, or a protocol, or a board code of conduct.
- It is increasingly common for boards to use formal and objective methods for recruiting new directors. These usually involve a nomination committee, a systematic review of the needs of the board, and a job specification, followed by an organised search for appropriate candidates, which may make use of headhunters.
- Formal letters of appointment for directors are now considered good practice. These are likely to include the board charter or protocol and a statement of the company's expectations, and are increasingly likely to indicate the maximum period for which new directors are expected to serve.
- The average tenure of directors has shortened dramatically. It used to be common, but is now rare, for directors to remain until they reached 72, and it is much more common for a period of two, three or possibly four terms of three years to be indicated.
- Induction training for new directors, either tailored to the individual or a standard procedure, has become more common. In addition some boards require directors to fulfill specific obligations every year, such as visits to

operating sites, in order to keep informed about the company and other matters which will increase their effectiveness.

- Some companies provide a detailed directors' manual to enhance effectiveness and to reduce the number of questions in board meetings.
- It is now generally established practice for boards to maintain a working relationship with the auditors rather than leaving it to management. The main burden of this is usually taken by the audit committee which is expected to consider audit plans in advance of the audit, and to review performance against them, as well as considering the management letter in some detail. In addition, the full board is likely to meet the auditors at least once a year. It would now be accepted as good practice for any proposal to change the auditors to be considered by the audit committee and ratified by the full board. These practices mark a substantial change from those of the 1980s, when it was common for relations with the auditors to be handled essentially by management.
- The use of internal auditors (sometimes employees of the company and sometimes a separate external accounting firm) has grown dramatically and it is now considered good practice for them to have a close relationship with the audit committee which should ratify the internal audit plan and consider the reports to which it gives rise. Where necessary the audit committee would settle any disagreements between the internal auditors and management.
- Systematic reviews of internal control systems, risk analysis and management, and compliance with a wide variety of company policies have become common. It is now considered good practice for boards to be proactive in satisfying themselves that management is handling such matters properly.
- It is considered good practice for boards to take the lead in setting the tone and character of the company. This involves the board setting an example but also involving itself with the company code of conduct.
- It is becoming increasingly common for the non-executive directors to meet regularly in the absence of any members of management, including the CEO. Some boards set aside a few minutes at the beginning of every meeting before inviting the CEO to join them, others arrange longer and more formal meetings of the non-executives, perhaps every quarter.

B How Much Effect Have The Changes Had?

In my observation most of the procedures and practices outlined above were relatively (or entirely) unknown in the early 1980s, and their introduction has involved boards in a much more proactive role in corporate governance. In particular, management in the companies using the new techniques is now much more accountable than it used to be. However, it must be emphasised that there are still a considerable number of listed companies which use few, if any, of the new techniques and which are still management dominated. There are others which nominally adhere to best practice and have set up some of the structures,

without having made much actual change to the way they operate. On the other hand there are many unlisted public companies, larger proprietary companies, government business enterprises and not-for-profit organisations which have gone some way to improve their governance by adopting new practices in which some of them have reached a high standard.

The scarcity of statistical data on boardroom activities makes it difficult to demonstrate the effect of the changes in the boardroom but a significant insight has been provided by the annual surveys conducted, since the early 1980s, by the consultants Korn/Ferry.³⁰ Although the sample used is far from constant, and the some of the questions included in the questionnaires have changed over time, the surveys shed considerable light on what is actually happening. Various other surveys, such as those conducted for a shorter period by the consultants ProNed,³¹ broadly confirm the Korn/Ferry results. It can be concluded that:

- The amount of time which directors are putting in to the discharge of their duties has roughly doubled since the early 1980s.
- The effectiveness of the time put in has been enhanced, particularly by the use of committees.
- CEOs are being removed far more frequently and their average tenure has been substantially reduced. For instance that of those in the Business Council, which represents the largest companies in Australia, is now 4.2 years and, according to recent calculations, will shortly be 4.0 years.³²
- The average tenure of non-executive directors has also reduced and is now about five years.
- The proportion of non-executive directors has increased from about a quarter in the early 1980s to about three quarters today. The proportion of independent directors among the non-executives has also increased.
- Not only has it become almost universal for the offices of chairman and CEO to be held by different people, except in special circumstances, but it is now accepted as good practice that the CEO of a company should not go on to become chairman of the same company.

Changes in the behaviour of directors is also indicated by the remarkable growth of director education. This has been dominated by the AICD which was created in 1990 by a merger of the Institute of Directors, which did no training at all, and the Company Directors' Association of Australia, which did very little. The membership of the combined body has more than doubled in 12 years and now stands at 16 200. The membership is active and in 2001–02 there were 26 000 participants in AICD events. From very modest beginnings, with a single course, the training program has become a major activity. Apart from the basic 'Company Directors' Course' which attracted 1900 students in 2001–02 (up from 1300 in 2000–01) there are 14 other core courses offering advanced or

30 See, eg, Korn/Ferry International, *US 28th Annual Board of Directors Study 2001* (2001).

31 See, eg, PRO:NED, *Survey Report Summary: Non-Executive Directors' and Chief Executives' Remuneration and Board Governance 2002* (2002).

32 Hugh Morgan (Speech delivered at the Melbourne Mining Club lunch, Grand Hyatt Hotel, Melbourne, 13 June 2002).

specialist training, for instance 'The Role of the Chairman'.³³ In addition to the AICD a number of other organisations are now offering courses aiming to enhance the effectiveness of directors.

The development of the board consulting industry is a further indication of the increased seriousness with which corporate governance is being taken in the boardroom. Hundreds of companies and other organisations now seek assistance from specialists, on an ad hoc or regular basis, about many aspects of their affairs, such as the role and functions of the board, board composition and the recruitment of new directors, and reviews of board performance.

There can be no doubt that large numbers of directors are giving a great deal more thought to their functions and their effectiveness, and my experience with hundreds of directors in scores of boards leaves no doubt that, since 1990, there has been very considerable progress in improving Australian corporate governance, particularly in making boards conscious of their responsibilities, and in making them aware that they are accountable to shareholders and must hold management accountable to them. There can also be no doubt that the process of creating awareness is accelerating and that many boards, and individual directors, are increasingly feeling competitive pressures on them to know more about governance and to make their boards perform better.

V WORK IN PROGRESS

Improvement, however, is not the same as perfection and there is still a long way to go. The recent corporate collapses are sufficient evidence that all is not well, but they form only the tip of the iceberg. There are many smaller companies in which corporate governance is still only a hazy notion, and other companies where corporate controllers, usually strong CEOs or substantial shareholders with board positions, insist on doing things their own way. There are also many companies in which the directors think that they are familiar with the concept of governance but have little practical familiarity with the detailed techniques available to them. Many of my students in the AICD courses find these a revelation.

While the corporate governance statements in the annual reports of listed companies show that their boards have given at least some thought to the matter, and while some of the reports are impressive in themselves, there is reason to think that there is considerable room for improvement even in the largest companies. Research into the top 100 listed companies, commissioned by the Australian Council of Super Investors³⁴ and released by them at their first annual conference in June 2002, indicates some areas of weakness. For instance:

- when audit, remuneration and nomination committees are taken together, executive directors made up 11 per cent of committee places;

33 These statistics are directly from the relevant executive in the AICD.

34 Geof Stapledon, *Corporate Governance and Trustees: Putting Principles into Practice* (2002).

- after more than a decade in which companies have used bonuses, shares and option schemes to align executive remuneration with shareholders' interests, the research finds that there is no statistically significant relationship between how well or poorly a company has performed and how much it is paying its CEO;
- there is evidence of inadequate disclosure of remuneration packages, which in some cases seems to be in breach of the law; and
- in light of the current debate about audit independence and the scale of payments for non-audit work by audit firms it is interesting to note the conclusion that on average, for every \$100 000 spent on the external audit, approximately \$209 000 is spent on non-audit fees.

A Drivers of Improvement

Against this background the recent public concern is hardly surprising. HIH, One.Tel and Harris Scarfe have stirred deeper feelings in Australia than any corporate events since 1990, and when the HIH Royal Commission reports in 2003, it seems probable that another legislative response will be forthcoming. By that time the consequences of the current governance debate in the US may well be clear. The Enron and WorldCom affairs have caused far greater outrage than anything we have seen in Australia. Combined with several other collapses and prosecutions, and coming in the aftermath of the major losses to investors following the pricking of the 'new economy' bubble, these failures have led to a serious loss of confidence in American corporate governance. It seems inevitable that there will be significant changes in the US. At present, it seems quite likely that there will be new legislation, though time is running out before the November mid-term elections. If Congress does not act, the proposals of the Securities and Exchange Commission ('SEC') and the New York Stock Exchange will probably make a significant difference.³⁵ Since Australian markets need American investment, this country cannot afford to be perceived to lag too far behind US standards and at least some of the North American changes can be expected to be reflected here.

Whether any likely legislation will make much practical improvement is another question. Nominal compliance is easy and cheap, but without the will to change it makes little difference. For instance, audit committees could be made compulsory, but several issues would remain discretionary. How often would they meet? How long would their meetings be? What would they discuss? Would they have the skill, courage, and determination to find out what is really going on, and to reinforce the independence of the auditors? Again, it could be made compulsory for institutional shareholders to vote their proxies. However, that

35 See, eg, SEC, *Proposed Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports* [Release No 34-46079, File No S7-21-02] 17 June 2002; SEC, *Proposed Rule: Framework for Enhancing the Quality of Financial Information through Improvement of Oversight of the Auditing Process* [Release Nos 33-8109; 34-46120; 35-27543; IA-2039; IC-25624; File No S7-24-02] 26 June 2002; New York Stock Exchange, *Report of the New York Stock Exchange Corporate Accountability and Listing Standards Committee* (2002), <http://www.nyse.com/pdfs/corp_govreport.pdf> at 22 July 2002.

requirement could easily be met by passing the form to the office boy and telling him to vote in favour of all management resolutions. Black letter law is often only a roadmap for the unscrupulous or the slothful — as the controllers of Enron showed when they parked the corporate debt in off balance sheet vehicles.

Significant improvement is much more likely if it is driven by the shareholders. It has been pointed out already in this article that both institutional and individual Australian investors are now involving themselves in governance far more than they did in the 1980s and that this has had, and is having, a beneficial effect on the way companies are controlled. At the same time it should be observed that there is much less shareholder pressure in this country than in the US or the UK. The ASA can certainly hold its head high, but its membership is only a tiny fraction of the individual investor community and it is continually short of money and competent volunteers. The institutional investors have even less reason for satisfaction. While the Australian Investment Managers Association was in existence it made a considerable impact, but after the merger which produced the Investment and Financial Services Association ('IFSA') other priorities seem to have taken over and the momentum has been lost. While listed companies have to take serious note when IFSA members express their views there is nothing in Australia comparable to the pressure from CalPERS or TIAA-CREF in the US or Hermes in the UK.³⁶

This situation may change and supporters of good governance can detect encouraging signs. IFSA is revising its Blue Book and some of its fund manager members have said that they intend to take their role in corporate governance more seriously. At the same time, the superannuation trustees who have been relatively inactive in the past are beginning to stir. The Australian Council of Super Investors was formed in 2001, and at its first conference in 2002 it recognised that a greater shareholder role in governance would lead to better company performance and hence to a more comfortable lifestyle in retirement for their members. The Council is considering ways in which its members' influence could be most effectively exerted. There is far more to this than voting proxies, which are at best a blunt instrument and a sort of ultimate deterrent; after all less than 15 per cent of the resolutions put to company meetings are contentious. Among the other ways of making boards and management feel more accountable are:

- *Selling, or threatening to sell, a small proportion of the shares in the institution's portfolio:* The prospect of the company's share price being undermined is likely to focus the attention of management more sharply than the registration of adverse proxies.
- *Moving resolutions at AGMs:* It is almost unknown for Australian institutions to make use of their legal right, but the attention which the ASA has attracted by its modest use of the practice suggests that its potential is considerable. It is worth noting that the use of shareholders' resolutions has

36 The Teachers Insurance and Annuity Association College Retirement Equities Fund ('TIAA-CREF') provides a range of financial services to those in education and their families. Hermes is one of the largest fund managers in Britain.

been developed considerably in the US where it is becoming more common for the dissidents to win a majority. Since the Enron collapse there have been 137 dissident resolutions in company meetings and 40 per cent have commanded majorities — compared with 24 per cent in the same period last year.

- *Asking questions of chairmen at AGMs:* Again the experience of the ASA suggests that this practice has considerable potential.
- *Asking questions of auditors at AGMs:* The *Corporations Act 2001* (Cth) provides that the shareholders elect the auditors,³⁷ and that they may question them,³⁸ but since it is virtually unknown for shareholders to do more than rubber-stamp board nominations, and since questions to auditors are rare, it is hard to believe that any shareholders take their legal relationship with the auditors seriously. There is a loophole in the law in that auditors are not required to attend AGMs,³⁹ and this should be closed, but in practice, since most auditors exercise their right to attend, there is scope for shareholders to reinforce audit independence by demonstrating their interest in it.
- *Writing to chairmen or CEOs to challenge decisions or express concern:* There has been a substantial increase in this practice in recent years and there is anecdotal evidence of its effect; for instance it is believed that, very recently, the chairman of a major company received strong protests about the publicly announced decision that he should be succeeded as chairman by the CEO of the company, and that the reversal of that decision stemmed from expressions of shareholder discontent. Again the ASA makes considerable use of the practice and records many of its initiatives in its magazine, *Equity*.
- *Arranging meetings with management or the CEO:* Over the last decade there has been a great increase in the number of informal meetings, and while most of these are for the purpose of briefing analysts, there have been many productive discussions which have contributed to better governance, some of them involving groups of institutions with common concerns. Probably the most successful of these were those leading to the restructure of the board of Coles Myer in 1995.

There is considerable room for shareholders to make greater use of all these practices and were they to do so the awareness of accountability among boards and management would be greatly increased. Of course shareholders are not always right, nor are boards always wrong, and no doubt there will be many cases when interventions are misconceived, but there can be little doubt that corporate governance would be greatly strengthened if the owners of companies took their role even more seriously.

Fortunately there is good reason to believe that shareholder activism will continue to advance, and that its growth may even accelerate. In many countries there has been a growing realisation that good governance reduces risks and

37 *Corporations Act 2001* (Cth) s 327.

38 *Corporations Act 2001* (Cth) s 250r.

39 *Corporations Act 2001* (Cth) s 250r.

enhances performance, and various methods are being tried to make boards more accountable. The US has been prominent in this and the activist examples of CalPERS, TIAA-CREF and Lens seem to be spreading. No doubt the outrage felt about the behaviour of Enron, WorldCom and other companies will stimulate US investors further and it may well lead to legislation which strengthens the ERISA requirements⁴⁰ (which encourage activism among institutional investors). Overseas, CalPERS in particular has developed its international activities with governance codes specific to foreign countries such as Britain and France,⁴¹ and it may be only a matter of time before an Australian code is produced. In the UK, the Blair government endorsed the Myners report⁴² in October 2001 and, following its recommendations, has indicated its intention to legislate to make intervention in investee companies a duty for trustees and fund managers, when it is in the interests of shareholders and beneficiaries so to do.⁴³ The increasing activism of Hermes and other UK funds suggests that the new legislation, when it appears later this year, will fall on fertile ground. In other countries too, the various McKinsey surveys show that most institutional investors are prepared to pay substantial premiums for the shares of well-governed companies.⁴⁴ The strengthening interest in governance by Australian institutions, mentioned above, is therefore a reflection of a broader trend and it is reasonable to hope that a decade or so from now it will have made a major improvement in governance practice in this country. However, no one should expect a dramatic change in months, or even a few years.

Among individual shareholders the membership of the ASA continues to rise rapidly. It has recently reviewed its organisational structure with a view to sharpening the effectiveness of its interventions, and its contribution to the governance scene will continue to grow; but its membership remains small and, again, no sudden or spectacular results should be expected.

B Some Outstanding Problems

Many of the issues which occupied the minds of those involved in corporate governance in 1990 have been settled and are fading from memory, but others have emerged into the spotlight and are likely to attract considerable debate over the next few years. Among the most important are those relating to the reliability

40 *Employee Retirement Income Security Act of 1974*, 29 USC §§ 1001–1461. This legislation imposes rules (the ‘ERISA requirements’) in relation to standards of conduct, responsibility and obligations for fiduciaries of employee benefit plans, as well as specifying penalties for fiduciaries that fail to fulfil obligations.

41 CalPERS, *United Kingdom Market Principles* (1997); CalPERS, *France Market Principles* (1997).

42 Paul Myners, *Institutional Investment in the United Kingdom: A Review* (2001)

43 HM Treasury and The Department for Work and Pensions, *Myners Review: Institutional Investment in the UK — The Government’s Response* (2001) 4, <http://www.hm-treasury.gov.uk/mediastore/otherfiles/myners_response.PDF> at 17 September 2002.

44 See, eg, McKinsey & Company, *Global Investor Opinion Survey: Key Findings* (2002), <<http://www.mckinsey.com/practices/corporategovernance/PDF/GlobalInvestorOpinionSurvey2002.pdf>> at 17 September 2002; Roberto Newell and Gregory Wilson, ‘A Premium For Good Governance’ [2002] *The McKinsey Quarterly*, Number 3, 54.

of company accounts, executive remuneration, excessive focus on the short-term, nominee directors and corporate social responsibility.

1 *The Reliability of Company Accounts.*

Many investors, many journalists, and some politicians believe that the auditing of company accounts should provide some sort of a guarantee of their reliability. This has never been accepted by the accounting profession, which for many years has pointed to 'the audit expectation gap'. On many occasions the profession has stated that an audit does not offer users of financial statements an absolute assurance of a company's soundness.⁴⁵

Nevertheless, there have been many recent cases, particularly in the US, in which auditors have signed off on accounts which did not give a true and fair reflection of the company's position, and which were sometimes based on dishonestly prepared figures.⁴⁶ There has been such an outcry about this that it is almost certain that there will be fresh legislation on the matter, and that controversy will rage about it for the next few years.

So far the focus has been on audit independence and particularly on the question of auditors performing consulting work for their clients outside the audit area. The concentration on this sub-issue will almost certainly prove counterproductive. As Professor Ramsay pointed out in his report to the Minister for Financial Services and Regulation,⁴⁷ there are several other factors that can contribute to undermining the independence of auditors. Even if non-audit work is completely banned there will still be cases in which undue influence is exerted by management, and the quality of the audits compromised. Perhaps more importantly, independence is only one aspect of the quality of an audit. The competence of the auditors, the scope of the audit, the honesty and openness of management, and the ability and diligence of the board audit committee are all relevant — and in the present debate little attention is being paid to these factors. It seems probable that, in a few years time, the expected legislation on audit independence will be shown not to have closed the audit expectation gap and the debate will flare up again with a different focus. More needs to be done. Perhaps a better way forward would be for shareholders to begin building relations with auditors, and for there to be a greater focus on the responsibility of directors, particularly on audit committees.

45 See Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, *Report of the Financial Reporting and Audit Expectation Gap Taskforce to the Joint Standing Committee* (1996); Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia, *A Research Study on Financial Reporting and Auditing — Bridging the Expectation Gap* (1994).

46 Prominent examples include Enron, WorldCom, Global Crossing and Tyco.

47 Ian Ramsay, *Independence of Australian Company Auditors: Review of Current Australian Requirements and Proposals for Reform — Report to the Minister for Financial Services and Regulation* (2001), <<http://www.treasury.gov.au/contentlist.asp?classification=14&titl=Publications>> at 23 July 2002.

2 Remuneration

Over the last 15 years there has been a dramatic increase in the levels of remuneration of senior managers and particularly CEOs. In the early 1980s, Australian remuneration levels were considerably lower than those in North America and many countries in Europe, and the increasing transfer of executives across national boundaries was tending to bring the higher overseas levels to this country. The rise was accelerated in 1985 by well-meaning legislation requiring the disclosure of remuneration levels. The politicians concerned believed that senior executives would be shamed into moderating their demands, or perhaps be forced to moderate them by boards, shareholders or public opinion; but this was wishful thinking. Once competitive levels were revealed, those in a strong negotiating position (which means most executives recruited from other companies) used the published information to ratchet up their own levels, and the upward spiral accelerated. By the late 1980s, there was growing pressure for executive remuneration to be linked more closely to results: the success of the company and the interests of shareholders. At first this was met by increasing performance bonuses paid in cash, but it was not long before the allocation of shares and options became more important, particularly for CEOs.

In the US, in 1995, a decision was taken by the accounting standards authorities which had the effect of making it optional for companies to treat the cost of options as expenses for accounting purposes,⁴⁸ and almost all US companies declined to do so. Their boards were thus in a position to provide enormous personal rewards to executives without apparently reducing company profits, and there was a strong temptation to attract outstanding executives by doing so. A competitive spiral began which was accelerated because a high proportion of US company boards are effectively dominated by chairmen/CEOs who have a vested interest in remuneration levels. The 'telephone number' remuneration packages have become so large that a political and investor backlash has developed and it seems highly probable that some action will be taken to rein in the explosion. The New York Stock Exchange, in a set of draft listing rules designed to raise the standards of US governance in response to the recent scandals, proposes to deal with this matter by strengthening the compensation committee, made up solely of independent directors, and by requiring share and option packages to be put before shareholders in general meeting.⁴⁹ The question of accounting for options is likely to be dealt with in a separate initiative, but that nettle is still to be grasped.

The position in Australia is not nearly so serious but international pressures are strong and, as the retiring CEO of BHP Billiton pointed out on leaving his position, Australian pay levels are still not competitive with those overseas.⁵⁰ However, there are growing signs of investor discontent and if the upward trend continues this is bound to increase. Remuneration can be expected to become an

48 Financial Accounting Standards Board, *Statement of Financial Accounting Standards (SFAS) 123: Accounting for Stock-Based Compensation* (1995).

49 New York Stock Exchange, above n 35, 10, 17.

50 Channel 9, 'Bon Voyage to Paul Anderson', *Business Sunday*, 30 June 2002, <http://businessunday.ninemsn.com.au/businessunday/INTERVIEWS/STORIES/STORY_1654.ASP> at 16 September 2002.

increasingly important issue. It appears, from the research done for the Australian Council of Super Investors,⁵¹ and from general observation, that the attempt to relate executive rewards to shareholders' interests has not been very successful, at least so far, and that some change of practice is desirable. However, it might be prudent to see how the issue is resolved in the US before attempting an Australian initiative.

3 *Short-Termism*

The average tenure of CEOs, and other very senior executives has been falling, and the period in which most have access to large numbers of options is only a few years. During this time, despite the theoretical justification for options, their interests are not closely aligned to those of shareholders. Their options come at no cost to them and they have to be exercised within a known period which is almost certainly shorter than that of investors saving for their retirement. Between the time they are issued with the options and the time they are able to exercise them they are able to exert considerable influence on the direction of their companies, and the temptation to strive for short-term results which will boost share prices, and so the profits from their options, is considerable. Particularly in the US, there is reason to think that this has been a major factor in determining the policies of some companies — and a significant factor in some of the collapses.

At the same time, fund managers operate in an extremely competitive environment and must have regard to their quarterly ratings as they strive to increase the volume of funds under management. There must be a considerable temptation for them to exert pressure on companies to produce short-term results and to avoid significant fluctuations in earnings — or at least to acquiesce when management adopt these goals.

Short-term pressures will often lead companies to pay less attention to long-term growth and are likely to be contrary to the interests of superannuation trustees and many individual shareholders. It can be expected that a good deal more will be heard about this issue over the next few years.

4 *Controlling Shareholders and Nominee Directors*

Particular problems for good governance arise when significant shareholders are present, or are represented, on the boards of listed companies. An even more difficult situation arises when the CEO is a major shareholder. Of course, in a closely held company the controller can do what they like with their own, but when capital is raised on the market, and investors commit their savings, that freedom should be lost. Unfortunately substantial shareholders often have interests that differ from those of other shareholders, and it is common for human beings to convince themselves that their personal advantage is justified by a wider interest. In consequence, there have been many occasions in which

51 Stapledon, above n 34.

major shareholders, or their private companies, have been enriched at the expense of other investors.

Since it is often possible for directors who own substantial blocks of shares personally, or who are the nominees of those who do, to present plausible and apparently objective arguments in support of their own interests, it is frequently difficult for independent directors to oppose them, particularly if they have less detailed knowledge of the company's affairs. Since independent directors often owe their positions to the controlling shareholders it is not unknown for them to suppress any misgivings they may have about arguments which happen to work in favour of the individual interests of controllers.

Such considerations have frequently led to abuses of governance. Listed companies whose boards include nominee directors, or directors who own substantial blocks of shares, present particular risks for investors, and our legal/governance system has, as yet, done little to address the problem.

5 Corporate Social Responsibility

The recently fashionable doctrine of 'corporate social responsibility', and particularly the notion of the 'triple bottom line', poses an emerging threat to good governance which, if it lasts, could be serious. Without clear accountability, good governance is impossible. However, there can be no clear accountability unless management understands that it is accountable to the board for delivering explicitly defined results, and that its performance can be monitored and assessed; and unless the board understands that it is similarly accountable to shareholders. The sole common interest of all shareholders is the ongoing prosperity of the company, and while there can be many ways of achieving this objective and many different strategies, the creation of wealth in perpetuity is the sole final criterion.

By elevating environmental and social considerations to the same level as the creation of wealth the concept of accountability is undermined. One major oil company recently published an annual report in which it wrote of a 'triple bottom line' made up of 'economic value added', 'environmental value added' and 'social value added' and of 'three different forms of accounting', which led it to pursue an 'acceptable return to shareholders' which it deliberately distinguished from a 'maximum return'. Regrettably, with some variations of wording other companies have begun to follow this example.

Leaving aside the conceptual and practical difficulties in finding objective forms of accounting which would provide credible, and generally acceptable, ways of measuring environmental and social 'value added', there can be no way of bringing all three to a single common denominator. If management is allowed to pursue three potentially divergent objectives it cannot be held accountable: it would be too easy for it to explain, say, a poor economic performance in terms of a temporary emphasis on one of the other criteria. Some shareholders may find it acceptable to entrust their investments to the goodwill and judgment of a particular group of company controllers without any clear criteria for calling them to account, but history suggests that it would not be long before unscrupulous operators made use of the arrangements.

This issue was considered by the Senate Standing Committee on Legal and Constitutional Affairs, which concluded:

It is the shareholders' investment that creates the company. Directors' fiduciary duties are premised on this fact and are designed to protect that investment. If company law were to impose new and at times conflicting duties (such as looking after interests which may be directly opposed to those of the corporators), directors' fiduciary duties could be weakened, perhaps to the point where they would be essentially meaningless. In general, requirements aimed at securing responsible corporate behaviour are therefore best provided in other than company law.⁵²

This does not mean that it is in shareholders' interests to disregard the environment and the societies in which they operate. On the contrary, it is always necessary, in the long-term interests of the company, to have regard to the legitimate interests of genuine stakeholders. Indeed, many opportunities for increasing short-term profit have to be subordinated to longer term considerations. Moreover, all companies must have regard to their reputations and to their relationships with governments and the societies in which they operate and, in the present climate of opinion, this will certainly mean having some regard to environmental and social considerations — up to the point at which it ceases to be in their long-term interests to do so. However, to elevate environmental or social considerations to a par with the creation of wealth — to argue that companies have an independent social responsibility — is to undermine good governance.

VI A PROGRESS SCORE

Over the last 15 years there has been steady, if uneven, progress towards better corporate governance. In my judgment, much of the outrageous behaviour which occurred in Australia in the 1980s would be unlikely to occur today. Investors are somewhat more secure and many companies are performing better; the media and the public are somewhat less prone to the adulation of corporate heroes. In my observation there has been a remarkable spread of awareness of the benefits of good governance, and of some of the techniques for achieving it. Many shareholders are trying to act like owners, many directors have a clear idea of what they should be doing and many managers are being assisted to manage better — even if they do regret the loss of much of their independence. Several of the major issues which dominated the governance scene in 1990 have been satisfactorily resolved, and progress has been made on others.

In 1990, it would have been reasonable to assert that Australian corporate governance lagged behind that in some other countries — certainly the US and the UK — and that the reputation of Australian companies and capital markets had been compromised. That can no longer be said, and it could now be argued that on average, corporate governance in this country is of at least a comparable

52 Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, *Company Directors' Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors* (1989) 98.

standard to that anywhere else. Certainly there are differences, and in some areas Australian practices lag, but in other respects a strong case can be made that we have set a good example. Many Americans were fond of proclaiming that their systems were the best in the world in every respect. For example, only a few months ago the Business Roundtable (which represents the largest corporations in the US) was immodestly reasserting that 'America has the best corporate governance, financial reporting and securities market systems in the world'.⁵³ That assertion was always suspect, and the recent scandals involving several of its most prominent members have revealed its hollowness.

Despite the progress made, there are still very large gaps in the understanding of corporate governance and there are many people in responsible positions who would prefer not to be held accountable. Some of the unresolved issues — such as those relating to the audit expectation gap, remuneration, short-termism, nominee directors and corporate social responsibility — still present serious problems, and some new issues have emerged. There is still much to be done before the majority of Australian listed companies can be considered well-governed. Outside the population of listed companies much more remains to be achieved.

Yet there is good reason to believe that the pressures making for better governance will continue, and perhaps gather speed. All around the world populations are ageing and governments have abandoned the hope of funding adequate pensions from taxes. There is a general recognition that private savings must be increased and invested. Since there is no alternative to the equity markets for at least a large proportion of these savings, their safety will remain a major concern for prospective retirees. More people, and weaker people, will be exposed to the consequences of corporate collapse and malfeasance. There are now far more votes in investor protection than there were in the 1980s, and when periodic failures do occur journalists will find plenty of sad stories to provide their headlines. In these circumstances it would be astonishing if further efforts were not made to improve corporate governance, and it is reasonable to expect that there will be at least as much change in the area in the next ten years as there has been in the last ten.

There is, however, no quick fix available. No simple solution, and no miracle of legislation, can transform human nature, provide instantaneous enlightenment, or eliminate risk from the capitalist system. There are many constructive steps which offer hope of worthwhile improvement, but none which can offer finality or flawlessness. So a decade from now, after many debates and many adjustments, perfection will still seem far away. There should be nothing surprising about this; for centuries strenuous efforts have been made to improve the system of democratic government, and its defects are still enormous.

Against this background the present outrage about the state of corporate governance should be seen in perspective: it is useful as a reminder of the

53 Business Roundtable, 'BRT CEOs Issue "Best Practices" Roadmap for Excellence in Corporate Governance Guidelines Proposed to Increase Trust in US Companies Post-Enron' (Press Release, 14 May 2002), <<http://www.brtable.org/press.cfm/702>> at 19 July 2002.

dangers of complacency, but the troubles are not the first and will not be the last. The discovery that a few Australian companies were badly governed is hardly remarkable; that hardship was caused is natural, and the coincidence of events was principally the result of wider economic factors, particularly the bursting of the most recent stock market bubble. The shock and anger in America is essentially a consequence of hubris. It is almost certain that significant changes in governance will emerge from the present indignation. Some of them will probably be wise, and Australia will be forced to consider which are applicable here. It will be important to remember that the US has special problems associated with the concentration of power at the top of the company, and the extent to which options have been abused. Thus, some of their responses may not be appropriate elsewhere.