

**РАЗДЕЛ 3
КОРПОРАТИВНОЕ
УПРАВЛЕНИЕ В АВСТРАЛИИ**

**SECTION 3
NATIONAL
CORPORATE
GOVERNANCE: AUSTRALIA**



**A PRINCIPLES-BASED ANGLO GOVERNANCE SYSTEM IS NOT A
SCIENCE BUT AN ART**

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Summary

Anglo governance systems rely of a number of controls to align shareholder and boards of director's interests. In general they are referred to as market control, regulatory control, and political and cultural control. Agency theory proposes that these control mechanisms are necessary as human nature is such that directors and managers act in a self-interested and boundedly rational manner in decision-making that can result in sub optimality. Notwithstanding that each country within the Anglo system accepts such controls are necessary they have their own foci and priorities, being a product of their own system's characteristics. This paper through interviewing a number of Australian business executives adds to the academic literature by providing evidence from the field of the important characteristics of the Australian governance system, the drivers of change and the effectiveness of the principles-based approach. It argues that debate needs to move beyond the principles versus rules approach to look at how firms can be provided with more guidance in operationalising some of the principles that appear to be key to governance effectiveness. It concludes that there is a need for a holistic model of governance that is broader than that focusing on the control/legalistic approach; that top management is important in setting and driving the in-firm governance agenda; that the public needs to be informed and educated about governance and its importance; and that disclosure still requires an improvement in quality.

Key words: Corporate governance, Australia, regulation, principles

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Introduction

Anglo governance systems rely of a number of controls to align shareholder and boards of director's interests. Various models (see Robins, 2006; Easterbrook, 1996) are put forward in discussing these controls but generally we can refer to them as market control, regulatory control, and political and cultural control. Agency theory (Eisenhardt, 1989;

Fama & Jensen, 1983) proposes that these control mechanisms are necessary as human nature is such that directors and managers act in a self-interested and boundedly rational manner in decision-making which can result in sub optimality.

Each country within the Anglo system uses different control mechanisms to differing degrees. Each also has its own foci and priorities, characteristics and drivers of change. For instance in

discussing the types of regulatory controls, the USA governance system is referred to as rules-based whereas the Australian and UK system is referred to as principles-based (Clarke, 2007). Clarke (2007:162) argues that rules require all members to act according to minimum *standards* of practice, which to gain broad acceptance however become minimum *acceptable* practice; adding though that the introduction of tougher rules in USA has believed to have improved reporting and governance behaviour. In contrast a principles-based approach works to influence a broad set of practices designed to meet stakeholder needs. Some argue that a reliance on rules and compliance is fraught with peril whilst at the same time arguing that objective standards are required to facilitate meaningful comparative analysis, to bring about discipline and to ensure shareholders receive fair share of rewards (Dallas, 2004:23). This paper through describing the Anglo governance system and in particular the Australian system focuses on regulatory control and the various changes that have occurred over the last decade and contributes to the debate surrounding rules versus principles. In addition the paper through interviewing business leaders adds to the academic literature by including business-leaders' perspectives on governance, why and what is changing and whether the changes that have occurred will lead to improved effectiveness.

Anglo Governance Systems

Anglo governance systems operating in USA, UK and Australia have specific characteristics that in total are referred to as a market-based system. Corporations operating in this system, focus on shareholder primacy, and are subjected to the market, which operates to ensure both efficiencies and effectiveness of managerial and board decisions. The market evaluates the willingness and ability of corporations to pay investors and adjusts the current price of stock. As firms raise new money through debt they must pay the rate of return appropriate to current strategies and risk as judged by the market. This assumes that the general populace has faith in the market, and that shareholders are willing to invest. In this process it is assumed that managers make rational decisions and choose whether to make investment decisions and raise funds through debt or equity; and if shareholders have faith in the market they will purchase shares. As such it is believed that the discipline of the market is greater than the discipline of formal 'governance' devices.

Market control aligns shareholders, directors and managers interests in a number of ways: through the market for corporate control; through product markets and through labour markets. Corporate control operates in such a way that inefficient operating is reflected in share price and in takeover activity. It proposes that shareholders can exit the market if they lose faith in the market, and in particular can sell their shares in corporations if directors and managers make

decisions that reduce their wealth. In addition product markets also exhibit controls over managerial behaviour ensuring that corporations compete effectively in market for goods and services or risk losing business. Moreover labour markets act as a control device as any reduction in shareholder value due to management inefficiencies may lead to decreases in their employment opportunities.

But in practice inefficiencies in market control have led to other actors in the governance system such as professional associations and government introducing professional and regulatory controls to broaden and strengthen the controls over the behaviour of directors and managers so that their focus on shareholder wealth is maintained and self-interest pushed aside. Easterbrook (1996:70) explains: "Entrepreneurs make promises to investors [and] if these promises are not optimal...then investors pay less and entrepreneurs ...bear costs of sub-optimality. ...[However} this mechanism depends on investors being able to evaluate promises made to them...so when markets are inefficient some substitute must be found". These include legislation, and professional, accounting and auditing standards, and organisational codes of conduct and ethics. Managerialists argue that strong legal rules are necessary to temper the enormous power that managers have and to ensure power is exercised consistently with the interests of shareholders (du Plessis, Mc Convill & Bagaric 2005:122-3). Clarke (2007:130) further explains that the Anglo governance system based on disclosure uses regulation to ensure that full information is provided to dispersed shareholders so that they can make informed investment decisions.

But even with these varied controls, we have witnessed numerous frauds, corporate scandals, and failures of standards and codes. We have seen stock options being used as a vehicle for huge personal gains, profits being inflated to placate stock market analysts and, deception used to allay commentary by analysts on less than expected performance. Indeed researchers (see Robins 2006 for a full discussion) have claimed that governance structures actually lead to deceptive practices, with legal but unethical accounting tactics, and a belief that the 'ends' justify the 'means'. As Paul Volcker US Federal Reserve (2002) stated "in light of the Enron Affair and the seemingly endless barrage of news about other firms restating profits, artificially embellishing revenues and creating obscure "special purpose vehicles" conveniently off their balance sheets, no one can reasonably doubt that there is a crisis in the accounting and auditing profession" (Robins 2006:36). Waring (2008) writes of corporate governance failures in liberal market economies as being based on organisations having a short-term business focus, perverse incentives and questionable managerial decision-making.

Many examples of such activity have been written of over the past decade (see Robins 2006): Enron's auditor Arthur Andersen guilty of obstructing

a SEC investigation into Enron's collapse; deficient auditing practices evident with Arthur Andersen audits of Enron and HIH; internal audit of WorldCom finding top executives engaged in massive accounting fraud inflating company profit by at least US\$7b; information about One.Tel's defective billing system withheld from the board and the resultant company collapse with a \$2.4b debt; Harris Scarfe's voluntary liquidation after 6 years of inflated asset values and accounting irregularities; HIH's collapse with debt of A\$5.3b with auditors claiming ignorance and executives being jailed.

Regulatory Control

A strong consensus emerged amongst policy makers and industry observers that existing management practices and government oversight were insufficient to promote a well-functioning and sound security market (Bertus, Jahera Jr. & Yost (forthcoming)). This resulted in tightening of regulatory control in USA through the Sarbanes Oxley Act (SOX) 2002 and in amendments to the Corporations Act – Corporate Law Reform Act 2004 (CLERP 9) in Australia. The SOX has numerous features to strengthen control focusing on three areas: executive compensation, shareholder monitoring, and board monitoring (Holstrom & Kaplan, 2005:71). Specific features include tightening of accounting standards and enhancing external auditor independence from management; improving the responsibility of CEOs and senior management; greater disclosure of internal controls and codes of ethics; certification by the CEO and CFO of all annual and quarterly reports; requirements of auditor independence; establishment of the Public Company Accounting Oversight Board (PCAOB); and new standards for company audit committees. In general the SOX Act 2002 is quite prescriptive in its approach in response to the failures mentioned above. In particular the CEO and CFO are required to give up any profits from bonuses and stock sales during the 12 months that follows a financial report that is then restated due to misconduct; executives have to report sales or purchases of stock within 2 days; greater disclosure is to be made of off-balance sheet financing and special purpose entities; improvements made in board monitoring; and overall increases in management and board responsibility for financial reporting and criminal penalties for misreporting.

Commentators (Holstrom & Kaplan 2005:83) in speaking of the SOX Act 2002 have argued that board behaviour will be effected through heightened monitoring, and though not necessarily adversarial should lead to more independence and inquisition by the board of managerial actions. They conclude that despite the problems, the US corporate governance has performed very well and that any more regulation would be overtly costly and counterproductive and lead to inflexibility and fear of experimentation. Although others have questioned the effects, with Clarke (2007:161) reporting a survey of 274 finance

managers which found that whilst 55% agreed that SOX increased investor confidence in financial reports, 44% agreed that financial reports were more reliable and 32% agreed that it helped prevent or detect fraud, only 14% agreed that the benefits exceeded costs. Indeed Zhang (2005, cf. Thomsen 2008:187) reports that in the first year of implementation there has been an increase in costs of at least 53% comprised of both internal and external costs plus audit fees. And it has been reported (see Thomsen, 2008:188) that additional costs has spurred organisations to delist from American exchanges and that regulation costs have led to reduced competitiveness in the US capital markets. Waring (2008:158) summarises the debate succinctly in stating "there is an ongoing debate in the corporate governance literature as to whether Sarbanes-Oxley was an appropriate legislative response to these failures; a question only time and experience seem capable of resolving".

In Australia, CLERP 9 has focused more narrowly on auditor independence, enhanced disclosure, transparent shareholder meetings and whistleblowing (Clarke, 2007:168). The legislation has strengthened financial reporting, ending an era of self-regulation in favour of the Financial Reporting Council; has introduced International Accounting Standards; has established the Corporate Governance Council; has reviewed the performance and accountability of regulatory authorities such as ASIC and APRA; and has established the group of 100 CFO's Code of Conduct (Robins 2006). The Act in a focus on audit reform provides auditing standards with the force of law; enhances disclosure of remuneration and links to corporate performance, with shareholders having a non binding vote and approval of termination payments; legislates for continuous disclosure of information that may materially effect share price; enhances shareholder participation through embracing technology, notice of annual general meetings, electronic proxy votes, and disclose of directors pre-positions; provides for protection of whistleblowers; and improves information in the prospectus.

In addition, in 2002 the Australian Stock Exchange (ASX) introduced guidelines - notwithstanding that these are not mandatory, listed companies must disclose the extent they are followed (see ASX 2007). These include statements of matters reserved to the board and delegated to senior management; independence of directors and Chair; disclosure of directors' tenure; establishment of code of conduct; and that non-executive directors should consider meeting independent of management.

But even so, questions have been raised about whether legislative changes and voluntary guidelines such as these will bring about improvements in behaviours and conduct. Phil Chronican, CFO Westpac stated that technically, "it has made no material difference. Previously I wrote to the Westpac board personally certifying the accuracy of the

company's accounts. Now that document is public and US criminal sanctions apply if I break the law. My workload has increased only slightly" (Schmidt 2003). A survey conducted by Deloitte Consulting of CFO's found that 50% said regulatory changes had not had a big effect on finance function and new rules were insufficient to prevent repeat of big corporate collapses like Enron and HIH (Robins 2006). Greg Larsen CEO Australian Society of Certified Practising Accountants (ASCPA) argued: "Fundamentally there is nothing wrong with Australia's financial system, which, in some cases is leading world best practice" (Harris 2002). Indeed accountants and auditors have resisted any external tightening of rules and regulations and criticised the rotation of audit teams (not firms) every 5 years, audit independence, and reporting of non-audit services (Robins 2006). Furthermore the Australian Directors of Corporate Governance International rejects the use of the ASX as a model and argues that it has a poor record on proposing governance reform. Others have commented that difficulties arise as ASX listing rules are non-binding and there are conflicts of interest as it is a listed company itself (Robins 2006).

Robins (2006) adds more generally that Australian responses to corporate scandals are considered to be "ill-coordinated and weak, when compared with apparent rigour of Sarbanes-Oxley". Explanations provided relate to the voluntary nature of codes of conduct compared to prescriptive legislation and the longer time-lines and incorporation of public debate and input from the accounting profession, businesses, shareholder organisations. Du Plessis, McConvill and Bagaric (2005:125) argue that whilst Australia's regulatory framework satisfies the OECD principles of good corporate governance on the two bases of promotion of transparent and efficient markets, and consistency with rule of law principles, it fails on the third which is clear articulation of division of responsibilities among the different supervisory, regulatory and enforcement authorities. Clarke (2007:147-8), and Digman and Galanis (2004:26) add that there is some evidence that this continuing division of regulatory powers has diminished the power of regulation, limited the pressure on company disclosure relative to other countries and resulted in a hands-off approach to infringements.

Notwithstanding, Clarke (2007:162) argues in support of the historical principles-based system of UK, Canada, Hong Kong and Australia over the rules-based system of USA. The former sets minimum standards of practice which it is claimed simply leads to the creation of new and imaginative ways to get around the rules; whereas the latter, in not setting standards, encourages improvement over time in order to meet the expectations of the stakeholder community at large. Although Clarke (2007:167-8) does add that Enron, HIH and One-Tel failures did lead to further reforms of corporate governance through CLERP 9. In addition, in questioning

whether further reforms will reduce the frequency and extent of corporate failure, he concludes (p.169) "the capacity of the system for reform and regeneration is very real, but also the apparently inherent instability and volatility in this increasingly market-based system".

Clarke (2007) also adds that the increasing demand for Corporate Social Responsibility (CSR) is another pressure on the governance system. Support for this comes from Waring (2008) who argues that in the Anglo governance systems, legal duties and responsibilities of directors should be enlarged to include enhancing and balancing stakeholder interests.

Others (Robins 2006; Buffini 2002) in arguing for a broader, but not regulatory, approach claim that Governance has to move beyond checklist templates; and that it is impossible to regulate for ethics. Graeme Samuel (ACCC) states that governance requires the right mix of personalities, expertise, commitment and leadership; that over-regulation will kill entrepreneurial spirit, crush innovation, shift resources towards compliance rather than staying ahead (Samuel 2003). Clarke (2007:266) concludes that "as pressures to conform to international standards and expectations increase, the resilience of historical and cultural differences will continue". On the same theme, Young and Thyil (2007; 2008) argue that in attempting to understand governance models an holistic view is more appropriate; one which reflects its multidisciplinary nature, reflecting macro factors such as cultural, historical, legal and national frameworks as well as micro factors such as vision and strategy, behaviours and codes, leadership and stakeholders. And Mayer (2000) concludes that "there is no single dominant system [and]... there may indeed be benefits to diversity, particularly in light of our current state of ignorance about the comparative merits of different systems [and] ... regulators should be ...encouraging the emergence of different types of financial and corporate arrangements rather than being restrictive". Whether based on rules or principles, each country's governance system reflects its own history, culture, legislature, social systems and environment.

Method

The sample for this study consists of seven interviews in six Australian corporations in public, private and government enterprises, operating in the brewing, mining, accounting and superannuation industries. The choice of the companies was based on convenience sampling. Simultaneously, a broad representation was ensured. Senior key executives in these organizations were interviewed using a semi-structured interview schedule. (Appendix A contains the schedule used). Interviewees were first phoned to explain the research, and a plain language statement and consent form, as approved by the Ethics Committee, were forwarded to them. The questions

were exploratory in nature and Patton (1990:424) has summarized the importance of qualitative enquiry: "The emphasis is on illumination, understanding, and extrapolation rather than causal determination, prediction, and generalization". Questioning was used to uncover deeper meanings and underlying reasons and interpretations from multiple sources. Each interview lasted for approximately one hour and was audio-taped. The transcriptions were sent to the interviewees for verification of accuracy. The verification fulfilled the need for credibility checks and ensured that the information was reflective of the participants' meanings and the interviewer did not introduce bias. Table 1 presents the sample used.

Table 1. Sample of organizations and position of executives interviewed

	Category of Organisation	Position of Executives interviewed
1	Mining Company A	Principle Advisor on Environment
2	Mining Company B	Company Secretary
3	Superannuation Fund	Executive Manager – Investments & Governance
4	Australian Government Enterprise	Corporate Secretary
5	Brewery A – 1	Director of Communications
6	Brewery A – 2	Company Secretary
7	Accounting & Consulting Firm	Executive Director AABS –RCIP

As the information produced by qualitative methods is voluminous, content analysis, as proposed by researchers such as Patton (1990:381), was used to identify, code and categorize its primary patterns. The data was coded according to the major themes, namely, perception of Australian corporate governance systems, the factors driving the evolution of corporate governance in Australia, the current governance models, factors that impacted on the governance systems of the organization, the nature and extent of the influence of the international environment on the Australian corporate governance system, effectiveness of existing corporate governance structures in Australia, and major concerns among the public regarding governance issues. Several minor themes emerged from the coding based on the major themes and they are presented in the findings and discussion.

Findings and Discussion

The Principles-based Nature of the Australian Governance System

Generally respondents spoke in favour of the principles-based system of Australia with additional comments such as: *'there seems to be a greater emphasis on the spirit of the law rather than the*

letter' (Brewery 1); and whilst it is continuously evolving, currently it is *'a mix of what is prescribed in legislation and the principles-based approach of the ASX'* (Australian Government Enterprise).

To explain the principles-based approach further, managers remarked:

We tend to be a little bit more of, 'you need to do these things and provided that you do these things within these boundaries you will be okay' (in Australia), if we don't comply we are happy to explain why, whereas theirs (USA) is you must comply. There is no debate (Mining Company B).

The US system is dominated clearly by Sarbanes Oxley and the legislation that takes that name and sections which require certifications or sign offs. The design, operation or effectiveness of internal controls is assessed in some detail. The level of work required to comply with the SOX regime is far greater than what would be required in alternative systems, as I say in the UK or in Australia (Accounting & Consulting Firm).

In formulating their governance frameworks, initially the firms interviewed simply followed the basic tenets and structures required by the ASX and the regulatory bodies, but over time, have realized the flexibility inherent in the system and started to customize it according to their own requirements. The following remark by one respondent portrays the learning process the firms went through (and are still going through) during the period of evolution of governance in Australia.

I mean the biggest pain was when everyone had to write their corporate governance statements. They all looked the same. I think that is starting to change. I do think that people are starting to get the confidence that they can break out a little bit of the formula' (Mining Company B).

The changing and fluid nature of governance was highlighted by all respondents in an unanimous view that governance evolves as the market evolves and it is not possible to reach a state where it could be termed as being 'exactly right'. As one respondent said, *'it is not a science it's more of an art'* (Brewery A1). This also links with the inherent flexibility of a principles-based approach in that principles are able to be interpreted to suit the firms' situation.

However, in integrating governance with the firm's operations a challenge is to see it as a value-add to business operations rather than simply being an underpinning structure based on a check-box system. For instance the government business enterprise manager stated:

basically governance is embedded in the system so we don't really have to think about it. But as a check each year the board audit committee or the risk committee will get a report which indicates what the requirements are, how and when they where met, just to make sure that nothing has been overlooked.

In this vein, even though the two large mining companies had an established governance model, the

remaining 5 firms did not have a specific governance model; although they emphasized that governance was part and parcel of their regulatory, administrative and financial frameworks. Industry characteristics may be a driver in the formalization of the mining industry's governance system with risk management being so important alongside stakeholder and environmental concerns which are often played out in the media. Mining companies are well aware of the risks associated with not being proactive in this area, and simply responding to concerns as they arise is fraught with danger.

In summary, although the respondents were clear that Australian governance was more principles than rules-based, findings confirm that the businesses are unclear about the connotation and scope of governance agenda. Whilst some were of the opinion that the Australian governance system was 'quite narrow' (Superannuation Fund), others felt that 'it probably leads the world' (Mining Company B). The remark of one respondent echoes the general perception of current governance systems.

I mean, it depends on what you are talking about with governance. Are you talking about the ASX corporate governance council stuff? Are you talking about the fears? Are you talking about social perceptions of companies? It really is a difficult thing to ask (Brewery A2).

These remarks highlight the fact that firms are clearly missing an holistic viewpoint of governance, thereby pointing to the relevance and timeliness of this paper. The flexibility accorded by the principles-based approach whilst often lauded by firms, also means that firms need to go through a trial-and-error process until they identify a system that is right for them. Based on the data, at this stage the firms, bar those operating in the mining industry, are unsure about the need for a governance system that is greater than that prescribed as a minimum by regulation and accounting controls and lack a pro-active response to heightened calls for an increasing emphasis on governance. The view of it being 'narrow' for instance shows that firms are not looking for a wider stakeholder perspective of governance but focusing on regulation and accounting controls as the basis of their framework.

Effectiveness

In general, respondents were of the opinion that Australian governance processes and implementation are far better than in the USA, although they tended to believe that the regulation path of the USA was in response to the severe collapses that occurred and hence understandable.

In discussing whether the rules-based approach will achieve the intended outcome one Consulting Firm observed,

I doubt it. Cost benefit analysis suggests that the costs far outweigh the benefits of it. An American company will fail again and SOX is not a

guarantee that, that won't happen. An interesting point of debate will be what will happen when that company does fail and was it fully SOX compliant or was it not? Contrast that with the Australian system where I think there is only one mandatory requirement within the governance rules there and that's the composition of the audit committee for an ASX 300 listed entity. And beyond that, Australian companies are free to find their own solution... I think it is the more realistic approach. As I say, there is no silver bullet or no magic wand that will prevent failures happening. And I think the American approach is very much tick- the-box. I think the approach followed by the 'comply or explain' countries is more realistic and more flexible for the different needs of different organizations, at different stages of their development' (Accounting & Consulting Firm).

The flexibility of a principles-based approach means that it lends itself open to interpretations by the firms. This means that the implementation and outcomes can be extremely varied and problematic. This phenomenon is explained by the Accounting & Consulting Firm.

Let me give you an example. The Remuneration principle is asking you to make sure that you have a remuneration strategy properly embodied through a committee. There is external benchmarking that would go on there. But there needs to be a clear link between reward and recognition. How that is transpired is that we now have remuneration reports within annual reports which run up to 10-12 pages, which at times you might need a degree in Quantum Mechanics to understand. The question is, are these reports adding any value? Is anyone reading the detail of them? Certainly executive pay is a hot topic. And people want to make sure that, especially if a company is struggling, that failure is not rewarded. But whether that translated to, as I say, a 12 page remuneration report full of graphs and statistics than actual real models, I don't know. So, I would question whether that has been an effective interpretation of the principles.

Respondents suggested that one way to ensure increased effectiveness was for the regulatory bodies to highlight lapses and present them for public discussion. For instance, notice this viewpoint,

ASX may have rules but it waives it too easily or it does not actually follow up on them. ...same with the likes of ASIC. But even if they do not take the punitive route, talking about it at least and highlighting these issues more will be an advantage (Superannuation Fund).

Disclosure and Transparency

In discussing the specifics of governance, disclosure was the primary factor discussed even though its influence was seen to be problematic. Disclosure has been highlighted in the previous section as being an important consideration in operationalising the

Remuneration Principle and in bringing important issues to the notice of the public. Another firm highlighted the importance of disclosure and transparency in adapting their governance system for firm-specific factors.

We looked at what other companies were doing... market leaders and other fast-moving-consumer-goods (FMCG) companies around disclosure, and ...also how they were integrating those considerations into their enterprise management framework... And I think what we have ended up with ... is the most relevant bits of that external experience and married it with our own sort of approach... We have not just cut and pasted it, we have grafted bits onto our own fundamental governance process...which is very much built around the board and the board committee and the enterprise risk framework...We haven't altered the fundamental structure but we have introduced some new agendas and some new criteria...(Brewery A1).

But in the case of proactively providing greater transparency and disclosure, the findings reveal that even though there is a push from investors is not necessarily being picked up by firms. Whilst on one side, 'investors are demanding higher standards both individually and institutionally' (Accounting & Consulting Firm), on the other side, the findings point to quite a bit of apathy. Respondents mentioned that there is not much incentive for firms to become more transparent and provide greater disclosures than what is mandated by law, as the customers and general public do not seem to be interested in knowing more about governance, nor do they want to actively participate in the running of the firm. As the Superannuation Fund states,

None of our members except for one or two companies have any interest in how we vote. And therefore why am I incurring this additional cost if my members aren't actually interested... We have enough trouble getting them to look at their statements ... I think that the vast majority of them quite frankly just have too many other things in their life. .. there is a whole group of people who probably don't even read the financial section in The Age (an Australian newspaper). ..As long as they are getting their dividends, the vast majority will probably be happy. .. but if they see something that is not specifically aimed at improving the profitability of their company in a specific visible sense than that's when you get people arching up against it.

Notwithstanding this comment, there is a change that is occurring in this arena with more active participation in the horizon, as Australian shareholders realize that their voice matters. As Mining Company B observed,

I think shareholder activism has definitely become a much bigger thing in this country. I mean more people own shares, it is just the bottom line. I think that the Australian Shareholders Association has done a lot. I think that people actually

understand now that they can have a significant influence.

And in regard to specific issues around disclosure of executive remuneration there is evidence of demands and impetus for action arising from the public due to media exposure on specific acts of companies. For instance, five out of the seven respondents mentioned that excessive compensation, remuneration and retirement payouts were one area where the public outcry was greatest, and that it was invariably a result of the media coverage and information dissemination. And in this area the comment presented earlier of the 12 page Remuneration Report highlights the problematic nature of disclosure in this area. The investors and public appear to be reactive, rather than proactive, with quite a narrow focus. Their activism is limited to issues *after* their occurrence and *after* they have been highlighted, rather than exhibiting voice in influencing aspects of governance that effect business value and then through that the remuneration of executives.

Holistic Nature of Governance

These views are in line with other comments in this paper that urge the regulators and experts to discuss governance issues in the public forum or through the media to educate the general public and increase their awareness. Findings reveal that governance should be viewed in a more holistic perspective reflecting a multitude of firm-specific factors and not just simply as a regulations/ principles conundrum. For instance, interviewees believed that it is leadership that drives the corporate responsibility agenda top-down, and that organisational culture, strategy and committee structures are important in achieving this. As the Superannuation Fund observed,

If the CEO and the directors don't believe in the environment's importance then why would you expect them to say to their staff it is important.

Sustainable Development (SD) was driven by the chairman. It would not work unless it was driven from the top. And now I guess as the SD committee is responsible, it is almost like part of the business. We have the committee up the top to continue to drive it. But, you really needed that person, that character to drive it (governance)...You needed that top level commitment' (Mining Company B).

The governance systems and processes should also align with the culture of the firm. Respondents' remarks on the above themes are detailed below.

I defy anyone to put in any set of rules that would have stopped those idiots... Basically the fault of HIH was that they had a board of dorks... and no amount of corporate governance rules, regulations, reporting, no amount of checks and balances you could have put over the top to avoid those problems. Those people and (their) organisation culture (mattered) (Brewery A2).

The ethical stance and moral codes of conduct of individuals, especially top management are also important in this regard.

If you have got the right sort of people in the place you are not going to have a problem. If they have the right moral fibre, you are just not going to have a problem (Brewery A2).

I mean like the HIH. All that behavior was already illegal. It was already outside the rules of listed companies and good disclosure and ethical business management practices. It is not as if that was perfectly acceptable behavior and attitudes have moved on. The fact is the rules were there but they weren't being followed (Brewery A1).

Governance systems need to be customized to the firm, taking into consideration factors such as firm size. Whilst large firms find that instituting the governance systems is worth the effort, small firms perceive it as a burden. For example, an executive from Mining Company B, a large Australian firm with global operations, remarked:

I think from our perspective (we are) a big company. It (our firm) has been able to do those things without any problems. I think that for smaller companies, I would have found it difficult. People have struggled.

And another consideration spoke of was the importance of board structures in implementing effective governance.

There is still the vast majority of companies that have flawed board structures, in particular. And I think if you have a flawed board structure it is unlikely the best things are going to flow through. You are unlikely to have best practice governance deeper within the business (Superannuation Fund).

This section highlights the broad nature of characteristics that practitioners believe effect and influence the governance framework. Best practice governance needs to expand from an either/or 'regulation-only' approach or a 'principles-only' approach, and incorporate behaviours, values and ethics.

Key drivers of Australian governance systems

Governance systems are not static and their fluidity is influenced by many factors in the environment. Firstly, from a control perspective, the new corporations law (CLERP 9) is clearly an impetus for change and has put greater liability on companies and greater focus on governance. As Mining Company A states there is 'liability for directors, for our board to be liable for not implementing the policies that the companies espouse'.

Secondly, moving away from compliance, broadening the perspective from the shareholder primacy to a stakeholder view of the firm has been an important recent development. This is considered to be a 'relatively embryonic driver' (Superannuation Fund) and as the respondent explains, there appears to

be an active approach by firms to communicate such a perspective to other firms they deal with, 'to get them to realize that there is a broader issue rather than just the shareholders' (Superannuation Fund).

But, the interesting point to note is that

this issue isn't actually driven by any moral or ethical type guidelines, but it is because the landscape has actually changed in that companies can no longer act solely for their shareholders with complete disregard for other stakeholders because of what we now term the social license... If they actually undertake activities which endanger that social license then it actually creates quite a real risk to their business (Superannuation Fund).

Thirdly, firms are being held accountable for putting rhetoric into practice. As Mining Company A mentions, there is a 'reputational driver in terms of whether or not the policies that we talk about are actually being implemented and are we improving our performance'. This driver is the cause for sustainability reporting according to this firm.

Another advantage of this reputational driver lies in the outcomes, such as being regarded as an employer of choice and from being recognized as a leader in their sector. As Mining Company A explains further,

it will give us access to land for us to develop mines on, to people who might want to work for the company who actually understands about environmental degradation and is doing something about it, or understands about how to minimize climate change impact, or understand about water use. The young people today want to work with companies who actually are doing what they say and are contributing more broadly to society, in fact contributing to society's transformation to sustainable development.

I think one thing is that we are an Australian icon therefore you know that makes a big difference. We are very conscious of the fact that we are watched and that we are to lead, and that people will follow or criticize. The size of a company and who you are makes a very, very big difference (Mining Company B)

If this firm is regarded as a responsible water manager we will be invited in because we might have some solutions to contribute ... For any new strategies, they are not about doing good in the world they are about business driver. Certainly there is the quid pro quo, by doing your business well and being a responsible water manager. That is the benefit to the environment. But the actual real purpose of it is access to water for this firm. These expectations on business are a big driver (Mining Company A).

This emerging public pressure is evident as 'investors demand higher standards both individually and institutionally' (Accounting & Consulting Firm, Brewery A1 and Brewery A2). But, it is as yet unclear as to the whether their demands will metamorphose into action on the part of both companies and investors. As Brewery A1 mentioned,

there is a large disconnect in terms of what people say they are interested in and what their behaviour indicates that they're interested in...whether or not they are genuine reflections of genuine interest, it's a bit hard for me to say. I have a strong sense, that there is a reasonable dose of fashion on the CSR side.

Even though firms appear to be in the process of assessing what actions are considered socially responsible, there is a lack of consensus on what is socially acceptable.

I think there is a risk that we will be saying a company should be doing one thing and the retail investor will be saying another...So, the hard part for any company, and anyone else trying to factor that in, is what is now socially acceptable and what will evolve and not be. That's the key issue. Something might be legal here in Australia but will there be other pressures which stop it being a sustainable business structure...it is all about assessing risk and factoring it into your company, rather than saying this is right and this is wrong, and if it is wrong you just don't touch it (Superannuation Fund).

Fourthly, the normal evolution of firms and the growth and maturity of societies and economies they operate in push changes in governance. As one respondent mentioned while discussing governance drivers,

I think it's the normal evolution of corporations and the corporate structure. And I say that because if you go back to the start of the last century and companies and company meetings, board meeting and relations between senior members and junior management and the workers are formal and very structured. As the century wore on... and as... we are now much more informal, no less structured in a way. And governance is just part of the same. It's the way corporations and societies develop over time (Brewery A1).

The company has grown up and realized that there is a need for checks and balances (Brewery A2).

Interesting, the well publicized corporate collapses did not get mentioned as key drivers, to the extent expected. There were a couple of responses to the effect that, 'I think there is a combination... I suppose of domestic and international collapses' (Australian Government Business Enterprise). But in general, the view is summed up by one respondent, 'I think the (international) influence has actually been pretty low, pretty light' (Superannuation Fund).

In summary, a range of drivers are pushing the evolution of governance systems. As one respondent stated,

it comes from governments, it comes from shareholders, it comes from the initiative of a country, it came out of HIH. I think we are very much part of the global economy and the Enrons and things like that. That being said it is quite different in America to the way it is in Australia but I

certainly think it was pushed more by accountability. About, you know, boards having to be accountable to their shareholders... (Mining Company B).

It is interesting to note the range of factors influencing governance and that the changes are not a simplistic and reactive approach to company collapses.

Implications and Conclusion

An important implication is the need for organizations to operate from a holistic perspective on corporate governance, moving beyond the tick box mentality to analyzing key drivers and variables that are key to governance effectiveness in their own contexts. As Letza et al. (2008) argue, corporate governance is a social, processual and relatively enduring reality driven by both internal impetuses and external environmental dynamics, rather than a pure economic or fixed reality, and hence cannot be studied in isolation from non-economic factors such as power, legislation, culture, social relations and institutional contexts. This paper illustrates this crucial perspective in several instances, with interviewees talking of the importance of taking into account factors such as the organization type and stage of development, ethics, reputation, and the media and public in developing their own governance framework. Young and Thyl (2008:102) have elaborated on this holistic perspective of governance and argued that a multi-dimensional approach is required that extends the analysis from a prescriptive regulatory approach that limits actions, to one that is more descriptive and provides an explanation of why actions occur and decisions are made. They argue that an emphasis on control and regulation will not stop governance failures if not set within a governance framework that encapsulates regulation, labour product and capital markets, and behavioural, cultural and ethical considerations.

The next important implication is the evolving nature of governance and need for customization by the firms. It is important that firms understand their environment, both internal and external, and map the implications of environmental change on their governance frameworks. As emphasized clearly in the ASX corporate governance principles and recommendations (2007:3), 'corporate governance practices evolve in the light of the changing circumstances of a company and must be tailored to meet those circumstances'. It is evident from these interviews that the mining companies understand the implications of their environment and the increasing importance of corporate social responsibility on risk and reputation and embed these considerations in their governance frameworks.

In this vein, the findings highlight the debate around the importance and effect of CSR and sustainability as a driver of governance, and raises questions about the level and practicability of incorporating CSR into the principles-based approach

to governance. We have seen principles formed around the stakeholder perspective in governance codes in UK and Australia, but operationalising them and integrating into the governance framework and the firm's strategy and operations still is problematic. Whilst Waring (2008) argues for the stakeholder approach to be given more weight through regulation and incorporation into directors' duties such an approach is not supported by the interviewees in this research.

Another important conclusion that emerged from this study is that the principles-based approach is clearly favoured in Australia over the rules-based approach. As Solomon (2007:169) argues in talking about the UK principles-based approach: "there is a persisting belief that genuine changes in corporate ethicality and attitude can only be achieved through a voluntary framework, which allows individuals to think about issues at hand". Interviewees were clear in not wanting further regulation over and above that required in areas of financial and auditing controls.

But the interview data lacks conclusive evidence of the causal chain between principles and effectiveness possibly due to the small sample or due to a lack of knowledge or understanding on the part of the interviewees. More research with a larger sample is required to understand the right mix of rules and principles and whether principles could be broadened to include more direction on behaviors, culture, leadership, values and ethics. In driving governance from the top and integrating it with the company's culture, governance practices would prove to be more robust. Here leadership styles and role modeling of behaviour are considerations raised in the interviews as important in operationalising and embedding governance practices. Moreover in considering the link that interviewees discussed between board structural models and ethical behaviour it is worth noting the lack of best-practice models in the Australian principles-based approach.

Furthermore the position of ASX and ASIC are found to be confusing in their roles as both guiders and monitors. In Australia the *Corporations Act* focuses on compliance and rules (albeit not as wide reaching as *SOX 2002*) whereas the role of other bodies is problematic. And when debate occurs in the media and business circles on the topic of strengthening ASX and ASIC's monitoring activities, it always reverts to a discussion of whether more rules are actually required.

This paper has highlighted the very narrow view of governance held by the general public with their focus on excessive compensation, unreasonable remuneration and unethical behaviour. Furthermore, expansion of the public's knowledge of governance is limited by the information asymmetry between those within the organisation and the public who rely principally on the media as their information source. This phenomenon is not limited to Australia and can be observed in many other countries. More guidance on disclosure is worth considering as a way to inform

the public, in particular shareholders, to enhance their involvement before catastrophic and noteworthy events occur.

Other questions then arise such as who should take responsibility for accurate and relevant disclosures? Benston, Bromwich and Wagenhofer (2006) observed that when an accounting principle requires judgment and interpretation the implementation will vary, hence it is difficult to state it as a standard. The authors similarly recommended that firms be provided with more guidance and concluded that the 'optimal standards' are somewhere in the continuum between 'principles-only' and 'rules-only', and thus not an 'either-or' approach. Moreover, Eccles et al. (2001, cf. Boesso and Kumar, 2007) observed that a company with an effective corporate governance system would, by providing access to relevant and high quality information, make an effort to invite new forms of stakeholder engagement. Boesso, G., and Kumar, K (2007) further argued that whilst investors' information needs, which were based on business complexity, appeared to affect the volume of voluntary disclosures across country contexts, they did not appear to affect the quality of disclosures. Thus the onus appears to be squarely on the company to not only provide timely disclosures but also to increase the quality and range of disclosure. Taking responsibility themselves at the company level for the quality and relevance of disclosure is likely to quieten the call for greater regulation.

If we are not to proceed along the path of more regulation then, in discovering what leads to best practice in a principles-based approach, research is warranted on the effects of the drivers, including shareholder voice and public perception, on the evolution and effectiveness of corporate governance systems. Also a greater understanding is needed of the effects of top management styles and organizational culture on in-firm governance practices, as well as best-practice board structures and its impact on board and management behaviour. In addition, company disclosure and its relationship to governance effectiveness and stakeholder engagement is an important area of further study. In conclusion the debate needs to move beyond the principles versus rules approach to look at how firms can be provided with more guidance in operationalising some of the principles that appear to be key to governance effectiveness.

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Appendix A. Interview schedule

- 1) How would you describe the Australian corporate governance system?
- 2) What are the factors driving the evolution of corporate governance in Australia?
- 3) What corporate governance models have been useful for you in your organization?
- 4) To what extent have existing corporate governance structures concerning listed companies in Australia been found to be ineffective? On what grounds?
- 5) How has the Australian governance system been influenced by the international environment?
- 6) What is the level of public awareness over the importance of effective corporate governance?
- 7) What are the major concerns among the public regarding corporate governance issues?
- 8) Can you describe the factors that have impacted on your organizational corporate governance system?
- 9) Can you describe the evolution of governance in your organization?