



Global trends in corporate governance

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- Technological advances in recent decades now mean that comparative information on governance systems is readily available
- Literature review provides evidence of a link between corporate governance and economic development via reliably functioning financial markets
- Adopting good corporate governance practices is worthwhile and should be a specific goal of every board

Australian corporate law reform has been consistently changing since 1989. It can be argued that at times we have had a revolution of reform, but it is far easier to argue that it has been an evolution of governance. This article explores the bigger picture, beyond the usual developments in case law and legislation.

Although it is important for governance professionals, directors, lawyers and company secretaries to keep up to date with changes, it is also important to look beyond the common boundaries. In effect this paper provides clues to the anticipated corporate reforms from around the world, by way of commentary on the current state-of-play. Corporate governance is a global phenomenon and the scholarly research is beginning to reflect those aspects of development.

It is said in Greek mythology that Theseus had a ball of string (called a 'clews') which he unwound as he travelled through a labyrinth, so he would not get lost. This article will in turn string together contemporary clues to the labyrinth of corporate regulations, by reviewing the global literature and placing it within an Australian context.

When we ponder on the bigger picture it is possible to overlook that the Organisation for Economic Co-operation and Development (OECD), in May 2012, projected that Australia would be the fourth fastest growing developed economy, at the rate of 3.1 per cent, only behind South Korea, Mexico and

Chile. One need not mention that New Zealand's predicted growth is 1.9 per cent, USA's 2.4 per cent, UK's 0.5 per cent and poor Greece is at -5.3 per cent!² The most recent economic events in Europe do not instil confidence that the global economy is out of the woods as yet.

Half-full or half-empty?

Alternatively, we could focus on the remarkable rate of insolvencies that are occurring in Australia. We are all aware of the two-speed economy, but the Australian Securities & Investments Commission (ASIC) is reporting the highest levels of insolvencies since statistical records were introduced in 1999.

In February 2012 over 1,123 businesses were placed in administration compared to 518 in January 2012. Forty per cent of the businesses placed into administration were court-ordered. Of greater concern is the fact that the 97 per cent of corporate administrations only return 11 cents in every dollar of debt. On world standards this amount is above similar schemes in the UK and USA. Insolvency is now big business and an excellent career choice for many trained accountants and lawyers.

The full impact of the financial crisis, around the world, post-2008 global financial crisis (GFC) is still having repercussions on the local economies and securities markets. Last month approximately \$56 billion was wiped from the Australian Securities Exchange (ASX) market and SuperRatings warned of superannuation being down by

3.2 per cent on balanced funds, as there is a global flight to safety at this time of uncertainty. By the end of May 2012, it was calculated that a total of \$105 billion was wiped off the ASX. However, next month the same valuation method could see a growth of a similar magnitude as last month's losses. This leads to natural uncertainty and investors switch to gold or other more safe havens.

The world is watching to see if Greece defaults and is forced (or elects) to leave the Euro-zone as well as what that might mean for the banking and finance sector. It is hard to see if this is a cause of corporate reform or time for a revolution. It is worth considering that when Sir Adrian Cadbury in 1992 delivered his landmark review of corporate governance³ following the pension (superannuation) scandal involving Robert Maxwell very few people had heard of either email or the internet. Now a quick Google search will display millions of references to the latest governance information from around the globe and access is available in a few clicks. The skill will always come from the evaluation and analysis of such information, and the ability to sift the wheat from the chaff.

More similar than different

The basic legal requirements of company officers and directors around the world are in fact remarkably similar. They tend to involve basic human concepts of honesty and acting in the best interests of the corporate entity and some specific regulations (such as minimum age, solvency, mental capacity, lack of criminal convictions and a list of things not to do like lying and stealing). The legal system of each country may change how these laws are expressed and enforced. Common law countries, like Australia, UK, New Zealand, Singapore, Malaysia and USA, may have a mixture of legislation (state or federal) and case law to cover the basics. In Civil Code countries, such as most of Europe and Japan, there is a much heavier reliance on the laws being included in the statutes than relying upon judicial developments.

It is important at the local jurisdiction level, for example in Australia, that there are some important specific developments occurring in officers' duties, or more commonly called 'directors' duties'. Currently there are approximately 1.9 million registered companies in Australia, and each company must have at least one director. Each financial year, ASIC, through the criminal enforcement of the Commonwealth Director of Public Prosecutions, successfully prosecutes at least 25 directors. This is on top of the many civil penalty actions and civil cases brought by regulators and shareholders against both the company and its officers.

Global corporate governance

There have been many reviews, reports, commissions, scholarly works on, and practical application to, the question of whether corporate governance adds value to an organisation, and in turn, whether one system better is than another. The answers have not always been carefully provided and there is overwhelming, corroborative, empirical evidence as to the impact of sustainability in governance.⁴

There is also a growing body of evidence as to the value-add of governance and international scholarship to demonstrate that one system is not superior to another. Thus, there is no direct evidence that the Anglo-American system of governance is superior to the European two-tiered boards or the examined Japanese or other Asian family-based (small control span) entities.

The GFC and the many 2011–2012 aftershocks with the European financial crisis can be stated to be a consequence of the failure of corporate governance. Without a doubt this is too simplistic an approach and a greater understanding of how global corporate governance actually works is required. There is an arguable connection or correlation, but is it significant enough a result to have a major change in government policy or a need for the private sector to react differently? It is fair to say that the debate as to what constitute 'good corporate governance' is still open; practical and empirical research

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in law, economics, finance, accounting and management, does not always arrive at the same conclusions.

The convergence debate

There is a certain level of arrogance in the Anglo-American literature that the one model of corporate governance is far superior to the other purported systems of governance. In the early 2000s there was a lot of material written by academic scholars suggesting that there would be a natural convergence of corporate governance practices into a single model.⁵

But subsequently there has been a very strong argument that governance is jurisdictionally irrelevant and that culture can play a major role in economic development. It is not appropriate to maintain a simplistic view of insider corporate governance systems, or for that matter for countries like Germany and Japan to receive global pressure in favour of a 'superior', shareholder orientated, outsider corporate governance system, such as those applied in the USA, UK and Australia. This is not really convergence, but a move to transformation of capital markets and an end to globalisation.⁶

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Changing nature of governance — global communication

The last 20 years of contemporary corporate governance, after the Cadbury Report and its equivalent reviews in New Zealand, Australia, USA, South Africa and many other countries, have seen a major shift, which is described well in *Boards that Work*.⁷ The ease of global communication enables not only the multinational or even transnational corporation to access the latest governance trends, but simple Google searches provide ample resources to examine, in depth, the practical and theoretical aspects of governance.⁸

The ability to compare and contrast successes and failures of systems of governance around the globe has become an effective tool in governance developments. In Australia, it was common for a director to sit on a board in Melbourne and get ideas for the board that they might sit on in Sydney. Now with a click of a tablet computer (such as an iPad or Google Nexus) or a smartphone, the innovative director can be checking on governance developments in Poland, Sweden or New Zealand.

Does global governance add value?

There are numerous studies as to the benefits of corporate governance for global entities, whether they be transnational corporations or the more traditional multinational companies.⁹ Around the globe, by far the majority of business entities are privately owned (and/or family businesses) with a small percentage being quoted on a local stock exchange, in a single legal jurisdiction.

As such, the often cited 'trickle-down effect' of big business adds to the cost of compliance without any real tangible benefit to the individual business. For an interesting and detailed analysis of corporate governance in the Asia-Pacific region, *Corporate Governance: An Asia-Pacific Critique*¹⁰ is an excellent starting point, with the 2012 *Global Corporate Governance Forum* review,¹¹ bringing the academic literature right up to date.

The breadth in literature and issues of governance, primarily from the legal regulation literature (rather than accounting, economic, finance or management) includes Professor John Farrar on the developments in greater China¹² to Professor Anona Armstrong dealing with tangible value of governance standards.¹³ Professor Roman Tomasic in 2000 analysed the international challenges of good corporate governance¹⁴ to Dr Bob Tricker on cultural dependence of governance¹⁵ to the even more local focussed comments of Dr Vicky Comino's article on better corporate regulation in 2011.¹⁶ All these commentators demonstrate a move away from convergence and a move towards a global transformation model.

Conflict with role of global governance

If there is little agreement with the role of corporate governance by legal scholars, there is even less so by economists. This conflict of views was illustrated at the CSA Annual Conference in December 2011, when David Thomas¹⁷ described the impact of the 'BRIC' economies with a positive slant, immediately followed by Satyajit Das¹⁸ on the unstable economic state of affairs of world economies. Therefore it is fair to conclude that governance is not a clear indicator of economic growth or stability.

The academic and practical literature continues to grow on what seems to be a monthly basis. This reflects the global understanding of the importance of corporate governance. Two recent resources, in late 2011 and January 2012, provide reliable sources and are free from the internet. One has a very practical framework and was produced by the global consulting firm Deloitte, whereas the other is produced by Professors Stijn Claessens and Burcin Yurtoglu.

Deloitte's *Director360*^o report,¹⁹ which is freely available on the internet, and was based on research conducted on Deloitte clients, and covered 215 directors in 12 different countries. The report's subtitle

is 'Changing Roles, New Challenges' reflects practical outcomes of concerns directors are facing in an economic downturn. What is interesting to note is that the findings across South Africa, Sweden, Germany, India, Japan, UK, Australia and USA are very similar to an empirical study conducted on purely Australian listed entities in 2007.²⁰

The focus of the study by Deloitte was on how boards were evolving in strategy, overseeing risk and board effectiveness generally. They also asked the directors to rate what was on the current board agendas, as well as the top issues for next 24 months. There is a clear debate over the monitoring role of the board of management — in particular the chief executive officer (CEO) — the performance of the CEO and their capacity to act as a mentor.

Key findings included that more than half of the directors are experiencing high levels of scrutiny by the regulators and 85 per cent felt they were developing strategy for the corporation. The majority of directors felt the board had a balance between governance and performance, but that compliance was a distraction in the economic downturn. The economic conditions were forcing the board and management to clarify roles and the top agenda items were consistent around the world. This report would be of great interest to many Australian company boards and executive officers.

At a much more substantial level, one of the most detailed international, comparative reviews of the corporate governance literature over the last decade was undertaken by Professors Claessens and Yurtoglu. This research covers economics, finance, management and legal scholarship and studies in many different countries and jurisdictions. The survey of the literature provides overwhelming evidence of the importance of corporate governance at a number of economic points.

Professors Claessens and Yurtoglu's *Focus 10: Corporate Governance and*

*Development — An Update*²¹ provides evidence of a link between economic development and corporate governance, based on extensive studies in many different countries, sectors and business organisations (from state-owned corporations to public listed entities). In sifting through the scores of academic studies the article attempts to determine what matters most in the way corporate governance can also support the economic development of a country and what is needed to implement good practices.

The extensive cross-country research shows financial development, such as sophisticated and quality banking systems, is a powerful determiner of sound economic growth. Where weak corporate governance can be seen to prevail in financial markets, they then tend to function poorly, by global standards, as investment markets. Poor governance increases market volatility, through a lack of transparency and by giving insiders the edge on information crucial to the market integrity and the basis of fair trading.

Blind faith is not a substitute for a thorough verifiable reporting by firms, led by boards of directors that clearly articulate their responsibilities and duties. Countries like Australia, New Zealand, the UK and USA may not be perfect and certainly have corporate scandals, but demonstrate the evidence of good corporate governance in respect of growth and sustainability.

Countries and companies adopting corporate governance best practices are not guaranteed success, but provide evidence of a clear move towards sustainability and establishing long-term success. This Claessens and Yurtoglu 2012 report provides ample evidence as to why adopting good corporate governance practices is a worthwhile activity and specific goal of every board.

Future comments and thoughts

There is no doubt that boards of directors need to be continually educated, across

a range of matters. Nelson Mandela has said that 'education is the most powerful weapon we can use to change the world'.²² This can be applied to everyone and in every capacity. There has been much discussion about the 'lifelong learners' and the need for continuing professionalism.

Directors, particularly non-executives, heavily rely upon the professional expertise of the company secretary and others within the management team. As such, the idea to continuously update education aspects beyond formal courses, so as to be up to date is critical. The demand for financial literacy courses since the outcome of *ASIC v Healey* [2011] FCA 717 (the *Centro* case) has been exponential.²³ It is understandable that directors are nervous about their legal responsibilities and are truly accountable to shareholders, creditors and the regulators.

Corporate litigation can take a long time to resolve, but the recent final approval of the \$200 million class action settlement for the 2007 mistakes in the accounts of the Centro group, make it worthwhile. The recent convictions of executives in the AWB corruption scandals from the 2003 Iraq bribes, is another example of slow justice.²⁴

But probably the most alarming outcome is the August 2012 conviction of Andrew Koval. As a 23-year-old foreign exchange dealer for Amalgamated Wireless Australasia Ltd (AWA) in 1986 he lost \$50 million. He managed to transfer \$1.5 million to his personal bank account in New York (with his co-accused, Jonathan de Fries) and fled the country in 1993. Every accountant and business graduate in the last 20 years would have studied the *AWA* case²⁵ on auditors' liability and the meaning of officers' duties.

The introduction and development of corruption legislation has become a prominent global issue. The Corruption Perceptions Index that is published by Transparency International, which covers 182 countries, indicates corruption risks. There are already some provisions, in the *Criminal Code Act 1995*, which cover Australian companies, as well as Australian

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and International Standards.²⁶ The *Bribery Act 2010* (UK) and the *Foreign Corrupt Practices Act 1977* (US) have been updated to tackle a number of global concerns. These international statutes have a broad reach, covering US and UK companies operating in Australia, as well as Australian companies operating internationally.²⁷ The damage to reputation for the Reserve Bank of Australia (through its subsidiary Securrency Note Printing) which is currently before the courts; Lend Lease's fraud settlement for US\$56 million and even the News Limited phone hacking scandal in the UK, are all immense examples for the reputation of a global business entity.

Conclusion

It is easy to be sidetracked by the latest trend of cases or the latest changes in legislation. However, the board's focus must be on the company's strategy and performance. It is notoriously difficult to predict the future, but we need to learn from the mistakes of the past. We can be prepared as governance develops in what has previously been discussed as clear trends, locally, regionally and internationally. This article is intended to start the conversation to help educate boards on an ongoing basis.

Directors, like all humans, have a variety of learning styles, which means that approaches may vary from reading a document, to listening to a good presentation or watching a YouTube video can be effective. The point is to continue to learn about the role of director and the role of developing corporate governance principles and how it should be applied to your entity.

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Notes

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- 25 *AWA v Daniels* (1992) 9 ACSR 383 (trial) and *Daniels v AWA* (1995) 37 NSWLR 438 (appeal)
- 26 Australian Standard on *Fraud and Corruption Control* (AS 8001–2008) and AS/NZS ISO 31000:2009 *Risk Management: Principles and Guidelines*
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