CORPORATE GOVERNANCE IN AUSTRALIA: A SNAPSHOT

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Legal Briefings – By **Ian Williams**

The past two decades has seen corporate governance take an increasingly prominent role within the Australian business environment. In the wake of high profile corporate collapses and against the backdrop of the global financial crisis, Government, companies and shareholders alike have actively advocated for the adoption of new systems of governance and more robust governance practices. Corporate governance has developed in Australia in an ad hoc and iterative manner. However, for the most part companies have embraced the evolution of corporate governance practices in Australia – particularly, principles-based approaches to corporate governance – as an important tool to enhance board and management accountability to stakeholders. This paper provides a brief snapshot of some of the notable features of corporate governance in Australia.

THE CORPORATE GOVERNANCE FRAMEWORK IN AUSTRALIA

The corporate governance framework in place in Australia extends beyond mere compliance with regulatory requirements and includes a mix of prescriptive and voluntary elements. Broadly, the three key elements include:

- **'hard' law,** being legally binding case law and legislative requirements, such as the *Corporations Act 2001* (Cth) (**Corporations Act)**,

- **‘soft’ law**, being the listing rules of Australian Securities Exchange Limited (**ASX**) which principally have effect as a contract under law, and

- **non-binding guidelines**, most notably including the third edition[1] of the ASX Corporate Governance Council’s Principles and Recommendations (**ASX Principles**).

The laws, rules and guidelines outlined above, together with market and investor expectations, form a framework for corporate governance spanning the systems and structures adopted by Australian companies, the duties imposed on Australian directors, internal company processes and policies, board and committee composition, internal and external audit processes, continuous disclosure and periodic reporting to shareholders.

CORPORATE GOVERNANCE AND COMPANY PERFORMANCE

Within Australia, there is a prevailing view that ‘good’ systems of corporate governance can support and improve company performance and this has influenced the extension of corporate governance beyond being simply a matter of legal compliance.

Despite a wealth of academic research drawing a link between corporate performance and systems of corporate governance, it is not clear whether this ‘link’ between governance and performance is causal or merely correlative. Regardless, while it is difficult to conclusively establish that good governance leads to good performance, it is clear (and uncontroversial) that poor governance practices in conjunction with poor performance places companies at serious risk of corporate failure.

Further, the adoption of robust corporate governance practices, which provide for accountability to shareholders and transparency for stakeholders, has an important ‘signalling’ effect in the market, improving investor confidence and assisting companies to compete for scarce capital.

KEY FEATURES OF CORPORATE GOVERNANCE IN AUSTRALIA

The current system of corporate governance in Australia is characterised by a number of features, including:

- extensive regulation and personal liability of directors,

- a move towards principles-based systems of governance, and
- influential large institutional investors and a strong investment 'infrastructure'.

Extensive regulation and personal liability of directors

Because of the ad hoc approach which has been adopted in relation to corporate governance reform in Australia – particularly legislative reform – the current system of corporate governance has resulted in 'over-regulation' in a number of areas. Prominent examples include laws imposing personal liability on directors and the remuneration reporting requirements under the Corporations Act.

An extensive number of provisions throughout federal and state legislation make directors personally liable if a company fails to comply with any one of a multitude of requirements. Legislation imposing personal liability on directors includes, amongst other things, the Corporations Act, trade practices laws, taxation laws, environmental laws and occupational health and safety laws. Key stakeholder bodies, including the Australian Institute of Company Directors (**AICD**), have actively lobbied federal and state governments to 'wind back' regulation imposing personal liability on directors on that basis that over-regulation can push directors' focus away from oversight, strategy and business opportunities and onto compliance issues. This advocacy has borne some results with a reduction in the number of legislative provisions making directors 'automatically' liable for the criminal conduct of the company. However, directors who fail to discharge their directors' duties or fail to meet other legal obligations may still have proceedings brought against them by a multitude of different parties – the company, shareholders, creditors, insolvency administrators and trustees in bankruptcy (in relation to insolvent trading) and regulatory authorities such as the Australian Securities and Investments Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC). In recent years, stronger corporate disclosure requirements, along with the establishment of litigation funders in Australia, have also provided fertile conditions for the growth of shareholder class actions, especially in situations where the market is surprised by a material negative market announcement (causing a drop in a company's share price).

Over-regulation is by no means confined to director liability and outside of that field it has, arguably, been most acute in relation to remuneration matters for listed companies. The introduction of an advisory vote in relation to listed companies' remuneration reports is generally considered to have been an effective mechanism to enhance remuneration disclosure and improve board and management accountability. However, the desire to enhance transparency by regulating extensive categories of required remuneration disclosures has resulted in lengthy remuneration reports which are less comprehensible to the ordinary shareholder. In response to the opacity of the regulated remuneration disclosures, many companies have started voluntarily providing additional disclosure of 'realised' or 'take home' pay to provide greater clarity to shareholders concerning the remuneration actually received by key executives.

Principles-based systems of governance

In the context of *ad hoc* regulation relating to corporate governance, it is unsurprising that the non-binding and principles-based approach adopted by the ASX Principles has resonated with and been widely accepted (even embraced) by Australian companies.

The ASX Principles were first introduced in 2003 and set out recommended corporate governance practices that, in the ASX Corporate Governance Council's view, are likely to achieve good governance outcomes and "meet the reasonable expectations of most investors in most situations".2 The ASX Principles are intended to give listed companies the flexibility to adopt alternative corporate governance practices if the board considers those to be more suitable to its particular circumstances, subject to a (legally binding) requirement for the board to explain its reasons for adopting those alternative practices.

The introduction of the ASX Principles has arguably resulted in 'convergence' occurring in some areas, with some companies treating the non-binding recommendations as more akin to 'requirements' given prevailing market expectations around following the recommendations. However, the majority of large listed companies do invest significant time and resources in developing and implementing tailored policies and procedures to support their own internal management and external engagement within the broader general guidelines provided by the ASX Principles. Indeed, while companies are required to benchmark their governance practices against the recommendations set out in the ASX Principles, the Principles themselves unequivocally recognise that there is no 'one size fits all' approach to governance and that companies may legitimately adopt different governance practices, based on a range of factors, including their size, complexity, history and corporate culture.[3]

Institutional investors, proxy advisors and shareholder associations

The continued evolution of corporate governance within Australian has, in large part, coincided with Australia's introduction in 1992 of a system of compulsory superannuation (pension) contribution (currently 9.5% of salary and wages), whereby Australian workers are indirect investors in domestic and global equities. Australia's consequential status as a 'shareholder society', including the large (and influential) investment infrastructure supported by superannuation, has had a large influence on the development of corporate governance.

Institutional investors, including superannuation funds, insurance companies, banks and hedge funds, are highly influential in Australia. Because their large shareholdings can impact companies' voting results, institutional investors have the ability to apply pressure on company boards and agitate for change, including in relation to corporate governance practices. Their focus on corporate governance is driven by their desire to enhance sustainable long-term returns on the savings entrusted to them as institutional investors.[4]

It is therefore unsurprising that the twin aims of most recent corporate governance reforms in Australia have been:

- the development of systems of governance which will protect and support the sustainable growth of shareholder wealth, and
- increased disclosure of companies' activities, performance, position and prospects, supported by enhanced dialogue and interaction between boards, management and interested investors.

In addition to institutional investors, there are a number of proxy advisor groups in Australia, both international and locally based, which advise institutional investors how to vote at a company's shareholder meetings and/or act as their proxy. These proxy advisors are increasingly taking a leading role in influencing dialogue around corporate governance, including by identifying governance risk, conducting proxy voting research and providing voting recommendations to institutional investors. There are also retail shareholder lobby groups such as the Australian Shareholders' Association, which monitor Australia's ASX 200 companies and provide similar services on behalf of retail shareholders.

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ENDNOTES

1. Published on 27 March 2014 and effective for listed entities' first full financial year commencing on or after 1 July 2014.
2. ASX Corporate Governance Council Corporate Governance Principles and Recommendations (3rd edition) page 2.
3. ASX Corporate Governance Council Corporate Governance Principles and Recommendations (3rd edition) page 3.
4. ACSI Guidelines.

MORE INFORMATION

For information regarding possible implications for your business, contact Ian Williams.

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